



SIGMA Papers No. 19

Effects of European Union
Accession: Part I Budgeting
and Financial Control

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**EFFECTS OF EUROPEAN UNION ACCESSION
PART 1: BUDGETING AND FINANCIAL CONTROL**

SIGMA PAPERS: No. 19

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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THE SIGMA PROGRAMME

SIGMA -- Support for Improvement in Governance and Management in Central and Eastern European Countries -- is a joint initiative of the OECD Centre for Co-operation with the Economies in Transition and the European Union's Phare Programme. The initiative supports public administration reform efforts in thirteen countries in transition, and is financed mostly by Phare.

The Organisation for Economic Co-operation and Development is an intergovernmental organisation of 29 democracies with advanced market economies. The Centre channels the Organisation's advice and assistance over a wide range of economic issues to reforming countries in Central and Eastern Europe and the former Soviet Union. Phare provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

Phare and SIGMA serve the same countries: Albania, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Estonia, the Former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Established in 1992, SIGMA works within the OECD's Public Management Service, which provides information and expert analysis on public management to policy-makers and facilitates contact and exchange of experience amongst public sector managers. SIGMA offers beneficiary countries access to a network of experienced public administrators, comparative information, and technical knowledge connected with the Public Management Service.

SIGMA aims to:

- assist beneficiary countries in their search for good governance to improve administrative efficiency and promote adherence of public sector staff to democratic values, ethics and respect of the rule of law;
- help build up indigenous capacities at the central governmental level to face the challenges of internationalisation and of European Union integration plans; and
- support initiatives of the European Union and other donors to assist beneficiary countries in public administration reform and contribute to co-ordination of donor activities.

Throughout its work, the initiative places a high priority on facilitating co-operation among governments. This practice includes providing logistical support to the formation of networks of public administration practitioners in Central and Eastern Europe, and between these practitioners and their counterparts in other democracies.

SIGMA works in five technical areas: Administrative Reform and National Strategies, Management of Policy-making, Expenditure Management, Management of the Public Service, and Administrative Oversight. In addition, an Information Services Unit disseminates published and on-line materials on public management topics.

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FOREWORD

Compliance with the European Union's budgetary, financial control and audit requirements is one of the basic obligations of EU membership. SIGMA examines this in two publications that chronicle the experiences of seven EU Member States, including its three newest adherents, in integrating EU budgetary, financial control and audit procedures and requirements with national ones. The publications also describe central regulations and procedures used by the European Commission and the European Court of Audit. The present publication complements SIGMA Paper No. 20 *Effects of European Union Accession—Part 2, External Audit*, on the impact of accession on external audit.

The purpose of these publications is to assist central and eastern European countries that have applied for membership of the European Union in discerning the ideas at stake, to give comparative information on the various approaches and solutions used by Member States and to sum up the experiences gained and lessons learned.

The approach is to provide an overview of the topic and analyse key issues for reflection and debate. The focus is on practical experiences gained and conclusions drawn by those who have been involved in the daily work of adaptation and development of the government administration in the seven countries. The two publications also provide insight into the implementation policies adopted and an overview of the regulations and procedures used. Appendices include lists of abbreviations and useful terms and a selection of EU regulations with full reference numbers, concerning budgeting, financial control and external audit.

The papers are not to be seen as “end-products”. Instead they intend to provide the basis for further seminars, workshops and discussions between practitioners in the countries of central and eastern Europe and the Member States.

The preparation of the papers (finalised in late Spring 1997) has been carried out in close collaboration with a reference group consisting of the authors and representatives from ministries of finance, committees for European integration and supreme audit institutions in the Czech Republic, Hungary and Poland. The authors work for government and supreme audit institutions in Austria, Denmark, Finland, France, Portugal, Sweden and the United Kingdom.

SIGMA wishes to thank the authors of the papers herein and the members of the reference group for their inspired and devoted work and the institutions they are representing for their active support of the project. The views expressed herein are the views of the respective authors and do not necessarily reflect the views of the institutions they represent, the reference group or SIGMA.

Initiated at SIGMA by Larry O'Toole and carried through under the responsibility of Kjell Larsson, the project has been developed in close co-operation with Richard Allen, and with the administrative and technical support of Belinda Hopkinson, Michael Koch, Françoise Locci and Alette Wernberg. This publication is forthcoming in French under the title *Les incidences de l'adhésion à l'Union européenne — Partie 1, processus de budgétisation et contrôle financier (Documents SIGMA : N° 19)*.

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TABLE OF CONTENTS

| | |
|---|----|
| THE SIGMA PROGRAMME..... | 1 |
| FOREWORD..... | 4 |
| ISSUE OVERVIEW By C.J. Carey..... | 11 |
| 1. The Budget — An Overview | 12 |
| 2. The Member State As Contributor | 13 |
| 3. The Member State As Beneficiary | 14 |
| (a) The Agricultural (Guarantee) Fund..... | 14 |
| (b) The Structural Funds | 15 |
| 4. Co-ordination Of Financial Control At EU And National Level | 16 |
| 5. A Common Structure Of Control? | 16 |
| 6. Conclusions..... | 17 |
| AUSTRIA By Edith Peters | 18 |
| 1. Chapter Summary | 19 |
| 2. The National System | 19 |
| 2.1. Political And Organisational Structure Of Government | 19 |
| 2.2. Federal Level And The Federal Budget | 21 |
| 2.3. The Main Budgetary Organs..... | 21 |
| 2.4. Effects Of EU Membership On The Austrian Budget | 23 |
| 3. Managing Receipts And Funds From The Community | 24 |
| 3.1. Classification Of Receipts/Funds For Budget Purposes | 24 |
| 3.2. Management Of Structural Funds | 24 |
| 3.3. Transfer Of Funds From The Commission Via Paying Agencies To Final Beneficiaries | 25 |
| 3.4. Systems, Routines And Procedures For Financial Control | 27 |
| 3.5. Post-Financing And Its Implication On The National Budget | 28 |
| 3.6. Division Of Responsibility Between The Different Bodies For Correct Implementation And Control Of The Use Of The Funds | 29 |
| 4. Managing Own Resources | 30 |
| 4.1. Estimation Of Customs Duties And Agricultural Levies..... | 30 |
| 4.2. Collection Of Customs Duties And Agricultural Levies..... | 30 |
| 4.3. Anti-Fraud Arrangements | 31 |
| 4.4. Calculation Of VAT Own Resources And The Fourth Resource (GNP Own Resources)..... | 31 |
| 4.5. Procedures For Transferring And Accounting For The National Contribution To EU | 32 |
| 4.6. Preparation Of Statistics | 32 |

| | |
|--|----|
| 5. Community Budget Process..... | 33 |
| 5.1. Roles Of The Ministry Of Finance, Line Ministries, Agencies, Regional And Local Authorities, Other Organisations And Permanent Representation In Brussels | 33 |
| 5.2. Change In National Budget Laws, Procedures And Systems..... | 34 |
| 5.3. Forecasting Receipts/Funds And Contributions | 34 |
| 6. Co-Operation, Co-Ordination And Contacts | 35 |
| 6.1. With The Commission And With Other Member States | 35 |
| 6.2. Cross-Sectional Co-Ordination..... | 35 |
| 6.3. Inspections From Different Auditing Bodies | 35 |
| 7. Organisational Issues | 36 |
| 7.1. Human And Technical Resources..... | 36 |
| 7.2. Training | 36 |
| Annex 1. Austria’s Accession To The European Union | 38 |
| Annex 2. Contributions To And Receipts From EU Budget | 40 |
| Annex 3. EU Structural Funds In Austria: Interlinkage Of Conceptual And Financial Co-Ordination Of Programmes..... | 41 |
| Annex 4. EU Structural Funds In Austria: Financial Procedures — Regional Programmes (Obj. 1, 2.5b, Reg. C) | 42 |
| Annex 5. Financial Control: The National System In Austria | 43 |
| DENMARK By Georg Ginsberg..... | 47 |
| 1. Chapter Summary | 48 |
| 2. Introduction..... | 48 |
| 3. The Expression “Financial Control”..... | 49 |
| 4. EU Legal Regulation Of Financial Control In The Area Of Structural Funds | 50 |
| 5. Danish Prerequisites And Framework Conditions For The Financial Control Of Structural Funds’ Grants..... | 51 |
| 6. Financial Control Of The Ministries Responsible For Structural Funds..... | 52 |
| 7. Entrusted People’s Financial Control Of The Use Of Structural Funds..... | 53 |
| 8. Partnership With The European Commission Regarding Financial Control Of The Use Of Structural Funds Grants | 55 |
| FINLAND By Eija-Leena Linkola | 58 |
| 1. Chapter Summary | 59 |
| 2. Background | 59 |
| 3. Legislative Basis And Instructions..... | 61 |
| 4. Roles And Responsibilities..... | 62 |
| 4.1. The Annual Budget Cycle Of The State Budget..... | 62 |
| 4.2. Preparing EU Budget Issues | 62 |
| 5. Impact Of EU Membership On Preparation Of State Budget Proposal | 64 |
| 5.1. Payments To The EU Budget | 64 |
| 5.2. Payments From EU Budget To The Finnish State Budget Or To Fund Outside The National Budget | 65 |
| 5.3. Costs Incurred By Administrative And Other Preparatory Work | 68 |
| 6. Evaluation And Auditing..... | 68 |

| | |
|---|-----|
| 7. Concluding Remarks | 68 |
| 7.1. Arbitrary Programming Work..... | 68 |
| 7.2. Complex Systems And Many Actors..... | 69 |
| 7.3. Monitoring..... | 69 |
| 7.4. Increased Workload..... | 69 |
| 7.5. Need For Deeper Co-Operation..... | 70 |
| 7.6. Comprehensive Training For Civil Servants..... | 70 |
| FRANCE By Benoît Chevauchez..... | 71 |
| 1. Introduction..... | 72 |
| 2. The Institutional Framework..... | 72 |
| 2.1. The State..... | 72 |
| 2.2. The Budgetary Organisation Of The State..... | 73 |
| 2.3. The Local Government..... | 74 |
| 3. The Community Budget For French Public Finance..... | 74 |
| 4. The Community Budget Administration In France..... | 75 |
| 5. The Management Of “Own Resources”..... | 76 |
| 6. The Management Of Expenditures..... | 77 |
| Annex 1. Protecting The EU’s Financial Interests | 80 |
| PORTUGAL By Vitor Caldeira | 83 |
| 1. Chapter Summary..... | 84 |
| 2. National System | 85 |
| 2.1. Legal Framework For Budgeting And Financial Control | 85 |
| 2.2. Organisational Structure For Financial Control..... | 85 |
| 3. Major Changes To The National System..... | 86 |
| 3.1. Own Resources | 86 |
| 3.2. European Union Funds..... | 89 |
| 4. Community Budget Process..... | 94 |
| 4.1. Integration Of National And Community Budget | 94 |
| 4.2. Change In National Budget Procedures (SEM 2 000) | 94 |
| 5. Co-Operation And Co-Ordination..... | 94 |
| 5.1. With The European Commission And Other Member States | 94 |
| 5.2. Inspections From Different Bodies | 95 |
| 6. Management And Organisational Issues | 95 |
| 6.1. Administrative Arrangements..... | 95 |
| 6.2. Professional Skills..... | 96 |
| 7. Ten Years Of Portuguese Accession To EU—Results And Future Perspectives | 96 |
| Annex 1. An Integrated Vision Of The Portuguese Financial Control System For Structural Funds.. | 98 |
| SWEDEN By Ulrika Barklund Larsson..... | 99 |
| 1. Chapter Summary..... | 100 |
| 2. Introduction..... | 100 |
| 2.1. The Swedish Administrative Model..... | 101 |
| 2.2. The Referendum..... | 101 |
| 2.3. The EEA Agreement And Statute-Drafting In Brief..... | 101 |

| | |
|---|-----|
| 3. Organisation And Horizontal Measures In The Area Of Budgeting And Financial Control..... | 102 |
| 3.1. Role Of The Ministry Of Finance | 102 |
| 3.2. Practical Preparations And Decisions On Principle Prior To Membership..... | 103 |
| 3.3. Issues Requiring Measures Regarding The EU Budget And Budget Process, Including The Swedish Contribution..... | 104 |
| 3.4. Issues Requiring Measures In The Area Of Financial Control, Auditing And Anti-Fraud... | 106 |
| 4. Some Lessons From The Various Sectors | 110 |
| 4.1. Customs Duties And Other Levies..... | 110 |
| 4.2. Agriculture | 111 |
| 4.3. The Structural Funds | 111 |
| Annex 1. The Swedish Budgetary And Auditing System..... | 113 |
| Annex 2. Some Additional Data..... | 119 |
| UNITED KINGDOM By Nicholas Ilett | 123 |
| 1. Chapter Summary | 124 |
| 2. Introduction..... | 125 |
| 3. The National System In The United Kingdom | 125 |
| 4. The Relationship Between Parliament (<i>For These Purposes, The House Of Commons</i>) And The Executive (<i>The “Crown”</i>)..... | 125 |
| 5. Relationships Within The Executive | 125 |
| 6. The Consequences Of EU Membership..... | 126 |
| 6.1. Financial Implications | 126 |
| 6.2. Technical Implications | 127 |
| 6.3. Revenue Side | 127 |
| 6.4. Expenditure Side | 128 |
| 7. Integration Of Community Finances Into The National Budget..... | 129 |
| 7.1. General Principles | 129 |
| 7.2. National Budget Presentation | 129 |
| 7.3. Treatment Of EC Budget Receipts In Departmental Budgets | 129 |
| 8. Areas Of Strategic Interest To EU Finance Ministries | 130 |
| 8.1. Central Financial Functions..... | 130 |
| 8.2. Financial Management And Fraud..... | 130 |
| 8.3. Budget Discipline..... | 131 |
| 8.4. Wider EU Policies With Financial And Economic Implications..... | 131 |
| 9. Administrative And Procedural Arrangements | 132 |
| 9.1. Co-Operation Between Finance Ministries | 132 |
| 9.2. The Organisation Of EC Budget Business Within Finance Ministries..... | 132 |
| 9.3. Finance Ministry Relations With Other Ministries..... | 132 |
| 9.4. The Permanent Representation In Brussels | 133 |
| 10. The Outlook For Community Financial Management Over The Next Few Years | 133 |
| 11. SEM 2 000 | 134 |
| Annex 1. Technical Note On The Relationship Between The European Community Budget And National Public Finances In The United Kingdom..... | 136 |

| | |
|---|-----|
| MANAGEMENT OF EAGGF–GUARANTEE OPERATIONS IN MEMBER STATES By Brian Gray..... | 140 |
| 1. Decision-Making Process | 141 |
| 2. Staffing The Administration Of Guarantee Operations In Brussels..... | 141 |
| 3. Organisation Of Services In The Member States | 141 |
| 3.1. Claim Processing, Verification And Payment | 142 |
| 3.2. Audit Departments | 142 |
| 4. Clearance of the Accounts | 143 |
| FINANCIAL CONTROL AND AUDIT IN THE EUROPEAN UNION By Alan Pratley..... | 145 |
| 1. Introduction..... | 146 |
| 2. Financial Control And Audit At Commission Level And Outside The Commission—An Overview..... | 146 |
| 3. Financial Control And Audit Within The European Commission..... | 147 |
| 4. Financial Control And Audit In Member States | 147 |
| 4.1 EAGGF-Guarantee Fund | 148 |
| 4.2 Structural And Cohesion Funds..... | 148 |
| 4.3 Community Revenue..... | 149 |
| 5. Co-Ordination Of Financial Control And Audit Between The Commission And The Member States..... | 149 |
| 6. Financial Control And Audit Of Other Areas Of Expenditure And Of Receipts..... | 150 |
| 6.1 Eastern And Central European Countries..... | 151 |
| 6.2 Central European Countries (CEC)..... | 152 |
| 7. Internal Control, Internal Audit, External Audit In Central European Countries | 152 |
| Appendix 1. Budget Procedures | 154 |
| Appendix 2. The Clearance Of Accounts Process | 156 |
| Appendix 3. List Of Useful Terms | 157 |
| Appendix 4. Some EU Regulations Concerning Budgeting, Financial Control And External Audit | 166 |
| Appendix 5. List Of Abbreviations..... | 170 |
| Appendix 6. Members Of The Reference Group..... | 174 |

ISSUE OVERVIEW

By C.J. Carey¹

1. Compliance with the EC's budgetary and financial control requirements is one of the basic obligations of EU membership. It can involve extensive modification of a new Member State's national budgetary procedures. This issue overview paper draws on the separate country papers which describe the experiences of selected EU Member States in more detail. It complements the publication SIGMA Paper No. 20 *Effects of European Union Accession — Part 2, External Audit* about the impact of accession on audit. In both cases, the approach adopted has been analysis of selected issues for reflection and debate.
2. SIGMA believes that a pooling of the responses of different Member States to the budgetary and financial control requirements of membership could be instructive for the applicant countries of central and eastern Europe, as well as signposting issues for possible future examination in the context of the EU's ongoing programme of financial management reform.
3. This overview paper offers a distillation of some of the experiences recorded by the Member States. It is necessarily both simplified and selective. For a complete understanding of the EC's budgetary and financial control requirements there is no substitute for study of the relevant legislation, which is listed in Appendix 4.
4. Until recently, EC law did not attempt to impose specific mechanisms of budgetary management at the national level, and left Member States a large measure of freedom to decide on the best way of integrating the flows of funds from and to the EU Budget with their own national finances. This situation may now be changing.
5. The mechanisms for managing EC finances have been the focus for continuing debate among the institutions and within the Member States for the past decade. Important reforms have been introduced with the aim of increasing accountability and value for money. Enlargement and the preceding negotiations are likely to add impetus to the process of reforming both the EC's budgetary rules and some of the principal expenditure policies borne by the EC Budget, notably the agricultural policy and the Structural Funds. These papers show that, particularly for some recent adherents to the EU, accession may be one element in a process of fundamental reform of national political structures and financial systems. In such case, the reform processes at EU and national level can be mutually supportive.

1. C.J. Carey is chairman for the European Commission's Conciliation Body for the clearance of EAGGF accounts. A former official at the United Kingdom Treasury, Mr. Carey was for four years (1974-78) on the staff of the United Kingdom Permanent Representation to the EEC in Brussels, and subsequently specialised in public audit and parliamentary accountability of expenditure. In 1983, he left the United Kingdom public service on appointment as a Member of the European Court of Auditors, a post he held for nine years.

1. The Budget — An Overview

6. The Commission, Council and Parliament all contribute to the process by which the EC's Budget is adopted annually, with the Parliament having the last word in most areas. The process is a long and complicated one. Familiarisation with it is an essential priority for any new Member State.

7. All the EC Budget's revenue originates from the Member States, and the Member States execute more than 80 per cent of the spending, though the Commission retains ultimate responsibility for implementing the Budget. From a Member State's point of view, some EC Budget expenditure replaces equivalent national expenditure. This used to be true for most of the EU's agricultural support spending, and is still true of part of it. There are other expenditures which are demonstrably and intentionally additional to the equivalent national programmes. The Structural Funds (SFs) are the clearest case in point.

8. For any given size of EC Budget, the size of a Member State's contribution (and its breakdown between different sources of revenue) is fixed *a priori* by EC law; but the Budget total is of course a matter for negotiation between Member States and between institutions. The size of an individual Member State's entitlement to budgetary and other receipts from the EC Budget is to a considerable extent a matter for negotiation.

9. A Member State needs to equip itself to perform three main types of role in relation to the EC Budget:

- i) An *information* role: the Member State needs reliable information, in an accessible form, in order to monitor and forecast the impact of the EC Budget on the national budget; it is also an essential source for the Commission of budgetary data, notably forecasts of own resources, movements of agricultural stocks and the rate of progress of SF programmes. The Member States have a general duty under Article 5 of the Treaty of Rome (to be reinforced by the Treaty of Amsterdam) to assist the Commission in its responsibility for managing the Budget.
- ii) A *negotiating* role: in its own interest the Member State will wish to negotiate (a) as a member of the Council, about the size and composition of the Budget; and (b) as a member of the Council and bilaterally with the Commission in order to maximise its benefit from SFs.
- iii) A *compliance* role: the Member State must comply with all relevant EC rules about collection and transfer of EC budgetary revenue and the proper management of funds received from the EC Budget. It must be vigilant in preventing, detecting and reporting fraud and irregularities against EC funds. The Commission requires a Member State not only to comply with the rules, but to be able to demonstrate after the event, on the basis of documentary records or other evidence, that it has done so.

10. For applicant Member States, effective fulfilment of these roles is likely to involve significant changes in machinery of government and the expenditure of some additional resources. Accounting and audit expertise, and computing resources, will be of special relevance. There is hardly any season of the year when budgetary business of one sort or another is not on the Council agenda at Ministerial or official level in Brussels. The range of interests affected by the EU Budget, and the speed of response required from national representations in Brussels, make it imperative for a Member State to have effective procedures in place for co-ordinating the views of different government services.

2. The Member State As Contributor

11. The impression given by the country papers is that adaptation to the requirements of the “own resources” system (see Appendix 3 “List of Useful Terms”) was a laborious experience for most of the Member States.

12. A prospective Member State will need to adapt its frontier and domestic taxation arrangements in order to deliver to the EU the required sums of own resources (all customs duties and agricultural levies) and the required share of VAT revenue. As an example, for the Portuguese authorities, as well as for other countries’ authorities, one of the major problems of accession was the necessity to improve officials’ skills at all levels in the customs administration. The solution adopted was a comprehensive training course in the Commission for customs officials. Accession to the EU will involve the adoption of EC levels of levies and customs duties (subject to any transitional arrangements). The Austrian authorities note from experience in their country paper: “One of the essential tasks in preparing accession is to foresee in time adaptation of national legislation according to customs matters”. It will also involve the introduction of a VAT system of indirect taxation where such a system does not already exist.

13. The provision of EU-compatible GNP data can also cause difficulty for new Member States. The Swedish authorities have commented: “With regard to the various types of payment that constitute [Sweden’s contribution of] own resources in the EC Budget, VAT-based payment is the most complicated and requires new calculations and good statistical documentation....It is also essential to adjust the system of national accounts in such a way that it can supply the information required to calculate the GNP-based payment.”

14. While the overall evolution of a Member State’s contribution to the EC Budget is a matter for the national Ministry of Finance, the management of its component parts is likely to involve different agencies and levels of government. Agricultural policy, customs, indirect taxation and statistics are among the competencies concerned. Most Member States have found it necessary to set up a specialist unit within the budget sector of the Ministry of Finance to co-ordinate all action in connection with the calculation, reporting and payment of their contribution. The Swedish experience is typical: “In our view, it is important for work on the contribution to be co-ordinated in its entirety. This co-ordination should take place in the Ministry of Finance. This would afford an opportunity not only to obtain an overall picture, but also to create a good interface with and interlocutor for the Commission. This makes matters easier for the Commission and national public administration alike.”

15. The so-called “traditional own resources” (the whole of a Member State’s receipts of levies and customs duties, less a 10 per cent collection charge) are legally the property of the Community. The Member State is acting as the agent of the Community in collecting these funds and ensuring that they are received by the Commission. These funds must therefore be transferred directly to the Commission by-passing national budgetary procedures. Some Member States use a *pro forma* entry in the national budget to inform their Parliament of the figures.

3. The Member State As Beneficiary

(a) *The Agricultural (Guarantee) Fund*

16. This Fund accounts for about half the total expenditure of the EC Budget. Day to day management of the expenditure is devolved to Member States, which are fully reimbursed by the Commission. There is a delay of at least 2½ months between disbursement of funds to beneficiaries and reimbursement by the Commission. A new Member State must therefore be prepared to provide the initial start-up finance.

17. Each of the various measures financed by the Fund is defined in permanent, specific legislation (Council and/or Commission regulation). The annual Budget authorises sufficient funds to enable the Member States to fulfil their obligations to beneficiaries in accordance with the different measures. Expenditure on some of the measures, notably those directed at price support, is volatile and difficult to forecast. Numerous working groups in Brussels try to keep track of the expenditure from month to month, while other working groups examine Commission proposals for new or amending legislation—typically with a view to strengthening financial and accounting controls in Member States, and reducing the risk of fraud. This activity makes significant demands on the time (and negotiating skills) of a Member State’s agricultural and budgetary experts.

18. The Member State is obliged to set up one or more paying agencies as the vehicle for disbursement to beneficiaries of receipts from the Fund. Paying agency status is granted (by the Member State) only to bodies which can demonstrate an ability to maintain high standards of accounting, financial management and financial control. The criteria which a Member State has to apply in deciding whether to grant paying agency status were spelt out in detail in a 1995 Regulation (Regulation 1663/95). The Member State must also select a certifying body (which must be operationally independent of the paying agency and need not be in the public sector) to audit the annual accounts of each paying agency.

19. Under the so-called “clearance of accounts” procedures, the Commission reviews the paying agency’s annual accounts in the light of the certifying body’s audit. In addition, and separately from the annual accounts, the Commission may subject the paying agency’s handling of EC funds to a more searching audit of compliance with EC rules. This sort of audit often covers more than one Member State. If the Commission finds evidence that the paying agency has failed to comply with EC rules, it reduces the agency’s current year funding by an amount which reflects the Commission’s assessment of the loss to EC funds.

20. The paying agency is also subject to audit by the European Court of Auditors, the EU’s external audit body. The Court has no direct power to sanction Member States, but its findings, which are presented to the Council and the Parliament, may lead the Commission to recover any irregular payments. Member States are increasingly expected to reply to any criticism of their management of EC funds by the ECA and to explain what they have done to put things right.

21. Regulation 1663/95 represents an important new departure from the EU’s previous practice of allowing Member States to interpret EC financial control requirements in the light of their national administrative traditions and practice. It also demonstrates that there need be no incompatibility between the doctrine of subsidiary and the Commission’s responsibility for safeguarding Community assets.

22. A paying agency needs staff who are conversant with both the agricultural and the budgetary legislation of the EC and a place within the structure of government which enables and encourages them to co-ordinate their work with their colleagues in the Ministry of Finance. Above all, the paying agency needs staff who are competent in financial management and a structure which gives due weight to the requirements of financial control.

(b) *The Structural Funds*

23. The SFs co-finance multiannual programmes in the Member States. In contrast with the expenditure of the Agricultural (Guarantee) Fund, which is characterised by a high degree of automaticity, there is a substantial discretionary element in the spending of the Structural Funds. Optimum exploitation of the potential benefits of the SFs is a labour-intensive exercise for Member States, both for this reason and because of the extensive co-ordination which is required in pursuit of the principle of partnership, which is basic to all the SFs' operations. As the Austrian paper notes: "The system of '*partnership*' is quite complicated because of the number of players at central, regional, local and EU-level. This results in heavy workloads and financial expenses, and brings discredit to basically positive instruments. It does not correspond to the ideal principle of a transparent administration and makes financial control more cumbersome."

24. For the national authorities, the preparation of bids for aid involves co-ordinating the views of different levels and agencies of government, and of non-governmental bodies. The monitoring of existing programmes is another collective operation, in which representatives of national, regional and local government and of the Commission all participate. For historical reasons, there is some overlap between the objectives supported by the different funds. For all these reasons, co-operation with the SFs has led to increases in the workload and changes in the procedures of some governmental agencies in most Member States, and in some cases the creation of new structures, such as the special units for the European Social Fund (ESF) set up by the United Kingdom and the Portuguese authorities, in the latter case prior to accession.

25. As regards financial control, Member States are required to verify the efficiency and regularity of all operations aided by the SFs, and to tell the Commission how they propose to fulfil that obligation. They also have a specific obligation to certify the validity of claims for payment, and in the case of final payments arrange for an independent certificate.

26. These obligations are less comprehensive and less detailed than the criteria which Regulation 1663/95 established for the authorisation of paying agencies. Nevertheless, in at least one case (Sweden), they were a contributory factor in a government decision to set up new internal audit units in the principal government agencies responsible for handling receipts from the SFs.

27. The Commission services can and do conduct on the spot audits of SFs expenditure in the Member States, and may also require the Member State to carry out specific enquiries. Any evidence of irregularity is likely to lead the Commission to insist on reimbursement by the recipient and is increasingly likely to lead to a net financial cost to the Member State. The operations of the SFs are also subject to audit by the European Court of Auditors.

4. Co-ordination Of Financial Control At EU And National Level

28. The activities of the various financial control and audit services at EU and national level have not always been co-ordinated to best effect. Co-ordination is partly a matter of timetabling. It is also a matter of methodology. For example, prior to the 1993 reforms the Commission services and Member States did not always see eye to eye about the relative importance of physical and documentary checks as evidence for the regularity of certain types of commercial transaction supported by Agricultural (Guarantee) Funds.

29. Co-ordination has not been helped by a lack of clarity in the division of responsibilities between the multiplicity of financial control and audit services in the ECA, Commission and Member States. Co-ordination has improved in recent years, and at the same time there has been increased involvement of national financial control and audit services in the safeguarding of EC assets. A helpful factor in this context has been a switch of emphasis by the Commission's Financial Controller away from *ex ante* approvals in favour of selective *ex post* controls of the sort also carried out by the ECA and many national audit bodies. These developments have been most marked in the case of the Agricultural (Guarantee) Fund, where the 1995 reform gave greater precision to the respective roles of the Commission and national paying agencies.

30. The position remains more fluid in relation to the SFs. With a view to making the best use of all the EU's financial control and audit services, the Commission's Financial Controller has invited Member States to sign protocols which would co-ordinate both the timetable and the methodology of work by the Commission's and Member States' financial control/audit services. This proposal has caused some difficulty for Member States with federal constitutions and/or decentralised systems of financial control, but about half the present Member States have already signed protocols and negotiations are well advanced with the others.

31. Negotiation about a protocol could provide an applicant country with useful insights into the scope and frequency of financial control work which it would be expected to carry out after accession, the minimum standards which the Commission would expect that work to meet, and thus the extent to which existing financial control and audit services might need to be strengthened prior to accession.

5. A Common Structure Of Control?

32. The national budget is the principal instrument used by existing Member States in order to account for the flows of funds to and from the EC Budget. Receipts from the EU are entered on the revenue side of the national budget (or occasionally shown as negative expenditure) while the expenditure side shows the disbursement of the same funds to beneficiaries and part (or sometimes all) of the national contribution to the EC Budget (cf. Paragraph 15 above). This treatment is not a requirement of EC law, and there are significant differences between the practice of different Member States. For example, the United Kingdom enters all transactions with the EC Budget on the expenditure side of the national budget. The Finnish authorities account for the price support subsidies of the Agricultural (Guarantee) Fund in a separate intervention fund which is outside the national budget and endowed with its own borrowing power. (There are however EC rules on the way in which flows of funds involving the EC Budget must be treated for national accounts statistics purposes.)

33. Since most Member States use gross accounting in their budgets, this treatment adds to budget totals of both revenue and expenditure. The figures concerned are not likely to be a valid

substitute for a comprehensive analysis of the EC's budgetary impact, since in most cases they omit an important part of the national contribution and some receipts.

34. On the other hand, the practice has the advantage of convenience, and this is the main reason why Member States have adopted it. Most of the flows of funds could be accommodated without difficulty in existing budget headings. More importantly, from the EU point of view, this practice ensures that the same safeguards and controls are *ipso facto* applicable to EC as to national budgetary funds. The Maastricht Treaty requires Member States to be equally conscientious in the protection of EU and national financial interests.

35. This is a good example of the kind of question which applicant Member States could discuss informally in advance of accession with the Commission and selected Member States. Countries which do not already possess fully operational policies of agricultural and regional support might not see any reason to channel EC subsidies through their national budget.

6. Conclusions

36. The country papers emphasise the importance of an early start to planning for EU membership. For example, Finland spent several years prior to accession developing its financial management and budgeting procedures with a view to smooth and flexible adjustment to the requirements of EU membership.

37. Training of staff is an essential element of preparation. The country papers (e.g. Portugal and Sweden) underline the importance of language training. Training in financial management skills could be equally important.

38. Above all, the country papers show how essential it will be for the applicant countries to supplement their formal contacts with the Commission and Member States with close and continuing informal contacts at technical level as well as senior official and political level.

AUSTRIA
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1. Chapter Summary

39. This paper focuses on important organisational changes which the Austrian national administration has undergone in order to set up a sound financial relationship between Austria and the European Community.

40. It presents the national system of government and the main budgetary organs (in terms of their legal capacity to deal with a matter or “competence”, internal organisation and staff number), as well as financial effects of EU membership on the national budget, including post-financing and its implication on the national budgeting procedure. The paper describes how EU financial directives have been implemented in Austria and what methods were applied to address specific problems.

41. EU membership necessitated only minor amendments to national regulations for budgeting and financial control because the existing system was flexible enough to fulfil requirements. As all transfers between Austria and the Community are enacted within the federal budget, there was no need for budget legislation changes.

42. In order to enforce co-ordination of national positions on various Community policies with regard to their financial implications and budgetary constraints, as well as to preserve national priorities and influence the decision-making process at the EU level, special administrative directives concerning budgeting co-operation and cross-sectorial co-ordination were issued.

43. This paper also gives an overview of the financial control system and the way in which responsibilities and control of financial flows to and from the European Union are distributed in the Austrian government administration. Due to the decentralised federal system of control resulting in direct responsibility of budget management authorities on the federal, *Länder* and local levels, the “bilateral protocol” on financial control over the Structural Funds is taking more time to be signed than in most other EU countries. Austria is concentrating on meeting requirements.

44. The Austrian administration managed to meet accession-induced demands without major organisational changes and more or less with existing staff due to the high efficiency and flexibility of the public sector.

45. However, rapid communication became extremely important and additional investments had to be put into information technology. Today information flows efficiently between the Ministry of Finance, the European Commission, our Permanent Representation in Brussels and the spending ministries thanks to fully equipped computer workstations, networking and electronic data exchange.

46. Finally, it is Austria’s experience that EU membership should be seen as a “living” matter; indeed, improvements in organisation and procedures must be carried out constantly rather than on a unique occasion at the time of accession.

2. The National System

2.1. Political And Organisational Structure Of Government

47. Austria is a decentralised federal nation with three levels of government:

- central government federation or *Bund*;
- nine regional authorities, (states or *Länder*); and
- a hierarchy of local governments (communities, municipalities) within each state.

48. The responsibilities of each level of government are defined in the federal Constitution. The federation and each state has its own constitution, parliament, government, administration and budget. Communities can also independently decide on their budgets under the respective state's supervision.

49. The central government (*Bund*) is responsible for, among other things, defence, law and order, universities and high schools, research, social security, postal services, railways, maintenance of main roads, as well as for foreign affairs, including matters of European integration. The central government also provides support for welfare, local transport and hospitals.

50. Regional governments (*Länder*) are responsible for primary education, housing, health and welfare, in particular for running and financing hospitals.

51. Some areas of responsibility come partly under the *Bund* and partly under the *Länder*, such as regional policy and agriculture. This shared responsibility creates pressure on the *Bund* and *Länder* to co-operate and co-ordinate their respective policies.

52. Municipalities have the responsibility for kindergartens, administration of schools, local roads, water supply and canalisation. In addition, the larger municipalities are responsible for a wider range of services, including hospitals and social and cultural facilities.

53. Because of its competence in foreign and EU affairs, the *Bund*—obliged by a special constitutional rule—must co-ordinate all EU matters that concern other levels of government.

54. The financial aspects of this federal structure are rather complicated. There are two main legal texts regulating the financial relations between central government, states and local authorities: the Fiscal Constitutional Law and the Financial Equalisation Act. The latter provides for (in particular):

- sharing tax revenues; and
- intergovernmental transfers (from central government to other levels).

55. The Fiscal Constitutional Law authorises the federal legislative body to decide on the Financial Equalisation Act. In this case, the federal Parliament must follow a special rule stipulated by the Fiscal Constitutional Law: the so called *equivalence principle*. This means that all rules for sharing tax revenues and granting transfers from one level of government to another level must reflect the actual allocation of public administrative burdens and must guard against overstraining the capacities of each authority (*Bund*, states and communities). Therefore, up to now the Financial Equalisation Act has been drawn up by mutual consent and decided upon in a convention between the *Bund*, states and the representatives of the communities. This federal legal arrangement usually remains in force for a few years.

56. The present Financial Equalisation Act had to be adjusted before 1995 (the first year of Austria's EU membership) because of a new budgetary burden stemming from the contributions to the EU Budget. This new burden has to be shared between the three levels of government.

57. As explained above, each level of government is principally autonomous and independent, even in budgetary matters. However, there are some informal institutions and procedures that help to organise financial co-operation from a budgetary point of view between the levels of government. This kind of co-operation has been intensified over the past two years since the rules of budgetary discipline, provided by the EC Treaty, apply to all public budgets at all levels of government. At present, the EU is negotiating a pact on stability and growth which will be an agreement about accelerating and strengthening the EC Treaty Rules on budgetary discipline. *Bund, Länder* and communities have agreed to reach a legal arrangement on budgetary discipline on a national level once the EC has established the stability pact.

58. In addition to budgetary policy, *Bund* and *Länder* co-operate on many issues, such as administrating and transmitting financial transfers provided by the EU.

2.2. Federal Level And The Federal Budget

59. The central government is the most important public body, and the federal budget is the biggest of all public budgets, i.e. about 70 per cent of the whole public sector.

60. The federal Parliament has two chambers: the federal Parliament (*Nationalrat*) and the Parliament of States (*Bundesrat*). The federal Parliament is the actual legislative body. The Parliament of States is the federal institution through which the states participate in the legislation of the Federation.

61. Federal Government is headed by the federal Chancellor. At present, the federal Government consists of 15 ministries. Government functions are organised around these ministries. Most of them are responsible for large services, e.g. education, science and research, agriculture, defence, taxation and public transport. Only a few ministries are small organisations and mainly are in charge of regulatory activities. Most ministries are organised into more than one department as well as a number of subordinated agencies and institutions.

2.3. The Main Budgetary Organs

2.3.1. Ministry of Finance

62. The central responsibility in all budgetary matters is held by the Ministry of Finance (MoF). The MoF is responsible for financial and tax policy and is therefore responsible for the expenditure and revenue sides of the budget in general and for the management of the entire budget. The MoF prepares the annual draft budget and the mid-term budget programme.

63. A further competence of the MoF is the management of federal fiscal issues. The MoF is responsible for co-ordinating budgetary policies of *Bund, Länder* and communities as well as for preparing and executing the Financial Equalisation Act.

64. Within the MoF all budgetary activities are co-ordinated by the Budget Department. It is responsible for general expenditure planning, general budgeting and expenditure control. The Budget Department with 50 professionals is split up into divisions. The Financial Management Division co-ordinates the preparation and implementation of the budget as well as accounting. The Budgetary

Policy Division (3 persons) is responsible for policy-oriented analysis, expenditure planning and forecasting.

65. With EU membership, a new division for Financial Aspects of Regional and Structural Policies (5 persons) has been established. This division has an important role in implementing and monitoring the receipts and expenditures in the framework of the common structural policies.

66. Seven divisions prepare the budgets of the spending ministries and monitor and control their implementation. With regard to European integration, the Agricultural Budget Division (5 persons) is the most important.

67. Last but not least, the Division of EU Finance (5 persons), is responsible for co-ordinating all budgetary matters concerning EU membership: within the Budget Department; between the Finance Ministry and the spending ministries; and between the three levels of government (*Bund*, *Länder* and local levels). This responsibility includes: preparing and executing all decisions on the national level concerning the EU Budget; co-ordinating and administrating the so-called “own resources”; and co-ordinating budgetary policies between the three levels of government.

2.3.2. *The Role of Line Ministries, Federal Chancellor and the Cabinet*

68. Spending ministries have to prepare and execute all national policies in their field of competence, including all decisions that are made on EU level. All ministries are authorised to execute their respective chapters of the federal budget under their own responsibility. However, to enable the Minister of Finance to fulfil his responsibilities for the management of the entire budget, he is vested—through the Constitution—with the right to take part in various aspects of budgetary management by individual ministers.

69. All government decisions are taken collectively and unanimously in the Cabinet, in particular the outline of medium-term budgetary policy, the so-called Budget Programme and the annual draft budget. The most important goal of the present Budget Programme is to fulfil the Maastricht criteria.

70. The annual budget guidelines are prepared by the Minister of Finance on the basis of the Budget Programme. The negotiations on expenditures and consolidation measures are held between the Minister of Finance, his Secretary of State and the responsible spending minister. Issues which cannot be settled bilaterally are referred to the Cabinet, which is headed by the federal Chancellor. Finally, the Cabinet approves the government draft of the budget, which is presented to the Parliament by the Minister of Finance.

71. In reference to EU policies, only decisions of great importance must be taken collectively by the Cabinet, as a matter of co-ordination. The most recent decisions, even those on EU matters, have been taken by the responsible minister. However, these decisions have been taken only after having co-ordinated with other ministries concerned, in particular with the MoF.

2.3.3. *Role of Parliament*

72. Parliament takes note of the Budget Programme, but it has no legal power to approve or even influence its contents.

73. All central government expenditures and revenues must be approved annually by Parliament. The draft budget is structured on approximately 2 000 budget lines (appropriation accounts): 1 300 for expenditures, and 700 for revenues.

74. Since all contributions to the EU Budget and nearly all receipts from the EU Budget are included in the federal budget, Parliament has complete information about these transfers. However, for legal reasons, contributions to the EU Budget cannot — and *must not* — be influenced by budgetary authorities, nor by legislative acts of the Parliament.

75. This requirement tends to restrain the room to manoeuvre in budgetary policy, as well as the power of all budgetary organs.

2.4. *Effects Of EU Membership On The Austrian Budget*

76. Annex 2 shows the contributions to and receipts from the EU Budget. The entire federal budget amounts to some Sch 800 billion. Austria had to contribute approximately Sch 25 billion to the EU Budget, its so-called “own resources”, in both 1995 and 1996. For 1997, we expect to contribute Sch 30 billion.

77. The returns from the EU amount an annual average of about Sch 15 billion. Austria therefore is one of the biggest net contributors to the EU Budget; the net contribution amounts to about 0.4 to 0.5 per cent of GDP.

78. The effects of EU membership on Austria’s budgets are not limited to these transfers. Three other effects have changed the structure of the federal budget:

79. The competence in common agricultural policy, including financing measures, exclusively resides with the EU. Therefore, all agricultural measures in the field of market regulation are budgeted on both sides of the federal budget, thus leaving no net burden on the national agricultural budget. Some of these measures have to be co-financed by Member States, and these expenditures remain as a national burden. This burden is shared between the central government and the *Länder*.

80. Structural policy measures according to the common Structural Fund rules have to be co-financed by the central government and the states. The transfers from the EU Budget are also budgeted on both sides of the federal budget and of the states’ budgets, too. Up to now this had no important effect on the balance of the respective budgets. The objectives of structural policy have now changed. However, because of the “principle of additionality”, the level of the national share of subsidies could not be decreased; on the other hand, on average it would not be increased.

81. The tax system had to be adjusted according to the respective common directives and regulations. In particular, the customs system has changed, and revenues from customs duties have to be transferred to the EU Budget. All these tax effects amounted in the first years to some Sch 8 billion.

82. Great efforts have been—and are being—made by all budgetary authorities to meet these budgetary challenges, at the same time as aiming to fulfil the Maastricht criteria.

3. Managing Receipts And Funds From The Community

3.1. Classification Of Receipts/Funds For Budget Purposes

83. All receipts are estimated in the draft budget and accounted for within the federal budget. All (Community) receipts/funds correspond to (national) expenditures. Estimation and accounting follow Austrian legal norms and undergo full budgetary control, which means that all financial flows are completely and transparently documented.

84. Receipts from EU funds are allocated to budget lines for the European Agricultural Guidance and Guarantee Fund (two lines: EAGGF-Guarantee and EAGGF-Guidance), the social fund and regional development. On the expenditure side, there is a special budget line for EU financing which goes directly to the *Länder*. Expenditures handled by federal authorities are allocated to budget lines of the specific co-financing ministry.

85. Expected European Social Fund (ESF) and European Regional Development Fund (ERDF) receipts can only be roughly estimated (in terms of amount and date expected) at the time when the national budget is prepared. Therefore, only a reminder of these expected receipts is indicated. Utilisation of these expected receipts is initialised by empowering the spending ministry to overrun the budget line according to actual receipts. Final mobilisation of already committed tranches is subject to clearly specified authorisation procedures.

3.2. Management Of Structural Funds

86. Structural Funds are primarily used to co-finance subsidies of the federation (65 per cent) or *Länder* (35 per cent). About 50 per cent of the subsidies is accrued for regional policies; 15 per cent for labour market policies and 25 per cent for agricultural policies (these percentages are estimated targets). The share in co-financing depends on the kind of Structural Fund. In the case of funds from the ERDF, the *Länder* make more financial means available. ESF funds are co-financed almost exclusively, and EAGGF funds up to 60 per cent. This situation mirrors somewhat the differences in spheres of competence between the *Länder* and the federation. (See Annexes 3 and 4.)

87. All receipts from the EU are handled within the federal budget and therefore are subject to full budgetary control. Entry posting is made in favour of the MoF; expenditures are made to the debit of those ministries that are in charge and responsible for national co-financing. If we take the example of an environmental project, the Ministry of Environment is responsible for payment of EU subsidies and national co-financing. The Ministry of Labour does the same for labour market projects, and the Ministry of Economics the same for Small — and Medium-sized Enterprise (SME) projects. This kind of system requires a lot of co-ordination because of the numerous players on federal and regional level.

88. The task of co-ordination has been undertaken by the three ministries that correspond to the funds (fund-corresponding ministries): the Federal Chancellery (14 persons) for EU-related matters for ERDF funds; the Ministry of Labour (8 persons) for ESF funds; and the Ministry of Agriculture (25 persons) for EAGGF-Guidance. The tasks of these three Ministries are: to call for Structural Funds instalments; to distribute receipts to the authorities and competent bodies; and to monitor operations.

89. The rate of *Länder* and the federation's contribution to finance the multi-year operational programmes differs according to each fund. The organisational structure in handling the funds differs too:

- *ERDF*: After splitting up receipts between *Länder* and the federation, the Federal Chancellery (ERDF-corresponding ministry) transfers payments to the *Länder* and informs the ministries in charge of ERDF measures (co-financing ministries). About 3-4 persons in each of the 9 *Länder*-authorities and at least 150 persons in all subordinated agencies and institutions are involved in ERDF-matters.
- *EAGGF-Guidance*: Complete organisation of aid from the Structural Funds concerning Objective 5a and 5b has been outsourced either to the Provincial Governors (*Landeshauptleute*) or special paying agencies or Chambers of Agriculture (about 160 persons altogether). All these bodies receive EU funds as well as national co-financing from the Ministry of Agriculture (MoA). This also pertains to financial resources from the *Länder*.
- *ESF*: Most transactions are managed by the regional offices of the Labour Market Service (about 15 persons) and the *Länder*.

90. The Austrian experience shows that this system of "partnership" is quite complicated because of the number of players at the central, regional, local and EU level. This results in heavy workloads and financial expenses, and brings discredit to basically positive instruments. It does not correspond to the ideal principle of a transparent administration and makes financial control more cumbersome.

3.3. *Transfer Of Funds From The Commission Via Paying Agencies To Final Beneficiaries*

3.3.1. *EAGGF-Guarantee*

91. Below is information on the transfer of funds from the Commission via paying agencies to the final beneficiaries.

- Membership duties are registered in a federal account in an Austrian bank.
- Payments for actions under the Common Agricultural Policy (CAP) are disbursed by the 6 paying agencies (*Agrarmarkt* Austria = AMA; *Zollamt Erstattungen* = ZA/E; Ministry of Agriculture and 3 paying agencies in the *Länder*) and charged to the national budget.
- The MoA reports these payments to EAGGF authorities (DG VI)
- EAGGF authorities inform the MoA if and when payments are accepted as made under EU law interpreted by the EAGGF-Committee.

- EAGGF makes payable the respective “advance payments”³ from the EU’s account to the national account administered by the Ministry of Finance. Expenditure in the national budget is compensated by income.
- Accounts are closed annually at the end of the EAGGF-financial year by mid-October.
- The clearing of accounts procedure states the final amount of payments by EAGGF to the national budget. It may involve further transactions between EAGGF and the national budget.
- “Green rates”: expenditure is declared by the Member State in national currency. Refunds are also paid in national currency. The exchange rate has therefore no influence on the balance.

3.3.2. *Structural Funds*

92. Transfer of Structural Funds payments proceed as follows:

- All payments of Structural Funds are transferred in European Currency Unit (ECU) to specific Austrian bank accounts in favour of the MoF (for each Structural Fund such an account has been opened). The ECU payment is converted into Schillings at the exchange rate of the day and charged to the national budget.
- The competent fund-corresponding ministry is informed immediately by the MoF of incoming EU transfers.
- These fund-corresponding ministries activate disbursement of tranches in Schillings to the paying agencies according to requests for Community aid.
- If the fund-corresponding ministry is at the same time the agency for extending national subsidies, it manages the funds together with the national subsidies. If not, the fund-corresponding ministry informs the spending ministry, thus triggering the respective payments.

3.3.3. *Non-Structural Funds*

93. It is sometimes difficult to follow the trail of Community funds. If the Community pays directly to the final beneficiary without transferring money first to a governmental paying agency, there is no information from intermediaries nor from final recipients on the flows of Community funds. These kind of non-structural payments do not pass through any governmental account. Their total amount is therefore very difficult to estimate because:

- the final beneficiary is under no obligation to inform governmental institutions about payment; and
- the EU, giving the instruction for the transfer, is not willing to publish these figures.

3. “Advance payment” is the technical term. In fact, EAGGF pays back what has been accepted as a due payment with a maximum delay of 2½ months.

94. These non-Structural Funds figures remain an unknown for the Member State until the European Court of Auditors publishes its report for the preceding financial year at the end of November.

3.4. Systems, Routines And Procedures For Financial Control

3.4.1. EAGGF-Guarantee

95. EAGGF's complex and strict information procedures were implemented by the Austrian authorities (the Ministry of Finance's Division for Common Market Organisation and the Ministry of Agriculture) in line with EC rules, and partially in advance of Community legislation. This was partly due to the fact that EU legislation coincided with Austria's entry into the EU, which favoured the introduction of totally new procedures. Information-sharing obligations should nevertheless be reviewed (by all Member States of the Community) because of the heavy administrative burden they imply. On the other hand, these obligations increase to a certain extent the security of financial transfers management.

96. EU law obliges the Member State to set up one or more paying agencies. These agencies are in charge of activating and dispersing payments to individual beneficiaries and informing the overhead structure about these payments. If there is more than one paying agency (as in most Member States), a co-ordinating body is required. The co-ordinating body (in Austria, this is the Ministry of Agriculture) collects the paying agencies' monthly information about payments made, controls the arithmetical correctness, and submits the information to the European Commission (DG VI). This structure is a new element in agricultural markets administration. It has proven to be efficient. The goal of uniform national data submission to the Commission is secured.

97. Up to now no payments have been refused by EAGGF. Reasons for this may include:

1. Austria combined the former market-regulating institutions⁴ into a single organisation in order to manage the internal side of the CAP. The *Agrarmarkt* Austria (AMA) is in charge of implementing most of the common market policies in this area. AMA is an independent body instituted by federal law and under authority of the MoA. The external side of the CAP is managed by the customs authorities especially the *Zollamt Erstattungen* (ZA/E)⁵. Several audits by EAGGF authorities have produced an especially good record of ZA/E. Though it seems that these institutions are working well, the final proof will be in the closing of accounts procedure.
2. Austrian authorities show a high degree of willingness to co-operate with EAGGF authorities. It is both a duty and a service of EAGGF to clear instantly any uncertainties

4 The state has been playing an important role in managing agricultural markets since the 1930s. To put it in a nutshell: CAP combines elements of market economy and of centrally planned economy. It goes without saying that this leads to considerable systematic problems and inefficiency.

5 The respective competences of AMA and ZA/E overlap in the area of granting export licenses. Granting licenses lays with AMA, whereas ZA/E is in charge of export management, such as paying export refunds, control of correctness, etc.

about implementation. It is a good strategy to come to EAGGF for explanations as frequently as needed, even when the slightest doubt exists.

3. EAGGF looks into national implementation of Community norms very frequently. Pressure on paying agencies to work swiftly is quite high.

98. It is important to bear in mind that entrepreneurs may well speculate on changes in the value of stocks induced by accession. This is possible due to the “single market” approach to accession, as in Austria’s case. Austrian experience points out difficulties with materially taking stocks, with their classification according to the EU’s Combined Nomenclature, and finally with collecting duties for excess stocks imposed by the EU⁶.

99. The estimated number of professionals involved in the agriculture expenditures business (EAGGF-Guidance and Guarantee implementation and control) is about 1 300 persons. EAGGF-Guidance counts about 185 professionals; EAGGF-Guarantee 737 persons; and 347 persons work in overlapping areas.

3.4.2. *Structural Funds*

100. Experience is scarce in this area. The Commission’s Financial Controller has been negotiating bilateral protocols on financial control over the Structural Funds. These protocols enable the Member State’s authorities to carry out system audits and to audit individual transactions on the basis of an agreed methodology or a national methodology which is accepted as equivalent.

101. Due to the federal and decentralised system of control, with direct responsibilities of budget management residing with authorities on federal, *Länder* and local level, such a system of financial control is not easy to implement in Austria.

3.5. *Post-Financing And Its Implication On The National Budget*

3.5.1. *EAGGF-Guarantee*

102. The CAP, though financed totally by EAGGF in principle, has considerable financial implications for the Member State. Firstly, the Member State pre-finances and therefore must bear financial costs (e.g. interest). Secondly, administrative costs fall on the Member State. Thirdly, there is no pardon for lagging behind schedule. The Commission only tolerates very short delays of Member State action either with payments themselves or with communications about payments. Even if a delay can be explained properly, the Commission will first deduct it from “advance” payments.

6. EU Regulation 3108/94 and Regulation 144/97 (in fulfilling Article 145, Paragraph 2 of the accession treaty) foresee the necessity of classifying rice (and olive oil) on stock as of 1 January 1995 according to the EU’s Combined Nomenclature. As the Austrian tariff code does not know subdivisions in (broken and wholly milled) rice, different kinds and quantities were not verifiable and duties consequently not accountable. In addition, stock-owners were not always identical with importers, therefore the Austrian authorities had difficulties in collecting those duties which were imposed by the EU for excess stocks (as of 1 January 1995) in March 1997.

103. “Effect of the first year”: EAGGF pays back within 2.5 months what the Member State pre-financed. The EAGGF year starts on 16 October and ends on 15 October, whereas the financial year starts on 1 January. Payments by the Member State for Community interventions of considerable financial volume⁷ have to be made after 16 October of the year “t”. This leads to expenditure by the Member State in its financial (= calendar) year “t” whereas refunds by EAGGF will be registered in the Member State’s accounts in the following financial year “t + 1”.

104. This mechanism leads to huge imbalances in the first year after entry that are only balanced over subsequent years. Regarding the Austrian experience, refunds for agriculture in 1995 were only Sch 1 134 million, while CAP-payments of Sch 9 056 million were actually made.

3.5.2. *Structural Funds*

105. A problem during the first two years of EU membership: Although ERDF funds arrived in time in Austria, they could not be paid out to the beneficiaries within the financial year 1995 and had to be reserved for the next year because of an unavoidably slow pay-off process in the start up phase. EU money as well as national money can only be disbursed in accordance with progress of investments and payments made by beneficiaries.

3.6. *Division Of Responsibility Between The Different Bodies For Correct Implementation And Control Of The Use Of The Funds*

106. As noted before, Austria is a decentralised federal state with three layers of government—federal level, nine *Länder* and communities (*Gemeinden*) within each *Land*. Each *Land* has its own constitution, parliament, government, budget and an autonomous and independent administration.

107. Annex 5 shows that there is no central financial controller even at the federal level. Budget management authorities like the federal Ministers or the federal Chancellor are legally and politically responsible within their area of competence for correct implementation of the funds (and at the same time for reimbursement in case of adverse dedication of the money). The main burden of control however lies with the agencies managing the funds. In order to execute financial control, each ministry has an internal audit and accounting department. Concerning contributions and receipts, this means that transaction of money is subject to usual control mechanisms (separation of directive and executive functions).

108. The Austrian system of financial control used to work well within the limited area of audit competence of each body (spending ministry, paying agency, etc.). Compared to other countries, the frequency of internal audits seems to be high. But the federal system makes it hard to control interfaces between the different audit bodies and to find a sort of “overall responsibility” for the entire financial flow of funds.

7. E.g. acreage payments for cereals which are the single largest operation under CAP in financial terms.

4. Managing Own Resources

4.1. Estimation Of Customs Duties And Agricultural Levies

109. Estimates are normally based on past revenues and forecasts for external trade for the year in question. It is, of course, also necessary to have estimates that take into account the effects of changes of agreements and/or customs laws (rates, rate structure). Calculations depend on the nature and size of the changes.

110. Accession to the EU implies in general a considerable change in customs duties and levies. This happens not only because the new Member States adopt the EU customs system, but because there may also be considerable “behavioural” shifts as to where taxes on imports are levied (known as the “Rotterdam effect”). Whereas changes in the rate structure can in principle be calculated on the basis of past trade statistics or duty data, the “shift effect” can hardly be estimated. Therefore, there may be considerable forecasting errors in the first years after accession.

111. From a budgetary point of view, the estimation of duties and levies is a minor problem, because 90 per cent of revenues are transferred, as own resources, to the EU Budget. Only 10 per cent remain at the national budget for collecting costs. Therefore, the influence on a Member State budget is rather low. In any case, for the Union, a good estimate of a new Member State’s customs duties and agricultural level is of limited importance because what counts is the sum of revenues of all Member States. This sum should be more easy to forecast even if new members join the EU because in total the “shift effect” vanishes and the new Member State’s revenue may be low compared to the EU total.

4.2. Collection Of Customs Duties And Agricultural Levies

112. Customs duties and agricultural levies have to be transferred according to the revenue. In Austria, the customs service is responsible for collecting the traditional own resources (including agricultural levies), and the Ministry of Agriculture and Forestry is responsible for collecting sugar and isoglucose levies. Establishment of whether or not levies are applicable is carried out by the custom authorities that are responsible.

113. According to the Community Customs Code and Regulation 1552/89, all established traditional own resources have to be reported to the Commission in the so-called A- and B-accounts. Although the existing data processing system was working well and rather sophisticated, accounting procedures had to be adopted in order to produce the reports demanded in EC Regulation 1552/89. There are still some difficulties in fulfilling the requirement of the yearly report on fraud and irregularities Article 17, Paragraph 3 according to Regulation 1355/96.

114. The Austrian Customs Service had already started long before accession to redesign the national collection system and to adapt it to the needs of the Common Market, especially with regard to own resources and the effective fight against fraud. Necessary steps had to be taken, such as personnel transfers; computer hardware and software upgrading in those customs offices which are located along the external border; developing computer networking and connections to important data base systems; and special training.

4.3. Anti-Fraud Arrangements

115. Member States are obliged to participate actively in measures to protect common financial interests and to implement adequate controls at the external borders to prevent customs frauds and contravention of prohibitions and restrictions. In order to comply with these obligations, the following anti fraud arrangements were planned and became operational with EU accession:

116. At the beginning of 1995, the Centre on Customs Information and Analysis was established in the Ministry of Finance. The Centre is *inter alia* in charge of:

- information collection, processing and analysis (operational and strategic analysis);
- introduction and implementation of risk analysis at operational level;
- risk management in the customs administration;
- communications co-ordination; and
- results evaluation.

117. At the regional level, seven anti-fraud co-ordinating teams were established in the customs departments of the Fiscal Regional Administrations which are attached to the MoF. These teams are responsible for regional risk analysis. They represent the link between customs offices and special units within their respective regions and the Centre on Customs Information and Analysis in the Ministry of Finance.

118. At external border crossings, special units implement risk-based controls and intensive checks of vehicles, buses and trucks. Rummaging halls as well as modern technical equipment have been provided. In addition, the Austrian Customs Law Implementing Act allows customs controls within the whole territory; indeed, it can be assumed that goods under customs control circulate throughout the territory. These controls are implemented by mobile customs units.

119. The growing demand for extensive reporting in the area of fraud and irregularities entails great expense and exceeds by far the 10 per cent allotted for collection costs, which can be retained from the amount to be paid in customs duties and agricultural levies .

4.4. Calculation Of VAT Own Resources And The Fourth Resource (GNP Own Resources)

120. Well before accession, a candidate for membership needs a good estimate of VAT own resources. If the VAT system is already similar to the EC VAT directive, it may be possible to calculate them by the procedure which is foreseen by Regulation 1553/89. In many cases, this method may not be sensible and it may be preferable to estimate the VAT base directly from the national accounts by taking the demand side aggregates and adjusting the figures where necessary. The first budgets after accession may be based on these estimates.

121. The calculation of the VAT base (for the annual report to the Commission until 31 July of the following year) is rather (and unnecessarily) complicated. The results can be taken as a base for future estimates of VAT own resources.

122. GNP calculation/forecast is made by ÖSTAT (Austrian Central Statistical Office). The Statistical Office of the European Communities (EUROSTAT) and the Commission are informed at the same time of the latest data. Forecasts of GNP contribution, as well as yearly account closure estimates, are based on this information.

4.5. *Procedures For Transferring And Accounting For The National Contribution To EU*

123. According to existing EU finance regulations, each Member State has to provide the national contribution by crediting the “Article 9 account” (EC Regulation 1552/89). In Austria this account has not been opened with Nationalbank, but is part of the federal accounting system. All credits (Austrian contribution to EU own resources) and debits (payments to the Commission) are listed, and the balance of account shows the actual state of own resources. Effective payments depend on Brussels cash-needs. Payments are also caused by the need to balance Article 9 accounts of other Member States (according to their share of total contributions).

124. This kind of upkeep of the Article 9 account ensures that Community owned resources do not leave the federal monetary holdings until the European Commission calls for payment.

125. As relevant information concerning payment orders arrive very late, there is a need to operate with excess expenditures. This makes it more difficult to plan the national monthly financial requirements.

4.6. *Preparation Of Statistics*

4.6.1. *Own Resources*

126. The main problem here is comparability of figures. Whereas the European Court of Auditors (ECA) and the Commission use credits received as equivalent for receipts, Austria uses actual payments as the national budget is governed by the cash-principle. Therefore, two parallel statistics have to be prepared in order to compare national figures with the results of the other EU 15 Member States published by the ECA.

4.6.2. *Funds/Receipts*

127. Allocation problems at the end of the year result in different figures at community and at national level. This is because payments made by the EC in January apply to the previous year; whereas for the Member States, they represent an income in the new year.

128. During the first years of membership, overall figures can show extreme fluctuations and are not representative for the later average. Different breakdowns of these statistics result in a user-unfriendly and non-transparent system. Even tables of the Commission and the ECA show the following for the Union’s expenditure:

- different structures for the same category (especially in Category 3 of financial perspective);
- different figures because not all payments can be directly related to a specific country, and each of the institutions uses a different system.

129. In general it can be said that the question of so-called back-transfers is a sensible one; the Commission avoids detailed reporting. At the same time, there is a need to satisfy the legitimate information requirements of the Austrian population.

5. Community Budget Process

5.1. *Roles Of The Ministry Of Finance, Line Ministries, Agencies, Regional And Local Authorities, Other Organisations And Permanent Representation In Brussels*

130. In adapting the domestic decision-making structures to EU membership, three major problems had to be tackled:

- how to co-ordinate the governmental policy-making process;
- how to involve the *Länder* in the above; and
- how to operate parliamentary scrutiny of government policy within the EU.

131. In a coalition agreement, both partners of the coalition decided on a system of complete formal equality between Foreign Ministry and the Chancellor's Office, e.g. working groups preparing for EU Council or COREPER I and II are chaired alternately.

132. Responsible for representing the Republic's interests, the federal Government must on a regular basis inform and ask for opinions from the following bodies on any important EU project:

- Council of Ministers;
- national Parliament (executive committee);
- *Länder* and communities (if a specific EU question affects their independent sphere of action or may otherwise be of interest to them); as well as
- social partners.

133. In certain cases, federal Government is bound to opinions given by the above; deviation is only possible for imperative reasons relating to foreign or European integration policy.

134. The central competence in all national and EU budgetary matters resides with the Ministry of Finance. The Minister of Finance is responsible for financial and tax policy in Austria and financial co-ordination of and participation in drafting and deciding on the Community Budget.

135. Four attachés of the MoF are delegates to the Permanent Representation in Brussels and one of them (budget committee representative) co-operates permanently with the MoF's Division of EU Finance (participates in the Community Budget process; co-ordinates all financial flows from and to Brussels; manages and forecasts own resources; and makes reports according to EC Regulation 1552/89).

136. One of the main tasks of the MoF is to preserve national interests and to influence the decision-making process on EU level (ECOFIN and Budget Council). The MoF must also ensure permanent co-ordination (between MoF and line ministries) of national positions on various Community policies with regard to their financial implications and budgetary constraints. Spending ministries are forced to follow calculation obligations for financially significant measures at the Community level in order to estimate internal effects.

137. A key question is how to finance political priorities of the Union in light of the budgetary rigour prevailing in Austria in order to meet the convergence criteria for the European Monetary Union (EMU).

5.2. *Change In National Budget Laws, Procedures And Systems*

138. As the transfers between Austria and the Community are nearly entirely carried out within the federal budget, there was no need for radical changes.

5.3. *Forecasting Receipts/Funds And Contributions*

5.3.1. *Forecasting Own Resources*

139. Forecasts for the European Union Budget in year “t” have to be established at the beginning of “t - 1”. GNP and VAT payments in “t” are based on these forecasts. They are corrected only in December “t + 1” according to recalculation of the GNP and VAT base.

140. In general, a simple elasticity approach can be applied for VAT forecasts, taking past revenues and estimating future developments according to the economic forecast of relevant aggregates (mainly private and partly public consumption). EU accession brings more forecast uncertainty in the short-run, because even if there are no changes in the tax rates there may be changes in the tax structure (e.g. what items are tax-free or when do reduced rates apply?). Changed tax procedures can cause short-term turbulence in forecasting. These supplementary forecasting problems should vanish after several years.

141. After a reliable calculation of the VAT base is done for the first time, future VAT own resources can be estimated in a similar way, as for the VAT itself, by using the forecast of the development of the relevant economic aggregates in the calculation.

5.3.2. *Forecasting Receipts/Funds*

142. Exact forecasting of Structural Funds is not possible for the following reasons:

- the amount of refunds will fluctuate depending on the present economic situation and therefore the capability (willingness) of the Member State to co-finance;
- most of the payments in Category 3 of the EU Budget (internal policies) go directly to the final beneficiary (non-structural refunds) and therefore do not appear in the national budget;
- delays exist in the first year, therefore refunds in the second year are disproportionately high.

143. In terms of EAGGF-Guarantee, it turned out to be rather difficult to estimate the volume of transfers under the CAP at the time of setting up the federal budget. The Austrian budgeting system, however, proved to be flexible enough to cope with this problem.

6. Co-Operation, Co-Ordination And Contacts

6.1. *With The Commission And With Other Member States*

144. There are many formal and informal communication channels between Member States and/or Commission services; whereas effective co-operation between applicant countries and the Commission and/or Member State demands additional efforts. The following example illustrates this.

145. One of the essential tasks in preparing for accession is to foresee in good time the adoption of national legislation in accordance to Community law on customs matters. For language reasons, it was obvious that the Austrian administration could use to a large extent German regulation on this subject. Contacts were established with the responsible persons, and Austrian civil servants were able to benefit from the exchange of information. The most intensive part of this preparatory work started not earlier than one year before accession. Personnel had to be trained and equipped with appropriate documentation in order to ensure full conformity of administrative procedures with Community law right from the start. Due to the fact that EC regulations are often imprecise, difficult to interpret and inconsistent, the MoF released specific instructions through electronic customs documentation.

6.2. *Cross-Sectional Co-Ordination*

146. According to special administrative directives (co-ordinating national priorities for common legislative acts) concerning budgetary co-operation and cross-sectional co-ordination, the Ministry of Finance must be informed as early as possible about any decision that might have financial implications, i.e. as soon as discussions start either in the Commission, in the related Council Working Group or in the European Parliament. The corresponding department in Austria is obliged to contact their respective budget division in the Ministry of Finance. At the latest, such budgetary implications are discovered at the weekly COREPER preparatory meetings, where final positions/orders are sent to the Permanent Representation in Brussels.

147. Cross-sectional meetings aim to enable accurate and timely co-ordination of national positions regarding Commission proposals and to ensure Austria's effective participation in the integration process. Each line ministry is responsible for co-ordinating its specific EU topic (documents, proposals, etc.).

6.3. *Inspections From Different Auditing Bodies*

6.3.1. *Court of Auditors*

148. The Austrian Court of Auditors autonomously and the European Court of Auditors (with the Austrian Court of Auditors) control on a regular basis the proper implementation and/or use of: traditional own resources; agricultural expenditure; Structural Funds; and VAT (the functioning of the VAT accounting and payment system.).

6.3.2. *European Commission*

149. Inspections of the European Commission aim to ensure that national management and controls are effective. These inspections are carried out regularly (at least once a year) either on an autonomous basis (independently of national controls) or on an associated basis (together with national controls).

150. DG VI conducts audits in the Member States several times a year. These audits not only concern the conformity of customs clearance procedures and records with Community law, but also internal control and payment procedures in the paying agencies. The latter have become particularly strict with the adoption of accreditation criteria for paying agencies through Regulation No. 1663/95. If the implementation of Community regulations does not meet with the auditors' approval, the controls result in financial rectification.

6.3.3. *National Administration*

151. Community as well as national law are in accordance with the necessity of national controls in addition to EU controls. The existing system of control in Austria differs according to the controlled object and the national authorities fulfilling this task.

152. For example, controls of traditional own resources, in terms of customs duties, are based on three levels within the national customs authorities divided in two sections: one for customs legislation and one for accountancy. Each level, and within this level each section (customs legislation or accountancy), has a certain local control area. The head of control is the Ministry of Finance.

7. **Organisational Issues**

7.1. *Human And Technical Resources*

153. Austria tried as far as possible to use existing organisational structures for implementation of financial and budgetary control in spite of changing objectives and tasks. As needed, existing institutional mechanisms and administrative procedures were adapted. Only a few new bodies have been set up, and some have been expanded.

154. The same is true for the size of staff. Although there was no significant accession-induced increase in personnel numbers overall, transfers to crucial areas took place. In general, the public sector proved high flexible and efficient in facing new challenges.

155. Investments had to be made in electronic data processing equipment and networking facilities to allow rapid communication with all involved partners.

7.2. *Training*

156. Since 1991 the Institute for Public Administration has been offering the so-called "Europa-Akademie", an intensive 4-month programme on main EU topics (European institutions,

decision-making process, EU law, economics, foreign languages, communication and negotiation techniques, politics), as well as a 12-month “EU curriculum” with similar contents.

157. A set of seminars on various EU matters are provided on an on-going basis together with regular language courses in the Ministry of Finance. In co-operation with the Diplomatic Academy in Vienna, custom-made training courses have been developed to prepare for the Austrian presidency in 1998.

158. Professionals are encouraged to spend some time in different ways in the Permanent Representation in Brussels or in related departments in the Commission in order to gain experience.

Annex 1. Austria's Accession To The European Union

159. Here is a chronological listing of steps in the Austrian negotiation process.

| | |
|-------------------|--|
| 17 July 1989: | Austria applies for EU membership; |
| December 1992: | European Council in Edinburgh: Agreement on the beginning of enlargement negotiations; |
| 1 January 1993: | European Economic Area (EEA) agreement comes into force; |
| 1 February 1993: | Opening of accession negotiations; |
| 13 April 1994: | Acceptance of the final texts; |
| 12 June 1994: | Referendum in Austria on membership (66.36 per cent "Yes" — 33.61 per cent "No"); |
| 24 June 1994: | Signature of the Accession Treaty in Corfu; |
| 11 November 1994: | Ratification by the Austrian Parliament; |
| 1 January 1995: | Full membership. |

160. The preparation of the Commission's opinion on Austria's application took 24 months. As the Commission presented the *acquis communautaire* topic by topic, most technical and political problems could be settled.

161. Financial details concerning the contribution to the EU Budget were the last points of our *acquis* screening. Austria's future as a net contributor was quite clear. Much time was spent on discussing the Common Agricultural Policy for which Austria had great reservations regarding the *acquis* (another crucial area was transit traffic).

162. Unlike previous enlargements, this enlargement took place within the framework of a single market without possibility of border controls. We were obliged to agree to the immediate opening of our market without the introduction of accession compensatory amounts for a transitional period, as had been the case in the previous enlargement. This resulted in a significant price decrease for certain agricultural products.

163. At the end of the negotiations, the EU offered extraordinary transfers ("Agro-budgetary package", Article 81 Accession Treaty) of a total amount of MECU 813 for a transition-period of four years:

| Year | 1995 | 1996 | 1997 | 1998 | Total |
|-------------|------|------|------|------|-------|
| MECU | 583 | 106 | 71 | 53 | 813 |
| Billion Sch | 7.60 | 1.40 | 0.96 | 0.72 | 10.67 |

164. This offer was made for two reasons:

1. In 1995, Austria could not receive payments from the Commission according the rules of CAP because Austria was not entitled to receive such payments for legal reasons (“green hole”). Indeed, Member States are only entitled to receive CAP payments from the EU if they had disbursed pre-payments 2.5 months ago. To replace these payments, the EU offered an extraordinary transfer which was calculated at approximately Sch 4.5 billion.
2. Austria had to accept the Common Agriculture Policy (CAP) from the beginning of its EU membership. To facilitate the opening of the markets in the agricultural sector (resulting in a sharp decrease in price level), Austria took extraordinary measures. To cover Austria’s budgetary burden stemming from these measures, the EU offered Austria an additional transfer.

Annex 2. Contributions To And Receipts From EU Budget

165. These figures marked ***are according to Austrian accounts, in particular the federal budget.

1. Contributions

| | 1995 (billion Sch) | % | 1996 (billion Sch) | % |
|---------------------------|------------------------------|------------|------------------------------|------------|
| Credits | | | | |
| GNP based resources | 5.25 | 23 | 7.36 | 29 |
| United Kingdom correction | 0.49 | 2 | 1.50 | 6 |
| VAT resources | 14.60 | 63 | 12.72 | 51 |
| Trad. own resources | 2.92 | 13 | 3.54 | 14 |
| Total credits | 23.26 | 100 | 25.12 | 100 |
| Payments | | | | |
| Gross payments* | 18.75 | | 29.94 | |
| Net payments | 18.43 | | 26.54 | |

2. Receipts

| | 1995 (billion Sch) | % | 1996 (billion Sch) | % |
|-----------------------------|------------------------------|------------|------------------------------|------------|
| Article 81 accession treaty | 7.60 | 73 | 1.4 | 6 |
| ESF | 0.63 | 6 | 1.6 | 7 |
| ERDF | 0.00 | 0 | 1.0 | 4 |
| EAGGF-Guarantee Section** | 1.13 | 11 | 16.2 | 73 |
| EAGGF-Guidance Section | 0.42 | 4 | 1.5 | 7 |
| Other receipts*** | 0.57 | 6 | 0.6 | 3 |
| Total receipts | 10.35 | 100 | 22.3 | 100 |

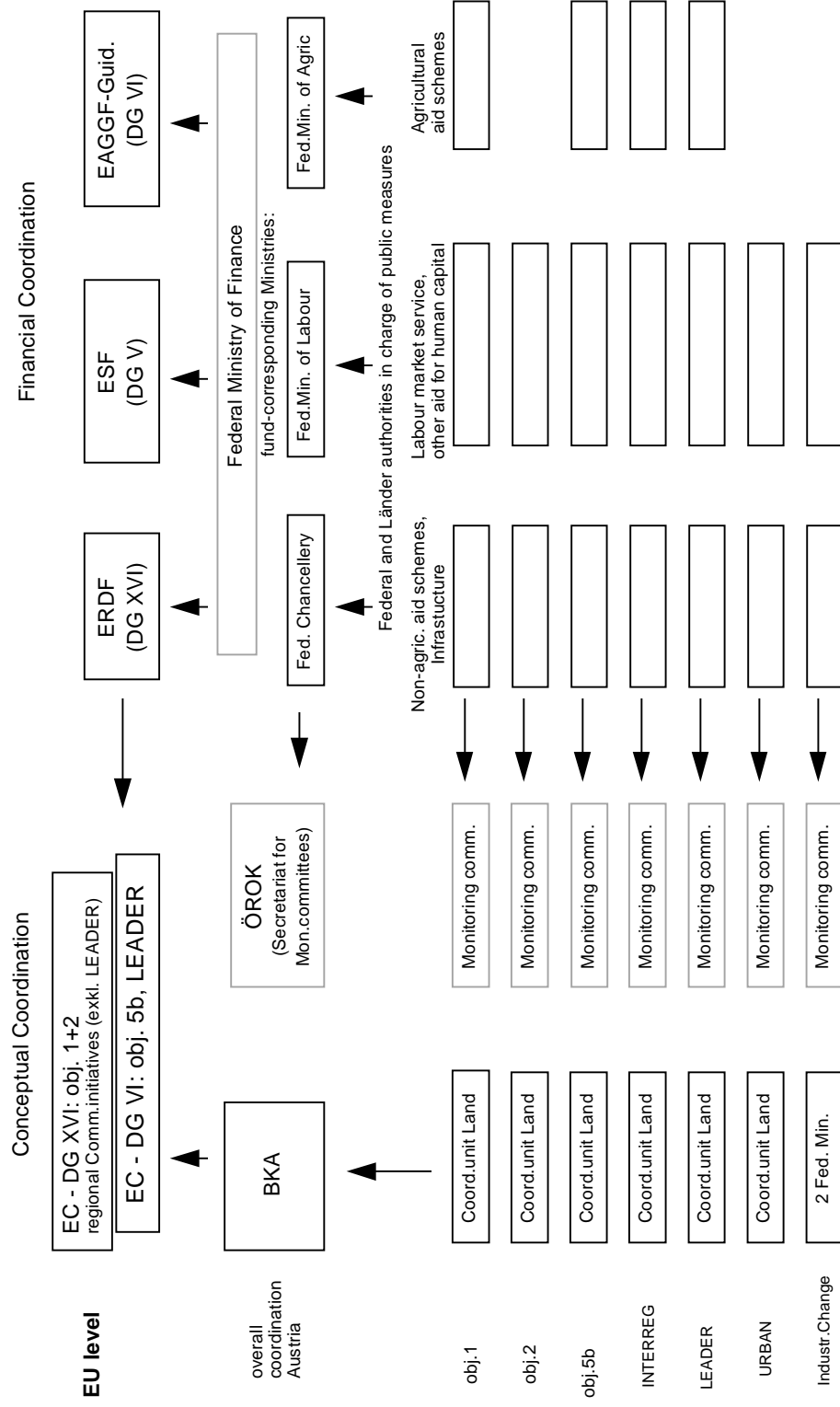
* gross: includes 10 per cent collection costs repayment (trad. own resources)

** 1996: *Bund* (Federation): 15 195 159 326.61.
Länder (States): 1 036 358 360.00.

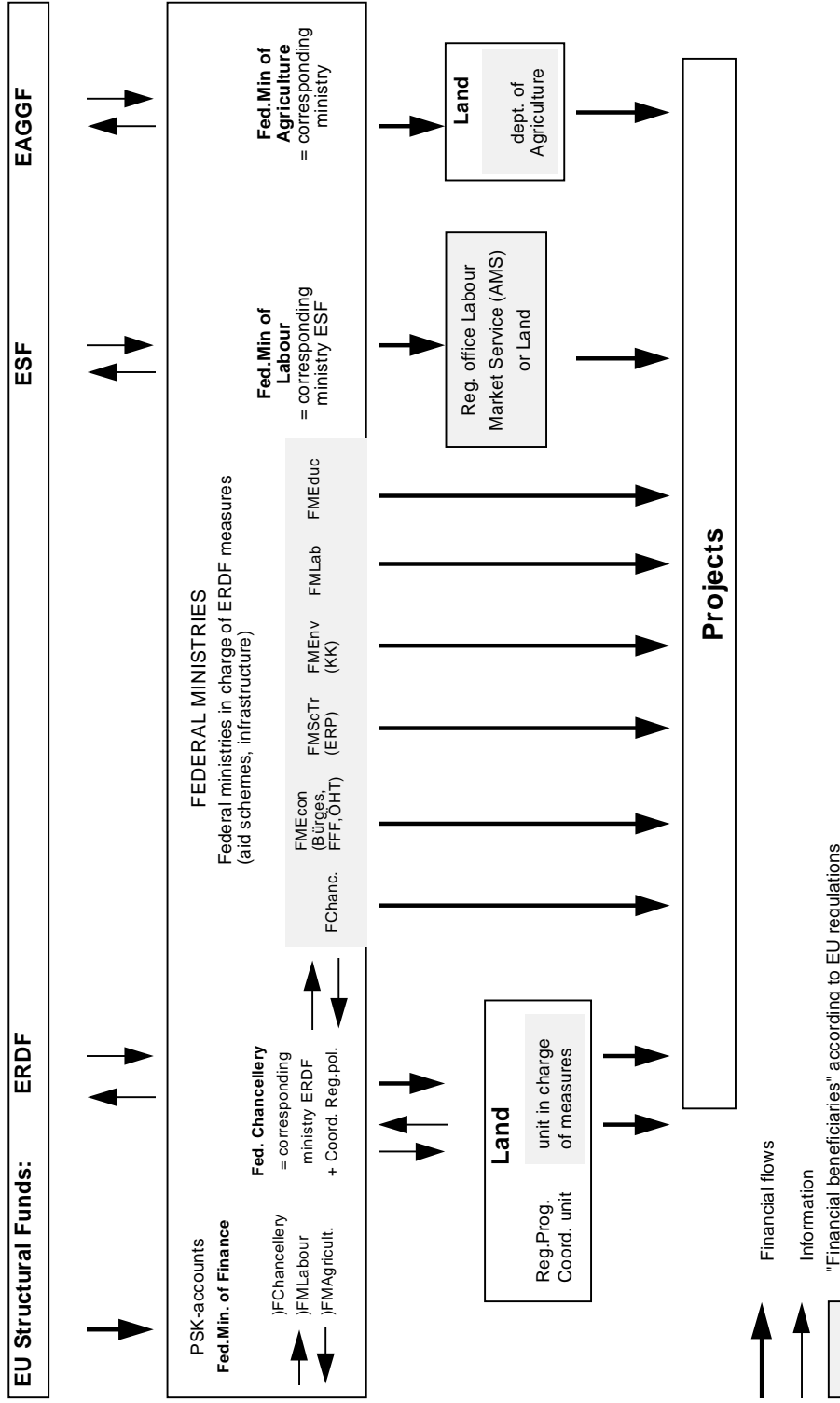
*** 1995: position "other receipts", European Court of Auditors (ECA), Annual report 1995; excludes exchange difference; (NB: accounting period of EU Budget).

1996: rough estimate.

Annex 3. EU Structural Funds In Austria: Interlinkage Of Conceptual And Financial Co-Ordination Of Programmes



Annex 4. EU Structural Funds In Austria: Financial Procedures — Regional Programmes (Obj. 1, 2.5b, Reg. C)



Annex 5. Financial Control: The National System In Austria

1. Drawing Up the Budget

166. The federal budget is adopted each year by Parliament (“Federal Finance Act”). The budget proper (i.e. the national financial estimates for the year ahead) is adopted as an annex to the Federal Finance Act. The Federal Finance Minister draws up a Finance Bill, which the federal Government then submits to Parliament together with the annexes, within a set time-limit. If the Parliament fails to adopt a budget for the coming year before the end of the current year, then the provisions in the federal Constitution on provisional budgets come into play.

167. It is important to know that the Federal Finance Act is not substantive legislation; it merely lays down the internal legal relationships between the various bodies involved in managing federal finances. It cannot be used as a basis for claims or commitments of third parties. The principle concerning the double legal conditionality of measures dealing with financial administration applies, i.e. federal resources cannot be spent without some basis both in federal financial law and, in particular, substantive law.

2. Internal Pre-Implementation Controls by the Finance Minister

168. Implementation of the budget is primarily the responsibility of the various spending departments. However, the Austrian Constitution gives the Finance Minister considerable power to intervene in implementation. Under Article 51a of the Constitution, the Finance Minister must ensure that “payments to honour commitments are made when due, within the limits on the availability of resources and in accordance with the principles of prudence, economy and effectiveness”. The same Article empowers the Finance Minister to cut spending, with the Government’s consent “if income and expenditure patterns require it or there is a significant change in general economic trends in the course of the year”.

169. The reason that the Constitution empowers the Finance Minister to intervene in implementation is that he is responsible for managing the overall budget. The scope of his powers is determined primarily by the relevant provisions of the 1986 Federal Budget Act (particularly Sections 43 to 45). The Federal Finance Minister must, *de facto*, be involved in implementing any major projects. The amount which can be spent without having to obtain the Finance Minister’s consent is laid down in the implementation decree attached to the annual Federal Finance Act, under “financial scope”.

170. The Finance Minister must ensure that:

- any project designed to enable the federal Government to fulfil its administrative duties is compatible with budget principles (prudence, economy and effectiveness), and the need for overall balance and financial solidarity between the federal Government, the *Länder* and the municipalities;
- it is possible to cover all expenditures arising from implementation of the project, taking account of the forecast concerning the budget situation and the economy in general;
- sufficient funds of the correct type are available to cover expenditure commitments, taking account of the relevant forecast and, in particular, existing commitments;
- all commitments entered into meet a real need; and
- payment deadlines are set in such way that payments can be made on time and in full.

171. The minister responsible for a given project and the Finance Minister must agree on a project before it is implemented. In certain cases, involving large amounts, the Finance Minister must be involved at the planning stage. If the minister responsible for the project and the Finance Minister fail to reach an agreement on the implementation of the project, either may put the matter to the Council of Ministers.

172. By virtue of its power to control budget implementation, the Budget Department of the Federal Finance Ministry is the most important pre-implementation control authority in Austria. This enables the Finance Minister to keep a check on the budget and the Government's finances, and he is both empowered and required to intervene in financial matters if there is a discrepancy between target figures and the out-turn.

3. Internal Financial Control by the Minister Responsible for the Area in Question

173. The ministers responsible for expenditure can use two bodies to carry out financial checks: the accounting department and the internal audit department in the ministry in question. The accounting department plays an important role in auditing the accounts as well as performing a number of other tasks. The Federal Budget Act (BHG) and the Federal Budget Directive or Ordinance (BHV), adopted in 1989, contain detailed provisions on the "internal auditing" to be carried out by the accounting departments as part of implementation of the budget (see particular Sections 90 to 92 of the Federal Budget Act). The internal audit includes the preliminary audit, budget-implementation audit and post-implementation audit.

174. The preliminary audit involves checking the sources for every individual payment claim and payment commitment, and the amounts. Everything is checked for legal and mathematical accuracy and for compatibility with the principles of prudence, economy and effectiveness. The preliminary audit should be as thorough as possible.

175. During the implementation audit, the orders are checked to ensure that their form and content comply with budget regulations and other provisions.

176. The post-implementation audit involves checking that the payments and clearing operations have been properly dealt with, that the relevant papers have been properly filed, that their form and content comply with the regulations and that valuables and other assets are available and recorded. After each post-implementation audit, an audit report is produced setting out the nature and scope of the audit and the main findings. While the preliminary audit should be very thorough, the post-implementation audit is more selective.

177. In addition to an accounting department, each ministry has an audit department, usually reporting directly to the minister. The legal basis for these departments is a Government decision adopted in 1981.

178. According to the “Guidelines for Internal Auditing in the Federal Administration”, issued by the Federal Chancellor’s Office, the most important tasks of the audit departments are as follows:

- checking that the organisation of the department is compatible with prudence, economy and effectiveness;
- putting forward rationalisation proposals and ideas for improving structures and procedures;
- summarising the inspection and activity reports of the Court of Auditors;
- helping with the drafting of organisational regulations and with important organisational measures;
- advising on the drawing up of procurement programmes and financing plans;
- advising on planning and implementation of major projects;
- helping with awarding major contracts; and
- ensuring that the public procurement regulations are observed.

179. As is clear from the list of their tasks, the audit departments play a largely ancillary role in the “system audit”. With regard to individual cases, they usually carry out their checks after the event, i.e. after the administrative procedures in questions have been completed.

4. External Financial Control by the Austrian Court of Audit

180. See also the paper on experiences of the Austrian Court of Audit by Mr Wolfgang Wiklicky in SIGMA Paper No. 20 *Effects of European Union Accession—Part 2, External Audit*.

181. The Court of Audit is independent of the *Nationalrat* and the *Landtage* and is responsible for checking implementation measures carried out by the federal Government or the *Länder*. The legal basis is formed by the federal Constitution and the Court of Audit Act of 1948. The Court of Audit functions as a federal body or a *Land* body, depending on whether it is examining the federal Government’s finances or one of the *Länder*’s. The President is chosen by the Parliament for a period of twelve years. His rank is equivalent to that of members of the federal Government or members of the *Land* government in question.

182. The Court of Audit is responsible for controlling the finances of the federal Government, the *Länder*, communities (with more than 20 000 inhabitants), groups of communities and other bodies

specified by legislation. With respect to the federal Government's finances, the Court of Audit's controls cover:

- all financial transactions at federal Government level (income and expenditure, loans, moveable and fixed assets);
- foundations, funds and organisations run by federal bodies for the federal Government; and
- activities over which the federal Government exercises financial or organisation control.

183. As a rule, the Court of Audit exercises its powers on its own initiative. It checks the account for mathematical accuracy and for compliance with the law and with the principles of prudence, economy and effectiveness. The Court reports annually to the Parliament. It also produces special reports on the special audits it may have conducted (usually upon the Parliaments' request).

DENMARK
By Georg Ginsberg⁸

THE STRUCTURAL FUNDS AS A CASE STUDY

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8. Georg Ginsberg is Consultant in the advisory controller function in the Agency for Financial Management and Administrative Affairs at the Danish Ministry of Finance. In recent years he has worked as Secretary for two inter-ministry committees on internal auditing in the government and on internal control and follow-up on results in the ministries. At present, he is Secretary for the committee concerned with the co-ordination of control with the EU Structural Funds' appropriations.

1. Chapter Summary

184. This paper deals with the Danish state authorities' financial control of the use of grants under the European Structural Funds. It also covers the state's co-operation in this area with the European Commission. The article deals with the financial control of the authorities administering Structural Funds as distinct from that control carried out by external auditing bodies (the Danish National Audit Office and the European Court of Auditors). The financial control described here is concerned with investigations of both regulation compliance and goal attainment in relation to the use of the appropriations.

185. The Danish financial control structure belongs to one of the most decentralised structures in the European Union. Indeed, financial control is left to the individual ministries which administer the appropriations. The Ministry of Finance plays a reduced role once Parliament, through the finance law, has accorded the appropriations to the individual ministers or ministries. In addition, financial control in Denmark is traditionally conceived of and dealt with as an integral part of the management and administration of the individual ministries. Special control bodies, such as internal audit or controller units, are only exceptionally established. In the area of Structural Funds, financial control is carried out by three ministries that co-operate closely in order to ensure a suitably standardised regulation and implementation of control, both at the programme level and the project level. Furthermore, all three ministries are in the process of establishing controller units with a view to, among other things, strengthen the co-operation with the Commission concerning the tasks of internal control and follow-up on results.

186. On the basis of the experience of recent years concerning the financial control efforts of Structural Funds in Denmark, the following lessons can be extracted:

- In order to ensure a uniform and precise basis for control efforts concerning all four Structural Funds, it has been necessary to supplement the EC regulations with a detailed set of national regulations, concerning, among other things, the presentation of accounts and the auditing process.
- The anchoring of the control structure in several ministries, divided according to sectors, gives rise to a need for transverse co-operation and consultation, both among the ministries and in relation to the European Commission. Here the Ministry of Finance can assume a role, partly as an intermediary and advisor in relation to the ministries responsible for Structural Funds, and partly as an interlocutor for the Commission.
- The expected financial control co-operation agreements between the Commission and the three ministries responsible for Structural Funds has made it necessary to restructure the organisation of the ministries' own control efforts. Thus, as a consequence of the coming co-operation agreement, special controller units that can function, among other things, as fixed contacts for the Commission's financial controllers will be established in each of the ministries.

2. Introduction

187. The European Commission and Member States are working to strengthen co-operation for the sound financial management of EU funds (see phase III in the Commission's programme for sound financial management SEM 2 000). The Commission wants, among other things, closer

co-operation with the Member States in the financial control of EU Structural Funds. The Structural Funds' significance in terms of cost for the EU Budget has been rising for a number of years, and the area is less regulated in detail than, for example, that of agricultural support.

188. Denmark has remained positive towards the Commission's efforts to strengthen co-operation and co-ordination of the financial control of the Commission and that of the Danish authorities in regard to the use of Structural Funds grants in Denmark. A committee on the co-ordination of the control of the EU's Structural Funds' appropriations has been set up to determine how co-ordination of the entire effort of financial control in this area can be strengthened.

189. In addition, the ministries in Denmark responsible for Structural Funds — in advance of and independently of the Commission's launch of its new programme for sound financial management (SEM 2 000) — have consolidated and specified the foundation for the financial control of the use of Structural Funds appropriations. Among other things, this has meant that supplementary legislation has been implemented concerning the administration of subsidies from the EU's Structural Funds in order to ensure a more unified and detailed basis both for authority and for the set of rules for administration, control, evaluation and sanctions in the area of Structural Funds.

190. Against this background, this paper will review the following topics:

- control arrangements in the Structural Funds area at the central, ministerial level (the prerequisites and main conditions for, as well as the content of, the financial control by the ministries administering the Structural Funds);
- so-called entrusted people's (auditors, etc.) financial control of Structural Funds' individual projects, on behalf of the Danish management authorities that grant subsidies; and
- co-operation between the Commission and the Danish authorities concerning financial control in the use of Structural Funds grants and the current initiatives for strengthening this co-operation.

3. The Expression "Financial Control"

191. Before a closer examination is made of Structural Funds' financial control, it is useful to define what is normally understood by financial control. The expression financial control will be henceforth understood in a broad sense, and perhaps in a broader sense than is traditionally the case. Here, financial control includes both re-examining whether the prerequisites for the grant given were met, as well as doing a follow-up to determine whether the financed activities were satisfactorily carried out in regard to the specified goals and strategies prescribed. Furthermore, it must be emphasised that financial control is exercised by the authorities themselves, and thus is distinct from the control administered by external audit (parliamentary financial control). The latter is carried out in Denmark by the National Audit Office and by the Public Accounts Committee designated by the Danish Parliament. In other words, financial control is the administration's own internal system of controls. It has two focal points: first, to determine whether decisions taken comply with existing rules and regulations ("are monies spent for the right purposes?"); and, second, whether the intended results are achieved in an economical and efficient way ("does one get value for money?").

192. This broad understanding of financial control is in line with Article 2 (a), Part 1 in the Council's financial regulation concerning the European Economic Community's Normal Budget

(consolidated text, May 1990): “The budget appropriations must be used in accordance with the principles of sound financial management, and in particular those of economy and cost-effectiveness. Quantified objectives must be identified and the progress of their realisation monitored.”

4. EU Legal Regulation Of Financial Control In The Area Of Structural Funds

193. Before the reform of the Structural Funds in 1988, subsidies were granted in the form of a contract between the Commission and the individual leaders of projects. After the reform, subsidies are normally given to programmes of several years’ duration that are negotiated between the individual Member States and the Commission. It is the Member State that is responsible for carrying out the programme, as well as ensuring that the subsidies are granted in a correct manner. The object of the reform is to increase the effectiveness of the use made of the Structural Funds, through improving, among other things, co-ordination among the funds. The activities of the funds are regulated through two common Council Regulations (the framework regulation and the co-ordinating regulation), as well as a separate regulation for each fund.

194. The general method for realising objectives and carrying out tasks under the Structural Funds is described in Article 4 of the framework regulation (No. 2081/93). It is apparent from this decision that EU activities are intended as a supplement to the corresponding national actions or as a contribution to these. These activities are determined through close consultation between the Commission and the Member State authorities in question, and with regard to other interested parties at the national level. This consultation or partnership includes the improvement, financing, prior evaluation, surveillance and subsequent evaluation of the activities.

195. The central rules concerning the financing of Structural Fund activities are discussed in the co-ordination regulation (No. 2082/93), Chapter VI “Financial Decisions”. This text deals with general requirements concerning the funds’ financial administration, including obligations, payments, use of the ECU, financial control, as well as the reduction, suspension and termination of grants.

196. In regard to financial control (Article 23) of the implementation of activities, Member States must take all measures necessary in order to:

- check at regular intervals whether the actions financed by the Community are being correctly carried out;
- prevent and punish irregularities;
- obtain the repayment of any funds lost through misuse or negligence.

197. Concurrently with the Member States’ own financial control, the Commission can (according to Article 23) control the actions financed by the Structural Funds, as well as the co-ordination and control systems of the Member States. In doing this, the Commission may use random and on the spot checks. The Commission ensures that its control is internally co-ordinated and in agreement with that of the Member States, so that no redundant controls are carried out, i.e. controls of the same conditions within the same period.

198. In regard to increased co-operation of financial control of the use of the EU’s Structural Fund grants, a number of co-operation agreements or protocols about financial control in the area of Structural Funds, between the Commission’s Directorate General for Financial Control (DG XX) and the relevant control agencies in the Member States, have been concluded. At the present time,

co-operation agreements in this area have been made between the Commission and eight of the fifteen Member States. The Commission has begun negotiations with the remaining seven Member States, including Denmark, in order to set up a protocol.

199. The individual co-operation agreements about financial control contain decisions about the following matters:

- objectives and principles for good management and administration;
- methodological basis for checks made on the spot;
- requirements for documentation of and mutual reporting about the implementation and results of the control work;
- co-ordination of control plans and programmes for control visits, and
- follow-up of the results of the control work.

5. Danish Prerequisites And Framework Conditions For The Financial Control Of Structural Funds' Grants

200. According to Article 5 of the EU Treaty, it is the responsibility of the Member States to make all normal or special arrangements necessary to ensure the fulfilment of the obligations that follow from the Treaty or from legal documents of the Community's institutions. In addition, the Member States shall facilitate the Community's performing of its tasks and refrain from making any arrangements that would jeopardise the realisation of the Treaty's objectives. Out of respect for this Treaty directive, Community law is administered by the Member States' administrative authorities as all-prevailing, in interplay with national regulations.

201. In the Structural Funds area, the Council Regulations are directly applicable in Denmark. It became evident, however, that there was a need for supplementary national legislation in order to ensure a practical and uniform foundation for the administration of these relatively complicated subsidy arrangements. Therefore, a detailed set of Danish regulations governing administration, control, evaluation and sanctions applicable for each of the four Structural Funds has been worked out.

202. Financial control of the use of EU Structural Funds' grants in Denmark are carried out according to the same legal guidelines and in the same way as the control of the Danish national co-financing of the Structural Funds' activities. This parallelism of controls is in line with the so-called assimilation principle in the Treaty's Article 209 A, Part 1, according to which Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests.

203. The starting point for the Danish governmental administrative authorities' financial control or internal control and follow-up on results regarding EU-financed and nationally financed Structural Funds measures is the Danish responsibility arrangements for ministers. According to this arrangement, it is the individual minister who has the ultimate responsibility for his or her administration. The minister—and thus the ministry's department (the minister's secretariat)—has the ultimate responsibility for the economic management and steering within the entire area of the ministry.

204. The Danish form of government implies as its consequence that the responsibility for the disposal of the appropriations approved by Parliament is unambiguously placed with the minister in question. As opposed to French-inspired systems, for example, where the Ministry of Finance carries out a prior control via a comprehensive system of financial controllers, or the English-inspired systems, where dispositions take place through delegation from the Ministry of Finance, a Danish minister — with a few exceptions — may decide over the appropriations without any other approval. An appropriation is, in other words, an authorisation to the minister, which in practice is delegated to the minister's department and the underlying agencies and institutions within the area of the ministry. This is naturally applicable also to grants for Structural Funds' objectives.

205. The minister's ultimate responsibility for the use of appropriations concerns the adoption and execution of satisfactory internal controls and follow-up on results in the ministry's financial administration and economic steering. In practice, this responsibility is carried out through the department's surveillance that: the given grants are not exceeded; the regulations for the grants and their disposal are kept; economy is shown; and required goals and results are realised.

206. With the established decentralised division of responsibilities and tasks in the area of governmental financial management (where the use of grants and the control thereof are under individual ministers and ministries), the role of the Ministry of Finance, in regard to financial control, is extremely limited. Nor does the Ministry of Finance have any authority to carry out prior or subsequent controls of other ministries' spending. Thus, there is no central control on commitments or outlays. However, as a result of the overall responsibility of the Ministry of Finance for government finances, there follows the obligation to take action, in so far as it becomes apparent that there are serious and unresolved financial management and control problems in a ministry. The Ministry of Finance may take advantage here of the possibilities that its role encompasses, such as instigating analyses and investigations in co-operation with the ministry in question, as well as offering advice.

6. Financial Control Of The Ministries Responsible For Structural Funds

207. As mentioned before, it is apparent from the Council Regulations for Structural Funds that the Member States are responsible for implementing the programmes, as well as ensuring that the subsidies are used correctly (see section 4). In Denmark, this responsibility lies, in the final instance, with the ministers who have the Structural Funds arrangements as one of their fields of work (see section 5).

208. Programme implementation is carried out by authorities in different administrative levels, since both the government and—on behalf of the regional fund and the social fund—regional and local authorities are involved. On the governmental level, the following three ministries are principally responsible for the Structural Funds' actions: the Ministry of Labour (for the European Social Fund–ESF), the Ministry of Business and Industry (the European Regional Development Fund–ERDF), and the Ministry for Food, Agriculture and Fisheries (the agricultural fund–EAGGF and the fisheries fund–FIFG). The majority of all applications for and grants made by the funds go through the three ministries. The department of each individual ministry has delegated the administration and control of grant funds to the relevant agency in the ministry.

209. The ministries' implementation of both the operational programmes adopted within the EU and national partnership and of those projects within the individual programme is mainly based on an interaction between the following Community regulations and national regulations:

- EU Treaty conditions, Structural Funds regulations (see sections 4 and 5 of this paper);
- supplementary national legislation concerning administration, control, evaluation and sanctions for each of the four funds; and
- national decisions on the government finance system, including budget planning, use of appropriations, book-keeping methods, as well as auditing.

210. The internal control and follow-up on results in the ministries responsible for Structural Funds will typically be carried out on an ongoing basis in the former case and *ex post* in the latter case. Current or ongoing financial control which can be said to be built into every well-functioning administration, concerns such things as approval of subsidy applications and the budgets of subsidy recipients, as well as payment of grants. *Ex post* financial control deals with subsidy recipients' follow-up reports on the progress of the supported project, such as accounts, activity information and reports on result attainment. In addition, the internal control and results follow-up can be submitted for any project-administrating entities with regional or local authorities.

211. Over and above the financial control that covers different phases of subsidy administration, the agencies administering the Structural Funds carry out random sampling local controls. This is done through visiting the subsidy recipients and any relevant regional and local authorities. It is endeavoured to complete each year on the spot checks of about 5 per cent of the projects underway, to which are added those projects which attract particular attention to themselves ("suspicious" cases).

212. In an on-the-spot control, the financed Structural Funds actions are checked for being carried out correctly (see co-ordination regulation Article 23 discussed in this paper in section 4). Among others, the following are to be examined:

- whether the projects are being carried out in agreement with the application and contract;
- whether the projects comply with the applicable regulations concerning the current economic management, filing of reports, book-keeping and auditing;
- whether auditing is taking place in accordance with the applicable auditing instruction.

213. In so far as control visits uncover irregularities, necessary steps are to be taken, including the recovery of money unjustifiably paid out (see co-ordination regulation Article 23).

7. Entrusted People's Financial Control Of The Use Of Structural Funds

214. The use of so-called entrusted people constitutes a very important part of the responsible ministries' control over whether grants from Structural Funds are used correctly and obtain the intended results. The group of entrusted people includes auditors in private companies, building inspectors appointed under a Royal warrant, and other people with particular financial or technical competence. Using entrusted people as an important part of financial control for Structural Funds' actions is in conformance with the way in which a great number of other, purely national subsidy arrangements are controlled by governmental authorities. Indeed, there is a long tradition of grant authorities employing entrusted people in control work. The alternative would be that the authorities themselves carry out all the internal control and follow-up on results, as is the case in some other EU Member States.

215. In order for a professional to be considered entrusted, the following conditions must be met:

- The control work is carried out on behalf of the authority granting the subsidy, which in this case means the ministry responsible for the Structural Funds.
- The content and form of the control work is standardised and controlled in detail by the administrative authority through legal regulation supplemented by instructions, guidelines, guiding letters and so forth.
- The control work is based on public authorisation for carrying out the relevant profession. Through abuse, the entrusted person risks losing authorisation and, as a consequence, the possibility for future work in the area.

216. The main task of the entrusted person is to issue a statement concerning the trustworthiness and validity of that documentation which the one responsible for the project (the recipient of the subsidy) submits to the government authority (the granter of the subsidy) with the request for a payment of Structural Fund support. In other words, approval of payment is dependent on the submission of certified documentation. Since it is principally a matter of an auditor's statements, here we concentrate mainly on the role of the auditor in a private company. In addition to the actual control work, the entrusted person can also give advice to the recipient of the subsidy.

217. The main objective of the auditor's work is to give the users of the information submitted by the person responsible for the project an impartial assessment of the quality (validity and reliability) of the information. This confidence is obtained through the auditor, who as an independent and professionally competent person, goes through and checks primarily the accounts of the project. The auditing places the auditor in a position to issue an audit-based opinion describing the extent to which the accounts are straightforward and meet legislative and authoritative demands, and, thus, can form a valid basis for a decision whether to grant the subsidy or not.

218. As with other private auditing, the private auditor is chosen and paid by the one responsible for the project who wants the subsidy. This creates the risk of compromising the auditor's independence from his client in the eyes of other people. To minimise this risk, various provisions are included in the Danish law concerning auditors. These provisions designate "auditors as representatives of public confidence" who are to protect public interest (that of the authorities, creditors, investors and so forth), such that the public can rely on auditors' statements. In addition, auditors can be made to assume responsibility if the quality of their work is below the normal standards. One or more of the following forms of punitive measures can be invoked in cases of irresponsibility: imprisonment, reimbursement or disciplinary action.

219. Danish government's use of auditors in private companies as an element in financial control for grants requires an effective control of the auditor's work, so that the auditor's own control work is the best possible guarantee that the money granted will be used in accordance with the specified conditions and goals. Thus, the auditor's work is controlled in detail through auditing instructions and guidelines which standardise what actions the auditor is to carry out. Similarly, this is the case in the area of Structural Funds, where the following main requirements have been laid down concerning the auditor's work:

- Auditing is to be done in accordance with so-called good public auditing practice, according to which both financial audit ("are monies spent for the right purposes?") and performance audit ("does one get value for the money?") are carried out (see the concept of financial control in this paper's section 3).

- The subsidy recipient must give the auditor the information and the assistance that the auditor judges necessary for the completion of his task.
- If the auditor notices irregularities in the administration of the grant money, he must immediately notify the subsidy recipient thereof, as well as ensure that the authorities granting the subsidy are similarly notified.
- The auditor must make an audit protocol that informs of work completed and of all significant conditions that have given rise to the observations.
- The audited project budget is to be given a statement from which it is evident that the budget has been audited in accordance with the instructions and guidelines concerning auditing. Any reservations and observations must be included in the audit statement.

220. As can be seen, the use that ministries responsible for Structural Funds make of entrusted people is a significant layer in the financial control of Structural Funds projects “in the field”. This arrangement means that all projects are closely followed by people with a high degree of independence and professional skill, combined with knowledge of local conditions.

221. Ministries standardise and control in detail, as mentioned, the work of the entrusted people. In addition, the authorities do a check on the quality of the controls done by entrusted people, in part indirectly when dealing with the subsidy recipients’ requests for grants and current reporting on the project’s implementation, and in part directly through on the spot control visits, which include, among other things, an investigation into whether the entrusted person’s work is done in accordance with official demands (see this paper’s section 6).

222. Finally, the Danish National Audit Office, as the external audit body, carries out a general control of the subsidy accounts in the area of Structural Funds, among others, through calling in such accounts for examination. The National Audit Office shall especially ascertain whether the accounts have been subjected to an adequate audit, whether the conditions for contributions have been fulfilled, whether the funds have been spent according to regulations, and whether overall, sound economic management has been applied in the administration of the funds.

8. Partnership With The European Commission Regarding Financial Control Of The Use Of Structural Funds Grants

223. The task of the European Commission is described in Article 155 of the EU Treaty, in which it is stated that one of the central tasks of the Commission is to be attentive to the implementation of those decisions stipulated in the Treaty or under its warranty. In other words, the Commission shall be responsible for the administration of EU law and take care that it is complied with. There are very few areas that are administered by the Commission, since the greater part of administrative tasks are assumed by the Member States, as mentioned in this paper in section 5. Much more important is the Commission’s control over whether the Member States’ behaviour is in accordance with the Treaty and the approved legal documents.

224. One of the most important questions in connection with the control function is to furnish the Commission with sufficient knowledge of actual conditions through giving the Commission access to information about and from the national administration. The Commission may demand information from the national administration in accordance with Article 5 of the Treaty, which stipulates the obligations of the Member States to co-operate loyally with the Commission. In addition to this,

several legal documents stipulate the Commission's right to on the spot checks of Member States and companies.

225. The Commission's checking that Member States uphold the Community's financial interests in a defensible manner is based, among other things, on the on-the-spot checks carried out by the Commission's finance controllers in co-operation with the national administrations. Control visits may take place of Member States' public authorities and of the financial actors (typically the subsidy recipients) who draw profit from the financial benefits. Control is typically made on whether administrative procedures are in accordance with Community regulations, whether the necessary documentation is found, as well as how financial transactions are carried out and whether a control thereof takes place. Council Regulation No. 2185/96 concerns the Commission's control and on-the-spot inspection with the goal of protecting the European Union's financial interests from fraud and other irregularities. This regulation contains general stipulations about control that supplement Community regulations about on-site control within individual sectors, including stipulations for the area of Structural Funds.

226. The partnership between the Commission and Member States regarding financial control of the use of Structural Funds grants is based, in particular, on co-ordination regulation Article 23 concerning financial control (see this paper's sections 4 and 6). Based on the stipulations contained in Article 23, the following elements of the previous co-operation between the Commission and those ministries responsible for Structural Funds may be mentioned:

- Reporting to the Commission on the control systems and administrative systems, Denmark has implemented actions to ensure that Structural Funds' measures are carried out effectively (see Article 23). This reporting is supplemented occasionally by reports about measures Denmark takes to prevent waste and maladministration of Community funds, including money from the Structural Funds.
- Reporting to the Commission about the Danish authorities' on the spot control of Structural Funds actions and follow-up of control visits (see Article 23, Part 1).
- Assistance to the Commission in planning and carrying out control visits decided upon by the Commission, including Danish participation in the visits in question (cf. Article 23, Part 2).
- Denmark's taking a position on and answering any critical points that may be raised by Commission connection with the controls made on-site.

227. Co-operation on financial control in the Structural Funds area is further supported by meetings on control questions in the following forums, among others:

- The annual meetings arranged by the Commission's Directorate General for Financial Control (DG XX), for the Commission's own financial controllers and those of the Member States. In meetings of recent years, emphasis has been placed on possibilities for strengthening co-operation concerning the control of Structural Funds, and experiences with present co-operation agreements or protocols have been discussed (see discussion of protocols in section 4).
- Separate meetings between the Commission and Danish authorities concerning control plans and intentions for the coming year for each of the four Structural Funds.

228. As mentioned in the introduction (section 2), both the Commission and Denmark are interested in strengthening the co-operation around financial control of the use of Structural Funds grants. One of the instruments for this is the setting up of protocols or co-operation agreements about internal control and follow-up on results in the area of Structural Funds (see section 4). Against this background, the Danish government has set up a committee concerning the co-ordination of the control of the EU's Structural Funds' appropriations. The committee's main task is to prepare discussions with the Commission concerning the setting up of co-operation agreements about financial control. The committee is close to finishing formulation of its proposal of how Denmark can fulfil the practical prerequisites for establishing a deeper partnership with the Commission, and, thus, setting up a foundation for entering into the mentioned co-operation agreements.

229. Seen from the committee's viewpoint, Denmark is ready to enter into co-operation agreements on the following basis:

- The agreements are based on the special Danish prerequisites, framework conditions, and regulations for the financial control of Structural Funds grants (see this paper's sections 4, 5 and 6). This entails, among other things, that the present division of responsibility and competence among the central, the regional and the local authorities be maintained, and that a significant part of the control work will continue to be left to entrusted people.
- The agreements are based on a re-organisation and strengthening of the surveillance done by the three ministries responsible for Structural Funds through establishing special control and inspection units—or controller units—at the agency level in each of the ministries, that can function, among other things, as fixed points of contact for the Commission's financial controllers.
- Entering into agreement takes place between the Director General for the Commission's financial control on the one hand, and, on the other, the director in each of the agencies responsible for the Structural Funds' administration and control, so that altogether there will be three separate agreements.

230. Discussions with the Commission about the detailed formulation of co-operation agreements may be expected to begin in the second half of 1997 in order that the agreements may be signed before the end of the year. With the completion of agreements, a useful framework will be set up for a gradually increasing co-ordination between the controls of the Commission and those of Denmark regarding the European Structural Funds in respect of the use of methods, as well as reporting. Thus, a basis for a more systematic organisation of the division of work between the Commission and the national control authorities concerning financial control in the area of Structural Funds should be established.

FINLAND
By Eija-Leena Linkola⁹

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9. Eija-Leena Linkola is Counsellor at the Public Management Department of the Finnish Ministry of Finance (FM). Her responsibilities involve issues of public management reforms, the impact of the European Union on State administration, and co-operation with the cross-border areas of Finland and the association countries. Ms. Linkola has worked for short periods at the European Institute of Public Administration and in the European Commission. This paper builds among other sources on discussions with Budget Counsellors Kati Suihkonen, Tauno Ylinen, Pentti Puoskari and Advisor Turo Hentilä and their expert comments on the text.

1. Chapter Summary

231. The time before Finland became a member of the EU was characterised by active public management reform. The reforms carried out at that time in the field of financial management laid a solid ground for meeting the challenges and incorporating the requirements of the EU into financial management and budgeting. These reforms included the use of ceilings in budget proposals, unbiased cost allocations, reform of accounting systems and use of market mechanisms.

232. When Finland finally entered the EU on 1 January 1995, only minor amendments to the regulatory basis of state budgeting and financial management were needed. New proceedings and systems for budgeting and financial management were designed at the Ministry of Finance in close co-operation with the other ministries. The Ministry of Finance issued the first guidelines for budget formulation incorporating the EC requirements in June 1994 (six months before membership).

233. Because the negotiations for Finland's membership were carried out within a relatively short period, the time available to construct national systems for the administration of the money flows from and to the EU was limited. Special attention was paid to the division of responsibilities between the Ministry of Finance and sectoral ministries and the responsibilities of the ministries responsible for matters related to the Structural Funds. The working committee that reviewed the budgeting of the Structural Funds has proposed an overall simplification of the system so that national financing contributions are entered under fewer items of expenditure. There is also a need to further develop both the budgeting of the EU funds and the implementation of Structural Fund programmes.

234. In addition, measures to develop the monitoring and internal auditing of the management of the EU money flows within the national administration are required.

235. Although budgeting has quite smoothly been adjusted to meet the demands of the EU, there are still many lessons to be learned as regards EU budgeting in practice. The following will require special attention in the future:

- programming (Structural Funds);
- managing of the payments from and to the EU;
- internal auditing; and
- better co-ordination and exchange of information between the ministries concerning the construction of payment systems, the follow-up of money flows, and internal auditing.

236. The accession of Finland to the EU was facilitated considerably by extensive training. A great demand still exists for training in financial management, both due to the reforms being prepared in the EU financial management SEM 2 000 programme, and due to the domestic need to develop more efficient and rational systems for the administration of the EU financing.

2. Background

237. During the ten years preceding Finnish accession to the European Union in 1995, significant modifications and reforms were made in structure, steering mechanisms, responsibilities and operational procedures in the public administration of Finland. The issues of improving public management had appeared on the political agenda at the beginning of the 1980's, but they gained

special momentum under the coalition Government which came to power in 1987. In 1988, the Government decided on a programme for reforming public management. This decision also stipulated measures to launch results management and framework budgeting. The two subsequent Governments have also given high priority to public management reforms. Comprehensive political support, as well as the commitment among political decision-makers and the administration to the reform programme, has widely been considered a main factor in the successful achievement of results.

238. The main reforms in the field of financial management are:

- The Government has applied its rightful authority to steering crucial state finance and has initiated budgetary frameworks to guide ministers in their budget preparations.
- State offices and agencies have adopted results management. This has shifted the focus away from the resources; and instead concentrated focus on the results achieved with those resources, the factors incurring costs in their use, as well as the transfer over to the offices of operational authority and economic responsibility in using the resources.
- State offices and agencies have been transformed into state-owned enterprises (which operate outside the scope of the budget, but the Parliament can set service and other operational targets for them). In some cases, they have been transformed into partly privatised joint-stock companies.
- The Act concerning fees and charges levied by state agencies has been amended.
- The provisions of the Constitution Act concerning state finance and the State Budget Act have been rewritten.
- Net budgeting of the expenditure on the activities of state offices and agencies and the revenue accruing from them has been enabled.
- The system for granting state subsidies to municipalities has been reformed from cost-based system to a lump sum system where the cost control lies within the authority concerned.

239. The developments described above have occurred alongside changes on a broader front. Long-term majority governments have become the political norm. The division of work and the power relationships between Parliament and the Government have changed as parliamentarianism has deepened further, so that the administration is more clearly accountable to the Government, and the Government under its parliamentary responsibilities in turn accountable to Parliament.

240. Reforms to the steering of financial management continued with the restructuring of the budgeting process. This included the use of ceilings in budget preparation, a results-oriented approach to budgeting, elimination of bias in cost allocation, reform of the methods by which accounting systems apply market-type mechanisms, and legislative developments related to the reforms. Consequently, some new practices and principles were created for a system of financial management adapted to the requirements, and concrete measures were developed as necessary for joining the EU and its system of financial management.

241. Upon EU entry, preparations related to state budgeting were implemented within a tight schedule. Since then, some amendments have been made. However, at present no surveys or comprehensive evaluation of the impacts of EU membership on financial management and the state budgetary process are available.

242. Now that co-operation in financial administration between Finland and the EU is on a stable footing, an assessment of the technical solutions adopted upon accession becomes more pertinent. This should address the extent of the importance of EU funds to the national budget, the budgetary principles for national cash flows, the degree of success in achieving objectives, and the practical compatibility of national and EU budgeting systems.

3. Legislative Basis And Instructions

243. The regulative basis for financial management and budgeting procedures was developed during the 1990's, following guidelines and principles aimed at smooth and flexible adjustment to the requirements of EU membership.

244. As regards the regulative basis of the state budget and financial management, EU membership necessitated only a few amendments to the regulations, orders and instructions issued by the Government and the Ministry of Finance. Conversely, the ministries, and in particular those ministries with responsibilities for Structural Funds, issued more detailed instructions for preparing budgets for their spheres of responsibility, and also compiled instructions and recommendations for operational and supervisory functions.

245. National principles, in very general terms, for utilising grants from the EU's Structural Funds, the division of work by administrative sector as well as the preparation of programmes were decided six months before membership by the Government. The national system set up to administer funds was created in line with this decision. The decision nominated the Ministry of the Interior, the Ministry of Labour and the Ministry of Agriculture and Forestry as responsible for the funds. Generally, the responsibility for co-ordinating and managing issues related to a specific fund is held by the ministry that has most to do with that particular fund. As regards the programming work of funds, it is supervised by the respective ministry according to the present division of responsibilities between the ministries.

246. New legislation on regional policy introduced in Finland at the beginning of 1994 changed the national structures for regional policy. The laws that came into force then defined the division of responsibilities for regional development amongst the authorities involved and also created the footing for regional development based on a programme of objectives. The intent underlying the new law was to adapt the system for regional development to conform with EC legislation and the application of EU regional policy.

247. Only a few, minor amendments to the State Budget Act and Decree were necessary, both during the preparatory period and as a consequence of Finland's first experiences as a Member State. The new regulations and instructions needed to adjust national budgeting procedure to the procedures for EU financial management were implemented by Government decisions. The Government decided in June 1994 to take possible EU membership into account in preparing the 1995 budget. The Ministry of Finance subsequently issued state offices and agencies with more detailed instructions for preparing budgets. The first regulations for formulating budgets that incorporated EU membership considerations were issued in June 1994. The budget formulating instructions currently in force contain instructions for the budgeting of EU funds.

248. Systematic consideration was given in the preparatory stage of membership to divide responsibilities between ministries in issues involving two or more ministries. A leading principle applied was that the ministry with main interest and concern in the issue shall act as a responsible for

co-ordinating the preparatory work and decision-making with other ministries concerned at the national level.

4. Roles And Responsibilities

4.1. *The Annual Budget Cycle Of The State Budget*

249. As regards preparing the state budget, the combined budget and medium-term planning cycle starts with the budgetary ceilings for two years following the next budget year. These are discussed and decided by the Cabinet in its conference in February. The ministries are supposed to detail the ceilings given by the Cabinet as guidelines to the agencies reporting to them.

250. Under the provisions of the State Budget Decree, the offices and agencies send their budget proposals with explanatory statements to the ministry to which they are subordinate. On the basis of these estimates, each ministry prepares an estimate for the budget for its administrative sector and submits the proposals with explanatory statements to the Ministry of Finance to be scrutinised and negotiated with the ministries. In August, the Cabinet has its Budget Conference, where the budget proposal is finalised and after that submitted to Parliament. Parliament debates the annual budget proposal and approves the budget at the end of the year. Parliament is informed about the implementation of the budget through the annual reports.

251. The budget proposals with the associated explanatory statements are prepared in accordance with the statutory budget provisions and the instructions issued by the Council of State and the Ministry of Finance.

4.2. *Preparing EU Budget Issues*

4.2.1. *Ministry of Finance*

252. The Ministry of Finance is responsible for preparing the issues of the EU Budget at the domestic level. It plays a central role in the preparation phase as well as in implementation and control of EU budget matters. The different tasks connected to each phase of the budget procedure require work of domestic resources throughout the year and are fixed with tight timetables.

253. The Ministry of Finance is responsible for steering the preparation of the budget by confirming the national positions and instructions to the Finnish representative in the Council's Budget Committee. In preparing these national instructions and positions, the Ministry of Finance liaises with other ministries and co-ordinates their points of view if needed in the Budget Section. The Budget Section is a cross-sectional co-ordination unit in the national EU decision-making system subordinate to the National Committee for EU affairs. The Ministry of Finance chairs the Budget Section. It has been decided that Ministry of Finance should be informed of all issues prepared by the sector ministries which have budgetary implications. The Ministry of Finance follows up the economic consequences of the EU programmes and proposals for EU directives and regulations.

254. For the most important issues, the Ministry of Finance provides via the National Committee for EU Affairs and the Ministerial Committee for EU Affairs proposals for national positions and

instructions for negotiations to the Government to be discussed and decided in its session. The Ministry of Finance delivers the positions and instructions to the Finnish delegate in COREPER and the Council's Budget Committee in Brussels. Experience has shown that positions and instructions should give room for flexibility in negotiation.

255. The new tasks and responsibilities acquired by the Ministry of Finance as a consequence of EU membership have fitted in well with the role and functions that the Ministry of Finance has in financial management and budgeting. No changes or modifications were necessary in the authorities, the division of responsibilities or the organisation itself.

4.2.2. *The Cabinet*

256. The Cabinet steers economic and financial policy-making assisted by two permanent Cabinet Committees: the Committee on Economic Policy and the Finance Committee. The role of the Cabinet in budgetary decision-making is crucial, since the Minister responsible for the budget represents Finland in the EU's Council of Ministers. The Cabinet supervises the Finnish delegate in participating in the negotiations in Council's Budget Committee which in practice is the main forum for a Member State to have an impact on EU Budget preparation.

257. The Government must actively inform Parliament of events at the EU level and ensure that Parliament can participate in the formulation of national policy concerning proposals by the European Commission. The Grand Committee in the Parliament deals with national EU policy formulation regarding matters belonging to co-operation on the first pillar (EC business) and the third pillar (internal and justice matters).

4.2.3. *Parliament*

258. Parliament has a different role in national decision-making on the budget to that in decision-making on the EU Budget. Parliament decides on the state budget, but has only indirect possibilities of influencing the EU Budget.

259. The Cabinet submits the Commission proposal for the EU Budget to the Parliament. Parliament is informed of the proceedings and may give instructions to the Cabinet concerning the Budget.

260. Commitment to the EU's common policies has constricted Parliament's budgetary powers. For instance, commitment to the EU's agricultural policy in effect means that Parliament cannot decide on the calculated basis for the EU's direct income support. Income support is financed entirely from EU funds. Parliament cannot actually decide on allocating funds that are items in the EU Budget because appropriations are determined by EC regulations. It is also deemed obligatory to include liabilities for Structural Fund programmes in the national budget. This emphasises the importance of the content of EU Budget items, particularly in informing Parliament of the consequences that, for example, agricultural policy will have in the subsequent budgeting year and what kind of programmes are to be implemented.

5. Impact Of EU Membership On Preparation Of State Budget Proposal

261. According to the Constitution, all forecastable revenue and expenditure must be included in the state budget and probable amounts allocated to them. In addition, the Constitution stipulates that EU funds for state agencies are primarily channelled through the state budget. In June 1994, the Ministry of Finance gave instructions to the ministries and agencies on how to address the impact of future EU membership in formulating their budgets.

262. Since the budget proposal for 1995 accounted for funds from the EU and payments to the EU based on assessments at that time, reviews were made in a supplementary budget in 1995 after negotiations about programmes had been concluded with the EU, and when the content of the programmes was known and the programmes had been approved by the Commission.

263. The Ministry of Finance also stated in the instructions it issued in 1994 for formulating budgets that the functioning of the budgeting system with respect to accounting for appropriations from the Structural Funds would be monitored and, if necessary, changed at a later date. During the first few years of membership, few amendments were in fact made, and these were mainly of a technical nature.

264. The aim in accounting for EU funds is to follow good budgeting practice, and avoid conflicting items in the budget and overlapping budgeting. The management of Structural Funds has been organised according to the principle of partnership based on the co-operation with regional, national and Community authorities.

5.1. Payments To The EU Budget

265. The decision made in 1994 concerning Member States' contributions laid down the revenue (own resources) which finances the EU's Budget. The EU's expenditure is covered by various sources of revenue: the traditional own resources (customs duties, agricultural levies, levies on sugar), a proportion of value-added tax (VAT) receipts, and a proportion of the GNP of each Member State (GNP-related contribution). From Finland's point of view, the VAT contribution and the GNP-related contribution are new items of expenditure. Conversely, the EU's traditional own resources are in fact the EU's sources of revenue which Finland collects for the EU and from which it retains a collection fee.

266. Collecting customs duties and agricultural levies included in the EU's traditional own resources for the EU means that Finland cannot retain any of the revenue from these. Consequently, the customs duties and agricultural levies to be collected for the EU cannot be included in Finland's state budget. The National Board of Customs collects the duties and agricultural levies directly and credits them directly to the EU. Similarly, the Ministry of Agriculture and Forestry collects levies on sugar and credits them directly to the EU. Finland receives a 10 per cent collection fee for collecting these payments which is budgeted under the Ministry of Finance's administrative sector as miscellaneous revenue. The actual administrative expense of collecting the payments is budgeted under the relevant administrative sector.

267. As mentioned above, the VAT contribution and the GNP-related contribution are new items of state expenditure that are included in the state budget. They are budgeted as expenditure under the Ministry of Finance's administrative sector.

268. As a Member State of the EU, Finland pays its contribution towards financing the European Development Fund, which is outside the EU Budget. This fund channels financing for development assistance based on the Lomé convention. Finland also became a member of the European Investment Bank, and as such Finland subscribed for its proportion of the Bank's share capital. Of the capital subscribed, 7.5 per cent will be paid up and the remainder is a liability that is payable on demand. A new member of the Bank also pays a corresponding contribution towards the Bank's reserves and provisions.

269. EU membership obliges Finland to observe the agreement concerning the European Coal and Steel Community (ECSC), under which Finland pays its share into the ECSC's fund. Similarly, EU membership obliges Finland to observe the treaty on the European Atomic Energy Community (EURATOM) and pay its share towards the capital of EURATOM's nuclear fuel procurement centre.

270. Payments outside the EU Budget are entered in Finland's state budget as the expenditure of that administrative sector with whose field of operation the payments are most closely associated. The payment towards the European Development Fund falls under the Ministry of Foreign Affairs' administrative sector. The paid-up share capital and the reserve fund payments payable to the European Investment Bank are budgeted under the Ministry of Finance's administrative sector. The payment towards the ECSC's fund and the capital payment to EURATOM's nuclear fuel procurement centre are budgeted under the Ministry of Trade and Industry's administrative sector.

271. Funds entered as revenue to the EU in practice fall due for payment mainly at the beginning of the year which has implications on national cash flows.

5.2. Payments From EU Budget To The Finnish State Budget Or To Fund Outside The National Budget

272. The most important part of the payments from the EU Budget to Finland consist of the subsidies in which the initiative-taker is either the Member State (e.g. Structural Funds, and programmes like Research and Development, Socrates, Leonardo) or the EU (e.g. pilot projects, community initiatives). The second most important type of transfers are loan financing, and thirdly, project financing. These payments are executed in Finland via the state budget, primarily according to the principle of gross budgeting; or the payments are directed to the funds outside the state budget (the intervention fund and development fund of agriculture); or the payments are channelled as a revenue directly to those responsible for project execution, e.g. municipalities or private organisations.

5.2.1. Payments for agriculture

273. The funds related to the EU's common agriculture policy (CAP) that are granted to Finland are paid from the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF). The costs of CAP are paid initially from the funds of Member States, but are refunded on the basis of reports submitted by the States.

274. The CAP payments granted to Finland are the following:

1. Direct income aid and CAP reform aid, such as compensatory payments or per hectare aids and premiums, which are totally paid by EU, are budgeted as revenue under the

Ministry of Agriculture and Forestry's administrative sector in accordance with the gross budgeting principle.

2. Accompanying measures or programmes (environment, afforestation, early retirement) of which EU pays only a part, is budgeted in the state budget, in line with the gross budgeting principle, as separate items of expenditure under the Ministry of Agriculture and Forestry. These items of expenditure in the budget must clearly show the EU contribution and the national contribution.
3. Intervention measures, which are totally paid by EU.

275. In order to administrate these payments, an intervention fund was established through legislation. This fund administers certain payments of the EU's common agricultural policy namely export subsidies, intervention purchasing, and support for private warehousing. EU subsidies channelled into this fund, and then redistributed, do not have an effect on the state budget. Only the transfer of the initial capital to establish the fund appeared in Finland's state budget. The fund was also empowered to take out loans so that it can operate independently of delays in the payment of EU subsidies. A description of the EU intervention fund and its activities was included in the explanatory section of the state budget for 1995.

276. Budgeting of the EU's income support is relatively straightforward as a consequence partly of following the EU's common agricultural policy and partly from the clear measuring norms received from the EU.

5.2.2. *EU Regional and Structural Policy*

277. Before EU membership in 1995, a system was created for the Finnish state budget of accounting for revenue received from the European Union's Structural Funds. Administration of the Structural Funds was arranged so that the distribution of work between the administrative sectors remained unchanged. The same principle was adopted for budgeting. As far as administering the funds was concerned, the choice was whether to organise administration according to the objective or according to the actual fund. The final decision was to base administration on the actual fund involved by appointing a ministry responsible for each fund that would undertake the administrative duties attached to the funds, distribute the funds to other ministries and indicate the national financing contribution necessary for receiving the funds.

278. Grants from the Structural Funds are always supplementary financing and contingent on partial national financing — generally at least 50 per cent. All three Structural Funds grant assistance. The national financing contribution can comprise both public sector financing (state, municipalities) and private financing.

279. It was agreed in the membership negotiations that Finland would receive an average ECU 340 million per year in subsidies for 1995–1999 at 1995 prices from Structural Funds included in the EU's Budget. Funds to be used on community initiatives (e.g. the Interreg, Leader, Adapt, Employment, Small- and Medium-sized Enterprises, Urban and PESCA programmes) are incorporated into the framework of the Structural Funds, so measures arising from organisational initiatives must include the appropriate programmes of objectives.

280. Receipt of EU financing from the EU Structural Funds for the above purposes is contingent at the national level on the drafting of planned objectives and programmes nationally and regionally,

and their approval nationally, as well as on negotiations about the programmes with the European Commission.

281. In accordance with the decision of intent made by the Council of State (1994), administration of regional objectives (6, 2 and 5b) are closely linked to the administration of national regional policy. The programmes are prepared by the regional councils. The Ministry of the Interior issues general instructions to the regional councils, and the various ministries issue instructions for preparing the programmes specific to their administrative sector. The Ministry of the Interior assembles the regional programmes into a single programming document for each objective and co-operates with other ministries in order to combine them into a harmonised and appropriate package promoting regional development. Consequently, regional policy throughout the country is a harmonised and appropriate package.

282. In line with the same decision of Government, the principal responsibility for harmonising actions towards Objectives 3 and 4 with measures under European Social Fund is held by the Ministry of Labour. The Ministry of Agriculture and Forestry is responsible for legislation and the drafting of programmes associated with Objective 5a for horizontal restructuring of agriculture.

283. One programme document was prepared within the national administration for each objective, either for the whole period (1995–1999) or for 2-3 years, for the negotiations with the European Commission. The programme documents included programmes to be financed from the Structural Funds, the largest projects in these programmes, as well as the EU's contribution and the national contribution.

284. All subsidies from the EU Structural Funds for financing Objectives 6, 2, 3, 4 and 5b are included in Finland's state budget and the gross budgeting principle applied in their entry. Each item of expenditure for each fund is further split by objective and by administrative sector. The appropriate ministry thus decides on the contributions to be used for specific projects.

285. The national financing contribution needed to finance programmes funded by the EU Structural Funds is listed in Finland's state budget as an item of expenditure of the appropriate administrative sector. For the purposes of formulating the budget, the administrative sectors must also ascertain the proportion of financing for technical assistance, pilot projects, etc., from funds outside the framework of the Structural Funds.

286. The assessment and measurement of revenue for Structural Fund programmes depends mostly on the implementation of the programmes. The periodicity of payments is estimated for each fund separately. If the periodicity is incorrectly assessed, the relevant item of revenue may show a surplus or deficit of tens of millions of Finnish marks.

287. The working committee that reviewed the budgeting of Structural Funds has proposed an overall simplification of the system whereby national financing contributions would be entered under fewer items of expenditure. The State Auditors' Office pointed out in its State Auditor's Report on the state budget that the explanations for EU items varied greatly in their informative content. The comments did not apply so much to measurement data but addressed more the lack of information on objectives. In the view of the State Auditors' Office observations, the Ministry of Finance should in the future emphasise the importance of description in the instructions for formulating the budget, in addition to technical budgeting issues. The instructions will be reviewed so that they may be applied at the beginning of the new EU programme period.

5.3. *Costs Incurred By Administrative And Other Preparatory Work*

288. The Ministries also had to ascertain what type of costs incurred by their attendance at meetings with the European Commission or Council would be paid by the EU. Similarly, the national administrative duties, and other functions, necessitated by administering the Structural Funds had to be determined, for which Finland could claim reimbursement as a Member State from the EU.

6. Evaluation And Auditing

289. The cash flows between EU and Finland have become a new and comprehensive target of auditing for State Auditing Office in Finland. It meant also establishing new co-operation with the EU, especially with the Commission and the European Court of Auditors as well as with domestic authorities.

290. The Ministry of Finance appointed a one-person committee in March 1996 to ascertain for each sector what requirements the regulations on controlling the management of EU finance place on monitoring systems and their workability, whether there was a need or any grounds for establishing a centralised, cross-administrational control unit, and how cross-administrational co-ordination could otherwise be made more effective in the monitoring process.

7. Concluding Remarks

291. Functional and operational routines for handling EU issues were established during the first years of membership. This work was guided by the goal of organising the management of EU affairs in domestic administration. This was done by using existing structures and adding the EU affairs management as an additional feature of other issues and tasks of each substantive area of civil servants. Establishing separate units or personnel engaged only with EU affairs was avoided as far as possible. It was not encouraged to have new employees, but the ministries and agencies were advised to reorganise and evaluate their present tasks and responsibilities in order to make room for new affairs to be taken care of. Thanks to wide training of civil servants in EU issues, this has been a successful strategy resulting in broad knowledge of EU issues of the civil servants in the administration. No lack of competence has been observed, even though one should bear in mind that several outstanding experts have been recruited to EU organisations.

7.1. *Arbitrary Programming Work*

292. Teething problems were encountered in the implementation of Structural Fund programmes, but underlying problems remain. The application of the requirements for EC regulations, procedures and supervision to the simplified practices in a culture of mutual trust and shared responsibility that enables a "lean" administration has been problematic. Regarding regional policies, the harmonisation of EU policies with national programmes and plans for regional objectives of the Structural Funds has led to a certain amount of incompatibility problems at the regional level. The need for liaison has increased and new monitoring systems and administrative procedures have been established. The Ministries responsible for administering the funds have actively developed these systems and procedures but the level of co-operation in these efforts would have had as a result more integrated systems and avoidance of overlapping with EU's monitoring systems.

7.2. *Complex Systems And Many Actors*

293. EU systems of subsidies and grants have proved to be more complicated than expected in both their regulations and procedures. The proposition of national financing related to EU programmes is to be included in the budget of the ministry responsible for granting them. Since the programmes are very extensive, these propositions have entered into the budget of nearly every ministry. The State Audit Office has pointed out that it needs to reconsider this manner of proceeding since it has caused confusion and complications in the implementation of the programmes.

294. The overall package of programmes—those of the European Commission, the ministries responsible for funds, the implementing authorities, and regional and national programmes—is a complex entity and in practice has at the national level led particularly to compatibility and co-ordination problems in using EU funds and the associated national appropriations.

295. The state budget is prepared for one financial year (i.e. the calendar year) at a time, whereas the EU programmes extend over several years. This situation has an effect on financial management both at the central co-ordinating level and at the regional and local level.

7.3. *Monitoring*

296. The importance of follow-up and control was stressed from the very beginning of the implementation of EU programmes. Many difficulties were encountered in creating the monitoring system for the programme of regional Objective 6. The programme was new for EU and many ambiguous goals were set concerning that specific programme. In addition to that, the content of this programme is manifold and hard to master.

297. The shortcomings of the monitoring systems will cause delays in cash flows from EU and that will increase the need for domestic financing which produces additional costs for the state.

7.4. *Increased Workload*

298. The additional workload this has caused could not have been anticipated. The backlog created in administration has still to be cleared. The heaviest burden has been carried by Ministry of Agriculture and Forestry. Both in the Ministry, as well as at the regional and local level, the increase of personnel has been obligatory to overcome the additional work load.

299. The demanding and precise nature of programming work could not perhaps have been stressed enough at the beginning. The formulation of programmes should have been started earlier, and should have been more thorough. The drafting of ideas and objectives for development into clearly project-based development programmes demanded a lot of work and was simultaneously a demanding learning process for all parties involved. In practice, it necessitated an extra round of budget negotiations between the Ministry of Finance and responsible ministries to formulate the state budget in the first two years of membership.

7.5. *Need For Deeper Co-Operation*

300. Another factor pertinent here was the inexperience of ministries responsible for funds in their new role of co-ordinating across administrative boundaries, as well as the difficult nature of programming work and the complexity of EU subsidy systems.

301. Friction has been caused by the application of the results-based steering system to the programming work. It is still necessary to streamline national administration, but the heavy and multi-layered supervisory system required by the EU under its regulations will surely continue to cause problems in national administration in the future. The objective in creating monitoring and supervisory systems should be to make the administration workable and appropriate, as well as enabling EU cash flows to be monitored with sufficient accuracy.

7.6. *Comprehensive Training For Civil Servants*

302. The process of adjusting to the EU has been considerably aided by extensive training programmes. The Ministry of Finance has co-ordinated and supported the EU integration training within state administration. The officials' own interest in voluntarily developing their skills has been essential factor in meeting the demands of the membership. Since the early stages of preparing for membership, a multi-step training programme was launched in the ministries and central administrative units. In the ministries especially, a basic EU training course targeted all groups of personnel. Later, more specialised courses focused on training those civil servants that dealt with and prepared EU matters.

303. During the past few years, funds reserved for integration training have steadily increased. It has enabled the arrangement of training from elementary courses and language studies to more individual studies and practice.

304. The Ministry of Finance, in close co-operation with the financial management of sectoral ministries, has planned changes necessary in the budgeting and financial management systems so that operational viewpoints could be properly addressed when creating systems and common procedures.

FRANCE
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1. Introduction

305. Among all the countries of the adopted sample, France presents a specific characteristic: as a founding member of the EEC, it never had to adapt itself to pre-established Community rules, but it contributed to their gradual creation. So this study will not place particular emphasis on the adaptation efforts undertaken by the French administration, but will analyse, in a general way, the budgetary and financial links between France and the European Union from the perspective of the institutional and administrative organisation as well as the financial and accounting procedures.

306. This document is complemented by a second paper on audit and control matters that appears in SIGMA Paper No. 20 *Effects of European Union Accession—Part 2, External Audit*. Nevertheless, separating these papers is probably quite artificial because, considering French administrative practices and culture, the management of funds and their control are tightly linked.

307. The presentation of the French administrative and budgetary framework will be followed by a general indication on the impact of the European Budget on the French one. Then the management of internal resources and expenditures will be studied.

2. The Institutional Framework

308. The governmental institutional framework is studied first at the state level and then at the local government level.

2.1. The State

309. Governmental policy is implemented by central services of about twenty main ministries with, depending on political circumstances, some secondary ministries and Secretaries of State. Organised according to a quite strong hierarchical principle, these central administrations are divided into departments — from three or four to about fifteen per ministry — which are responsible for legislation and audit matters, but in principle have no responsibility in direct management.

310. In most of the main ministries, the responsibility for day-to-day operations are given to local offices spread out across the whole territory. At the level of the French local subdivision (called *département* in French) administered by a Prefect, the local services of each ministry are co-ordinated under the supervision of the Prefect (*Préfet*), a State civil servant directly appointed by the Government. For about twenty years, an increasing role in the co-ordination of the actions undertaken by the prefects has been given to the Regional Prefect (*Préfet de Région*). The Regional Prefect, who is also the Prefect of the main *département* within the same region, co-ordinates the action of four to six prefects.

311. The Ministry of Finance is generally grouped with the Ministry of the Economy. The Fiscal Legislation Department (*Service de la Législation Fiscale*) is responsible for the design of fiscal policy. Tax collection is shared between the Taxes Directorate General (*Direction Générale des Impôts*) with 80 000 agents dealing with direct taxation, and the European VAT, and the Customs and Excises Directorate General (*Direction Générale des Douanes et des Droits Indirects*) — with 19 000 agents dealing with customs taxation and the non-Community VAT. The state budget is prepared and managed by the Budget Directorate (*Direction du Budget*) with 250 agents, the

accounting and financial implementation of which is provided by the Public Accounting Directorate (*Direction de la Comptabilité Publique*). This directorate with its 56 000 agents is also responsible for the accounting and the treasury of the local governments. The Treasury Directorate (*Direction du Trésor*) and Forecast Department (*Direction de la Prévision*) straddle the two ministries. The Treasury Directorate has particular responsibility for the public debt and external financial relations. The Forecast Directorate studies the main economic trends.

312. As all other ministries, the Ministry of Finance has local offices, particularly the Public Treasury (*Trésor Public*) network run locally by the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) in each subdivision (*département*) administered by a prefect. These offices report on the Public Accounting Directorate (*Direction de la Comptabilité Publique*). They are the cashiers of all income and expenditure of the public authorities, including central government and local government money, which are managed in the same treasury account. There are also accountants for income and expenditure transactions of the state budget and local government budget. More recently they were asked to control the expenditure commitments, when the money comes from the state budget but the expenditure are local. Finally, they also collect part of the money for the financing of the public debt.

2.2. *The Budgetary Organisation Of The State*

313. The state budget is prepared by the Budget Directorate (*Direction du Budget*) under the supervision of the Ministry of Finance. The Budget Directorate has a fundamental role in the whole procedure of preparation and implementation. The parliamentary vote, which takes place on 31 December of each year at the latest, brings few modifications to the governmental proposal, particularly for the expenditure part.

314. After being controlled by the Constitutional Council (*Conseil Constitutionnel*, an independent body to which an appeal may be made to pronounce on the constitutionality of Government decisions), the budget is implemented by each ministry which appoints to that end central and local commitment officer (*ordonnateurs*). The local commitment officers are the territorial delegates of the central commitment officers. They are responsible for committing the expenditures of the ministries, i.e. recruitment and remuneration of civil servants, signature for public procurement, allocation of grants, etc., under the name and the responsibility of the corresponding ministry.

315. However, to become legally final and bind the State to a third party, the commitment must be stamped by a Financial Controller (*Contrôleur Financier*) named by the Ministry of Finance and working under the supervision of the Budget Directorate (*Direction du Budget*). When the expenditure is locally committed by the commitment officer of a territorial service of the State — often the Prefect — it is financially controlled by a collaborator of the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) working under the supervision of the Budget Directorate.

316. Moreover, the commitment officer do not deal directly with the payment funds of the incurred expenditure. The expenditures are paid by the accountants of the Public Accounting Department (*Direction de la Comptabilité Publique*), i.e. the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) at local level, as instructed by the commitment officer. Then the accountant has to pay, if the payment order is regularly established. Any irregular payment becomes the accountant's personal financial responsibility, so the accountants are requested to take out an insurance policy.

2.3. *The Local Government*

317. Since the early 1980s an important decentralisation movement transferred central powers and resources to the local government, which are spread across three levels:

- 25 regions (*régions*) created in the 1970s, which are responsible for the main infrastructure, vocational training and, partly, for university buildings.
- 100 *départements* created two centuries ago, which are responsible for social assistance, some infrastructure and, partly, secondary schools.
- 36 000 communes — with a tendency to try to regroup some of them — which are responsible for local equipment, urban transport, primary schools, some hospitals, and cultural and sport activities.

318. Each local community is administered by a council elected by the direct universal suffrage. Their budget is financed partly by local taxes and partly by global and automatic State transfers. This budget is voted by elected councils, without prejudice of regulatory control, and it is implemented by the local executive, i.e. the mayor of the commune.

319. However, the State financial departments supervises the implementation of local budgets. On the one hand, the local communities are required to deposit their funds in the unique account of the State Treasury (*Trésor de l'Etat*) which manages them on their behalf. In return, the State guarantees the local communities a regular supply of funds. On the other hand the cashier/accountant of each local community legally is a State civil servant of the Public Accounting Directorate (*Direction de la Comptabilité Publique*). Forty per cent of its 58 000 agents also work for the local communities without charge to the local communities.

320. Created in 1982, the 25 Audit Regional Chambers (*Chambres Régionales des Comptes*) — one per region — audit the local finances. The management of these Chambers is linked to the Audit Office (*Cour des Comptes*) to which they report. Their audit over accounting practices is complemented by a assessment on the relevant use of funds by local representatives. The state accounts at local level are not within the jurisdiction of the Audit Regional Chambers (*Chambres Régionales des Comptes*).

3. **The Community Budget For French Public Finance**

321. In 1996, the division of the French GDP — FF 8 000 billion — is as follows: 21 per cent State finances; 9 per cent local finances; and 22 per cent social finances.

322. For the same year, the total contribution of France to the Community Budget is FF 89 billion, which is fifteen times more than in 1981. Between 1981 and 1996, the contributions of the Community's Budget from the State income increased from 3.8 per cent to 6.3 per cent. Very high until 1988, the growth rhythm of the Community contributions slowed down during the last years, and even dropped in 1995. Concerning the 1995 gross payments, which are the latest available statistics, the French taxes break down as follows:

- VAT resource: 62 per cent;
- GNP resource: 21 per cent;
- customs duties and agricultural deductions: 13 per cent;

- sugar contributions: 3 per cent.

323. The Community expenditures for the benefit of France were ECU 9.9 billion in 1994, that is to say 16.5 per cent of the Community expenditures, because of the important financing obtained from the Common Agricultural Policy (24 per cent of the Community agricultural expenditure takes place in France). The situation for Structural Funds was not as good: France received only 9 per cent of the EAGGF-Guidance (EAGGF: European Agricultural Guidance and Guarantee Fund), ESF (European Social Fund) and ERDF (European Regional Development Funds) credits. The 1995 Community credits received by France break down as follows:

- EAGGF-Guarantee: 83 per cent - 62 per cent for cereals and oilseeds and 21 per cent for animal production;
- ESF: 6 per cent;
- ERDF: 4 per cent; and
- EAGGF-Guidance: 2.5 per cent.

324. Finally, even if these financial elements have to be handled very carefully, France is the fourth net contributor after Germany, United Kingdom and Netherlands, with a negative balance of ECU 1.7 billion in 1994. This represents ECU 46 per inhabitant.

4. The Community Budget Administration In France

325. Here are the relevant official bodies at the administrative level:

- In Brussels, the Permanent Representation includes a budgetary unit of 3 people under the supervision of the Financial Adviser. This unit works in collaboration with Agricultural, Social and Regional Advisers, who are the other important members of the Permanent Representation. In principle, a Permanent Representation Member always accompanies the French government civil servants who attend the meetings of the different groups of the Council or the Committees of the Commission. All information between Paris and Brussels, in both directions, has to be made available at the Permanent Representation.
- In Paris, the correspondent of the Permanent Representation is the Secretariat of the Interministerial Committee for European Affairs (*Secrétariat du Comité Interministériel pour les Questions Européennes*). In contact with the Prime Minister and often run by a member of his personal staff, the Secretariat of the Interministerial Committee for European Affairs employs about 150 agents coming from all ministries. A financial advisor, assisted by about six agents, co-ordinates all the budgetary, financial and fiscal dossiers.

326. For budgetary matters, the main ministerial departments are the following ones:

- The Budget Directorate (*Direction du Budget*), which plays a decisive role in the areas of income and expenditure. It is assisted by the Forecast Directorate and the National Institute of Statistics and Economic Studies (*Institut National de la Statistique et des*

Etudes Economiques — INSEE) for macro-economic aspects and for the determination of VAT and GNP resources.

- The Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), under the supervision of the Directorate of Public Accounting (*Direction de la Comptabilité Publique*), which runs the unique State account and therefore controls the daily management of movements of funds, in both directions, between Paris and Brussels.
- The Directorate General of Customs and Indirect Duties (*Direction Générale des Douanes et des Droits Indirects* — DGDDI), for the traditional own resources.
- The budget departments of the ministries responsible for expenditures relating to the negotiation and implementation of the European Budget, namely the Ministry of Agriculture and the Offices of Agricultural Intervention (*Offices d'Intervention Agricole*) controlled by it, the Ministry of Interior with the Delegation for Regional Planning and Action (*Délégation à l'Aménagement du Territoire et à l'Action Régionale* — DATAR) for the ERDF, and the Ministry of Social Affairs with the Delegation for Vocational Training (*Délégation à la Formation Professionnelle*) for the ESF.

327. All these official bodies have a particular role in negotiating of the Community Budget:

- The Permanent Representation in Brussels and the Secretariat of the Interministerial Committee for European Affairs have a general co-ordination and information role.
- The Budget Directorate, six agents at the European Office, runs the whole procedure.
- The macro-economic framework and the internal resources are prepared by the Forecast Department (*Direction de la Prévision*) and, in a marginal way, by the Customs and Fiscal Services Department (*Direction des Douanes et des Services Fiscaux*).
- The French amendments to the budget draft are prepared during several meetings at the Secretariat of the Interministerial Committee for European Affairs with the Budget Directorate (*Direction du Budget*) and each ministry concerned with these expenditures. In case of disagreement, the Prime Minister is asked to arbitrate.

328. During the whole progress of the transfer procedures between the Council and the Parliament, particularly in the Budgetary Committee (*Comité Budgétaire*), the Budget Directorate (*Direction du Budget*), jointly with the Financial Adviser of the Permanent Representation, defends French interests under the supervision of the Secretariat of the Interministerial Committee for European Affairs, which checks the interministerial nature of the French positions.

5. The Management Of “Own Resources”

329. There are two main categories of resources: the traditional own resources, and the VAT and GNP resources.

330. The traditional own resources: customs duties, agricultural levies, sugar contributions — except the sugar reserves contribution directly received by the Funds of Intervention and Regulation of the Sugar Market (*Fonds d'Intervention et de Régulation du Marché du Sucre* — FIRS) which pays an instalment in June and the balance in December — and monetary compensatory amounts are

collected by the Customs and Excises DG (*Direction Générale des Douanes et des Droits Indirects* — DGDDI). This organisation employs 19 000 agents, but the collection of the Community income represents only a small part of its activity. Following the receipt of funds by its own accountants, it transfers them to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) via the Chiefs Treasurers and Paymasters (*Trésoriers-Payeurs Généraux*) and deposits them into the central account of the Commission in FF. These transfers are made the first working day after the 19th of the second month following their notification, after deduction of the 10 per cent collection costs which are credited to the general state budget. In some cases, the Commission can request in advance the payment of some transfers.

331. The VAT and GNP resources are estimated and planned within the framework of the Community budgetary procedure. In the Own Resources Committee, the French delegation is mainly composed of a mixed Budget/Forecast team. Depending on the procedure results, the Budget Department (*Direction du Budget*) issues the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) on the first working day of each month a payment order to the central account of the Commission corresponding to one twelfth of the budgetary taxes voted for VAT and GNP. In some cases, the Commission can request some anticipated payments.

332. The central account of the Commission can also be credited with other sums coming from the French budget, for example European Development Fund contribution or transfer representing the reimbursement of sums rejected by the Commission within clearance procedures.

333. At internal budgetary level, the proper resources of the Community are technically processed as deductions from the national budget income, in the same way as deductions from national income made on behalf of the local government. Criticised by the French Audit Office, this procedure was recently formally modified: an article of French budget law, generally agreed by a vote in December of the year preceding the corresponding financial period, indicates the provisional total amount of deductions from receipts made on behalf of the European Budget during the following year. Brought in for purely political reasons, the vote on this article has no legal effect.

6. The Management Of Expenditures

334. More complicated than income management, expenditure management is different for each main category of the Community expenditures.

335. For the EAGGF-Guarantee, the main role is played by the eleven approved Agricultural Intervention Offices (*Offices d'Intervention Agricole*), that is to say one per each product category: National Interprofessional Office for Cereals (*Office National Interprofessionnel des Céréales* — ONIC), National Interprofessional Office for Milk and Dairy Products (*Office National Interprofessionnel du Lait et des Produits Laitiers* — ONILAIT), etc. Organised with similar structures, these Offices are State public organisations, managed by boards of directors including representatives of the corresponding agricultural occupations and civil servants representing the Ministry of Agriculture and the Ministry of Finance. The director of each office is named by the Government. Most of the staff come from the Ministry of Agriculture and its operational expenditure is paid through a subsidy from the same ministry. The accountant, who is personally financially responsible, is a finance civil servant, jointly appointed by the Ministry of Finance and the Ministry of Agriculture. The main decisions, particularly regarding accounts and budgets, must be approved by

the same ministries. State Controllers, named by the Ministry of Finance, control the main commitments and supervise the financial activities of the Office.

336. A co-ordinating agency, the Central Agency of Guidance Organisations in the Agricultural Sector (*Agence Centrale des Organismes d'Intervention dans le Secteur Agricole* — ACOFA), is shared by all the Offices. It has three functions:

- common management of the treasury, which allows the Agency to borrow funds for pre-financing Community transfers, in accordance with the Community regulations;
- expenditure control and reporting; and
- management of common services, such as computer services, purchasing and payments.

337. These Offices deal with 95 per cent of the EAGGF-Guarantee payments. For expenditures implemented on behalf on the Commission, the role of the Offices is extensive. First, during European Budget preparation and negotiations, they provide the Ministry of Agriculture and the Ministry of Budget with projections and planning information concerning the needs for the next financial period. During the implementation of the Budget, they pass their treasury requests every month to the Commission, via the Ministry of Budget, according to a schedule — most often monthly — which is peculiar to each kind of agricultural production and assistance. After the requests have been examined in Brussels by the relevant management committee, the Commission pays the necessary funds via a transfer order sent to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) from its central account held within this Agency. If necessary, the Commission has to draw on available funds held elsewhere to credit its account at the Central Accounting Agency of the Treasury. The Offices then distribute assistance grants to entitled beneficiaries after examination of the request dossiers. They also participate in audits and sometimes in clearance procedures.

338. Nevertheless, some expenditures are paid directly by the Ministry of Agriculture, particularly the grant for the “suckling cow”. These dossiers are examined by the Local Agricultural Departments (*Directions Départementales de l'Agriculture*), which are the territorial departments of the Ministry of Agriculture, one per subdivision administered by the Prefect. In this case, before the expenditure is paid and after the funds are put at the disposal of the French state through a transfer order sent by the Commission to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), a budgetary credit of an equivalent amount must be registered in the budget of the Ministry of Agriculture. It is the procedure of “*fonds de concours*” which — during the current year and by the means of a parliamentary vote — allows an increase in the budget by an amount which is equivalent to the taxes received by a third party. Included in the national budget, the expenditure are then implemented according to the French procedures:

- commitment by the commitment officer: the Local Agricultural Department (*Direction Départementale de l'Agriculture*), in the name and on behalf of the Minister;
- payment by the accountant: the Chief Treasurer and Paymaster (*Trésorier-Payeur Général*); and
- audit by the Audit Office according to the conditions of common law.

339. However, as the revised Common Agricultural Policy favours direct assistance to the person over indirect assistance to the products, the scheme explained above was substantially modified. For

direct assistance allocated according to the area for cereals or oilseeds and the number of animals raised for slaughter, the assistance dossiers are prepared by the Local Agricultural Departments (*Directions Départementales de l'Agriculture*) which, because of their work in the field, have a better knowledge of the farms. These dossiers are then transmitted to the Offices which make the payment.

340. The reform of the Common Agricultural Policy disrupted the working methods of the relevant administrations, which had to process hundreds of thousands of complex individual dossiers within a few months instead of the few thousand dossiers they were accustomed to.

341. For the Structural Funds — EAGGF-Guidance, ERDF, ESF and FIIG— the procedure is quite different from the one explained above. However, its similar scheme is based on the very important role given to the Region Prefect (*Préfet de Région*) or more exactly to his main deputy in charge of economic affairs: the Secretary-General for Regional Affairs (*Secrétaire Général pour les Affaires Régionales* — SGAR).

342. Credits are scheduled within a regional co-ordination committee composed of the Secretary-General for Regional Affairs (*Secrétaire Général pour les Affaires Régionales* - SGAR) and the top civil servants of the local government. When allocation decisions have been made by the Commission — DG VI, V or XVI depending on the cases — the funds are transferred by the Commission to the French budget by a payment order to the Commission's central account at the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), and credited to the budget of the concerned Ministry for assistance funds. The expenditure is then paid by the relevant territorial services: the local commitment officer is in charge of the commitment, and the Chief Treasurer in charge of the payment. The whole process is monitored by a committee made up of the co-ordinating committee mentioned above and a Commission representative.

Annex 1. Protecting The EU's Financial Interests

Examples of Fraud Detected by French Customs and Involving EU Resources or EAGGF Aid

1. Common Agricultural Policy

1.1 Contraband Hungarian Butter

343. On the French-Italian border, a customs brigade seized 23 tonnes of illegally imported butter of Hungarian origin, thereby uncovering a case of fraud on the EU Budget. Subsequent investigations by customs authorities showed that the lorry driver, a German national, had picked up the trailer at a motorway parking area in Austria. The driver deliberately made a detour of several hundred kilometres to go to Belgium and complete customs formalities there, and more specifically in the port of Antwerp, where the goods were declared to be a consignment of sauce, which attracted a reduced rate of tax at the point of entry for consumption within the European Union.

344. Had it not been for the intervention of French customs agents, the fraudulent import of these 23 tonnes of butter, headed for Italy, would have occasioned a FF 400 000 loss for the Budget of the European Union in the form of lost Common Agricultural Policy levies.

1.2 14 000 Tonnes of Dried Milk of Non-EU Origin

345. The European Commission had initiated an inquiry into the activities of a firm in the dairy product sector. Diligent investigation by French customs at the national level uncovered a complex web of commercial dealings between two companies—a web through which agricultural import levies were evaded while export refunds were collected at the same time.

346. In order to fulfil its contracts with Algeria (for 13 945.5 tonnes), the first company would buy dried milk in Poland and the Czech Republic through its United Kingdom subsidiary. The milk was then stored in another Member State before being exported. This storage in a customs warehouse made it possible legally to interrupt the transit procedure that had been applicable to the milk. The non-EU dried milk could then be treated as having EU origin thanks to a system of double billing and falsification of accompanying documents and shipping forms. As a result, import levies were not paid, and export refunds, paid on EU agricultural products, were requested.

347. In a second fraud, identical procedures were used to transfer goods fraudulently to the European market without paying the corresponding levies.

2. Industrial Products

348. Two violations were detected during a check on the operations of two French companies, involving imports, between 1992 and 1995, of bicycles that were not subject to duty and tax because their stated origin was Vietnam. The investigation showed that all of the components (frames, forks,

handlebars, hubs, rims and brakes) had been imported into Vietnam from China and accounted for 99 per cent of the price of the bicycles. Only final assembly took place in Vietnam. This finding suggested that production of the bicycles had been shifted from China to Vietnam in order to escape payment of an anti-dumping levy on Chinese bicycles and to benefit, wrongly, from preferential tariff arrangements.

349. Pursuant to Council Regulation EEC 1468/81 on mutual assistance between administrative authorities, France sent a report of fraud to the EC's Unit for the Co-ordination of Fraud Prevention (UCLAF) so that investigations could be extended to the other Member States concerned, and to urge that an EU-level inquiry be conducted in Vietnam.

350. That inquiry, which was carried out in 1995, led to cancellation of the certificates of origin by the Vietnamese authorities, and provided evidence that production had been shifted for the sole purpose of circumventing the anti-dumping duty. The two companies were charged with submitting false declarations of origin. The imported goods, having a value of FF 79.3 and 162.5 million respectively, had escaped payment of FF 6 and 27 million in customs duty.

3. Transit Schemes

351. Instances of contraband have been detected with regard to illicit textile imports that were being sold in the Paris area. The case began with a seizure of 6 341 shirts of Indian origin from the warehouse of a Paris company. No import declaration had been filed when the goods arrived in France. They had been declared as in transit (with duty and tax therefore suspended) to Belgium, where they were to obtain customs clearance.

352. In fact, the goods were delivered directly to consignees in Paris with no payment of duty or tax, and with total disregard for the rules of foreign trade, which set import quotas under the multi-fibre arrangement between the European Union and certain other countries. The bills of lading were sent by mail to the Belgian forwarding agent who cleared them by establishing fake customs declarations.

353. In addition, another such case was detected under similar circumstances, involving two containers of jeans imported from the United States via Belgium.

4. So-Called "Sensitive" Goods

354. Fraudulent movements of cigarettes, which are classified as "sensitive" goods because they are heavily taxed and highly subject to fraud, often involve large-scale organised contraband. While such movements seem to have avoided French territory in 1995, they have obviously returned. This is made plain by a number of consecutive findings during inspections of shipments in transit. The shipments involved, headed for the black market in Spain or Italy, averaged around 12 tonnes.

355. The interception last spring of 33 tonnes of cigarettes at Le Perthus is a perfect illustration; it was the largest seizure of cigarettes to date by French customs agents. The goods were discovered in three lorries—two registered in Liechtenstein, the third in Switzerland—that were headed for the Spanish border. The vehicles had been fitted with fake customs seals. According to the transit documents in the drivers' possession, they were supposedly transporting plastic tubes between Switzerland and Portugal. The cigarettes that were seized seem to have been loaded in Italy, very probably in Naples.

356. Numerous incidents show that medium-scale trafficking remains largely limited to the Andorran border and the Nord-Pas de Calais region. A great many of the cigarettes seized from small-time traffickers were on their way to the United Kingdom, Germany or Spain. This traffic is very often associated with that of alcohol, as shown by the large number of mixed seizures, for the most part involving United Kingdom nationals.

PORTUGAL
By Vitor Caldeira¹¹

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11. Vitor Caldeira is Deputy Inspector General of Finances in the Inspectorate General of Finances (IGF), Portugal. He is in charge of planning and monitoring IGF activity on financial control of own resources and Community expenditure, and of co-ordinating the national internal control system relating to financial flows to and from Community Budget. He is also responsible for the external representation of IGF on these issues. Mr. Caldeira is a member of the EC's Advisory Committee on Anti-Fraud Measures (COCOLAF).

1. Chapter Summary

357. This country paper intends to draw an overall picture of the impact that joining the EU has had on the Portuguese financial control and budgeting system. Major changes are stressed, with an emphasis on concrete and operational difficulties faced and on the solutions adopted to solve them.

358. The effects of Portuguese accession to the EU on budgeting and financial control were felt even before acceding. Some lessons for the future can be pointed out regarding our experience.

359. It is fundamental to provide, at least a year before acceding, a comprehensive training programme dealing with general Community organisations and procedures for officials appointed to carry out tasks relating to these matters. Technical assistance from the European Commission must be fully benefited from.

360. Simultaneously, regulatory obligations regarding budgeting and financial control must be carefully studied. Preliminary planning and a time-table for managing the implementation of new obligations in order to adapt the national budgeting and control system to EC requirements are also very important.

361. Joining the EU certainly shall demand adaptations on the part of national administrations to respond appropriately to the European regulatory framework. However, there are no ideal models to be followed. This is an important lesson to note.

362. Accession can reveal the necessity for specialised structures in some areas, namely in agricultural and Structural Funds, such as the paying agencies related to the EAGGF–Guarantee section or a specialised agency for ESF, for instance.

363. In some cases, it can be prudent to use the natural vocation and experience of already existing public departments to carry out the new obligations in this area.

364. A central unit in the finance ministry is fundamental to provide internal (to and from other ministries and agencies) and external (to and from Commission and Permanent Representation in Brussels) exchange of relevant information and to monitor the budgeting process.

365. A good co-ordination of internal audit and financial control appears to be a very important contribution to support a well-functioning system and to facilitate the contact with the Commission's Financial Control Unit (DG XX).

366. The reforms underway leading to a Community-oriented financial control system may have fundamental implications for the existing national organisation for financial control or internal audit. However, the creation of new and potentially costly administrative structures must be carefully evaluated.

2. National System

2.1. Legal Framework For Budgeting And Financial Control

367. According to the Portuguese Constitution, the national budget must assume the form of a law and is prepared, organised, voted and executed in compliance with the budget law. This law contains principles and rules that are mainly the same as those found in the Financial Regulations of the EU.

368. A proposed budget is prepared by the Government, under the co-ordination of the Ministry of Finance, involving all line ministries.

369. In drafting the budget proposal, the Government must give priority to its legal or contractual obligations and to its investment and development policies. To prepare this budget proposal, a central role has been committed to the Directorate General for Budget in the Ministry of Finance.

370. Once the Government has its budget proposal ready, the Parliament discusses and votes the Budget Law initiating its control function as prescribed in the Constitution.

371. The Directorate General for Budget is also responsible for the control of budget execution in all government departments and for preparing the State General Accounts to be submitted to the Parliament and to be audited by the Court of Auditors.

2.2. Organisational Structure For Financial Control

372. The Portuguese finance control system adopts a model that distinguishes different types or levels of intervention. External and internal types of control are distinguished.

373. External control has a political level, with the national Parliament; and a jurisdictional level, with the Court of Auditors. The Court of Auditors, as a supreme audit institution, is responsible for the external audit.

374. The horizontal level of internal control is fulfilled by the Inspectorate General for Finance (IGF).

375. The IGF depends directly on the Finance Minister and is responsible for financial control of all public expenditure and revenue. Its intervention covers all relevant items of the national budget and departments of public administration, including public enterprises, municipalities and grants and subsidies to private entities.

376. Finally, there are internal audit bodies in the various ministries in charge of sectoral level of control.

377. All these bodies have the competence to control public expenditure and revenues in the national or community budgets.

3. Major Changes To The National System

3.1. Own Resources

3.1.1. Estimation and Collection of Customs and Agricultural Levies

378. EU accession in 1986 has demanded only internal adaptations within the existing structure of the Finance Ministry in order to respond to the new obligations for the estimation and collection of customs duties.

379. Customs administration took on new responsibilities to estimate and collect traditional own resources without great difficulties. The major problem faced at that time involved the necessity to improve officials' skills at all levels, namely regarding Community customs regulations.

380. For that purpose, the Portuguese authorities set up before accession a comprehensive training programme for customs officials, dealing with own resources. This programme involves a 2-3 day stay in the European Commission services related to customs and own resources in order to have operational exchange of views on different subjects (e.g. estimation and accountability of own resources). These Portuguese officials were charged to provide afterwards, in Portugal, specific training on these matters to all custom officials. Procedural manuals were also developed to support improved performance by the customs administration.

381. Some difficulties concerning the information system and its computerised framework are being felt for the accountability of own resources that have not been collected from the operators (B accountability) and to establish the appropriate link in the case of irregularities and fraud that are to be transmitted to the European Commission under the last amendments of Regulation 1552/89.

382. Regarding financial control, this is the responsibility of the Customs Internal Audit Unit.

383. The competence to co-ordinate internal audit action on own resources belongs to the IGF. This involves, in particular, inspections and audits of the Portuguese bodies responsible for estimating, collecting, controlling and transferring own resources to the European Commission.

384. Due to some operational difficulties, only during the last two to three years has it been possible to develop an integrated action in this area by IGF. To avoid duplication and zones of no control, an important effort is being carried out at present to give coherence to the work of both audit bodies.

385. The implementation of the single market in 1993 imposed changes on customs administration organisation. In particular, personnel was reduced from 2 400 in 1992 to 1 700 in 1996. In addition, the Directorate General for Customs was put in charge of all excise duties.

386. The major problem faced after this period relates to the prevention and combating fraud. One of the measures adopted in 1993 necessitated a restructuring of the customs central anti-fraud unit, with the establishment of an intelligence division and the setting-up of a fraud prevention division within the customs directorate.

3.1.2. Calculation of VAT and GNP Resources

a) VAT Contribution

387. Due to the fact that the Portuguese VAT base was substituted, in the first three years after accession, by the equivalent of 55 per cent of GNP, the Portuguese authorities did not pay due attention to the estimation of VAT own resource.

388. This caused significant problems concerning the calculation of VAT resource that are now beginning to be resolved.

389. First, the major difficulty deals with the statistical data that must be provided by the National Institute for Statistics to estimate the weighted average tax, mainly to have good statistical information from national accounts on investment, consumption of different product groups (that have different VAT rates) and stock variations. To solve this problem, the tax administration and the National Institute for Statistics signed a protocol to set up a permanent contact group and in the last year significant progress was achieved.

390. Secondly, there are some grey zones relating to the information on VAT collection that demand clarification of the division of responsibilities between the different departments involved: the Directorate General for Budget and the Directorate General for Treasury. The changes that are in progress regarding the recovery information system and the accountability of refunds of VAT¹² will enable this problem to be solved.

391. The necessity to endow with appropriate and sufficient human and technical resources the competent department of the tax administration in order to calculate the VAT contribution is another constraint that has not been resolved. In fact, the complexity of establishing the VAT base requires expertise on VAT and national accounts. It also demands specific computer software.

392. For VAT, the tax administration in co-operation with the Directorate General for Studies and Forecasts and the Directorate General for European Affairs of the Finance Ministry, are responsible for establishing the annual forecast of VAT own resource. Two senior officials from the tax administration are specifically charged with this task.

393. The competence to co-ordinate national internal audit action on the VAT own resource also belongs to the IGF. This involves, in particular, audits of the Portuguese bodies responsible for collecting, controlling, calculating and transferring the VAT contribution to the European Commission.

b) GNP Contribution

394. The proper process of estimation and budgeting by the national authorities of GNP contribution involves providing them with the statistical data supplied to the European Commission by the National Institute for Statistics.

12. VAT refunds are the sums that are given back to some entities, like Armed Forces and diplomats, that are exempt from paying VAT.

395. In Portugal, the Directorate General for European Affairs of the Finance Ministry is responsible for presenting to the European Commission the estimation of Portuguese GNP contribution.

396. To achieve this estimation, the Directorate General for Studies and Forecasts of the Finance Ministry provides the appropriate information on the macro economy and growth rate of GNP forecasts, supported by data supplied by the National Institute for Statistics.

397. Some constraints have been faced in this area due to the lack of information exchange between those departments. The problem has been solved by a protocol for technical collaboration established in 1993 that sets up clear obligations from both departments to co-operate on GNP forecasts.

3.1.3. Procedures for Transferring and Accounting Contributions to EU

398. To create the most appropriate procedures for the transfer and accounting of own resources to the European Commission, it was necessary to adapt existing rules regarding the budgetary process.

399. A specific budgetary line was created to record estimation, collection and transfer of traditional own resources. Other contributions (VAT and GNP resources) are integrated into a specific line of the budget of the Finance Ministry according to the estimation made by its relevant departments and are submitted to national budgeting control procedures.

400. The Directorate General for Budget is responsible for accounting for all these resources according to the transfers made by the Directorate General for Treasury to the European Commission.

401. The Directorate General for European Affairs of the Finance Ministry plays an important role in co-ordination in this area, namely by centralising the flow of information to and from Community authorities (DG XIX — Budget). Administering this information flow is not an easy task, especially providing information in a timely manner to the relevant departments.

3.1.4. Statistics

402. The National Institute for Statistics provides to Eurostat and national bodies concerned with VAT and GNP own resources the appropriate statistical data (see Item 3.1.2).

403. There were some difficulties concerning the statistical calculation methods used, mainly those concerning administrative public sector, parallel economy and tax evasion.

404. Those problems were solved with the permanent follow-up of the National Institute for Statistics by Eurostat.

3.2. *European Union Funds*

3.2.1. *EAGGF–Guarantee Section*

a) *Paying Agencies*

405. Before joining the EU, Portugal already had an agency called the National Agricultural Intervention and Guarantee Institute (INGA) responsible for payment of the bulk of national agricultural subsidies, whose main financing came from levies on certain imported goods¹³.

406. The need for a specialised agency to centralise the financial inflows of EAGGF–Guarantee section and to co-ordinate the different paying agencies (for instance, those for wine, olive oil, fisheries) was felt immediately after accession.

407. The INGA was transformed for this purpose in May 1986. Legally, INGA depends both on the Minister of Finance and the Minister of Agriculture.

408. The evolution of the Common Agricultural Policy (CAP), mainly the reform of 1993–95, has brought about important changes on the national level concerning paying agencies.

409. In the first place, the competence to pay and control aid for the new supporting measures (agri-environmental schemes, afforestation of agricultural land, and early retirement for farmers) was placed on the existing Agricultural and Fisheries Development Assistance and Financing Institute (IFADAP) which had already the responsibility for agricultural Structural Funds.

410. On the other hand, INGA centralises the payments for all other aid from EAGGF–Guarantee section.

411. Portugal now has only two paying agencies where about 900 officials work¹⁴. The clearance of accounts reform of 1995 for EAGGF–Guarantee funds has implied several major adjustments in these paying agencies.

412. These changes have not been easy to achieve and some difficulties remain. The fact is that those two paying agencies have only a conditional accreditation. They must fulfil all legal criteria for accreditation, mainly on written procedures and checklists, protocols with external entities, and internal audit.

413. An important effort is being carried out to obtain accreditation from the Finance Minister, which is the Portuguese competent authority for approving paying agencies. The evaluation of the compliance of the agencies to the relevant criteria is carried out by the IGF.

b) *Management And Financial Control*

414. Despite the role of co-ordination body given to INGA, according to the provisions of the last amendment of Regulation (EEC) 729/70, the management of EAGGF–Guarantee fund in Portugal must be analysed according to the nature of the aid involved.

13. This agency has sixty officials.

14. 350 officials at INGA and 550 at IFADAP.

415. Therefore, centralised management is carried out by the two paying agencies mentioned above. They are assisted in preparing and implementing supporting measures by different external bodies (for instance, the Directorate General for Fisheries in the fishery sector, and the Vineyard and Wine Institute in the wine sector) and by the regional agricultural directorates of the Ministry of Agriculture.

416. On-the-spot checks are also carried out by these agencies. Depending on the measure involved, other control bodies can carry out physical inspections (for instance, the Directorate General for Customs recording export refunds and the Control Agency for Community Olive Oil Aid in the olive oil sector). Private auditors can also carry out controls on behalf of the agencies.

417. Financial control is performed by the sectoral audit body of the Ministry of Agriculture and by the IGF.

418. Some of these control bodies are also responsible for the ex post controls of Regulation (EEC) 4045/89, under the supervision of the IGF, which acts as the “specific body” set out in the regulation. It prepares the annual programme of control of EAGGF–Guarantee beneficiaries on the basis of a risk analysis system, monitors its execution, and prepares the annual report.

419. The great difficulty involved in this framework is the co-ordination of the actions carried out in the different sectors or aid schemes by the controlling bodies in order to achieve the level and the quality of controls imposed by Community or national regulations. To solve this problem, the IGF as “specific body” has improved the monitoring of the annual programme of controls. IGF has also set up audit methodologies in this area and reviews all the reports.

420. After the clearance of accounts reform of 1995, the IGF was charged with the certification process of the annual declaration of expenditure of EAGGF–Guarantee fund. It was discussed whether a better solution might be to commit audit certification to an external auditor or even to a private audit firm. Our experience told us that the solution adopted is indeed the more appropriate one for Portugal, due to the nature of the IGF (a high-level control body operating at interministerial level).

c) Tracking, Monitoring And Reporting Irregularities And Fraud

421. In Portugal, responsibility for the detection and preliminary investigation of fraud and irregularities concerning EAGGF–Guarantee section lies with the same bodies that are charged with management and financial control.

422. The Interministerial Committee for Co-ordination and Control of the Application of the EAGGF–Guarantee Section Financing System was established in 1991 to provide the most efficient response to the provisions of Regulation (EEC) 595/91. All control bodies are represented in this Committee. The IGF chairs the Committee.

423. The Committee’s main task is to monitor, centralise and assess information on irregularities involving that fund and to supply such information to the European Commission.

424. This solution has proved satisfactory and the experience teaches us that this is a good way to deal with all matters relating to irregularities and fraud.

425. Concerning the definition of the national agencies involved and the procedures to apply sanctions against certain recipients of funds from EAGGF (the black list), the necessary law has not yet been published. This delay has caused some operational difficulties.

3.2.2. *Structural and Cohesion Funds*

a) *National Management and Control Systems*

426. In view of Portuguese accession to EU, some measures were envisaged by the successive governments in power, in the years prior to Portuguese entry into the EU, regarding the way public administration and government would manage and control Structural Funds.

427. As there are several differences between the Structural Funds, there were different repercussions in the Portuguese public administration.

428. In some cases, it became necessary to create new government agencies as was the case with European Social Fund Affairs Department (DAFSE) that appeared in 1981 as a group within the Ministry for Labour, and was officially created in 1983, long before Portugal joined the EU (1986). At that time, 20 officials worked at DAFSE. Now about 100 officers work there.

429. New responsibilities were also committed to the existing Agricultural and Fisheries Development Assistance and Financing Institute (IFADAP) in view of the management of EAGGF-Guidance section. This happened just after Portugal joined the EU.

430. For the other Structural Funds, there was no need to create new government agencies or departments. Arrangements and adjustments in the already existing government departments were considered adequate to face the impact of these new financial support lines, mainly ERDF and FIG.

431. What happened in the first period after accession tells us that it is not sufficient to create specialised bodies to manage and control Community funds. It is fundamental to have coherent and global co-ordination of all areas and bodies involved.

432. So, to correct some errors, mainly in ESF, a specific structure for management, follow-up, evaluation and control of the execution of the first Community support framework (1989-1993) was established in 1990. This experience has revealed some weaknesses that led to important adjustments in the managing and control structures for the second Community support framework (1994-1999).

433. The present management system is supported by a decentralised structure of managers and management units for the several programmes or operational interventions. To carry out global management there is a management committee for Structural Funds at which the top officials of the conceded authorities are present.

434. The global co-ordination of the Community support framework belongs to a governmental committee. This committee is chaired by the Minister for Planning.

435. To evaluate the economic and social impact of the Community support framework, there is an "observatory" that, among other assignments, sets the basic guidelines for the evaluation work of external consultants. This "observatory" is comprised of independent experts.

436. A system-oriented approach¹⁵ for financial control and internal audit is one of the major adjustments made in 1994 regarding the control system of Structural Funds.

437. The present system of control, which maintains a centralised structure with a better legal clarification of each one's responsibility, is composed of three levels¹⁶. The first level is carried out by the managing agencies (now 34 in number). That level covers checks, preceding and accompanying, decision-making by management bodies and checks on end recipients. The second level of control is carried out by the departments charged with internal audit in the ministries involved and the designated authorities for each fund. This covers analysis of the first level control system and, wherever necessary to test its effectiveness, checks on end recipients. Finally, high level financial control is carried out by the IGF which is responsible for promoting actions to link the different levels of control, evaluating the reliability of the national system and making proposals for its improvement.

438. This approach calls for an integrated aid co-ordinated intervention at all levels of control. To achieve this goal, the experience in progress in Portugal is supported by a control cycle. Each year, the control cycle unfolds itself in three phases. The first phase concerns the preparation of the control programme, based on a risk analysis approach, and the distribution of the actions among the different audit bodies. The second phase corresponds to the execution of the planned actions, according to methodologies previously adopted. In the third stage, the global report of all control activity is produced. It is important to note that this control system may be complemented by audits carried out by private audit firms.

439. Some important constraints in the operation of this model must be pointed out. A good performance of the system supposes a strong global co-ordination and that is not yet completely in place. The absence of qualified personnel to carry out audits in the first and second level of control is a major problem. To surpass this problem, private auditors are hired to act on behalf of these control bodies. It must be stressed that these private auditors must fulfil the requirements defined by the public control bodies.

440. Finally, it must be added that a particular scheme was built in 1994 to organise management and control of the Cohesion Fund. The structure established is similar to that of management and control of the Structural Funds.

b) Co-Operation And Co-Ordination With The Commission's Financial Controller

441. The IGF signed a bilateral protocol on financial control over the Structural Funds with the Commission's Financial Controller (DG XX) in June 1996, and in October signed an additional protocol in relation to the Cohesion Fund.

442. This protocol provides for the IGF to carry out system audits and audit individual transactions on the basis of an agreed methodology that equally takes into consideration the national methodology. The protocol also provides for the establishment of a joint annual audit programme by both services. The audit programme has a margin of flexibility to allow for changes that might become necessary and its execution is subject to a follow up by the end of the month of June.

15. This approach adopts "l'audit des systèmes" as basic methodology.

16. See an integrated vision of the Portuguese financial control system for Structural Funds in Annex 1.

443. Although it is the first year of the protocol, we found the experience of co-ordination very useful to avoid duplications on the audit actions carried out by the IGF and the different services of the European Commission.

444. On the other hand, effectiveness of the control effort can be improved by covering all risk areas that both parts have stressed. We believe that good co-ordination can reduce the control effort carried out by the Commission Services in Member States and has the potential to achieve the most efficient management of the resources applied for control.

445. The actions taken by the IGF and the corresponding reports sent to DG XX can give the Commission a comprehensive view of the adequacy and reliability of the Portuguese control system.

446. To fulfil the obligations of the protocol, the IGF has specific audit teams to carry out the audits programmed for each fund, and a single unit to co-ordinate their action.

447. In order to improve national auditors' skills and to develop a closer co-operative relationship with the auditors of DG XX regarding operational issues, such as methodologies, a short seminar was held in Brussels. The results were very good and a similar seminar in Lisbon is being prepared for the exchange of experiences.

448. The major difficulty concerns the timetable for co-ordination of audit programmes. We are trying to overcome that problem by improving the national planning and programming process for 1998.

c) Tracking, Monitoring And Reporting Irregularities And Fraud

449. The model adopted in Portugal to track irregularities is based on the national control system (referred to under Item 3.2.2).

450. According to that model, the IGF is responsible for monitoring and reporting irregularities and fraud. Its main task is to centralise and assess relevant information on these matters and to supply such information to the European Commission (UCLAF).

451. Some difficulties must be stressed.

452. A major problem concerns monitoring all bodies that are involved, and making sure that all of them supply due information on time and are familiar with the concept of irregularity as defined by the regulations. This problem is not yet solved satisfactorily. An important effort is being carried out by the IGF to help these agencies to fulfil their obligations in this matter. It should be pointed out, however, that it also took some time to achieve some degree of harmonisation between the entities concerned with irregularities in EAGGF-Guarantee within the Committee (referred to in Item 3.2.1 C).

453. Another important question to solve regards the link to the relevant departments of the Minister of Justice, mainly in those cases of irregularities and fraud that are qualified as criminal offences.

454. Due to the diversity of the bodies involved, it was preferable to find a solution similar to that practised in agricultural expenditure through an Intergovernmental Committee.

455. It is important to add that close co-operation with UCLAF, mainly through seminars and technical assistance, has the desired impact on the skills of national officials in this area.

4. Community Budget Process

4.1. Integration Of National And Community Budget

456. The national budgeting process has been summarised in section 2 above. The connection between both national and Community budgeting processes is achieved through national authorities charged with economic and financial forecasting and budget execution. Despite the central role played by the Finance Ministry, there is some degree of autonomy in line ministries and agencies charged with Structural Funds expenditure and EAGGF–Guarantee.

457. The Portuguese Permanent Representation (PR) in Brussels is linked to national authorities through several financial counsellors (five at present). Some of them are members of the Council's Budget Committee.

4.2. Change In National Budget Procedures (SEM 2 000)

458. The action programmes on forecasting and budget execution, which have been endorsed by the Council according to the final report on SEM 2 000 (third stage) initiative, demand closer co-operation and permanent contacts between the European Commission and the Portuguese authorities when preparing annual budget expenditures and during budget execution.

459. To achieve this, a single contact point to liaise with the Commission Directorate General for Budgets has been nominated in the Portuguese Finance Ministry¹⁷.

460. The contact point works within the Portuguese Directorate General for Budget. This represents an important change in traditional channels of information to the Commission and involves a new exercise of internal co-ordination between all the agencies and governmental departments responsible for funds proceeding from the Community Budget.

461. It is admissible that this single contact point can also improve the exchange of information to the Foreign Affairs Ministry and to PR in Brussels in facilitating the task of Portuguese members of the Council's Budget Committee.

5. Co-Operation And Co-Ordination

5.1. With The European Commission And Other Member States

462. This item refers only to the co-operation beyond that directly imposed by Community regulations provisions.

17. This solution has been adopted as a consequence of the SEM 2 000 Programme.

463. We have already pointed out the process of co-operation and co-ordination between DG XX and the IGF (see Item 3.2.2 B). It is also important to emphasise the co-operation with UCLAF in these matters relating to irregularities and fraud and with the Commission Directorate General for Budgets on forecasting own resources.

464. Regarding co-operation among Member States, the “joint audit initiative” on traditional own resources carried out by Denmark, the Netherlands, the United Kingdom and Portugal can be mentioned. The objective of this initiative is to improve the quality of internal audit (on customs duties) through the development of common audit methodologies. The joint initiative has led the Commission to set up a specialised audit group within the Advisory Committee on Own Resources and has produced and tested two audit modules (one general and the other on transit).

465. In the last meeting of the joint initiative group, in Lisbon, the need for internal audit units in customs administration was stressed.

466. This is probably a very interesting action for central and eastern European countries to join as observers, even before accession.

5.2. *Inspections From Different Bodies*

467. As emphasised above, the IGF operates at an interministerial and horizontal level in all areas related to the Community Budget. As a consequence, the action on financial control performed by the different internal audit units is subject to a co-ordinating process to avoid duplication or no control zones.

6. Management And Organisational Issues

6.1. *Administrative Arrangements*

468. Some administrative arrangements were made in the Ministry of Finance before accession.

469. The European Affairs Unit was created to promote the co-ordination of internal and external action of the Finance Ministry relating to EU. The main task of this unit deals with the co-ordination of all departments of the Finance Ministry. It also co-ordinates the Finance Ministry with the Interministerial Committee for European Communities chaired by the Foreign Affairs Ministry, and with the PR in Brussels.

470. This unit has about 20 officials, but a need to increase this number is felt at present.

471. Being a good solution in theory, the fact is that this unit has not completely achieved its purpose. So, other departments of the Finance Ministry have parallel functions in some areas mainly due to the lack of effective co-ordination. The new Directorate General for European Affairs is trying to overcome this difficulty.

472. A unit for co-ordinating Community controls has been established within the IGF. This unit is charged with the co-ordination of internal control relating to financial flows of Community Budget. Before accession, two auditors were responsible for this task. Now, there are sixteen.

473. The experience with this unit has been very important and positive. It has enabled the IGF to play a central role in Community financial control issues, both at a national level and as a contact point with DG XX.

6.2. Professional Skills

474. The complexity of Community regulations and of its decision-making process has demanded initial training for Portuguese officials that were in charge of European matters before accession. The Directorate General for Public Administration and the National Administration Institute have co-ordinated a training programme dealing with general Community matters (e.g. institutions and decision-making process of the Community), and the different departments have set up specific seminars for specific matters (e.g. agricultural policy, Structural Funds.)

475. These officials must be permanently kept up-to-date on EU matters. For this purpose, the exchange of experiences with officials from other Member States and the Commission is fundamental. The National Administration Institute also provides short seminars (a week-long) related to different matters that are changing in the EU (e.g. monetary union, impact of the Euro, etc.)

476. Portuguese authorities pay great attention to language skills of the officials that are in positions involving relationships with colleagues from other Member States or from the Commission. To those who participate in European meetings, specific training is available on language skills, negotiation and techniques for conducting meeting.

7. Ten Years Of Portuguese Accession To EU—Results And Future Perspectives

477. The impact of Portuguese accession to EU on budgeting and financial control began before acceding with pre-accession aid that was managed through *ad hoc* structures placed in the public administration.

478. Accession revealed the necessity for specialised structures in some areas, namely in agricultural and Structural Funds, such as the main paying agency for the EAGGF—Guarantee funds or the specialised agency for ESF.

479. We have also tried to use the natural vocation and experience of existing public bodies to carry out new obligations in this area. This was the case for the Directorate General for Regional Development for ERDF or the Directorate General for Customs for own resources. The same was true for the Inspectorate General of Finance for financial control on both sides of the Community Budget.

480. The framework of EU is in constant evolution. This is a fact that demands permanent adaptation on the part of the national administration in line with European progress. However, the creation of new and potentially costly administrative structures must be carefully evaluated. There is a risk of supplementary bureaucracy, which should be avoided.

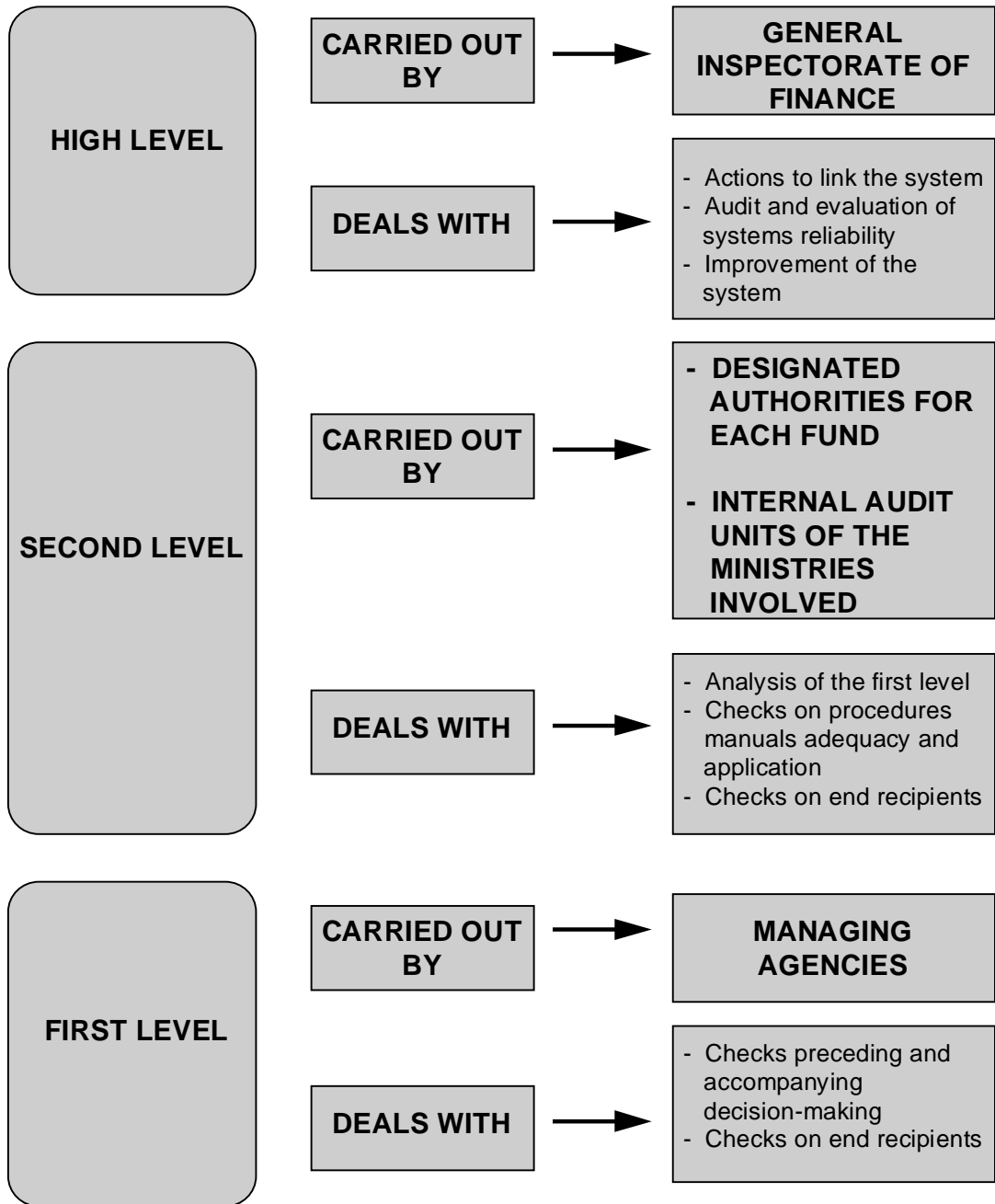
481. The Commission's SEM 2 000 Programme claims for closer co-operation between the Commission and Member States. Major changes regarding financial control systems of Member States have been highlighted. The extension of clearance of accounts provisions on agriculture

expenditure to the Structural Funds and own resources seems to point to a Community-oriented financial control system.

482. This may have fundamental implications on existing national organisation for financial control or internal audit. The experience of co-ordination by the DG XX under co-operation protocols could be very interesting for this purpose.

483. To achieve an equivalent level of protection of Community financial interests in all Member States involves specifying minimum standards for the national control authorities. This is a major task for the future.

**Annex 1. An Integrated Vision Of The Portuguese
Financial Control System For Structural Funds**



SWEDEN
By Ulrika Barklund Larsson¹⁸

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1. Chapter Summary

484. This paper aims to give an overview of the measures taken to adapt the Swedish budgetary and financial control systems to the requirements following the EU membership. The following lessons learned are highlighted:

- It is important that national preparations starts early, well before accession. In the beginning, the most important steps are to:
 - launch training programmes (language and technical skills);
 - establish contacts with the Commission and Member States on the expert level; and
 - assess the quality of present systems for budgeting and financial control in the light of the EC Treaty and Regulations.
- The quality of systems is often improved if EU funds can be handled in the same way as national funds. If the national system does not meet EC requirements in some respect, it may be worthwhile to consider changes also for the national resources. In some cases, however, it is inevitable to create specific functions or routines for the EU funds, both in policy-making and administration and control of EU revenues and expenditures.
- The complexity of and resources needed for purely technical matters, such as creation of necessary electronic data processing (EDP) systems, must not be underestimated. Differences in powers between EU and national inspectors and auditors may be avoided.
- Good co-ordination between the Ministry of Finance and the line ministries, as well as rapidity and timeliness, are crucial for the process to work smoothly and results to be achieved. This is equally important in budget-related matters, as well as financial control and anti-fraud measures. The Ministry of Finance should be given a leading role in the process to formulate the state's position on proposals and strategic decisions.
- The set-up of systems for financial management, control and internal audit within the areas of agriculture, Structural Funds and customs should be given high priority and careful consideration. It is expected of all Member States to co-operate closely with the Commission's Financial Controller (DG XX).
- The relationship between national and regional levels can be difficult if the division of responsibilities in the management and control process is not clarified at an early stage.
- EC requirements change continuously in order to improve efficiency and strengthen the protection of the Communities' financial interests. This is an ongoing process which probably will never cease. All Members of the Union must therefore be prepared, and set up their systems accordingly, for further negotiations, tighter EC rules and further adjustments in their respective national systems.

2. Introduction

485. A few points should be mentioned from the start to facilitate understanding of the measures implemented by the Swedish government in conjunction with Sweden's EU membership since 1 January 1995.

2.1. *The Swedish Administrative Model*

486. The Swedish administrative model diverges in some ways from the prevalent models in the rest of Europe. It is based on the absence of ministerial governance; rather, small ministries exist with mainly policy functions alongside government agencies (which are strong and in many respects independent from the ministries) that are responsible for operative state activities. The model is characterised by delegation and decentralisation of decision-making from the Government to agencies, but also within the agencies. Consequently, the Swedish Cabinet Office is small compared to most other countries in Europe (3 700 employees of which 1 500 work within the Ministry of Foreign Affairs). The Ministry of Finance has about 400 employees of which roughly 60 persons work at the Budget Department.

487. At an early stage, the Government adopted the principle that as few separate systems as possible were to be created for the administration, budgeting, financial control, etc., of EU Budget funds in relation to national funds. This approach was, in particular, prompted by quality considerations, since the risk of misunderstanding and errors would otherwise increase. In some cases, it has proved difficult to combine the various administrative traditions specific to the Sweden and the EU, and we have therefore had to create new functions, regulations and routines. Broadly speaking, however, the Swedish administrative model has proved compatible with Union-related activities.

488. The Swedish administrative model, with its organisation and systems for budgeting, supervision and auditing, is described in more detail in Annex 1. A description of the transfers of payments between Sweden and the EU, an organigramme picturing the Ministry of Finance and a brief description of the administrative resources required following Sweden's accession to the EU are included in Annex 2.

2.2. *The Referendum*

489. In March 1994, Sweden was accepted as a full member of the EU with effect from 1 January 1995. However, the question of whether Sweden would join was settled by a referendum held on 13 November 1994. The referendum was itself not binding on the Government and *Riksdag* (Swedish Parliament), but the political parties had pledged to comply with the people's will as expressed in the referendum. For this reason, administrative and other more technical preparations were not immediately initiated. From a purely practical point of view, the delays ensuing from the belated referendum were unfortunate.

2.3. *The EEA Agreement And Statute-Drafting In Brief*

490. As a result of the European Economic Area (EEA) agreement, Sweden came to be included in the single market from 1 January 1993. Consequently, the large-scale work of implementing EC ordinances and directives in this area had already been carried out by the time of Sweden's full EU membership. This favoured the capacity of the ministries concerned to undertake implementation of the EC's legal documents that were associated with responsibility for administering much of the Community's funds and own resources under national statutes. The amount of work needed should not be underestimated. It required a substantial effort not least by the agencies responsible for the operational implementation of the EC legislation.

491. One lesson learnt from the statute-drafting work is that it demands from the ministries and the agencies concerned not only ample knowledge of EC law but excellent linguistic skills. Since EC regulations were not available in Swedish until — in many cases — long after 1 January 1995, we were obliged to base our legislative work on language versions other than Swedish. In some cases this resulted in misunderstandings, with consequent needs for clarification.

492. We based our statute-drafting work primarily on the English, French, Danish and German versions. One observation we made in comparing various language versions was that disparities between them were fairly common. However, it should be added that the official translations into Swedish have not always been entirely satisfactory either. Examples of substandard work may be found in the translation of the Financial Regulation. We find the problems entailed by this translation so considerable that the Ministry of Finance is now carrying out a review that will probably result in a request that the official Swedish version be revised.

493. For its participation in the EEA, Sweden had to pay a contribution to the EU Budget. A payment system was created for this whereby sums were transferred from accounts forming part of the state payment system in the Bank of Sweden to the Commission's account that was opened in the Bank of Sweden for this purpose. This method, which simplified matters, was then retained when we became a full EU Member State.

3. Organisation And Horizontal Measures In The Area Of Budgeting And Financial Control

3.1. Role Of The Ministry Of Finance

494. The Budget Department of the Ministry of Finance is responsible for issues relating to principles of budgeting, accounting, financial control and auditing in the state sector. When Sweden joined the EU, a unit in the Budget Department was formed to deal exclusively with these matters when they are connected with the EU. This unit, which consists of 7 persons, is also in charge of national preparation of EU Budget business, and also for Sweden's contribution and some co-ordination of joint ministerial issues. However, co-ordination of some of the ministry's own EU-related matters is handled by the International Affairs Department, in particular the national preparation of ECOFIN meetings.

495. Establishing a special unit for this purpose in the Budget Department was not the obvious solution, since new circumstances or additional activities in the national setting are normally integrated into the department's regular line organisation. However, we considered that the particular conditions applying to EU-related activities and the ensuing specific knowledge requirements are so unique that they justify a special organisation. This remains our assessment today.

496. The EU unit at the Budget Department also has an important task in spreading knowledge about the EU Budget, the budget process and the systems for financial management and control. This is done through regular training courses for officials in the Cabinet Office, but also through seminars for individual ministries on demand.

497. Line ministries' checks with the Ministry of Finance concerning the Swedish position on discrete Union budget matters are not carried out, however, with the EU unit but rather with the department's line organisation, in the same manner as for national funds. Nevertheless, where the

matter relates to spending items in the Union Budget, it is the EU unit that, owing to its overriding responsibility, finally sends instructions to the Permanent Representation in Brussels, where staff from the Ministry of Finance are responsible for Swedish action in the Council's Budget Committee.

498. It is worth noting that there is scope for further improvement of the co-ordination within the ministry as well as between ministries.

3.2. *Practical Preparations And Decisions On Principle Prior To Membership*

499. The Ministry of Finance embarked on preparations in the areas of administration, budgeting principles, accounting, financial control, etc., in conjunction with the *acquis* reviews of Community regulations with the Commission in spring 1994. These meetings were attended by experts from Austria, Finland, Sweden and the Commission, who studied all Council regulations to identify unclear points and potential problems in implementing the regulations liable to be incurred by the would-be Member States.

500. We also held meetings on a bilateral level with the Commission and with representatives of the Member States in a number of capital cities starting in March 1994, when it had become clear that we were welcome to the EU. The purpose was to obtain more information on how to interpret the regulations for the EU Budget, the Swedish contribution, and financial management and control, and to obtain advice on what practical steps we should take. We gave priority to the Member States whose administrative traditions resembled those of Sweden, but we also visited others. This was immensely useful to us, since it is very difficult to understand the implications of the regulations by merely reading them. We obtained valuable knowledge of the practical work done in the Council by participating in the meetings as observers, as we were invited to do from the summer of 1994.

501. However, because of the referendum, the Ministry of Finance was unable to put forward early government decisions on how Community funds were to be managed in Sweden. Finally, we were nonetheless "compelled" to submit a bill to the *Riksdag* two weeks before the referendum (Government Bill 1994/95:40). This was essential in order to allow the necessary time for the *Riksdag* to take the requisite decisions before our membership became a *fait accompli*.

502. In this bill, the Government laid down the fiscal policy guidelines to be applied by Sweden in connection with EU membership. The severely strained state of public finances, coupled with the fact that Sweden is among the countries that are net contributors to the EU Budget, made for stringent requirements as part of strict budgetary discipline.

503. The Government also described the flows of funds involved and requirements as to how they should be budgeted, administered, monitored and checked at ministerial and agency level. A summary of the guidelines is included in Annex 1. The Government's priorities in the area of financial control, auditing and anti-fraud measures were also clarified. Moreover, the Government requested from the *Riksdag* the requisite authority to effect payment of the Swedish contribution to the Union Budget, and also to provide capital for the European Investment Bank (EIB) and the Coal and Steel Community (ECSC). This government bill was passed by the *Riksdag* and came to serve as a kind of bible for the officials at the Cabinet Office and the agencies concerned, since the principles presented elucidated important premises as to how the various activities were to be managed in Sweden.

504. Here, two important lessons may be learnt. First, if Sweden were on the brink of membership today, the Ministry of Finance would probably try to embark on the practical preparations earlier, and also urge the other ministries concerned to do the same. Secondly, we would once more opt to present a bill with roughly the same focus and content.

3.3. *Issues Requiring Measures Regarding The EU Budget And Budget Process, Including The Swedish Contribution*

3.3.1. Connection With The National Budget

505. To incorporate EU Budget funds into its national budget, Sweden did not need to implement any legislative amendments for the simple reason that, at the time, no law concerning the national budget existed. However, the National Budget Act that came into force on 1 January 1997 contains no special regulations for EU-related funds paid into or out of the Union Budget, since we found no reason for this.

506. EU funds are budgeted and reported in gross form in the national budget. Grants from the Union, administered by Swedish government agencies, are reported as revenue in the budget, while the payments to grant recipients are included under “appropriations” on the expenditure side. This practice admittedly enlarges the total of the national budget, but it has the advantage of showing clearly how much money is paid into and out of the EU, and for what purposes. It also makes it easier to integrate into the national budget process the commitments ensuing from EU-related activities. Another advantage is that the entire set of regulations governing public financial administration is automatically applicable to the funds entered in the national budget.

3.3.2. National Handling Of EU Budget Issues

507. In order for an issue to be eligible for decision by the Government, the ministry responsible must receive prior approval from the Ministry of Finance and any other ministries concerned. The approval requirement has also served well for EU matters. This means that the views brought forward by the representatives of the government at Council meetings must be agreed in advance. The brief respite often allowed between presentation of proposals and initiation of negotiations (less than one day is not unusual) means that there is sometimes no time for this handling process. But with highly developed interfaces between the ministries and a well-considered basic position on Sweden’s main objectives for the sector concerned, coping even with time limits like this is becoming ever more practicable.

508. Under special decisions, agencies involved in working groups and committees in the Community have also been enjoined to obtain instructions from the ministry concerned. Overall, these measures are highly advantageous since they promote overview at central level and consistent Swedish action. One of the difficulties we still encounter is that of securing knowledge of and influence over the several thousand different working groups and advisory committees linked to the Commission, in which it is often decided which proposals are to be presented by the Commission to the Council.

509. Accordingly, no general responsibility for handling of EU-related issues has been transferred from the ministries responsible to the Ministry for Foreign Affairs. Nor has the latter

ministry been given any superior role in settling matters of principle or other particularly important issues in other ministries' spheres of responsibility. Instead, a special group of under-secretaries of state from the ministries concerned, headed by the Cabinet Office, has been set up to discuss major policy issues. In addition, a unit responsible for more general co-ordination has been established at the Ministry for Foreign Affairs. The tasks of the unit are primarily co-ordination of instructions for the COREPER meetings and co-operation with the *Riksdag*. This co-ordination function is now under scrutiny.

510. One problem remaining is that we have not yet found a sound model of how issues that have not yet been possible to resolve, between the ministries concerned, should be settled when time is limited.

3.3.3. *Instructions To Swedish Negotiators*

511. In principle, every Swedish negotiator in the Council is to be provided with an instruction from the responsible ministry in Stockholm. This instruction should state the Swedish position on the matter and recommend how the negotiator should act. It has proved important for the instructions to state clearly the national objectives for the sphere of activities in question. They should also provide the members of committees and working groups with clear mandates to negotiate, by giving unequivocal priority to Swedish interests and clearly defining the bottom line. This would enable the negotiators to act more constructively and effectively, thereby attaining more. The negotiators' situation is naturally facilitated by their familiarity with the other countries' positions, and also by their attempts to forge alliances with other Member States when joint interests exist.

512. As a basis for instructions on various specialist matters, it is, of course, important for priority to be given early, at the national level, to the issues defined as dominant for one's own country. It should also be clarified which issues are to receive the most attention, and how different sectors are ranked in terms of priority. In this way, the scope for obtaining a hearing is increased. At the same time, the fact that it may be difficult to get such priorities defined at the national level should not be disregarded.

513. Finally, relations with the Permanent Representation in Brussels should be mentioned. The Ministry of Finance has a total of six delegates at the Representation, with two people responsible for issues relating to the budget, financial control and auditing, etc. We have given priority to establishing rapid and direct channels of communication between the responsible officials in the capital and those at the representation, so that both sides are well aware of what is going on at each place. Summing up our experience and aspirations, good co-ordination, speed and timing are crucial for a process to work smoothly and results to be attained.

3.3.4. *Work On The Swedish Contribution*

514. In our view, it is important for work on the contribution to be fully co-ordinated. This co-ordination should take place in the Ministry of Finance. Co-ordination offers an opportunity not only to obtain an overall picture, but also to create a good interface with and interlocutor for the Commission. This makes matters easier for the Commission and the national public administration alike. Work on the contribution has also proved to require highly specific knowledge concerning customs duties, VAT, GNP and financial forecasting.

515. As a result, we have opted to consolidate work on the contribution at the Budget Department's EU unit and, instead of establishing a major function, call in specialist expertise from other departments in the Ministry of Finance and the agencies concerned when necessary. Day-to-day tasks are not beyond the capacity of this organisation to cope well with, although some vulnerability to staff turnover may be involved.

516. With regard to the various types of payment that constitute our own resources in the EU Budget, VAT-based payment is the most complicated and requires new calculations and good statistical documentation. Since there are differences in VAT rates for different product groups, adjustments must be made in the documentation for calculations to provide a uniform basis for all Member States' calculations. It is therefore important to review the methods and statistical data needed, well before the first report on the calculation basis for VAT is submitted. In particular, early contact with the Commission is important here.

517. It is also essential to adjust the system of national accounts in such a way that it can supply the information required to calculate the GNP-based payment. Sweden will not switch to European Standards for Accounting (ESA 95), the system adapted to EU requirements, until 1998. Meanwhile, we must therefore carry out adjustments in the basis of the accounting system.

3.3.5. Payments To The EU Budget

518. Regarding routines for payments to the EU Budget, as already mentioned, it was helpful that we had already transferred funds to the budget during the EEA period. We were able to build further on the model devised in consultation with the Bank of Sweden. Here, it may be noted that the EU regulations permit the Commission's account to be placed in such a way that lending requirements are not affected until an actual payment from the account is made.

519. Transfers to the Commission's account are made by the agency responsible for the state payment system. The agencies in charge of dealing with the various types of payment transfer funds to the agency responsible for the account, which in turn initiates payment to the Commission.

520. The Ministry of Finance is not at all involved in the transfer of the payments. But it of course requires current information about the payments made in order to monitor the development. The information also serves as a base for discussions with the Commission and, not least, for advice to the Minister of Finance due to the payments implication on the national budget.

3.4. Issues Requiring Measures In The Area Of Financial Control, Auditing And Anti-Fraud

3.4.1. Role Of The Ministry Of Finance

521. Although the Ministry of Finance has long been responsible for policy-making concerning financial control, EU membership entailed something entirely new. Indeed, these issues — like those involved in external auditing and anti-fraud measures — tend in the EU setting to be dealt with as special policy areas, although the regulations are to be applied in the various sectors.

522. This fact, coupled with the pre-membership decision by the Government and *Riksdag* that these issues were to be given priority by Sweden, meant placing one person at the EU unit in charge

of handling policy issues in these areas. This responsibility also includes liaison with the Directorate General of Financial Control (DG XX), the Commission's unit for the co-ordination of fraud prevention (UCLAF) and the European Court of Auditors (ECA). All matters connected with individual sectors are, however, normally referred to the ministries and agencies concerned — a fact that is not always appreciated by the Commission representatives, since they would normally prefer to be able to turn to one liaison officer in each Member State.

3.4.2. Division of Responsibility between the Ministry of Finance and Line Ministries, and between Ministries and Agencies

523. Although the Ministry of Finance has overriding policy responsibility for financial management and control, it is incumbent on the ministries concerned to ensure that the principles adopted by the Government are implemented in the respective sectors. This entails a responsibility to ensure that the requisite government decisions concerning responsibility and powers are taken to supplement the EC regulations. These decisions must, of course, correspond to the basic guidelines laid down in Government Bill 1994/95:40. For the Ministry of Finance's part, we examine the proposals drawn up and ensure conformity to the principles adopted.

524. One important principle in Swedish public administration is that the government authority responsible for disbursing public funds should also be fully accountable to the Government for the proper administration and use of those funds. This also applies in cases where responsibility for dealing with individual matters has subsequently been delegated from the central government agency to agencies at regional level. The central agencies are, normally, also responsible for all the work of summarising and reporting to the Government and other interested parties how the funds have been used. Consequently, the paying agencies — those appointed to disburse EU funds — are obliged to ensure that EC requirements regarding management and control are also fulfilled.

525. In Sweden, we opted from the very start to concentrate responsibility for administration of EU subsidies in one central government agency per fund, i.e. four altogether. These four fund agencies have also been charged with dealing with all payments for their respective funds which entails full responsibility for ensuring that the monies are administered and used correctly. The agencies with responsibility for these funds are also accountable to the Government for ensuring that corrective measures are implemented in the event of irregularities. Finally, these agencies are also responsible for all regular reporting to the Government and the Commission including financial accounting, any irregularities, etc.

526. At the same time, responsibility for taking decisions on individual applications for funds has been delegated to central government agencies at the regional level. It therefore follows that the co-operation between the regional agencies dealing with the decisions and the central agencies exercising fund responsibility must work smoothly.

527. Given this division of responsibility, it is the central fund agency concerned that is contacted by the Commission during its inspections on the spot in Sweden. Where checks carried out by DG XX are concerned, the Ministry of Finance is always informed. This is an expression of the Commission's desire to involve the Ministry of Finance as its principal counterpart in Sweden. We pass on information to the ministry concerned and to the National Audit Office, but take no measures of our own.

528. Finally, the Ministry of Finance's co-operation with the line ministries and agencies concerned should be mentioned. Our experience is that it is important that the Ministry of Finance takes a leading role in formulating the Member State's position on proposals and strategic decisions concerning financial management and control and the fight against fraud. At our request, the ministries concerned, as well as the central government agencies in charge of administering EU funds and the National Audit Office have each appointed a correspondent for matters relating to these issues. These officers are normally provided with all proposals put forward and other documents issued by the Commission, and asked to state their views. With the correspondents at the ministries, we agree on proposals concerning Swedish positions and action for the meetings in Brussels.

529. Prior to major meetings with the Commission in which horizontal issues are discussed—e.g. in the group of personal representatives of the Minister of Finance, who assist the Commission in its work on the Sound and Efficient Management (SEM 2 000) programme, or in COCOLAF (UCLAF's advisory committee on anti-fraud measures)—we also sometimes call all the ministries' and agencies' correspondents to a meeting at the Ministry of Finance.

530. Although communication takes place in a manner that is often highly informal, this procedure ensures co-ordinated action on Sweden's part. This is important especially when a proposal from the Commission is discussed in different committees and working groups at the same time. If representatives from the same Member State present totally different viewpoints, it jeopardises not only the confidence in the Member State but also makes the negotiations much more difficult.

3.4.3. Establishing Internal Auditing Functions

531. Council regulations for the various budget sectors require Member States to have functions responsible for financial control. Our interpretation of this term is that it covers an obligation to ensure that systematic internal controls exist in systems, routines and organisations in every sector. It also requires the existence of functions that — independently from the management — check that internal control is effective, i.e. functions for internal auditing.

532. In Sweden there was some form of internal audit by the early 1980s in government agencies, whose independence came to be questioned. These functions were then transferred to the National Audit Office to be used for external auditing instead. However, at some agencies new functions for internal auditing were established at the agency's own initiative.

533. Nevertheless, in 1994 the government decided to introduce a mandatory requirement that professional and independent internal auditing functions be set up at the government agencies in charge of large sums. The imposition of this requirement coincided well with the commencement of Sweden's membership, and it was therefore decided that all the agencies that administered large-scale funds from the EU Budget were to be subject to the requirement. These regulations are contained in a special ordinance on internal auditing at government agencies.

534. Under this ordinance, Sweden was also better equipped when the Commission's Directorate General of Financial Control (DG XX), in its Financial Protocols, took the initiative for formalised co-operation between internal auditors who examine the area of Structural Funds in the Commission and in the Member States. To date, agreements have been concluded with roughly half the Member States. These agreements vary in content and nature, since they are adapted to national conditions. However, they all contain agreements to share audit findings, co-ordinate audit plans and participate

in joint audits. Objectives and the basic methods used in the internal audit (based on generally accepted international auditing standards) are also specified.

535. For Sweden, where internal auditing is linked not to the ministries but to the central government agencies, it was natural for the heads of the internal audit divisions at the agencies concerned to be the parties to the agreement. Three identical protocols were therefore signed in autumn 1996 by the heads of the internal audit divisions at the three central agencies in charge of administering the regional development fund (ERDF), the social fund (ESF) and the agricultural guidance and guarantee fund (EAGGF) respectively and by the Director-General of DG XX. An identical agreement is also to be drawn up for the fisheries fund (FIFG) once internal auditing has been established at the agencies responsible.

536. Member States are subject to no formal obligation to enter into co-operation agreements with the Commission. However, all Member States consider it advisable to do so, and this resulted in a recommendation from the ECOFIN Council and the European Council in December 1996, urging the Member States that had not yet signed agreements with the Commission to do so as soon as possible.

3.4.4. Giving The Court Of Auditors A Liaison Function In Sweden

537. External auditing must be conducted independently both at national level and in the EU. Accordingly, the Ministry of Finance had no specific measures to implement in the area prior to membership, with one exception. Article 188c of the Treaty on the European Union states that the European Court of Auditors' (ECA) examination on the spot in the Member States shall be carried out in liaison with the national audit bodies. Since there are two audit bodies in Sweden, the National Audit Office and the Parliament Auditors, we saw a need for this task to be clearly assigned to the former owing to its status as the supreme audit institution in Sweden. This has been done by means of a supplement to the Office's directives.

538. We have also found that, in its audits, the European Court of Auditors has broader powers than those enjoyed by our national auditors, since the ECA — pursuant to a clause in the Financial Regulation — is entitled to audit the grant recipient's accounts on the spot. This issue is being dealt with in the Ministry of Finance. It is a reasonable premise that the national audit bodies should have powers as extensive as those of the ECA. If this is to be the case, it means that a special statute must be introduced.

3.4.5. Setting-Up Of A Committee For National Anti-Fraud Measures

539. In Sweden, the issue of fraud and other irregularities received attention at an early stage. The demand was made that anti-fraud measures must be implemented at EU level. We also perceived a need to create a horizontal organisation at national level that would consistently work to promote national measures in the area. In spring 1996 the government therefore established the EU Anti-Fraud Committee, with representatives from each governmental agency that administers EU funds on a large scale, the National Tax Board, the National Audit Office, the police, prosecutors and judges, and the ministries concerned.

540. The committee chairman is from the Ministry of Finance. The committee is charged with promoting co-operation between ministries and agencies, especially between administrative agencies

and the judicial system. It also has the task of providing information on developments in Sweden and the measures to be implemented. The committee may also propose measures, where necessary, to strengthen the Swedish capacity to protect Community funds. Accordingly, the requirement of the EU Treaty that EU funds should be protected in the same manner as national funds, and the decision of the European Council decision in Madrid in 1995 that protection of EU funds should be equivalent for all sectors throughout the Union are important premises for the committee's work. Co-operation with the Commission's anti-fraud unit (UCLAF) is also included in the committee's duties, but not where specific cases are concerned since these are the responsibility of the agencies with operative accountability.

541. To date, our experience has been that the committee has actively helped to strengthen protection of the Community's financial interests in Sweden. The need for the committee may possibly diminish after some years, when the systems have stabilised and evident shortcomings have been remedied, but so far our experience has been entirely favourable.

542. Sweden has still not heeded the Commission's wish that a special, horizontal organisation be set up for operative investigations in cases of suspected fraud. However, a new agency to deal with economic crime is being formed in Sweden, and it is entirely possible that this agency may be capable of filling this need.

3.4.6. Monitoring Of Swedish Implementation

543. At the Ministry of Finance we have been anxious to obtain verification that the administration of EU monies fulfils the stringent requirements that apply. Accordingly, the Government has charged the National Audit Office with examining the existing systems in the area of Structural Funds, and with submitting proposals for possible improvements. The Office had already, at its own initiative, carried out an examination of this kind for the EAGGF-Guarantee Section. The EU Anti-Fraud Committee has also surveyed whether the agencies concerned have the requisite regulations and powers, so that appropriate measures can be taken in the event of irregularities.

544. In these investigations, it has emerged that there are still certain shortcomings. This has resulted in measures being taken by the Government and the ministries concerned. Other shortcomings are still under consideration. Our experience is that it is in the Ministry of Finance's interest to push for investigations of this kind to be carried out, in order thereafter also to monitor the implementation of measures.

4. Some Lessons From The Various Sectors

4.1. Customs Duties And Other Levies

545. In the customs sector, several major inquiries into the consequences of membership were carried out. One fundamental idea was that EU membership would automatically mean that the Swedish customs organisation could be trimmed down when we joined the customs union of the single market. This was the aim, although it was realised that membership would entail the adoption of several new customs duties. When it became clear that Norway was not to join the EU, the scenario was transformed since Sweden then became responsible for controlling one of the EU's longest frontiers with a non-EU country, both at sea and on land.

546. Regarding practical issues, such as accounting and payment to the EU of the duties collected, a remarkable spurt was achieved in autumn 1994 to enable Sweden to meet Community requirements from day one, i.e. 1 January 1995.

547. Our experience is that, in the preparatory work, we devoted insufficient attention to the altered situation ensuing from the fact that Sweden borders on a non-EU country, and the control requirements stemming from this situation. All the technical issues that had to be solved in connection with accounting of customs duties collected and payments made could also have received attention earlier.

4.2. *Agriculture*

548. The Ministry of Agriculture, with its central government agency the Swedish Board of Agriculture, was in the vanguard of preparations for membership. The Board presented a report at the end of June 1994 that also covered issues of how administration should be arranged, which requirements were being imposed on payments, accounting and control systems, etc.

549. At the Ministry, drafting was underway of the national statutes and ordinances that would be required in order for Sweden to be able to implement the EC's regulations in the farming sector. Difficulties were encountered as a result of wide-ranging and complex rules, coupled with the fact that no major decisions could be taken before the referendum. On the agency level, one major challenge was to create a large number of computer systems needed for the implementation of the CAP. The time and resources for this task was clearly underestimated.

550. In conclusion, some reference should be made to the new system for clearance of accounts for the EAGGF–Guarantee Section. Only a limited number of agencies in each Member State are permitted to disburse grants. These paying agencies must fulfil a series of specific requirements regarding financial control, etc., before they are given authority to make the payments.

551. Advance checking that the requirements are met must be carried out by an organisation appointed by the Member State. Sweden opted to appoint the Ministry of Agriculture to be the accrediting body. The Ministry takes the decision on the basis of documentation from the agency, supplemented by an auditor's certificate from the National Audit Office verifying the correctness of the information supplied by the agency. The latter was a prerequisite for the Ministry of Agriculture as it does not have any information of its own which could verify the information from the agency. The new system also contains requirements that the annual accounts for EAGGF be examined by an independent auditor at national level. The National Audit Office was appointed as the certifying body, since this task of examination largely corresponds to the work carried out in the course of the regular annual audit.

4.3. *The Structural Funds*

552. The Structural Funds are characterised by a mix of requirements concerning national administration, stated in Council regulations, and of bilateral agreements concluded between the Member State and the Commission in what are known as Single Programming Documents (SPDs). Each programme rests on the objectives laid down for the Structural Funds. The programme approach necessitates national preparations in close liaison with local and regional representatives. In Sweden, it was decided that project applications for each programme should normally be dealt with at regional

level. In several cases, however, there was deemed to be no existing organisation that, on an adequate regional and local basis, was suitable. This culminated in the setting-up of a series of “decision-making groups”, linked to the various programmes, with the task of examining and deciding on the various grant applications.

553. In the Council’s regulations, one manifestation of the partnership approach has been demands for special monitoring committees. The function of these committees is to monitor and evaluate whether the programmes are achieving the objectives adopted. The committees also have a certain right to redistribute funds between different projects and programmes in relation to the decisions originally taken by the designated authorities. Although some decision-making responsibility has been given to the committees, this has not curtailed the requirements of Member States’ responsibility for ensuring that the funds are used for the correct purposes.

554. Issues relating to financial administration, checks, responsibility for measures in the event of irregularities, etc., were initially overshadowed, resulting in implementation based on much greater uncertainty than, for example, in the agricultural sector. We can still see the consequences of this in the fact that the requisite provisions relating to the obligations and powers of designated authorities in relation to the regional decision-making groups have not yet been incorporated into the national regulations.

Annex 1. The Swedish Budgetary And Auditing System

1. The Structure Of Swedish Public Administration

555. Public administration in Sweden differs in certain respects from that in most other countries. By tradition, we have comparatively small government offices (some 2 000 employees, excluding the Foreign Service) and free-standing — in some measure independent — administrative agencies. Another typical feature of the Swedish administrative model is its emphasis on the government's collective responsibility.

556. The Swedish *Riksdag* (Parliament) passes all statutes affecting private individuals. Moreover, it is incumbent on the *Riksdag* to resolve on public expenditure and revenues, and also the disposition of the state's net assets. The Government submits proposals to the *Riksdag* in the form of bills. If the Government is solely to submit a report to the *Riksdag*, without any proposal, this is done in the form of an official letter to the *Riksdag*.

557. The Government is responsible to the *Riksdag* for ensuring that state activities are conducted in an efficient and correct manner. Day-to-day administrative work is managed by public administrative agencies which, on their own responsibility, execute the *Riksdag*'s and Government's decisions. The administrative agencies' links with the Government are mediated by the ministries concerned, but the agencies are subordinate to the Government as a whole. The Government's authority to issue directives for an administrative agency is possessed by the Government as such but not by individual cabinet ministers (i.e. not ministerial rule).

558. In formal terms, the Government has far-reaching powers to control the agencies' activities through its decisions. Public administrative agencies are nevertheless assured by law a certain independence vis-à-vis the government. This applies to decisions in matters involving the exercise of official power over an individual or local government authority or relating to the application of law. In such matters, the Government may not interfere with the manner in which an administrative agency decides on an individual case.

559. Furthermore, the Government has in many respects refrained from imposing detailed regulations on individual agencies. The relationship between the Government and the administrative agencies is, instead, characterised by the agencies' strong, independent position in relation to the Government. This is manifested in, for example, the fact that the administrative agencies have largely been entrusted with the task of drawing up detailed regulations for their own respective sectors within the framework of enabling legislation passed by the *Riksdag*. This independent position is also reinforced by the fact that all communication between the Government and the agencies is public — a tradition of many years' standing in Sweden that is valued as a great strength in public sector activities. This is also an important issue for Sweden in its co-operation with the EU.

560. There are roughly 200 central administrative agencies. These agencies' functions and the principal features of their organisation and working methods are regulated in official instructions

decided upon by the Government. Each agency has its own official instructions, which are issued in the form of an ordinance. The Government also has other instruments of control, such as special government decisions and directives, and also the right to appoint agency heads, certain other senior executives and agencies' governing boards.

561. The financial management system is characterised by the fact that the agencies have been given extensive freedom to decide on the detailed nature of their own work, in organisational and financial matters alike. Simultaneously, an agency's management is directly responsible to the Government for ensuring that activities are conducted efficiently and in accordance with current regulations. This responsibility is a matter of ensuring, first, that the payments mediated by the agency are correct and its funds have been used for the appointed purpose and, secondly, that mistakes, acts of deception and inefficiency within the agency's sphere of activities are remedied.

562. The administrative agencies have no general statutory authority to issue regulations. The regulations issued by the agencies originate in authorisation specially decided upon by the government, usually in the form of an ordinance.

563. Under the central administrative agencies there are, in many sectors, regional and local agencies. In these cases, the central agency has the overriding responsibility for activities. The customs sector is one example of this. In each county, there is also a central government agency, the county administrative board, that bears responsibility for co-ordinating public-sector activities in the county. The county administrative boards engage in regionally oriented activities for which a central administrative agency often bears primary responsibility. They also follow up and evaluate inputs in various sectors of society.

564. In addition, there are local government authorities or municipalities (numbering 288 at present) and county councils (23) at local and regional level. Their independence, including their right to levy taxes on citizens, is pursuant to the Swedish Constitution. The local authorities are in charge of services of a more technical nature, such as the provision of electricity, streets, transport services and physical planning. They are also responsible for education, care of children and the elderly, and other social services. The county councils are responsible for health and medical care.

2. The Budget System

565. On 1 January 1997 Sweden will adopt the calendar year as its fiscal year. In conjunction with the 1997 budget, several novelties will be introduced that are all aimed at bringing about improved fiscal discipline. The preparation of the budget with effect from the 1997 budget will take the following form:

- In April, the government will present to the *Riksdag* a bill on economic policy for the forthcoming fiscal year, with "fiscal updates" relating to the current fiscal year.
- This will include guidelines for economic policy and also the Government's proposed ceilings for public expenditure over the years ahead. On the same occasion, a supplementary budget will be presented for the current fiscal year.
- In September, the budget and finance bill will be presented, with detailed proposals regarding revenues and expenditure for the fiscal year. The bill will include accounts of the central Government's assets and liabilities. Spending will be broken down among the

areas of expenditure decided upon by the *Riksdag*. Each proposal will be related to results attained in the area.

- The *Riksdag* will process the budget bill in two phases. In phase one, the *Riksdag* will, in a special resolution, determine the level of spending in each of the 27 areas of expenditure. The sum must be within the scope of the expenditure ceiling decided upon in the spring. In phase two, decisions will be taken on the objectives and distribution of each appropriation.
- Once the *Riksdag* has passed the budget, the Government will issue directives to all the agencies. These directives will contain the objectives and performance requirements that the Government considers the agency should attain during the year. They will also define the financial frames provided for the agency in the form of appropriations, etc.
- The *Riksdag* and Government have, to a large extent, delegated to agencies themselves the task of deciding, within the framework of resources allocated, how their funds are to be used and activities organised. In order to create financial incentives favouring sound financial management, the agencies have been granted the right to save or borrow certain amounts from the subsequent year's running-cost appropriation. Since these funds are subject to interest, economisation is rewarded, while loans entail interest costs. Grant and tax-collection funds are, however, managed in a more traditional manner since they are usually wholly governed by law. These appropriations, too, must fall below the expenditure ceiling decided upon, and these funds are therefore also subject to spending checks.
- The agency will give an account of the outcome — both financial and otherwise — of its activities in a formal annual report to the Government. The financial part of the report will cover all funds received or mediated by the agency, irrespective of financing source. Similarly, the performance report will contain information on all activities for which the agency is responsible, irrespective of financing source.
- In the course of the fiscal year, a number of fiscal updates will be made, calculated on forecasts for the final budgetary outcome. It will be incumbent on the ministry concerned to find financing for any excess expenditure, by reassigning priorities between different areas of expenditure or by altering regulations.

566. All in all, these features represent a massive tightening-up of the regulatory frameworks for both the *Riksdag*'s and the Government's budgetary work, since the work of budget preparation:

- focuses on the overall level of expenditure for the whole public sector;
- commences with assessment of the general objectives and is then, only after spending levels have been fixed, succeeded by sectorial discussions;
- concentrates on expenditure instead of the budget deficit, which was formerly more the focus of fiscal policy; and
- entails a more stringent follow-up of the expenditure trend, with compensatory measures required if the trend is negative.

3. The Financial Control And Audit System

567. The Swedish administrative model encompasses a uniform control structure for the whole of public administration. This is applied in the same way for both national funds and those linked to the EU's Budget.

568. The agencies responsible for activities must carry out follow-up, checking and supervision to ensure that activities are conducted in accordance with current regulations and that funds are used in a correct and efficient manner. This applies both to national funds and to funds derived from or intended for the Community Budget.

569. Special functions for internal auditing at most of the major agencies examine the quality of the agencies' internal checking and financial accounts. Provisions on the internal auditing of central government agencies are contained in a special ordinance. Internal audits are carried out in accordance with approved accounting principles based on international standards, independently both from the management and in relation to executive staff. The internal audit yields a report to the agency's board of directors, who then resolve on measures prompted by the observations of the audit. The internal-audit reports are available for external auditing. Before the auditing plan for the internal audit is decided upon, consultation takes place with the external auditing agency, the Swedish National Audit Office (RRV).

570. RRV conducts external, independent audits and is responsible for both annual auditing of accounts and the management's administration and efficiency audits of central government activities. RRV examines all public agencies, a large number of state-owned enterprise and foundations, and also activities conducted by the central government in general. Where companies and foundations are concerned, RRV appoints additional auditors alongside those elected by the annual general meeting of shareholders (AGM), and is also empowered in certain cases to carry out efficiency audits. The auditor appointed by the Office performs his work in co-operation with the auditor(s) appointed by the AGM, and they are jointly responsible for the focus and execution of the examination and the statement on the accounts and administration. This procedure was resolved upon by the *Riksdag* in 1993 for the purpose of strengthening the audits of these companies and foundations.

571. RRV reports to the relevant organisations and to the government. The Office examines (in the same way as for national funds) the use, control and accounting of funds pertaining to the Community Budget. It also assesses the efficiency with which commitments are carried out. RRV's reports are public. Proposals are currently being prepared to augment RRV's scope for obtaining access to information on and from final recipients of funds from the Community Budget or corresponding sources. RRV is also obliged, under Article 188c of the Treaty of Rome, to assist the European Court of Auditors in its examinations in Sweden.

572. The annual audit concludes with a statement in the form of a formal audit opinion. Here, RRV expresses its views both on whether the agency's annual report as a whole is true, i.e., reliable, comparable and correct, and on the agency management's administration. The audit opinion is submitted to the government. If RRV has presented a qualified report or otherwise pointed out grave deficiencies, the agency examined must, in an official communication to the Government, report on what has happened and what it intends to do to eliminate these deficiencies.

573. The Government in turn must, each year, submit an account to the *Riksdag* concerning what measures the government has taken in response to RRV's observations. The shortcomings identified by RRV invariably receive a great deal of attention in the media and from politicians. It is, for

example, not uncommon for the *Riksdag* standing committee concerned to arrange hearings attended by the agency in question, RRV and the minister in charge. RRV also, when so required, delivers special audit reports to the agency's board for remedial action.

574. Within the framework of its efficiency auditing, RRV carries out 20 major examinations a year. RRV is entirely free to choose its area of examination. The emphasis is on assessing the efficiency with which the central-Government commitments are implemented, but RRV may also pronounce its opinion on these commitments as such. RRV carries out both audits of large-scale public commitment, e.g. of efficiency in various parts of the social-insurance system, and audits concerning fulfilment of objectives and efficiency in individual activities. These reports are normally delivered to the agencies concerned and the government.

575. The agencies' boards of directors are obliged to consider RRV's report, and RRV normally requests that the agency furnish it with an account of the measures being undertaken. RRV's reports are often included in documentation for public inquiries or for the preparation of government resolutions. These reports too, are often given a great deal of attention in the media.

576. RRV may also carry out examinations on behalf of the Government, but can decline such a commission if there is a risk of it encroaching on RRV's independence. One example of a government commission recently completed by RRV related to the extent of fraud in the systems of cash labour-market assistance and social insurance.

577. The Parliament Auditors constitute the *Riksdag*'s auditing body. The Auditors are politically appointed members of the *Riksdag*. The work of examination is largely carried out by office staff. Under the law governing the work of the *Riksdag* Auditors, they can examine all state activity, including the Government's work, and report direct to the *Riksdag*. Funds derived from or destined for the Community Budget are included in their examination on the same basis as entirely national funds. The examinations are conducted largely in the same way as RRV's efficiency audits.

578. Finally, the Swedish committee system is worth noting. Every year numerous commissions of inquiry, with or without parliamentary representation, are appointed. Their task is often to evaluate the outcome of activities or regulatory systems in a particular area. In 1994 a general directive was adopted for all the committees to the effect that a committee must, as its initial task, assess the reasons why the state should be involved in the activity at all. Moreover, the committees are obliged not only to calculate the financial consequences of their proposals, but also to propose means of financing them. A committee may not conclude its work until it has fulfilled these obligations.

4. National Control And Checking Of EU—Related Funds

579. In December 1994, the *Riksdag* adopted the guidelines that are to apply to Sweden's administration of EU-related payments and grants, and also to how EU funds are to be protected from unauthorised or inefficient use. These guidelines are entirely based on the principles laid down in Article 209a of the Treaty of Rome. The guidelines may be summarised as follows:

- High priority is given to monitoring the efficiency of, and checking adherence to, EU regulatory frameworks. Swedish national checking and auditing inputs are being increased.

- Both Swedish payments to the Community Budget and the reverse flow, from the Community Budget to Sweden in the form of grants and structural support administered by the state, are budgeted and reported gross in the Swedish government budget.
- EU funds administered by Swedish central government agencies are regarded as state funds and are subject to the same provisions regarding responsibility, reporting, follow-up, financial control and auditing, and also the same systems of sanctions. This means that the annual reports of the agencies responsible include EU-related activities, and that the management of funds is subject to the same auditing by the National Audit Office (RRV) and the Parliament Auditors as national funds.
- To the extent that EU law imposes special requirements in these respects, e.g., regarding reporting and checks, the agencies responsible must satisfy EU requirements over and above national requirements. Generally speaking, the national regulations have been found to tally well with the provisions in the EU regulatory frameworks.
- As few agencies as possible are to be responsible for disbursing EU-related funds. Besides internal checking functions, they must also have functions for internal auditing. The quality of their checking inputs and internal audits is also subject to RRV's examination.
- There is to be a co-ordinating agency in each sector that continuously monitors performance in the sector and exercises supervision of the correctness of payments and how they are entered in the accounts. This responsibility also includes working for measures to be undertaken if deficiencies or opportunities of raising efficiency are identified. This is particularly important in sectors where two or more national agencies collaborate.
- It is incumbent on each relevant sectorial agency to co-operate with other EU Member States and the Commission to protect the Communities' financial interests. In addition, a special governmental committee is being set up with responsibility for co-ordinating national anti-fraud efforts on the part of the agencies and ministries concerned.

Annex 2. Some Additional Data

580. This annex consists of some additional data on the financial flows between Sweden and the EU, the administrative consequences of the Swedish membership and an organigramme describing how the Ministry of Finance is organised.

1. Transfers Of Payments Between Sweden And The EU

581. The following amounts are calculated to be paid to and from the EU Budget during the budget year 1997 (in 1 000 SEK). Potential grants from the EU Budget for research, TEN's, etc. are not included as they are based on contractual bilateral agreements.

| Payment to the EU — The Swedish Contribution | 20 525 000 (ca. 2 500 mecu) |
|---|------------------------------------|
| - Custom duties | 3 230 000 |
| - Agriculture levies | 570 000 |
| - VAT-based payment | 8 215 000 |
| - Fourth resource (BNI= <i>Gross National Product</i>) | 8 510 000 |
| <hr/> | |
| Revenues from the EU | 9 225 000 (ca. 1 100 mecu) |
| <hr/> | |
| <i>EAGGF Guarantee section</i> | 6 074 000 |
| - Per hectare aid and set-aside support | 3 740 000 |
| - Environmental support | 766 000 |
| - Intervention | 400 000 |
| - Export refund | 350 000 |
| - Animal products | 818 000 |
| <i>Structural Funds</i> | 2 515 000 |
| - EAGGF Guidance section | 365 000 |
| - FIFG | 100 000 |
| - ERDF | 800 000 |
| - ESF | 1 250 000 |
| <i>Compensation (temporary reduction)</i> | 636 000 |

2. Administrative Resources Needed To Handle The EU Requirement

582. As the EU-related operations are administrated as an integral part of the national operations, it is not possible to identify the administrative costs directly related to the Swedish membership. Neither is it meaningful to draw far-reaching conclusions from any figures as they depend heavily on the current national situation regarding existing national operations, organisation and priorities, and also on geographical and demographical circumstances.

583. However, in order to give a picture of the effects of the EU membership on the state sector, a survey was made in 1996, based on inquiries sent to ministries and agencies (*Statskontoret* 1996:7). The result of this survey may give an indication of the administrative costs.

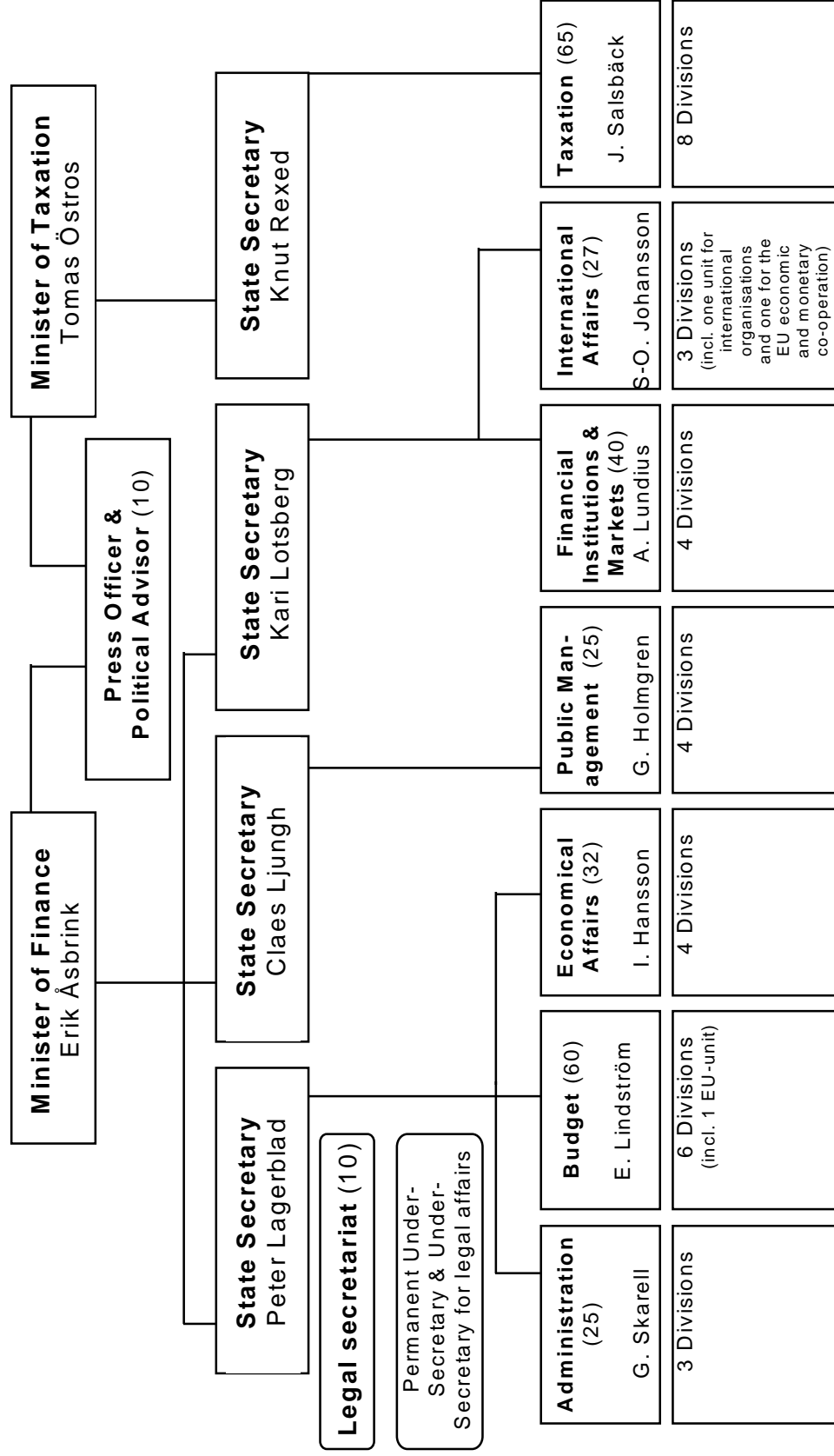
584. The inquiry included some questions on the need of resources:

- Half of the 13 ministries estimates that they devote between 20-39 per cent of their working-hours to EU-related issues. Four ministries estimates their time spent to be under 20 per cent, meanwhile two ministries are intensively engaged in EU-related work. These two, the Ministry for Foreign Affairs and the Ministry of Agriculture, states that 75 per cent respective 90 per cent of their time is devoted to EU matters.
- When it comes to numbers of employees, one ministry has not recruited any new staff due to the EU membership, seven ministries have recruited between 1-4 extra staff, two ministries 5-9 staff and three ministries over 10 new staff. As comparison, it should be mentioned that the total number of staff in the Cabinet Office is about 3 600, of which 1 400 belongs to the Ministry of Foreign Affairs. From experience about 15 per cent are on leave.
- All ministries stated that they would need more resources for producing instructions to Swedish representatives, and also for participating in meeting in Brussels. Half of them also feels a need to devote more resources to legislative work. Equally, a majority of the ministries states that they need to strengthen their competence in the area of negotiation skills, investigatory work and legal support.
- 78 agencies on the central and regional level replied the inquiry. 85 per cent of them states that they do not keep their accounts in a way that makes it possible to identify the costs related to EU operations. Instead, they have estimated how much of their running costs is spent on EU-related work. The majority estimates that the costs falls below 5 per cent of their total administrative costs. Only 8 of the 78 agencies estimates that the EU costs exceeds 20 per cent.
- 15 agencies do account for the administrative costs for EU-related work separately. Eight of them states that the costs exceeds SEK 1 million.
- 39 agencies state a great demand for additional resources to cope with the new tasks related to the EU. These are primarily needed for investigations and participation in meetings. A majority of these agencies also believes that they need increased competence in several areas, where the most important ones are language skills, negotiation skills, legal competence and investigatory competence.

585. The inquiry also included questions on the ministries and the agencies participation in working-groups and committees in Brussels (EU institutions):

- The Ministries of Finance, Industry and Trade, Agriculture, Justice and Communications are the ministries which participate in most working groups and committees in Brussels. The Ministry of Finance and the Ministry of Justice participate in about 20 Council working groups. The Ministry of Agriculture participates in over 100 committees connected to the Commission.
- A majority of the agencies (57) states that their staff participates in expert committees under the Commission, followed by participation in management committees (35) and Council working groups (26). Nineteen of the agencies say that their staff participates in all kinds of meetings. The majority of them within the Ministries of Environment, Agriculture, Communication and Industry and Trade.
- Only a few agencies state that their staff participates in more than five working groups and committees. But the majority of the agencies says that they participate in meetings in Brussels at least once a month.

Ministry of Finance of Sweden



UNITED KINGDOM
By Nicholas Ilett¹⁹

19. Nicholas Ilett is Head of European Union Finance in HM Treasury. He is the United Kingdom “Personal Representative” on the Commission’s Group on SEM 2 000. Mr. Ilett’s previous Treasury appointments have included local government finance, financial regulation and a posting to the United Kingdom Permanent Representation in Brussels.

1. Chapter Summary

586. In the United Kingdom, the Finance Ministry (Treasury) plays a strong central role in public finance, but responsibility for financial management of public expenditure, including expenditure financed by the EC Budget, is delegated to spending Ministries.

587. Spending Ministries are accountable to Parliament for the legality, propriety and value for money of their expenditure.

588. There are special arrangements for contributions to the EC Budget required by Treaty to be paid automatically, i.e. without specific Parliamentary authority.

589. Expenditure financed by the EC Budget is handled in the same way as national expenditure, though there are some special administration and control bodies.

590. Arrangements for the integration of United Kingdom transactions with the EC Budget into the national budget are designed to make the flows involved as transparent as possible (particularly the United Kingdom net contribution) and to promote efficient resource allocation and budget discipline across both budgets.

591. In Community discussions, the Treasury pursues strategic interest in the areas of EC Budget discipline and financial management. It also pursues strategic interests in policy areas with significant financial or economic implications (for example, policy reform and the Inter Governmental Conference).

592. Careful attention needs to be given to organisation of EU work within Finance Ministries, to training and development, and to relations with other Finance Ministries.

593. The EC's Financial Management Reform Programme (SEM 2 000) is moving the Community's financial management arrangements towards greater delegation, accountability of spending units, and partnership between the Commission, and the Members States who spend most of the EC Budget. By the time of the next enlargement, EC financial management requirements are likely to be more demanding than at present.

2. Introduction

594. This paper discusses the inter-relationship between United Kingdom public finances and those of the European Community. Since it is now more than 25 years since the United Kingdom joined the EC, the paper does not describe in detail how United Kingdom systems were adapted on joining. Rather, it highlights the main issues which now arise, and how we deal with them, largely from the perspective of the Treasury (Finance Ministry).

3. The National System In The United Kingdom

595. In order to explain how United Kingdom systems have adapted to reflect EU membership, it is necessary to describe the basic elements of United Kingdom systems. It is important to understand that arrangements in the United Kingdom are effective because of the way in which the different parts of the system interact, rather than to look at individual parts of the system in isolation.

4. The Relationship Between Parliament (*For These Purposes, The House Of Commons*) And The Executive (*The “Crown”*)

596. On the revenue side of the budget, all taxes are voted by Parliament. This principle dates from the 13th century, was confirmed by the Civil War between Parliament and the King in the 17th century and led to the American War of Independence in the 18th century (taxation of American colonists unrepresented in the Westminster Parliament).

597. On the expenditure side of the budget, Parliament authorises (“votes”) nearly all expenditure on an annual basis. It can in principle refuse or reduce expenditure proposed by the Government, but cannot increase it. (In practice, a Government without control over the House of Commons would not continue.)

598. Parliament oversees the administration of public finances closely, with the help of the National Audit Office whose Head is an officer of the House of Commons. Ministers are politically accountable to Parliament.

599. Permanent officials designated as Accounting Officers answer personally to the Public Accounts Committee (PAC) of the House of Commons for the legality, propriety and value for money of their Departments’ expenditure. Accounting Officers are generally the most senior permanent officials in Departments. If an Accounting Officer is asked to do something which he or she would not be able to defend to the Public Accounts Committee as representing good value for money, he or she should seek an instruction from the Minister before proceeding. This is reported to the Treasury and the National Audit Office (NAO) and may lead to an NAO report to Parliament which could stimulate political discussion. The responsibilities of an Accounting Officer are so important that much of the time of the most senior officials is spent on financial management matters.

5. Relationships Within The Executive

600. Virtually all central Government revenue is collected by specialist departments which report to Treasury Ministers and is centralised in accounts under Treasury control. This includes those own resources of the EC which are collected in the United Kingdom. The Chancellor of the Exchequer

(Finance Minister) decides on taxation policy in consultation with the Prime Minister but by convention without consulting other Ministers.

601. The Treasury has a legal identity distinct to that of all other departments²⁰, and enjoys strong legal, customary and administrative powers over central government expenditure. In particular:

- the Treasury must agree to *all* expenditure (this is additional to the basic requirement for Parliamentary approval). In practice, the Treasury exercises this control in a strategic manner, giving widespread delegated authority to spend. The Treasury will take a close interest in any proposals which are novel or contentious even where only small sums are involved;
- the Treasury can request whatever information it sees fit about spending and about policies with spending implications;
- no proposal involving spending may be put to the Cabinet for collective ministerial discussion unless the Treasury has agreed the analysis of the financial implications;
- the Treasury is in charge of public expenditure planning as well as of revenue planning;
- only the Treasury may formally seek Parliamentary authority to spend (via “estimates”).

602. In practice, this implies that the Treasury has an important influence in virtually all policy issues handled by the Government. It is equipped to carry out these functions and other departments are accustomed to the need to maintain a close dialogue with the Treasury.

603. However, under the United Kingdom system, spending departments are accountable for the use to which they put the resources which they are allocated. The Treasury does not have a “financial control” function in the sense of DG XX in the European Commission or of the Financial Controllers or Inspectorates of some other countries. Nor are Treasury officials located within spending Departments.

604. The Accounting Officers of spending departments are assisted by finance staff under a Principal Finance Officer (a key senior official with both management and policy responsibilities) and by their internal auditors.

6. The Consequences Of EU Membership

6.1. Financial Implications

605. Membership of the EC has significant financial implications for the United Kingdom. Our gross contribution net of the United Kingdom abatement is around 1.1 per cent of GDP and 2.5 per cent of general government expenditure (GGE). Our net contribution is around 0.5 per cent of GDP and 1.3 per cent of GGE. This has been a subject of acute political and public interest since we joined the Community; particularly because until the United Kingdom abatement was agreed in 1986, the United Kingdom’s net contribution was quite disproportionate to the United Kingdom’s relative wealth. Even today the United Kingdom’s net contribution is greater than our relative wealth would justify. One reason for these difficulties is that the United Kingdom receives the lowest EC spending by head of any of

20. The Chancellor of the Exchequer (and indeed the Prime Minister, whose formal title is First Lord of the Treasury) technically exercise the powers of the Treasury. Other Ministers exercise the power of the Secretary of State.

the 12 long-standing Member States (i.e. excluding those who joined in 1995, for whom steady-state figures are not yet available).

606. Partly because of the degree of political and public interest, United Kingdom systems for dealing with the public finance consequences of EU membership are designed to maximise transparency and so far as is possible to strengthen financial discipline within the EC.

6.2. *Technical Implications*

607. EU membership has implications for revenue collection, for expenditure management (budget “execution”) and accounting, and for national budget planning (revenue, expenditure and the fiscal stance).

608. When the United Kingdom joined the EC, we had therefore to make arrangements which fitted both the United Kingdom systems described above and EC requirements. Subsequently, we have had to make further changes to meet developments in the Community’s rules. Yet further changes can be expected, particularly in the context of the Financial Management Reform Programme (SEM 2 000) which the United Kingdom strongly supports.

6.3. *Revenue Side*

609. First, and most important, joining the Community meant taking on a Treaty commitment to pay contributions to the Community as required by Community law. The European Communities Act 1972 therefore empowers the Treasury to pay contributions direct to the Commission, without a specific Parliamentary procedure, where the demand to pay is lawful. In other words, the principle described in section 4 above, that Parliament votes expenditure annually, has been set aside for contributions to the Community Budget.

610. The Treasury therefore takes great care to ensure that demands for payment are correct. It has occasionally sought special Parliamentary authority to pay where there was doubt about the lawfulness of a particular demand. The Treasury also publishes information about the EC Budget, and particularly United Kingdom contributions and receipts, on a regular basis. And, critically, the Treasury provides the United Kingdom Parliament with a mass of information about EC finances to assist the very important United Kingdom Parliamentary scrutiny process. Treasury Ministers conduct several Parliamentary debates on the EC Budget and related issues (such as Court of Auditors reports) each year.

611. Second, national tax authorities assumed responsibility for the collection of the traditional own resources (customs duties, sugar and agricultural levies) effectively on behalf of the Commission. This involves respecting complex Community rules which do not always sit easily with national procedures or appear cost-effective. This can lead to disputes—usually about whether national authorities have been negligent or whether the rules have been properly applied—and sometimes to demands on the Member State to make good on losses.

612. The operational relationship between national tax collectors and DG XIX needs careful management. Our experience is that the Commission is driven by the understandable concern to be seen to enforce the rules equally across the Member States and to reflect the letter of the law. This allows less room for discretion than our national tax collecting authorities would normally expect to exercise, for example in cases of possible administrative error or where there are disproportionate administrative costs or economic consequences. There can also be difficulties where a debtor also owes tax to national Government and a balanced judgement has to be struck about the best way to handle the dossier.

613. Issues of a similar kind can also arise with VAT, even though Member States' obligation is to pay a sum based on a statistical calculation rather than actual VAT receipts.

614. Payment to the Commission of own resources is handled centrally by the Treasury. This minimises the risk of error which could lead to penalties, and ensures that the Treasury learns of contentious issues. It also assists the Treasury in forecasting the volume and timing of contributions to the Community. This is an important element in national budgetary planning (see section 7.2 below).

6.4. Expenditure Side

615. On the expenditure of the national budget, the vast majority of agricultural and Structural Funds receipts are routed through United Kingdom Departments to the ultimate beneficiary, for example farmers or local Government. The Departments handling this money are responsible for it in exactly the same way as for national money, i.e. it must be voted, their Accounting Officer must account for it, the National Audit Office audits it, and the Public Accounts Committee of the House of Commons will summon the Accounting Officer to explain any shortcomings.

616. In addition, expenditure from the EC Budget is subject to Community rules and to inspection, audit and appraisal by Community institutions. These will include inspections by both the appropriate operational Directorate General (e.g. DG VI for agriculture) and the Financial Controller (DG XX) of the Commission as well as by the European Court of Auditors.

617. The consequence is that Community expenditure is on the whole more complicated and expensive to administer than national expenditure. We accept this as a "necessary evil" given the key principle that the Commission has Treaty responsibility for the execution of the whole of the Budget and that subsidiarity arguments do not apply where the protection of the Community's financial interests is concerned (Edinburgh European Council Conclusions 1992). Even so, there is scope for rationalising national and EC controls (both internal financial control/audit controls and external audit). Work on this is in hand mainly in the context of SEM 2 000.

618. Generally speaking existing institutional mechanisms and administrative procedures have been adapted as necessary to handle EC expenditure. However, a number of specific bodies have been created for this purpose where Community rules require or the scale or complexity of Community finance operations makes that sensible. The most significant of these are the agencies which handle agricultural finance (the Intervention Board for Agricultural Produce—IBAP). Other bodies or units have been set up to oversee structural expenditure. For example, a specialist unit administers European Social Fund expenditure which can prove difficult to manage effectively in the United Kingdom, as in other Member States.

7. Integration Of Community Finances Into The National Budget

7.1. General Principles

619. As noted, the United Kingdom system is designed to maximise transparency and budget discipline in the Community. It is also designed so far as possible to promote coherence between public expenditure financed by the United Kingdom taxpayer through the EC Budget and public expenditure financed by the United Kingdom taxpayer through the national budget.

7.2. National Budget Presentation

620. Transactions involving the EC Budget do not appear on the revenue side of the national budget in any way. They are entirely accounted for on the expenditure side. Specifically:

- receipts from the EC Budget form part of the public expenditure plans of the relevant Departments (principally Agriculture and the various departments with Structural Funds responsibility);
- that part of the EC's external spending notionally attributed to the United Kingdom (at present about 14 per cent, equivalent to the United Kingdom's financing share of the EC Budget as a whole) forms part of the expenditure plans of the Department for International Development (previously the Overseas Development Administration);
- the balance, which by definition constitutes the net public sector payments made by the United Kingdom to the EC Budget, is shown in the public expenditure plans as a Treasury spending programme.

621. The Treasury also publishes full details of the United Kingdom's gross contribution and its abatement. However, while these are important statistics, they are not used as public expenditure planning aggregates.

622. Experience shows that it is very difficult accurately to predict the United Kingdom's net contribution in any year. This makes the Treasury programme for the domestic consequences of EU membership a particularly volatile part of the national public expenditure arithmetic. This volatility can be sufficient, at the margin, to influence overall budget strategy. In other words it can determine whether or not there is sufficient room for manoeuvre in the national budget to make a tax change, adjust expenditure in another area, or to adjust the borrowing requirement. Partly this is for reasons special to the United Kingdom, such as the United Kingdom's different financial year (April—April). But partly it is because of the difficulties in forecasting the timing of receipts and the overall spending rate of the Community Budget. The latter problems are shared with other Member States.

7.3. Treatment Of EC Budget Receipts In Departmental Budgets

623. As explained in section 5 above, the planning, within agreed totals, and the management of expenditure from the Community Budget are the responsibilities of the relevant spending departments.

624. The United Kingdom operates detailed arrangements to ensure that where appropriate national spending levels are adjusted to reflect changes in Community spending levels (on the whole, this means

that increases in Community spending can either be offset by appropriate reductions in national spending, or a decision can be taken not to offset in a particular case). These are:

- as noted, attributing the United Kingdom share of EC external spending to the relevant United Kingdom Ministry's budget;
- adjusting the relevant United Kingdom public expenditure programme to reflect changes in the level of EC spending on *internal policies*, mainly on research and development but also covering a wide range of other policies on, for example, culture, health and education.

625. From the perspective of the United Kingdom Government as a whole, these systems permit the United Kingdom administration to decide objectively whether to react to an adjustment in the level of the EC Budget by an offsetting adjustment in the corresponding part of the national budget, or whether to adjust the national budget as a whole, thus affecting spending on national policies which are not related in any way to the EC policy. So far, as individual United Kingdom departments are concerned, there is an incentive to consider whether proposed adjustments to EC spending—in the areas for which they are responsible, and over which they conduct negotiations in Brussels—offer equivalent value for money to the spending of an equal amount through the national budget. In this way, both the Departments concerned and those with whom they are negotiating in the Community are reminded that the Community Budget is not a free good. This is an important message for budget discipline.

626. These arrangements do not apply to United Kingdom Structural Funds receipts, to which the Community's additionality requirements apply. But departments are required to include these receipts in their public expenditure plans.

627. The Treasury would be happy to provide further details of these systems on request.

8. Areas Of Strategic Interest To EU Finance Ministries

8.1. Central Financial Functions

628. It will be seen from the paragraphs above that the Treasury has an operational role in the payment of contributions and in the forecasting and monitoring, for national budgetary purposes, of gross contributions, receipts and so of the net contribution. Clearly, the Treasury also has a strategic interest in these matters.

629. Elsewhere, the Treasury's activities in EC finance are largely strategic. They are intended to ensure that systems are effective and that the overall thrust of policy is consistent with economic and financial objectives. Indeed, experience has shown that there are a number of areas in which the Treasury—like other Finance Ministries—needs to exercise such strategic influence. Some of these areas are discussed below.

8.2. Financial Management And Fraud

630. One area in which the Treasury, like other EC Finance Ministries, has found it necessary to take a close interest is in the strengthening of the EC's financial management and anti-fraud mechanisms. Recent work in this area has been centralised in the Commission's Group of Personal Representatives of

Finance Ministers on SEM 2 000 (the “PRG”). One task of the PRG has been encouraging national administrations to give proper consideration to improving the financial management of Community funds.

631. This reflects the strong interest which finance ministries have in the effectiveness of Community systems even though they do not generally handle much of the detailed administration. It also reflects the fact that the central finance functions of Community institutions are still relatively weak, compared to those in many Member States. Considerable effort is being put into achieving the necessary improvements, but these are not yet complete. Further, significant changes are likely over the next few years.

632. Finance Ministries are closely involved in developing Community policies on related matters such as the relationship between the Commission’s Financial Control and equivalent bodies in Member States (the Internal Audit services which advise Accounting Officers in the United Kingdom). There are also issues on external audit policy, for example on strengthening the powers of the European Court of Auditors (ECA) and co-operation between the ECA and national audit institutions (NAIs); and on the development of value for money criteria and evaluation in Community policies.

8.3. *Budget Discipline*

633. One area in which the United Kingdom Treasury is taking a close strategic interest is in the improvement of the budget discipline mechanisms within the Community. These are the set of legal and procedural arrangements for ensuring that expenditure plans are fixed and maintained at affordable levels, and that policy decisions in individual sectors are consistent with the overall expenditure ceilings. On the one hand improving budget discipline requires the reinforcement of the role of those services of the Commission with responsibilities analogous to those of finance ministries (particularly DG XIX). On the other hand, budget discipline requires collective attention from finance ministers through ECOFIN and the Budget Council, and through finance ministry interventions in the co-ordination of national positions in capitals.

634. Finance ministries are also naturally concerned with financial consequences of specific Community policies, either because of the total cost (notably in agriculture), or because of the difficulty of accommodating a wide range of policy decisions taken by different Councils within the existing financial framework (notably in internal spending), or because particular proposals might breach Community law or otherwise have undesirable characteristics (such as exposing the Community Budget to off-balance sheet risks). This tends to mirror the interest which finance ministries take in the development of national policies, particularly where these have significant financial implications, whether for the volume of spending, or for potential future commitments, or for budgetary principles.

8.4. *Wider EU Policies With Financial And Economic Implications*

635. There is also a third range of EU issues in which finance ministries take a close interest. For example, many of the issues tabled at the Inter-Governmental Conference have substantial financial implications. Just as finance ministries would be closely involved in national machinery of government discussions which have important economic or financial implications, so they seek to exercise an appropriate level of input into relevant IGC discussions. Finance ministries will, of course, also play an important role in the enlargement negotiations and in the preparatory decisions on reform to the Union’s present policies.

9. Administrative And Procedural Arrangements

9.1. Co-Operation Between Finance Ministries

636. Community procedures provide some opportunities for finance ministries to work together in the areas discussed above. Their objective is to ensure that the Community decision-making process gives proper weight to financial matters, offsetting the relative weakness of the central finance functions of the Community, and compensating for the fact that much Community business is conducted by foreign ministries whose main expertise lies in the field of foreign affairs rather than of governance. In particular, ECOFIN is increasing its exercising authority over a wider area of business, as shown by the discussion at the Informal ECOFIN in Nordwijk in April 1997.

637. There are, of course, opportunities for finance ministries to co-operate informally with their counterparts in other Member States.

9.2. The Organisation Of EC Budget Business Within Finance Ministries

638. Most Member States have divisions in their Finance Ministries specifically responsible for EC Budget issues. In the United Kingdom, this division has always been situated in the European part of the International Finance Directorate, though specific responsibilities for agricultural and for Structural Fund expenditure are now located in the public spending areas of the department with diagonal reporting links to the European area. The European Finance Division of the Treasury has diagonal reporting links to the national budget co-ordinators, and a horizontal link to the Treasury Accountant who is responsible for the physical payment of contributions. Our understanding is that broadly similar arrangements exist in Germany and the Netherlands.

639. Another model places the EU Finance Division in the budget directorate of the Finance Ministry, with co-ordinating links to the European or international side which would typically have responsibility for co-ordinating ECOFIN business. We understand that this is broadly the position in France, Belgium, Sweden and Austria.

640. In some other Member States, particularly those who are or have been significant net recipients from the Community Budget, finance ministry arrangements may place greater weight on the central management of receipts from the EC Budget. We understand this to be so in Ireland, Spain and Italy.

9.3. Finance Ministry Relations With Other Ministries

641. As always, the detailed organisation of administrative systems will reflect national preferences, differing national systems and political and administrative culture considerations. There is no ideal model. What is, however, clear is that in order to be effective in this area it is necessary for finance ministries to pay attention to a number of basic points:

- Finance ministries must have sufficiently strong *authority* (legal, political or institutional) to carry real weight with the other ministries with whom they do business, notably agriculture ministries, foreign ministries and prime minister's offices;
- they must be equipped to do business directly with other finance ministries;

- the officials who staff EC finance posts need to have the aptitudes, skills and training to carry out EC business as well as the relevant traditional finance ministry skills. There are, of course, other areas of finance ministry business where EC-specific skills are required—for example, in the monetary area and in the financial institutions area. Overall, finance ministries need to build up a cadre of EC-expert officials. The United Kingdom Treasury is still working towards this objective, after 25 years of EU membership;
- on the whole, if the choice has to be made, it is probably better to use staff with EU skills in Community business even if these staff are not those who would otherwise have been chosen for a particular task. Nominating staff just because they occupy an appropriate position with non-EC functions in the ministry can lead to difficulties unless the individual has the appropriate EC skills and aptitudes.

9.4. *The Permanent Representation In Brussels*

642. A great deal of EC financial business, particularly on the EC Budget, is of course conducted through Permanent Representations in Brussels, and Permanent Representations play a key role in policy development. Most of the six officials in the United Kingdom Permanent Representation who are engaged on EU financial business are seconded from the Treasury or other financial agencies (for example, Customs and Excise or the Bank of England). We understand that this is usually the case with other Member States.

643. Experience shows that very close co-operation and frank and effective communication between the national capital and the Permanent Representation are nevertheless essential in order to conduct business efficiently. Experience also shows that the presence of seconded experts (and strategic thinkers) on EC financial business in Permanent Representations is not a substitute for having such experts (and strategic thinkers) in finance ministries in capitals, and indeed vice versa.

10. *The Outlook For Community Financial Management Over The Next Few Years*

644. The remainder of this paper concentrates on the specific issue of Community financial management systems. The essence is that applicants for EU membership will have to position themselves to meet requirements when they join which will be more demanding than the present requirements.

645. The Community has embarked on a wide-ranging programme of financial management reform. The agenda for reform can be traced back to the extensive changes to the financial management articles of the Treaty agreed at Maastricht. This agenda encompasses much of the ground covered by this paper.

646. The main grounds for reform are a recognition that the Commission's budgeting and financial management capacity has not developed to match the growth of the Community Budget and that in key respects the Commission's procedures have become outdated. In a political sense this translates into serious public concern in Member States about poor use and sometimes misuse of Community funds. In more than one Member State, political and public annoyance at the level of irregularities and fraud hindered the ratification of the increase in the own resources ceiling agreed in principle in 1992.

647. There is also a general feeling that greater co-operation is needed between the Community institutions and the Member States. In particular, without better co-operation between the Commission which is responsible for Budget execution and the Member States which spend over 80 per cent of the Budget, it will prove impossible to obtain improvements on the scale which public opinion demands.

11. SEM 2 000

648. Sound and Efficient Management (SEM) 2 000 is the Commission's programme of financial management reform.

649. *Stages 1 and 2* deal with the Commission's internal arrangements. The emphasis is on increasing the accountability of the operational units. This involves moving away from the traditional *ex ante visa* financial control and the strict division between *ordonnateur*, *comptable* and *controlleur*, towards a system which gives policy managers more responsibility and above all more accountability for the resources they use.

650. A first step has been the establishment of proper financial units within the spending Directorates-General, and raising the quality, quantity and status of the staff employed in these. Over the longer term, Directorates-General will become more accountable for their use of resources with the desired effect of freeing staff within DG XX (financial control) from routine control duties to a more effectively targeted source of expertise on best practice, value for money, consultancy, and internal audit.

651. In parallel, new budgeting systems are giving DG XIX a role more akin to a budget ministry in the preparation of the Commission's Preliminary Draft Budget.

652. *Stage 3* of SEM 2 000 covers the relationship between the Commission and the Member States as partners in the operation of the Community Budget. This includes:

- more precise definition of the eligibility of expenditure for financing from the Structural Funds;
- establishing a structured working relationship between the Commission's Financial Control and the equivalent authorities in Member States (financial control or internal audit, according to system) so as to avoid overlaps and increase the effectiveness with which these inspection resources are used. This is being set up under the "Protocols" between the Commission's Financial Controller and her counterparts, many of which have already been signed;
- more constructive partnership between the ECA, the Commission and Member States (again in their role as managers of Community Budget funds), including follow-up to ECA comments by Member States as well as by the Commission, and an expectation that Member States will respond to criticisms made of their financial management of EC funds by the Commission;
- co-operation in the forecasting of cash flow, to reduce premature demands on Member States to finance the EC Budget;
- the extension of the principle that a Member State which mismanages Community funds should bear a financial penalty from the agricultural area, where it already applies, to other areas of the Budget. This would require different systems to the "disallowance" used in agriculture.

653. It would be misleading to predict how far these developments will have moved the goal posts by the time of the next enlargement. But it is reasonable to suggest that:

- there will be a more co-operative relationship in Community Budget operations between the Commission and Member States;

- there will be more accountability, both on the operational units of the Commission and on bodies within Member States which spend Community money;
- the emphasis will be on the ability for Member States systems to meet a common standard of performance, rather than on the standardisation of systems. In other words, co-operation will proceed on the basis of respect for existing systems provided these can develop where necessary;
- there will be wider use of financial penalties for mismanagement, as the counterpart to giving greater responsibility and accountability to the people in charge of policies.

654. Finally, it is likely that the European Parliament will play a fuller part in calling those who are accountable for Community funds to account, building on the experience of its Budgetary Control Committee and on its successful Temporary Committee of Enquiry into Transit Fraud.

Annex 1. Technical Note On The Relationship Between The European Community Budget And National Public Finances In The United Kingdom

1. Introduction

655. This note describes the main features of the relationship between the Community Budget and the national budget. It is intended primarily to help those who need to know about the impact of Community finances on national public finances, rather than as a guide to Community finances.

2. The Main Numbers

656. The Community Budget currently spends about £70 billion, roughly equivalent to total local authority spending in the United Kingdom (in June 1997 there were about 1.40 ECU to the £). The United Kingdom gross contribution is usually around 14 per cent of that figure. Total public sector United Kingdom receipts fluctuate between years, but, taking one year with another, stand at about 8 per cent of the EC Budget (£4.5 billion). In recognition of the gap between its gross contribution and its receipts, the United Kingdom receives an abatement which broadly speaking reduces its net contribution by two-thirds, one year in arrears. In 1996, the abatement was about £2 billion, and the net contribution about £2.5 billion; these figures fluctuate significantly from year to year.

3. The Revenue Side Of The Budget

657. EC finance does not feature on the revenue side of the United Kingdom budget at all. The proceeds of some taxes go to the Community in whole (the traditional own resources, i.e. customs duties and agricultural and sugar levies) or in part (VAT). These appear in national accounts like any other revenue and are shown in the Financial Statement and Budget Report as such.

4. Expenditure Side Of The Budget

4.1. General Principles

658. In the United Kingdom, the whole of the impact of Community finances is shown on the expenditure side of the national budget so as to give the most meaningful information possible to Parliament and the taxpayer. The detailed arrangements are designed to ensure that, so far as is possible, the distribution of public expenditure in the United Kingdom from both budgets is optimal, though obviously the United Kingdom has much less control over the volume and distribution of EC Budget expenditure. These systems also reinforce budget discipline both in the national and the EC Budget. They aim to discourage the impression that the EC Budget is a free good, and to compensate so far as possible for weaknesses in the central finance functions of Community institutions. Some other Member States pursue similar objectives; in France, for example, gross contribution is shown as a "levy" on the revenue side of the national budget.

4.2. *Public Expenditure Planning*

659. The key points are as follows:

- Expenditure by the United Kingdom public sector financed by EC receipts is treated as expenditure by the relevant United Kingdom department (mainly agriculture and Structural Funds). Departments need public expenditure cover, i.e. authority to spend, for expenditure financed by these receipts in the same way as they require cover for any other public expenditure.
- The United Kingdom's share (about 14 per cent) of the cost of the Community's external aid forms part of the Department for International Development (DFID) budget and is planned as such.
- The United Kingdom's net contribution, technically described as "net payments", is treated as a separate programme for which the Treasury is responsible.

660. In other words, the public expenditure plans treat the United Kingdom's EC receipts as expenditure by the responsible department, and the net contribution as a charge on the Exchequer which has to be top-sliced from the total available for national expenditure. Receipts plus the net contribution are equal to the gross contribution after abatement, which is (taking one year with another) the amount of cash the United Kingdom actually hands over to the EC.

661. In addition to public sector receipts, the United Kingdom private sector receives payments direct from the EC, which are funded by the United Kingdom's net contribution to the EC. These are of the order of £500 million a year (much of which is for research) and are included in the abatement calculation.

662. Another way of looking at this is to break down the United Kingdom's contribution in resource transfer terms, i.e. in economic rather than in legal terms.

| | <i>£bn</i> approximate trend amounts at present |
|--|---|
| Gross contribution | 9.1 |
| <i>less</i> abatement ²¹ | (2.4) |
| Gross contribution after abatement (cash paid over) | 6.7 |
| <i>less</i> United Kingdom public sector receipts | (4.3) |
| United Kingdom net contribution | 2.4 |
| <i>less</i> ²² United Kingdom “share” of EC aid Budget (attributed to DFID) i.e. transfer payments to third countries | (0.6) |
| United Kingdom “net payments” (public expenditure planning aggregate) | 1.8 |
| <i>less</i> transfers to United Kingdom private sector via EC Budget | (0.4) |
| United Kingdom transfer to rest of EC | 1.3 |

663. Historically, Community expenditure has grown much faster than national expenditure. The consequence is that, for a given national public expenditure objective, growth in the United Kingdom net contribution will displace national expenditure priorities since there is less money available to spend within the United Kingdom. But growth in the gross contribution also affects national priorities even if United Kingdom receipts increase enough to keep the net contribution stable, since these receipts from the EC Budget finance expenditure which is not necessarily in line with United Kingdom priorities.

664. United Kingdom public expenditure systems have a number of features designed to offset these effects. The basic principle is that increases in Community spending should be offset so far as possible by reductions in equivalent United Kingdom spending, rather than by reductions across United Kingdom spending as a whole. This principle has been described by a former French Budget Minister as the *principe de constance* and is also pursued by other Member States. In the United Kingdom, these mechanisms are as follows.

665. First, United Kingdom departments must have full public expenditure cover (i.e. authority to spend in their agreed spending plans) for expenditure financed by receipts from the EC Budget, i.e. they cannot just accept money from Brussels and add it to their plans. The two main areas are:

- *agriculture*, which is *sui generis* (unique) because so much of agricultural policy and expenditure is determined by the Community, and CAP expenditure is much greater than national expenditure; and
- the *Structural Funds*, for which there is a pooling mechanism designed to take account of mechanical difficulties in planning for EC receipts. Essentially, the pooling mechanism is a form of insurance against unanticipated shortfalls in provision for receipts in which most of the relevant departments participate. (Scotland and Wales do not participate since they use their “Blocks” to smooth out peaks and transfers in receipts.)

21. Based on previous year.

22. Also less by some further, minor adjustments.

666. Community legislation requires Structural Fund spending to be “additional” to what Member States would otherwise have spent. The present Community additionality requirement is that national finance for structural purposes should not be less than in the preceding programming period. Like other Member States, the United Kingdom demonstrates regularly to the Commission that it has respected these requirements.

667. A system of attribution applies to the Community’s external spending, i.e. aid to non-member countries. The United Kingdom’s share of this is included in DFID plans, i.e. put crudely the amount available for the DFID to spend on bilateral aid is their total provision less the amount of EC aid deemed to be financed by the United Kingdom. Similar arrangements apply to other external expenditure, e.g. on the Common Foreign and Security Policy, though the amounts are far smaller.

668. Finally, the EUROPES²³ mechanism applies to the Community’s internal policies (research, Transeuropean Networks or TENS²⁴, and a host of small policies on culture, health, environment etc.). For the most part, these policies involve transfers directly to the private sector in Member States, for example for research, though there are also public sector transfers. The principle here is that adjustments in the level of Community spending are offset by adjustments to the equivalent area of national spending. The effect is similar to that of attribution on the DFID budget; growth in Community spending means that more of the United Kingdom effort is allocated by Brussels and less by London. But the mechanism is different, reflecting the fact that a large number of departments and departmental expenditure programmes need to be covered because of the width and variety of Community internal policy expenditure.

669. The EUROPES mechanism offsets relevant United Kingdom public sector receipts against the overall EUROPES adjustment. Such public sector receipts are treated as described above.

670. EUROPES operates through reductions to the relevant departmental baselines. Departments must make a case for additional provision if they feel they cannot accommodate these reductions without unacceptable damage to their national objectives.

23. The term EUROPES is derived from “European” and “Public Expenditure Survey”, the United Kingdom procedure for setting public expenditure.

24. Transeuropean Networks are mainly railways, and sometimes motorways and information technology networks.

MANAGEMENT OF EAGGF–GUARANTEE OPERATIONS IN MEMBER STATES
By Brian Gray²⁵

25. Brian Gray is since 1992 Head of Unit, DG VI, AI.3, responsible for the clearance of the accounts of EAGGF–Guarantee. He previously worked as an official with the European Court of Auditors in the areas of development aid (10 years) and the Guarantee Fund (3 years). He is an English Chartered Accountant, and until 1978 was an audit manager for Deloitte's, a firm of public accountants, in Zambia and London.

1. Decision-Making Process

671. Virtually all of the Guarantee Fund measures are 100 per cent financed by the Community²⁶. The payments are, however, executed by the Member States, with the Commission reimbursing some five weeks later the total disbursed in each month.

672. Each measure is defined in general terms in a Council Regulation, and the detailed provisions are laid down in Commission Regulations. Decisions by Council are based on a proposal from the Commission, which is examined by the Member States' representatives in a technical committee (Special Committee for Agriculture or SCA), and then by COREPER (permanent representatives of the Member States in Brussels) before being presented to the Council of Ministers of Agriculture. Decisions by the Commission are taken after consulting the management committee for the agricultural sector concerned, and formally obtaining their opinion.

673. Once a measure has been decided and the Regulations have entered into force, the Member States must implement the measure. To do this, each State adopts national legislation aimed at allocating between the appropriate services responsibilities for the receipt of aid claims, for checking that the claim is eligible for the aid, for paying it and for keeping proper records. National legislation also lays down the detailed rules specifying such matters as the nature of the claim form, the supporting documents and records to be kept by the claimants, and the methods of checking the eligibility and accuracy of the claim.

2. Staffing The Administration Of Guarantee Operations In Brussels

674. Once the policy in an economic sector is agreed by the Council of agricultural ministers, the subsequent examination of a proposed measure concerns largely the way in which it will be implemented in the Member States. Thus, officials attending the SCA are senior officials in the service responsible for implementing policy measures, and those attending the management committees are representatives of this service, or of the operational departments concerned by the proposal being discussed. Member States aim to ensure that the regulations finally adopted take account of their particular circumstances, and that the staff who will be responsible for applying them fully understand how they should be interpreted and how they should be implemented.

675. A good understanding of legal texts is necessary, but not only lawyers should attend the committee meetings; senior operational staff can contribute the most towards the development of workable measures.

3. Organisation Of Services In The Member States

676. As a general principle, Member States are free to implement the Guarantee measures in the way each finds the most appropriate, and in accordance with national legal and administrative systems. The cost of administration is borne by the Member State and not by the Community Budget²⁷, except for certain contributions made from time to time towards the cost of putting into place new or improved control systems.

26. The exception concerns accompanying measures (agri-environmental, forestry and income aids), which are 50 per cent or 75 per cent co-financed by the Community.

27. Article 1(4) of Regulation 729/70.

3.1. Claim Processing, Verification And Payment

677. The most common organisational model for the processing of claims is to:

- centralise in one department the administration of aids to the commercial and industrial sector (export refunds, intervention storage, processing aids); and
- delegate to regional departments the administration of aids to individual producers (arable crops, animal premiums).

678. The rationale for the latter arrangement is that the inevitable anomalies and errors in claims from a high number of claimants are best dealt with at the local level, and that only regional administrations can mobilise the high number of inspectors required to make on-farm verifications.

679. For the reason of attaining a sound division of duties, checks on the veracity of aid claims should not be undertaken by officials of the department responsible for receiving and authorising aid claims, but by departments technically competent for undertaking the physical checks. Such technical departments may be veterinary offices, agronomists, dairy product experts, or laboratories.

680. Whilst decentralisation of the various tasks to regional and technical services is necessary to enable each claim to be dealt with, the information on all claims must be centralised, in order to allow the Member State to undertake cross-checks such as those required by the integrated control system²⁸; to ensure safe-guards over the payment procedures; and to allow the Commission to verify the operation of the claim processing procedures.

681. The centralisation of recording and accounting information is the responsibility of the paying agencies. Each Member State is required, under Article 4 of Regulation (EEC) n°729/70, to set up as small a number of paying agencies as possible given its institutional and constitutional constraints, and to ensure that these attain a high degree of control over their financial and accounting procedures. The different elements of the control systems are defined in the annex to Regulation (EC) n°1663/95.

682. It is particularly the paying agency which must be staffed by officials with a high level of competence in the fields of computer systems, finance and audit, as it is the paying agency which ultimately ensures that all requirements of community legislation have been met before claims are authorised for payment. The paying agency also has to keep a detailed record of information on claims, as specified by the Commission²⁹. It has to record the intervention storage operations, and monitor the clearing of advances granted under many aid schemes, and the follow-up of recovery orders.

683. If more than one paying agency is designated, then a service has to be designated as a Co-ordinating Body, to act as a single interlocutor with the Commission, and to promote a uniform application of Community rules.

3.2. Audit Departments

684. Member States are required to set up two departments responsible for ex post audits. One is the Certifying Body, required to undertake an annual audit of the paying agencies' accounts, and to report on their compliance with the accreditation criteria. The second is the service responsible for the ex post

28. Regulation 3508/92 OJ n° L355 of 5 December 1992.

29. Decision 2732 of 3 October 1996 (not published).

scrutiny of the accounts of all beneficiaries of the Guarantee Fund, with the exception of individual producers. Both are staffed with officials trained in auditing techniques, together with, in the case of *ex post* scrutinies, by some customs inspectors.

4. Clearance of the Accounts

685. Under Articles 2 and 3 of Regulation (EEC) 729/70, the Commission is only empowered to accept for Community financing those payments which fully comply with Community rules. These rules require a certain proportion of aid claims to be checked, and these checks are required to be sufficiently effective to prevent and detect fraud and irregularity³⁰. Thus, the Commission is entitled to refuse the financing of individual claims found not to comply with Community rules, and also to refuse claims which were not properly checked before payment.

686. The Commission examines, under the clearance of the accounts procedure, the Member States' implementation of the Guarantee Fund. It:

- verifies the reliability of the annual accounts of the paying agencies, largely through its examination of the reports and certificates of the certifying bodies, and adopts an annual decision accepting the amounts declared; and
- undertakes visits to Member States to verify the conditions under which the Member States managed the funds, and if these were unsatisfactory and there was a risk of loss to the Fund, it can recover all or part of the expenditure declared³¹.

687. Particularly when the required controls were not effected by the Member States' services, it decides to refuse a percentage of the payments, most frequently 2 per cent, 5 per cent, or 10 per cent³². Before such a decision is taken, the Member State has the opportunity to discuss and explain the Commission's findings, first in writing, then in bilateral discussions. There is also the possibility of submitting the file to a Conciliation Body³³, made up of five independent experts of senior level. When the Commission finally takes its decision, the amount refused is recovered from the Member State, which can later appeal to the Court of Justice against the decision.

688. The amounts corrected in this way can be very substantial, and it is in the Member State's interest to ensure that its administrative procedures are of the standard required, even if the costs of adequately staffing and equipping its services appear high.

689. The Commission's policy of applying these corrections may seem unduly strict and punitive, but it should be seen against the perception, in the eyes of the public, that the Common Agricultural Policy suffers from an unduly high level of irregularity and fraud, and provides opportunities for abuse. Backed by the European Parliament and the European Court of Auditors, the Commission is determined to bring the Member States to exercise their control over Guarantee Fund payments with the utmost of seriousness.

30. Article 8 of Regulation 729/70.

31. Article 5 of Regulation 729/70.

32. Document VI/216/93, appendix 2.

33. Decision 94/442/EC of 1 July 1994.

690. In recent years, examples of the most significant corrections, in terms of the amounts reclaimed from Member States, concern failures to apply the milk quota regime (Italy, Spain), failures to put into place the olive register and olive sector computer file (Greece, Spain), the failure to implement proper controls over public storage of beef (France, Germany, Ireland, Italy, United Kingdom) and of cereals (France, Italy), and failures to apply effective checks on export refunds (most Member States).

FINANCIAL CONTROL AND AUDIT IN THE EUROPEAN UNION
By Alan Pratley³⁴

34. Mr. Alan Pratley is since 1990 Deputy Financial Controller of the Commission of the European Communities. He joined the Commission in 1973 and worked in the area of administration and financial control, including periods as Deputy Chef de Cabinet to the Commissioner responsible for Budget, Financial Control and Administration, and as Director of General Administration.

1. Introduction

691. The purpose of financial control and audit in the European Union is to provide the assurance to the taxpayer through the Council of Ministers and the European Parliament that European Union funds are well-managed and spent in accordance with the objectives of the Union and the general and sectoral regulations governing the policies to be pursued. The current Budget of the European Union amounts to some 90 billion ECU. Since the EAGGF-Guarantee Fund (covering the implementation of the Common Agricultural and Fisheries Policy) and the Structural Funds together represent some 80 per cent of the Budget, the importance of co-ordinating financial control and audit between the Commission, the Member States and the European Court of Auditors is self-evident. It is no less necessary in other areas.

2. Financial Control And Audit At Commission Level And Outside The Commission—An Overview

692. Sound financial management in the Commission is based on the internal control in the spending departments, which is provided by the resource directorates or financial management units of the departments; on the internal audit provided by the Directorate-General of Financial Control (DG XX); and on the external audit provided by the European Court of Auditors.

693. Sound financial management outside the Commission is based on the internal control in the national, regional and local public service organisations responsible for spending; on the internal audit provided by specialist units in the national ministries (or by central bodies like the *Inspection Générale des Finances in France*); and on the external audit provided at national, regional or local level.

694. Where European Union funds are spent in Member States, there is necessarily close co-operation between the Commission and the Member State as regards internal control and internal audit. This may be illustrated as follows:

1. For expenditure managed and executed directly by the Community, the internal control is provided by the managing Directorate-General with *ex ante* approval of financial transactions and internal audit provided by the Directorate-General of Financial Control (DG XX). (In the case of aid to countries outside the Union, there is some involvement of the public services of the beneficiary state.)
2. For expenditure co-financed by the European Union, the internal control in the Member State is provided by national, regional or local government services (and by public corporations, universities or the private sector in the case of research), with internal audit by the Directorate-General of Financial Control and Commission services (in conjunction with corresponding internal auditors in the Member State in the case of the Structural Funds and Research).
3. For EAGGF-Guarantee expenditure, financed 100 per cent by the Community but managed by the Member State, internal control is provided by the accredited national agencies in the Member State, with internal audit by a national control body, by the Directorate-General of Financial Control and by the authorising Directorate-General.

695. The external audit is provided in all cases by the European Court of Auditors, in collaboration as appropriate with the external audit bodies of the Member States, and to a limited extent in informal collaboration with the external audit bodies of beneficiary States.

696. Given its formal responsibility for the execution of the European Union Budget, the Commission has to be able to show that there is adequate internal control at all levels and that it provides or uses an appropriate internal audit function both for direct expenditure and where Community funds are disbursed and managed by Member States or agencies. In the latter case, it is essential to ensure an adequate and uniform level of management and control in all Member States.

3. Financial Control And Audit Within The European Commission

697. Within the European Commission, financial control and audit are organised as follows:

1. Expenditure commitments are authorised by the Commission itself for large programmes and actions. For subsidiary actions and smaller amounts, the Commission delegates the authorisation of expenditure to Directors-General of operational departments and designated grades within them.
2. The Director-General is responsible for ensuring adequate internal control through a directorate (or unit) responsible for the management of both human and financial resources and directly accountable to him. The directorate (or unit) acts as a counterweight to the operational directorates and units and is responsible for checking that internal control is in place and functioning and that there is an appropriate evaluation function in place to provide for *ex ante*, ongoing and *ex post* evaluation. The resources directorate is also responsible for on-the-spot controls of direct expenditure related to actions carried out by organisations situated outside the Commission.
3. The Directorate-General of Financial Control audits internal control of Directorates-General by *ex ante* checking, where appropriate on a sampling basis, of all receipts (including recovery of undue expenditure) and expenditure (commitments, payments) and by internal audit on a systematic basis at appropriate intervals of management and control systems in Directorates-General. Internal audit covers financial audits, accounting audits, management audits and performance audits. The *ex ante* control and internal audit functions are modulated on the basis of risk analysis; weak systems and performance will call for intensified control and audit.
4. The financial management structure of the Commission is completed by the Accountant, who is responsible for the accounting system and the execution of payments.

4. Financial Control And Audit In Member States

698. As indicated at the outset, some 80 per cent of the European Union Budget is managed and spent in the Member States. The two main areas are the Common Agricultural (including Fisheries) Policy (the EAGGF-Guarantee Fund), accounting for some 45 per cent of the European Union Budget, and the Structural and Cohesion Funds, accounting for some 35 per cent of the Budget.

4.1 EAGGF-Guarantee Fund

699. In the case of the EAGGF-Guarantee Fund, the Commission finances actions at 100 per cent and distributes an advance payment to each Member State each month. The Member State distributes the money to the various beneficiaries through paying agencies, which are either part of or supervised by the responsible ministries. The paying agencies administer the funds in accordance with the provisions of Council regulations and present yearly accounts to the Commission for approval some six months after the end of the financial year (15 October). Council regulations lay down detailed rules for the organisation and accreditation of paying agencies, for accounting procedures and for the frequency and intensity of controls for the different actions. There are also detailed regulatory provisions covering the audit certification to be produced with the accounts, and the bodies to be put in place in each Member State to co-ordinate the work of paying agencies and other organisations involved in the operations of the EAGGF-Guarantee Fund.

700. In addition to the clearance of the actual accounts, the European Commission is responsible for checking/auditing the systems of management and control in each Member State and, where weaknesses are identified, to apply corrections (generally deductions) to the amounts claimed. These corrections, which may be imposed during a period of up to two years following the end of the financial year, are based on failure to maintain satisfactory systems, including the carrying out of the prescribed frequency and intensity of controls.

701. The internal auditing is carried out by the Directorate-General of Agriculture, the Directorate-General of Fisheries and the Directorate-General of Financial Control. The external auditing is carried out by the European Court of Auditors.

4.2 Structural And Cohesion Funds

702. Unlike the EAGGF-Guarantee Fund, where the European Union provides 100 per cent financing, the Structural Funds provide for co-financing by the European Union and are conceived as a partnership, using the existing management and control systems of the Member States. The Member States are required to ensure that their systems enable operations to be completed successfully and that action is taken to prevent irregularities and recover unjustified expenditure. The Commission itself, after consulting the Member State, may reduce, suspend or cancel assistance in respect of an operation or measure where there has been irregularity or significant change in the nature or conditions for its implementation without the Commission's prior approval.

703. Under the Structural Fund regulations, the Member State is required to provide the Commission with a description of the management and control systems established. It shall also keep and make available to the Commission any appropriate national control reports on the measures included in the programmes or other operations. It is also required to designate authorities (usually ministries) to certify the validity of payment requests.

704. The Commission services (Directorates-General of Social Affairs, Agriculture, Fisheries, Regional Development and Financial Control) provide the internal audit function as provided for by the Structural Fund regulations, which authorise them to carry out on-the-spot checks in respect of operations financed by the Structural Funds and of the national management and control systems. The Commission services may also require the Member State to carry out on-the-spot checks to verify the regularity of payment requests.

705. The European Court of Auditors is responsible for the external audit function in relation to the Structural Funds.

4.3 Community Revenue

706. Community own resources consist of customs and agricultural duties, the resource based on VAT, and a complementary resource based on GNP. As regards traditional own resources (customs and agricultural duties), they are collected from economic agents by Member States according to their own national procedures, adjusted where necessary to comply with Community own resources regulations. Member States have their own control and audit systems. Furthermore, the Commission services may also require Member States to carry out on-the-spot checks, participate in some of the regular checks conducted by national authorities, and may on their own initiative carry out on-the-spot checks in association with national officials.

707. As regards the own resource based on VAT, controls and audits on VAT taxable persons are made by national authorities. The Commission services check the procedures and the actual calculations made by Member States to determine the amount made available to the Commission pursuant to this resource, as well as to the GNP resource.

5. Co-Ordination Of Financial Control And Audit Between The Commission And The Member States

708. Given the extensive nature of the operations of the Common Agricultural and Fisheries Policy (EAGGF-Guarantee Fund) and of the Structural Funds, it is essential to ensure that the limited financial control and audit resources available to the Commission and those of the Member States should be used in the most efficient possible way. The Structural Fund regulations require the Commission to ensure that any checks carried out are performed in a co-ordinated manner so as to avoid repeating checks in respect of the same subject matter during the same period.

709. In 1979, the Commission made the Directorate-General of Financial Control responsible for co-ordinating the on-the-spot control missions (verifications and audits) carried out by Commission services in the Member States.

710. To this end, the Directorate-General of Financial Control has launched two actions in close consultation with the Directorates-General responsible for the management of the Common Agricultural and Fisheries Policy (EAGGF-Guarantee Fund) and the Structural Funds.

711. In the case of the Common Agricultural and Fisheries Policy, there is already co-ordination between the Directorates-General of Agriculture and Fisheries and Financial Control to avoid overlap in their control and audit programmes and to ensure that the audit effort is concentrated on areas of greatest risk. In order to improve co-ordination further in the Member States, meetings are held twice a year by Commission services with representatives of the paying agencies of the Member States. The aim is to move towards agreed and consolidated programmes being available from the beginning of the annual control and audit exercise.

712. In the Structural Funds context, the work of co-ordination is even further advanced. The Directorate-General of Financial Control has signed protocols or administrative arrangements with eight Member States and negotiations are well advanced with the other Member States. These protocols or administrative arrangements provide for:

- the alignment of audit methodology;
- agreed and consolidated annual audit programmes and the exchange of completed reports;
- the provision of appropriate data for the audit trail.

713. The protocols are signed by the Financial Controller for the Commission and by the central control authority (e.g. *Inspection Générale des Finances* in France, *Intervención General* in Spain) for the Member State where this function exists, or by the head of the relevant ministry, together with his head of internal audit in Member States where other control structures exist. The audit methodology used by the Commission for systems audits is an integral part of the protocol, supplemented as necessary by the respective national control methodology and a common methodology is used for audits of particular programmes or actions. Audits are undertaken separately or jointly by the Member State control bodies and the Commission services. Control reports are exchanged and, where possible, the national control authorities summarise the main findings from audit bodies at regional and local level.

714. Co-ordination meetings are normally held twice a year between the Commission and the Member State control authorities, covering all the Funds. In the early autumn, the Directorate-General for Financial Control (DG XX) sends to Member States the indicative on-the-spot audit programmes of the Commission services for the following year, and invites Member State control authorities to submit their own indicative programmes. The co-ordination meeting is then held for which the Commission prepares a summary of the findings in relation to each Fund in the Member State, drawn from the reports of the Commission services, of the European Court of Auditors and of the national control authorities. Against this background and any other data which can contribute to the overall risk analysis, the meeting then examines the indicative programmes in order to eliminate duplication or overlap and draw up a consolidated programme which takes account of the available risk analysis. The European Court of Auditors, which receives the material examined at the meeting including the consolidated programme, also draws up an indicative programme for the following year, which can take account of the agreed and consolidated programme. A second co-ordination meeting is held in June-July to review the implementation of the consolidated programme and make any necessary adjustments.

715. The third element of the protocols—the audit trail—flows from the organisation of management and control in each Member State. Under the Structural Fund regulations, each Member State is required to provide a description of its management and control systems. The Commission is using consultants to construct an overall model based on the descriptions supplied after verification with the Member States, so that possible gaps or incoherencies can be corrected. The resulting audit trail will show how the payment claims are established. It will also enable national and EU auditors to check that EU funds are reaching beneficiaries within a reasonable period and that it is possible to reconcile the payment claims presented to the Commission with actual expenditure made by the ultimate beneficiary or at regional or national levels. A clear audit trail also facilitates the verification by the auditors that viable legality and regularity controls are in place and functioning satisfactorily.

6. Financial Control And Audit Of Other Areas Of Expenditure And Of Receipts

716. The other areas of expenditure covered by the Commission concern direct expenditure funded and managed by the Commission and may be summarised as follows:

| | |
|--|------|
| Internal policies including training, social and employment policy, energy, consumer protection. | 2.1% |
| Research and technological development. | 3.8% |
| Administrative expenditure. | 4.7% |
| External action. | 6.5% |

717. As indicated under section 3, financial management is the responsibility of the authorising officer (Commission, Directors-General and designated officials), the Financial Controller and the Accountant. Operations are not confined, however, to the Commission. Direct expenditure is channelled through grants, service and supply contracts to administer programmes and actions taking place within and outside the Union in close consultation with Member States and beneficiary countries. In recognition of the geographical spread of these activities, the Financial Regulation provides for the Commission services, notably the Financial Controller, to carry out on-the-spot checks on the use of EU funds. Beneficiaries of EU subsidies and grants are required to accept the verification of the use of these funds by Commission services and the European Court of Auditors.

718. The co-ordination of financial control and audit with Member State authorities is well-developed in relation to the collection of own resources, i.e. the receipts from Member States which ensure that the Budget is balanced. The Commission discusses with Member States usually twice a year the control programmes, as well as the main results of its audits, in the context of an advisory committee of Member States and Commission experts. An audit sub-group has also been set up to exchange relevant audit information and practices. Co-ordination is also well-developed in the area of research grants which are intended to complement national research programmes.

719. Outside the Community, EU funds are used to further its policy aims in the Third World and in the countries of Central and Eastern Europe, many of which are candidates for accession to the Union.

720. The major contribution to the Third World is made through the European Development Fund (+/— 1.5 billion ECU a year), which is managed separately from the EU Budget by Commission services, in partnership with third world countries in the framework of the Lomé Convention. The financial control and audit procedures of the Commission are applied to these operations.

721. The Third World also benefits from EU funding from the main budget for projects managed by UN agencies. In accordance with the requirements of the Financial Regulation, Commission services and the European Court of Auditors verify the use of EU funds in these operations both through access to the relevant financial information and records and through on-the-spot visits.

6.1 Eastern And Central European Countries

722. The EU actions in relation to the countries of Eastern and Central Europe are channelled through the TACIS and Phare Programmes. The TACIS Programme, covering Russia and the countries of the former USSR, is administered from Brussels in contact with EU delegations or TACIS offices in the countries concerned. The Phare Programme covers projects in the Central European Countries (CEC), which are managed from Brussels, working through EU delegations in these countries and project management units located in central ministries. The present paper concentrates on the operation of the Phare programmes in the countries applying for membership of the European Union and on the conclusions to be drawn from experience to date as seen from the viewpoint of the Directorate-General of

Financial Control (DG XX) and the other Commission services, notably DG I and DG IA. The conclusions are based on the day-to-day work of Financial Control on the files dealt with in Brussels and on audit missions by DG XX to the countries concerned, including fact-finding missions and seminars.

6.2 Central European Countries (CEC)

723. The CEC have had to evolve from a centralised state system in which the public administration in general and financial control bodies (if they existed) could not function independently. There was therefore no experience of modern “project administration” including public procurement with contracts awarded through tendering procedures. At the same time, these countries had to adjust to the destabilising impact of the introduction of free market conditions.

724. The Commission has tried from the outset to use the Phare Programme as part of a learning process for the CEC administrations. In addition to the importation of project management expertise through largely western consultants, Phare has set up a network of project management units (PMUs). These PMUs have been implanted within the existing administrative structure, normally in the relevant central ministry. The PMU has been headed by a senior ministry official and staffed by personnel from the ministry, supplemented by expatriate experts on secondment by way of contracts between the Commission and various EU consultancy firms. It was intended that in this way expertise would be acquired by national officials “on the job”, with a view to the ministry itself being able to take over the management and control of projects in the way that EU Member State ministries manage and control Structural Fund projects.

725. There is still some way to go in achieving the objective of making CEC public administrations able to manage and control EU funded projects. The following problems have been identified:

- the transfer of expertise from consultants to national officials has not been as complete and effective as intended and there is pressure from ministries to extend external consultant contracts;
- the unfavourable market conditions for the recruitment of highly qualified public officials compared with the inflated salaries of the private sector, which has led to the loss of ex-PMU staff to the private sector;
- the measures taken by some CEC States to counter the trend noted in the second point above either by transferring the management of Phare projects to private “foundations” often in the same ministry and paying private sector salaries, or by “topping up” the public administration salaries of national officials administering Phare projects;
- the difficulty in staffing PMUs in those countries which do not wish to use measures such as those described in the third point above.

7. Internal Control, Internal Audit, External Audit In Central European Countries

726. Since the reform process in CEC began in the early 90’s, budgetary control facilities and institutions have been set up in most countries. There is, however, no common concept of internal control, internal audit and external audit in CEC. The “fact-finding missions” and the seminars organised by DG XX in these countries have shown that there is neither the model of a financial controller carrying out ex ante control of transactions with a centralised internal audit function as in a number of EU Member States, nor the northern European concept of a self-regulating financial management system in each

ministry based on strict rules of budgetary execution and accounting, reporting to the Parliament and supervised by the Finance Ministry. Most CEC have an external audit function (Supreme Audit Institution) on the lines of a Court of Auditors or National Audit Office, reporting to the Parliament in some cases. In some countries the Supreme Audit Institution may combine its external audit function with the ex ante control of certain expenditure. The notion of the independence of the external auditor is not firmly established in all CEC and in the early years of the reform the external audit function was exercised in some cases by a control ministry forming part of the government.

727. Following contacts with DG XX and the European Court of Auditors, a number of CEC have expressed interest in adopting an institutional approach and methodology of the control of public funds, similar to those in the European Union and its Member States. The most notable example is Hungary, which has set up an internal audit office at government level (the Government Control Office), initially under the Ministry of Finance, now reporting directly to the Prime Minister. Its mandate is to follow the execution of the State budget and to ensure that the principles of sound financial management are properly respected. Hungary has also set up a “classic” external control or supreme audit institution, reporting independently to Parliament and called the State Audit Office.

728. The situation is much less clear and organised in other CEC, although there is a general readiness to use the models developed in the European Union in order to be able to deal effectively with EU requirements and aid schemes after accession. There is understanding for the principle enshrined in Article 209(a) of the EU Treaty that Member States will take the same care in administering EU funds to combat fraud as in the administration of the national budget.

729. DG XX/Financial Control is exploring the possibilities of practical co-operation with financial control and audit bodies in the CEC. The Hungarian Government Control Office has already carried out controls on Phare Programmes and is interested in developing a framework, in co-operation with DG XX, to develop controls in a structured manner, drawing on the experience of control co-ordination between the Commission and the Member States in the Structural Fund context. In the run-up to accession, the financial control and audit of the Phare projects can provide the preparation for the internal control and internal audit structures which will be needed after accession. There is, moreover, provision in the Phare funds for institution building projects and the appropriate technical assistance.

730. The ongoing objective must be to encourage the CEC to develop effective internal controls within ministries at central, regional and local level, so that there is proper accountability for the management of funds and the execution of projects. The internal audit function in each ministry will need to be developed from scratch in most countries, with a clear remit to ensure that the internal controls are in place and functioning effectively. The internal audit function, while independent of the external control, should be appropriately synchronised with it so that the external auditor can use the work of the internal auditor. Independence is a key requirement for both internal and external audit, with the latter reporting to Parliament. The European Union can contribute effectively to this process, not only by providing advice, technical assistance and example, but by offering clear models for public service institutions which the CEC can adapt to their particular traditions and circumstances.

Appendix 1. Budget Procedures

A. Summary Of EC Budget Procedures

731. There are three main elements to the Community's budgetary procedures.

732. First, the Own Resources (OR) ceiling which sets an absolute upper limit to the revenue which the EC may raise from Member States. This will be 1.27 per cent of Community GNP from 1999. Since the Community Budget must balance (i.e. may not borrow), the ceiling constitutes an upper limit to how much may be spent (subject to some minor miscellaneous revenue items). The OR ceiling is set out in the Own Resources Decision, changes to which must be agreed unanimously by Member States in the Council and must be ratified by Member States by a procedure similar to the ratification of Treaty changes (i.e. requiring the approval of national Parliaments in most Member States).

733. Second, the medium term expenditure plans known as the Financial Perspectives. These set out spending profiles for the main categories of expenditure for a 5/7 year period (most recently for the period 1993-1999 agreed at the Edinburgh European Council in December 1992). The Financial Perspectives are based on an Inter Institutional Agreement between Council, Commission and European Parliament rather than on a formal legal instrument, and do not have the quasi-Treaty status of the Own Resources ceiling.

734. The present Financial Perspective ends in 1999. The expectation is that a further Financial Perspective will be agreed, but there is no legal requirement for this.

735. The present Financial Perspective was agreed by unanimity by the European Council and may be amended by qualified majority voting in the Council and with the agreement of the European Parliament (but always within the OR ceiling).

736. Third, the annual Community Budget. This is the legal instrument which authorises revenue and expenditure for the year in question. The Budget must by Treaty be affordable within the OR ceiling, and under the Inter Instrumental Agreement must be affordable within the Financial Perspective.

737. The annual Budget procedure is complicated, involving a "navette" (shuttle) between the Council and the European Parliament.

738. In brief:

1. the Commission prepares its Preliminary Draft Budget (PDB) in May of the preceding year;
2. the Council holds its First Reading at a Budget Council in July to adopt the Draft Budget (DB). This follows discussions between the Presidency, the Commission and the Parliament (the triologue) and detailed preparation by officials in the Council's Budget Committee (normally staffed by Finance/Budget Ministry officials seconded to Permanent Representatives);

3. the European Parliament holds its First Reading of the Draft Budget in October, amends the Draft Budget and returns it to the Council;
4. the Budget Council holds its Second Reading in November, and then returns the Draft Budget to Parliament;
5. the Parliament adopts the final, or Adopted Budget, usually in December.

739. During these exchanges, the basic principle is that the Council has the last word on “obligatory” expenditure (the vast bulk of which is on agriculture) and the Parliament has the last word on “non-obligatory” expenditure (most expenditure other than agriculture).

740. The detailed procedures and rules are complicated. New Member States need to acquire a good working knowledge of these.

741. Finally, expenditure from the Community Budget must have a legal base, i.e. there must be Community legislation which authorises the policy on which money is to be spent. An entry in the Community Budget does not of itself authorise expenditure in the absence of a legal base.

B. Study On Budgetary Rules And Practices In The Member States

742. The Directorate General XIX is currently conducting a study in co-operation with the International Institute of Administrative Sciences on “Budgetary Rules and Practices in the Member States”. The study, to be completed in September 1997, will among other things give an oversight of procedures used and budget principles applied in the Member countries. Contact persons are Jean-Pierre Baché, Head of Unit, Directorate General XIX, Budgets, and Catherine Bourtembourg, Deputy Director General, IIAS.

Appendix 2. The Clearance Of Accounts Process

743. Expenditure under the agricultural schemes is subject to regulatory provisions which require expenditure to be made according to Community rules within the framework of the common organisation of the markets. To enable the Commission to ensure the provisions are met, the Commission required Member States to introduce new arrangements from the 1996 Accounting year. These were:

- all Member States formally to accredit paying agencies responsible for administering EAGGF schemes, subject to administrative and control criteria;
- where more than one paying agency is accredited, a Co-ordinating Body to be appointed to act as representative of the Member State for distributing Commission texts, promoting harmonised application of scheme implementation, sending to the Commission information stipulated in regulations and ensuring that all accounting information required for statistical and control purposes is held at the Commission's disposal. (The Co-ordinating Body in the United Kingdom is the Intervention Board);
- an independent Certifying Body to be appointed by each Member State to audit and provide a certificate in respect of the completeness and accuracy of the EAGGF Accounts and compliance with paying agency criteria. (The National Audit Office is the independent Certifying Body in the United Kingdom).

744. The annual Clearance of Accounts procedure is split into two parts. These are Financial (on the basis of the Accounts and supporting Certificate sent by Member States) and Compliance (based on on-the-spot visits by Commission auditors to check compliance with scheme regulatory requirements).

745. Where a Compliance audit reveals a weakness in procedures, the Commission will make proposals to refuse (disallow) part of the scheme expenditure, reflecting the level of risk to which they consider deficiencies have placed Community funds. Disallowance may not involve expenditure effected prior to twenty four months preceding the Commission's formal advice of its findings. The results of the audit and any resulting disallowance will be the subject of full discussions with the Commission prior to issue of the formal advice. Member States can then appeal to a Conciliation Body whose function is to reconcile the divergent positions of the Commission and the Member State concerned.

746. The financial consequences of Compliance audits will be included in the Financial decision which is to be taken by 30 April of the following accounting year. The Commission's published Decision specifies the amounts recognised for EAGGF financing. These sums include accounting adjustments and corrections, some of which may be to the credit of the Member State. The net amount disallowed is required to be refunded to the Commission. A Commission Decision can be overturned only by a successful challenge to the European Court of Justice, which must be mounted within two months of publication or of any prior formal notification.

747. [In the United Kingdom the financial consequences result in a charge on the Exchequer.]

Appendix 3. List Of Useful Terms

***A priori* audit** See *ex ante* control.

***A posteriori* audit** See *ex post* control.

Accountability A key concept in modern management theory and practice. It means that managers are held responsible for carrying out a defined set of duties or tasks, and for conforming with rules and standards applicable to their posts. The person or body to which the manager must report and answer for his or her actions is made explicit and he or she may be rewarded for good performance or suffer the consequences of inadequate performance. A manager of an organisational unit may also be held accountable for the actions of subordinate staff.

Governments introducing reforms in public management have generally tried to delegate greater flexibility and autonomy to managers as a means of improving efficiency and effectiveness of their operations. Since this gives the manager greater power to make decisions, the reforms have included much greater emphasis on accountability as a means of balancing and checking his exercise of that power. In relation to work carried out by government ministries and agencies, accountability may be:

- **internal**, to a higher level of management, in which managers are assessed on a regular basis on the way in which they have carried out the tasks set out in their job description, with pay increases and/or promotion prospects frequently dependent on the outcome of such assessments (performance appraisal);
- **external**, to parliament, the public or central agencies such as the supreme audit institution (SAI), for their own performance (and, in the case of senior officials, for the performance of the organisation which they manage).

Accounting controls Those procedures and documentation concerned with safeguarding of assets, the conduct and recording of financial transactions and the reliability of financial records. They are frequently based on standards issued by the Ministry of Finance or the SAI to ensure comparability of accounting practices across all ministries and conformity with national and/or international conventions. See also *Control* (1).

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| Accruals account | A part of the accounting records which records liabilities. For example, if an organisation pays ECU 100 000 annually in arrears at 30 June for services received, by 31 December it has therefore received 50 per cent of those services for no payment and should make an accrual for a liability of ECU 50 000 at 31 December. |
| Administrative controls | <p>Refer to non-financial procedures and records of ministries which ensure compliance with rules governing activities such as:</p> <ul style="list-style-type: none"> • the appointment, promotion and disciplining of personnel; • public procurement; • equal opportunities for minority groups; • the handling of correspondence; • travel and entertainment, etc. See also <i>Control</i> (1). |
| Appropriation accounts | Have a wide variety of uses in practice, but may refer to funds separately identified by an organisation for specific purposes. For example, a government may establish an appropriation account to monitor and record payments to private consultants. |
| Audit | <p>May be carried out to satisfy the requirements of management (internal audit), or by the SAI, or any other independent auditor, to meet statutory obligations (external audit). A particular task of internal audit is to monitor management control systems and report to senior management on weaknesses and recommend improvements. The scope of audits varies widely and includes:</p> <ul style="list-style-type: none"> • financial audits, covering the examination and reporting on financial statements, and the examination of the accounting systems upon which those statements are based; • compliance or regularity audits, which examine legal and administrative compliance, the probity and propriety of administration, financial systems and systems of management control; and • performance audit/value for money audits, which assess the management and operational performance (economy, efficiency and effectiveness) of public programmes, particular ministries and agencies in using financial, staffing and other resources in meeting their objectives. See also <i>Control</i> (2). |
| Audit evidence | The evidence gathered by the auditor as part of the audit procedures. |
| Audit objectives | Define intended audit accomplishments. |

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| Audit report | Refers to the report of the auditor made once the audit work has been carried out. For example, an auditor's report on an organisation's financial statements will set out the results of the auditor's work in connection with the financial statements. |
| Audit risk | Refers to the risk that the procedures carried out by the auditor will not detect matters which, if known, would require the auditor's report to be altered. |
| Audit sampling | Refers to where the procedures carried out by an auditor are on a sample of an underlying population, relevant to the audit work, rather than the whole of that population. |
| Auditors certificate | Refers to the report of the auditor made once the audit work has been carried out. For example, an auditor's report attached to an organisation's financial statements may be referred to as the auditor's certificate on those financial statements. |
| Authorisation (financial) | Implies that the authorising authority has verified and validated that the activity or transaction conforms with established policies and procedures. (300.03.2a). |
| Budgeting | Refers to the process whereby an organisation will plan for its future financial activities. |
| Central agencies | Those organisations in the executive branch that co-ordinate the activities of, and provide guidance to the operating ministries and agencies. Practice vary widely from country to country, but central agencies are generally regarded as including: <ul style="list-style-type: none"> • the Ministry of Finance; • the Cabinet Office, or the ministry assisting the Prime Minister or the Council of Ministers in the development and co-ordination of policy; • the ministry or agency responsible for developing and co-ordinating policies in relation to human resource management within the public sector; • the Supreme Audit Institution; and • the Ministry of Foreign Affairs, in certain areas of work such as policy on European integration. |
| Clearance of Accounts | See Appendix 2 on <i>The Clearance of Accounts Process</i> |
| Community Structural Frameworks | These are the EAGGF-Guidance Section, FIFG, ERDF and ESF. |

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| Consolidated accounts | Those accounts which are drawn up to reflect the affairs of a group of entities. For example, a ministry or holding company with many different operating agencies subsidiary companies may prepare consolidated accounts reflecting the affairs of the organisation as a whole, as well as accounts for each operating agency/subsidiary. |
| Control, controls | There are two meanings relevant to management and administration: <ol style="list-style-type: none"> 1. mechanisms and means for guidance, self-regulation, or restraint, intended to prevent mishap, as in a pilot controlling an aircraft. Many languages do not have words directly equivalent to this meaning of “control”. In some countries, for example the Netherlands, the English word is borrowed and used to convey this meaning of control; and 2. to check, verify, audit or to keep a copy of the accounts. |
| Corruption | There are many different definitions of the concept. One is the, “active or passive misuse of the powers of Public officials (appointed or elected) for private financial or other benefits”. |
| Due professional care | Calls for the application of the care and skill expected of a reasonably prudent and competent auditor in similar circumstances. Due professional care is exercised when audits are carried out in accordance with standards set for the profession. |
| Economy, efficiency and effectiveness: | <ul style="list-style-type: none"> • Economy means acquiring the necessary resources (finance, staff, buildings, equipment, etc.) to carry out an activity at the least cost. • Efficiency means achieving maximum output from a given level of resources used to carry out an activity. • Effectiveness means the extent to which the activity's stated objectives have been met. |
| <i>Ex ante</i> control | The auditor is involved in authorising public expenditure. Payment orders and supporting documentation received are checked whether the transactions have been properly authorised, are legal and regular, and whether there are sufficient provisions in the budget. |
| <i>Ex post</i> control | At least three types. Those SAIs with a judicial function examine and pass judgement on the records of those individuals who have personal responsibility for the use of public funds. Financial audit, including the examination of documentation relating to a series of transactions, allows the SAI to report on the state accounts and provides the basis for the legislature to give some form of discharge or opinion. Performance audit, focusing on particular aspects of public expenditure, addresses wider issues of economy, efficiency and effectiveness ³⁵ . |

35. *State Audit in the European Union*, The National Audit Office, United Kingdom, 1996.

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| External auditors | Refers to the auditors of an organisation which are not under the control of the organisation and may not report to objectives set by the organisation. External auditors are often distinguished from internal auditors. |
| Financial control | <i>See Management Control.</i> |
| Financial management | Covers the legal and administrative systems and procedures put in place to permit government ministries and agencies to conduct their activities so as to ensure correct usage of public funds which meets defined standards of probity and regularity. These activities include the raising of revenue, the management and control of public expenditure and financial accounting and reporting, and, in some cases, asset management. |
| Financial statement | The accounts drawn up by an organisation to report its financial affairs. Financial statements are often prepared under regulations governing matters such as their content and publication. |
| Financial statement assertion | An assertion relating to a set of financial statements which may be considered by an auditor as part of the audit procedures. For example, an assertion may be made that the financial statements reflect a complete record of all of the financial transactions carried out by an organisation in the period, and an auditor may carry out procedures to test that assertion. |
| Findings | Pertinent statements of fact. Audit findings emerge by a process of comparing what should be with what is. |
| Fraud | <p>The severest form of an irregularity. The term fraud is defined in the Convention on the protection of the European Communities' financial interest decided the 26 July 1995 (OJ No. C316, 27.11.1995). The Convention is drawn up in accordance with the rules for the EU third pillar as the rules concerns penal issues (the regulation mentioned above concerns administrative measures and sanctions and are therefor drawn up under the rules of the first pillar).</p> <p>The definition of fraud affecting the EU-budget (given in Paragraph 1 of Article 1 of the Convention) is quite lengthy, the core is that it needs intentional act or omission to have an irregularity defined as a fraud and therefore punishable by Court proceedings (all other acts can therefore only be sanctioned through administrative measures as fines and denial of further funding, etc.) states:</p> <p>For the purposes of this Convention, fraud affecting the European Communities' financial interests shall consist of:</p> <p>(a) in respect of expenditure, any intentional act or omission relating to:</p> <ul style="list-style-type: none"> - the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities; |

- non-disclosure of information in violation of a specific obligation, with the same effect;
 - the misapplication of such funds for purposes other than those for which they were originally granted.
- (b) in respect of revenue, any intentional act or omission relating to:
- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities;
 - non-disclosure of information in violation of a specific obligation, with the same effect;
 - misapplication of a legally obtained benefit, with the same effect.

Going Concern

Refers to the ability of an organisation to pay its debts as they fall due. An organisation which is able to do so is a going concern. One of the key assumptions underlying the general preparation of financial statements is that they are prepared on the basis that the organisation is a going concern.

Good administrative management

For example: Financial Control has all the necessary information at its disposal to enable it to carry out its subsequent checks from the outset and can freely perform the audit tasks provided for in the Regulations.

Good management of funds

For example:

The expenditure financed by the Community is actual and legitimate.

The initiatives financed by the Community are conducted in accordance with the regulations; measures are taken to prevent and pursue any irregularities, and to recover any amounts lost as a result of an irregularity or negligence.

The EC contribution is accompanied by a real national contribution, according to the percentages stipulated in the decision to grant assistance.

The timetable for the release of funds by the Commission does not differ greatly from that of spending by the managing body.

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| Good operational management | <p>For example:</p> <p>Operations form part of a Community Support Framework (CSF). They are consistent in respect of each other.</p> <p>The choice of operation is based on a satisfactory <i>ex ante</i> assessment.</p> <p>The decision to commit a further instalment of a particular programme is based on suitable annual monitoring.</p> <p>An ex post assessment serves to gauge the socio-economic impact of the operation and is used at a later date.</p> <p>The financing plans for the operations are sufficiently detailed. They refer to the indicative financing plan set out in the CSF.</p> |
| Independence/ Independent auditor | Refers to an auditor who carries out audit work freely and objectively. |
| Internal auditing | An independent appraisal function established within an organisation. |
| Internal control | <i>See Management control.</i> |
| Irregularities | <p>Defined in Article 1, Paragraph 2 in the horizontal Council regulation on the protection of the Communities' financial interests (2988/95) as following:</p> <p>"Irregularity" shall mean any infringement of a provision of a Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure.</p> |
| Job description | A set of tasks or activities to be performed by an individual which delimits the function of the job (or position) occupied by that individual. |

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| Management control | <p>Or <i>Internal control</i> is the organisation, policies and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision making.</p> <p>It is the responsibility of an organisation's management to establish and monitor management control systems, not that of the external auditor. However, an external auditor should comment on the absence or adequacy of such systems since a consequence of good management controls is that less detailed auditing of individual documents and transactions will be necessary. See also <i>Accounting Controls, Administrative Controls, Control (1)</i>.</p> |
| Management information systems (MIS) | <p>Refer to those sources of data and records held within ministries or agencies which are designed as a common pool of information to assist managers in carrying out their responsibilities. Financial management information systems (FMIS)—a sub-set of MIS—are widely regarded as essential for most ministries and agencies to manage their resources better. Such systems may also assist in the evaluation of programme performance, in workload planning and in monitoring progress towards objectives. Management information systems form a key element of management controls.</p> |
| Materiality | <p>Refers to the significance of a matter in relation to a set of financial or performance information. If a matter is material to the set of information, then it is likely to be of significance to a user of that information.</p> |
| Outcomes | <p>Refer to what is ultimately achieved by an activity, as distinct from its outputs which relate to more direct or immediate objectives. Thus, the outcome of a random breath-testing campaign conducted by the police may be a decline in the incidence of drink-related motor vehicle accidents, whilst one of the outputs could be the number of drivers charged with exceeding the legal alcohol limit. It is often difficult to measure outcomes.</p> |
| Outputs | <p>Refer to what is produced directly or immediately by an activity. Depending on their nature, outputs may, or may not be straightforward to measure. Thus, the number of hospital cases treated by a doctor is likely to be easier to measure than the advice on a policy issue submitted by a health administrator to his chief executive or minister, which can only be evaluated in a qualitative and essentially subjective way.</p> |
| Own resources | <p>EU own resources refer to customs duties and agricultural duties (<i>traditional own resources</i>), the resource based on VAT, and a complementary resource based on GNP.</p> |

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| Performance appraisal | Assessment against a set of predetermined criteria of the efficiency and effectiveness with which an individual fulfils an agreed set of tasks. Such appraisals are frequently used in assessing whether managers should qualify for pay increases or promotion. |
| Performance audit | Audit covering economy, efficiency and effectiveness aspects of social programmes (or any other activity). See also <i>ex post</i> control. |
| Performance measurement | Assessment against a set of predetermined criteria of the economy, efficiency and effectiveness with which an organisation carries out a particular activity or range of activities. Organisations may be set regular targets on particular aspects of their performance—financial returns, efficiency, quality of services supplied, etc.—against which their performance is monitored and evaluated. |
| Programme evaluation | The process whereby the activities undertaken by ministries and agencies are assessed against a set of objectives or criteria. This may include an assessment of programme outcomes. Programme evaluations may be conducted on a regular basis. They may be internal evaluations, or may be carried out by a third party such as the Ministry of Finance, the SAI, or an external consultant. |
| Principle of additionality | Additionality means that the funds of the European Community should not replace, but be an addition to national regional policy funds. |
| Principle of subsidiarity | The subsidiarity principle is intended to ensure that decisions are taken as closely as possible to the citizen and that constant checks are made as to whether action at Community level is justified in the light of the possibilities available at national, regional or local level. Specifically, it is the principle whereby the Union does not take action (except in the areas which fall within its exclusive competence) unless it is more effective than action taken at national, regional or local level. It is closely bound up with the principles of proportionality and necessity, which require that any action by the Union should not go beyond what is necessary to achieve the objectives of the Treaty. |
| Risk analysis/assessment | A systematic process for assessing and integrating professional judgements about probable adverse conditions and/or events. The risk assessment process should provide means of organising and integrating professional judgements for development of the work schedule. |
| Supreme Audit Institution (“SAI”) | Refers to any organisation which sets standards for audit work. The organisation itself will depend on the particular scope of the audit. |
| Traditional Own Resources | EU traditional own resources refer to customs duties and agricultural duties. See Own resources. |

Appendix 4. Some EU Regulations Concerning Budgeting, Financial Control And External Audit

Primary law

| Regulation/directive etc. | Subject |
|----------------------------------|--|
| TEC ³⁶ , Article 5 | Establishing general obligations of the Member States. |
| TEC, Article 155 | Obligations and responsibilities of the European Commission. |
| TEC, Article 188a-188c | Provisions for the European Court of Auditors. |
| TEC, articles 199-209 | Financial provisions. |
| TEC, Article 209a | Fight against fraud. |

Secondary law

Budgeting

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 1231/77 | Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities. (Implemented by 3418/93). |
| 3418/93 | Commission Regulation (Euratom, ECSC, EC) No. 3418/93 of 9 December 1993 laying down detailed rules for the implementation of certain provisions of the Financial Regulation of 21 December 1977. |
| 94/729 | Council Decision (EC, Euratom) of 31 October 1994 on budgetary discipline. |
| Interinstitutional agreement | Budgetary discipline and improvement of the budgetary procedure. |

Expenditure

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 729/70 | Regulation (EEC) No. 729/70 of the Council of 21 April 1970 on the financing of the common agricultural policy. |

36. Treaty of the European Economic Communities also known as the Treaty of Rome.

Own Resources

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 88/376 | Council Decision (EEC, Euratom) of 24 June 1988 on the system of the Communities' own resources (Implemented by 1552/89). |
| 1552/89 | Council Regulation (EEC, Euratom) No. 1552/89 of 29 May 1989 implementing Decision 88/376/EEC, Euratom on the system of the Communities' own resources. |
| 1553/89 | Council Regulation (EEC, Euratom) No. 1553/89 on the definitive uniform arrangements for the collection of own resources accruing from value added tax. |
| 89/130 | Council Directive (EEC, Euratom) of 13 February 1989 on the harmonisation of the compilation of gross national product at market prices. |
| 94/728 | Council Decision (EC, Euratom) of 31 October 1994 on the system of the European Communities' own resources System of own resources of the EC. |

Financial Control And External Audit

| Regulation/directive etc. | Subject |
|----------------------------------|--|
| 2988/95 | Council Regulation (EC, Euratom) No. 2988/95 of 18 December 1995 on the protection of the European Communities financial interests. |
| 2185/96 | Council Regulation (Euratom, EC) No. 2185/96 of 11 November 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities' financial interests against fraud and other irregularities. |

Agriculture

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 1663/95 | Commission Regulation (EC) No. 1663/95 of 7 July 1995 laying down detailed rules for the application of Council regulation (EEC) No. 729/70 regarding the procedure for the clearance of the accounts of the EAGGF Guarantee Section. |
| 4045/89 | Council Regulation (EEC) No. 4045/89 of 21 December 1989 on scrutiny by Member States of transactions forming part of the system of financing by the Guarantee Section of the European Agricultural Guidance and Guarantee Fund. |
| 307/91 | Council Regulation (EEC) No. 307/91 of 4 February 1991 on reinforcing the monitoring of certain expenditure chargeable to the Guarantee Section of the European Agricultural Guidance and Guarantee Fund. |
| 3508/92 | Council Regulation (EEC) No. 3508/92 of 27 November 1992 establishing an integrated administration and control system (IACS) for certain Community aid schemes (Implemented by 3887/92). |
| 3887/92 | Commission Regulation (EEC) No. 3887/92 of 23 December 1992 laying down detailed rules for applying the integrated administration and control system for certain Community aid schemes. |
| 723/97 | Council Regulation (EC) No. 723/97 of 22 April 1997 on the implementation of Member States' action programmes on control of EAGGF Guarantee Section expenditure. |
| 515/97 | Council Regulation (EC) No. 515/97 concerning mutual assistance between authorities of the Member States and co-operation between these authorities and the Commission to secure the correct application of customs — and agricultural legislation. |
| 386/90 | Council Regulation (EEC) No. 386/90 of the 12 February 1990 on the monitoring carried out at the time of export of agricultural products receiving refunds or other amounts. |

Structural Funds

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 2052/88 | Council Regulation (EEC) No. 2052/88 of 24 June 1988 on the tasks of the Structural Funds and their effectiveness and on co-ordination of their activities between themselves and with the operations of the European Investment Bank and the other existing financial instruments (Implemented by 4253/88). |
| 4253/88 | Council Regulation (EEC) No. 4253/88 of 19 December 1988 laying down provisions for implementing Regulation (EEC) No. 2052/88 as regards co-ordination of the activities of the different Structural Funds between themselves and with the operations of the European Investment Bank and the other existing financial instruments. |

Customs Co-Operation

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 210/97 | Decision No. 210/97/EC of the European Parliament and of the Council of 19 December 1996 adopting an action programme for customs in the Community (Customs 2 000). |

Reclaiming Of Amounts And Sanctions

| Regulation/directive etc. | Subject |
|----------------------------------|---|
| 595/91 | Council Regulation (EEC) No. 595/91 of 4 March 1991 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the common agricultural policy and the organisation of an information system in this field. |
| 1681/94 | Commission Regulation (EC) No. 1681/94 of 11 July 1994 concerning irregularities and the recovery of sums wrongly paid in connection with the financing of the structural policies and the organisation of an information system in this field. |
| 1469/95 | Council Regulation (EC) No. 1469/95 of 22 June 1995 on measures to be taken with regard to certain beneficiaries of operations financed by the Guarantee Section of the EAGGF |
| 745/96 | Commission Regulation (EC) No. 745/96 of 24 April 1996 laying down detailed rules for the application of Council Regulation (EC) No. 1469/95 on measures to be taken with regard to certain beneficiaries of operations financed by the Guarantee Section of the EAGGF. |

Appendix 5. List Of Abbreviations

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| ACA | Austrian Court of Audit= <i>Rechnungshof</i> |
| ACCT | Agence Comptable Centrale du Trésor (<i>French Accounting Agency of the Treasury</i>) |
| ACOFA | Agence Centrale des Organismes d'Intervention dans le Secteur Agricole (<i>French Central Agency of Guidance Organisations in the Agricultural Sector</i>) |
| AMA | Agrarmarkt Austria |
| AMS | Arbeitsmarktsservice (<i>Austrian Public Employment Service</i>) |
| ATS | Austrian Schillings= <i>Österreichische Schilling</i> |
| BCC | Budgetary Control Committee of the European Parliament |
| BHG | Bundeshaushaltsgesetz (<i>Austrian Federal Budget Act</i>) |
| BHV | Bundeshaushaltsverordnung (<i>Austrian Federal Budget Ordinance</i>) |
| C&AG | Comptroller and Auditor General (United Kingdom) |
| CAP | Common Agricultural Policy |
| CEC | Council of the European Communities <i>OR</i> Central European Countries |
| CICC | Commission de Co-ordination des Contrôles Communautaires (<i>French Co-ordination Commission of the Community Controls</i>) |
| CNASEA | Centre National pour l'Aménagement des Structures des Exploitations Agricoles (<i>French National Centre for Planning of Farms Structures</i>) |
| COCOLAF | UCLAF's Advisory Committee for the Co-ordination of Fraud Prevention |
| COREPER | Committee of Permanent Representatives of the European Union |
| CSF | Community Structural Framework |
| DAFSE | European Social Fund Affairs Department |
| DAS | Declaration d'Assurance (French for Statement of Assurance — See <i>SOA</i>) |
| DATAR | Délégation à l'Aménagement du Territoire et à l'Action Régionale (<i>French Delegation for Regional Planning</i>) |
| DB | Draft Budget |
| DFID | British Department for International Development |
| DG V | Directorate-General V (Employment, Industrial Relations & Social Affairs) of the European Commission |
| DG VI | Directorate-General VI (Agriculture) of the European Commission |
| DG IX | Directorate-General IX (Personnel and Administration) of the European Commission |
| DG XVI | Directorate-General XVI (Regional Policies) of the European Commission |
| DG XIX | Directorate-General XIX (Budgets) of the European Commission |

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| DG XX | Directorate-General XX (Financial Control) of the European Commission |
| DGCCRF | Direction Générale de la Concurrence, de la Consommation et de la Répression des Fraudes (French General Department of Competition, Consumption and Fraud Repression) |
| DGDDI | Direction Générale des Douanes et des Droits Indirects (<i>French General Department of Customs and Indirect Duties</i>) |
| EAGGF | European Agricultural Guidance and Guarantee Fund (= FEOGA in French) |
| EC | European Community <i>OR</i> European Commission <i>OR</i> European Council |
| ECA | European Court of Auditors (= CCE in French) |
| ECOFIN | Economic & Finance Council of Ministers |
| ECSC | European Coal and Steel Community |
| ECU | European Currency Unit |
| EDF | European Development Fund |
| EEA | European Economic Area |
| EEC | European Economic Community |
| EES | European Economic Space |
| EIB | European Investment Bank |
| EMS | European Monetary System (Consists of two parts: ECU and ERM) |
| EMU | Economic and Monetary Union of the EC (also known as European Monetary Union) |
| EP | European Parliament |
| ERDF | European Regional Development Fund |
| ERM | Exchange Rate Mechanism |
| ESA | European Standards for Accounting |
| ESF | European Social Fund |
| EU | European Union |
| EURATOM | European Atomic Energy Community |
| EUROSAI | European Organisation of Supreme Audit Institutions |
| EUROSTAT | Statistical Office of the European Communities |
| FEOGA | See EAGGF |
| FF | French Francs |
| FIFG | Financial Instrument for Fisheries Guidance |
| FIM | Finnish Mark |
| FIRS | Fonds d'Intervention et de Régulation du Marché du Sucre (<i>Funds of Intervention and Regulation of the Sugar Market</i>) |

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| GDP | Gross Domestic Product |
| GGE | General Government Expenditure |
| GNP | Gross National Product |
| IBAP | British Intervention Board for Agricultural Produce |
| ICLAF | Instance de Co-ordination de la Lutte Anti-Fraude (<i>French Co-ordination Authority for the Fight against Fraud</i>) |
| ICN | Institutions de Contrôle Nationales |
| IFADAP | Instituto de Financiamento e Apoio ao Desenvolvimento da Agricultura e Pescas (<i>Portuguese Agricultural and Fisheries Development Assistance and Financing Institute</i>) |
| IFAP | International Federation of Agricultural Producers |
| IGC | Inter-Governmental Conference |
| IGF | (Portuguese) Inspectorate General of Finance |
| INGA | Portuguese National Agricultural Intervention and Guarantee Institute |
| INSEE | Institut National de la Statistique et des Etudes Economiques (<i>French National Institute of Statistics and Economic Studies</i>) |
| INTERBEV | Association Nationale Interprofessionnelle du Bétail et des Viandes (<i>French National Interprofessional Association for Cattle and Meat</i>) |
| INTERLAIT | Association Nationale Interprofessionnelle du Lait (<i>French National Interprofessional Association for Milk</i>) |
| INTOSAI | International Organisation of Supreme Audit Institutions |
| ISC | Institutions Supérieures de Contrôle (<i>SAI in English</i>) |
| IT | Information Technology |
| MoA | Ministry of Agriculture |
| MoF | Ministry of Finance |
| MS | Member State of the European Union |
| MUS | Monetary Unit Sampling |
| NAI | National Audit Institution |
| NAO | National Audit Office |
| NATO | North Atlantic Treaty Organisation |
| ONIC | Office National Interprofessionnel des Céréales (<i>French National Interprofessional Office for Cereals</i>) |
| ONILAIT | Office National Interprofessionnel du Lait et des Produits Laitiers (<i>French National Interprofessional Office for Milk and Dairy Products</i>) |
| OR | Own Resources |

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| ÖSTAT | Österreichisches Statistisches Zentralamt (<i>Austrian Central Statistical Office</i>) |
| PAC | Public Accounts Committee (in several Parliaments) |
| PDB | Preliminary Draft Budget |
| PMU | Project Management Unit |
| PR | Permanent Representation in Brussels |
| PRG | Commission's Group of Personal Representatives of Finance Ministers on SEM 2 000 |
| PSA | Finnish Parliamentary State Auditors |
| RR | Swedish Parliamentary Auditors= <i>Riksdagensrevisorer</i> |
| RRV | Swedish National Audit Office= <i>Riksrevisionsverket</i> |
| SAI | Supreme Audit Institution |
| SCA | Special Committee for Agriculture |
| SEK | Swedish krona |
| SEM 2 000 | Sound and Efficient Management Programme (Financial Management Reform Programme) |
| SF | Structural Fund |
| SGAR | Secrétaire Général pour les Affaires Régionales (<i>French General-Secretary for Regional Affairs</i>) |
| SGCI | Secrétariat du Comité Interministériel pour les Questions Economiques Européennes (<i>French Secretariat of the Interministerial Committee on European Economic Questions</i>) |
| SIGMA | Support for Improvement in Governance and Management in Central and Eastern European Countries |
| SME | Small and Medium-sized Enterprises |
| SOA | Statement of Assurance (= DAS) |
| SPD | Single Programming Document |
| TEN | Trans European Network |
| UCLAF | European Commission's Unit for the Co-ordination of Fraud Prevention |
| VAT | Value Added Tax |
| ZA/E | Zollamt Erstattungen (Austrian Customs Authority) |

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