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The budget of the European Union

– towards an integrated control system

THE EUROPEAN UNION'S (EU) BUDGET-FOUNDATIONS AND EVOLUTION

The European Union's budgetary, legal and operational environment is complex and unique. The financial and control framework has evolved in line with the unification of budgetary instruments, the progress of common policies and the advancement of inter-institutional harmonisation.

The various players in the budgetary process (Council, Parliament and the Commission) were established as a result of the founding treaties[2]. The Luxembourg Treaty set out arrangements for budgetary decision-making powers, later modified in the 1975 Brussels Treaty[3], which provided the rules currently in force; the Brussels treaty also assigns budgetary control powers to the European Court of Auditors.

Further significant changes to the budgetary and financial framework were introduced in 1988[4] with the Inter-Institutional Agreement (IIA) on budgetary discipline. This measure aimed to improve inter-institutional cooperation, budgetary discipline and management, by making budgetary discipline the shared responsibility of the Parliament, the Council and the Commission. The agreement sets out the financial framework along with its implementing provisions and outlines procedures for collaboration and conciliation on budget related issues. Reforms were in part motivated by the enlargement of the community in 1986 (Spain and Portugal) and the ambitions which accompanied enlargement such as the single market and social cohesion.

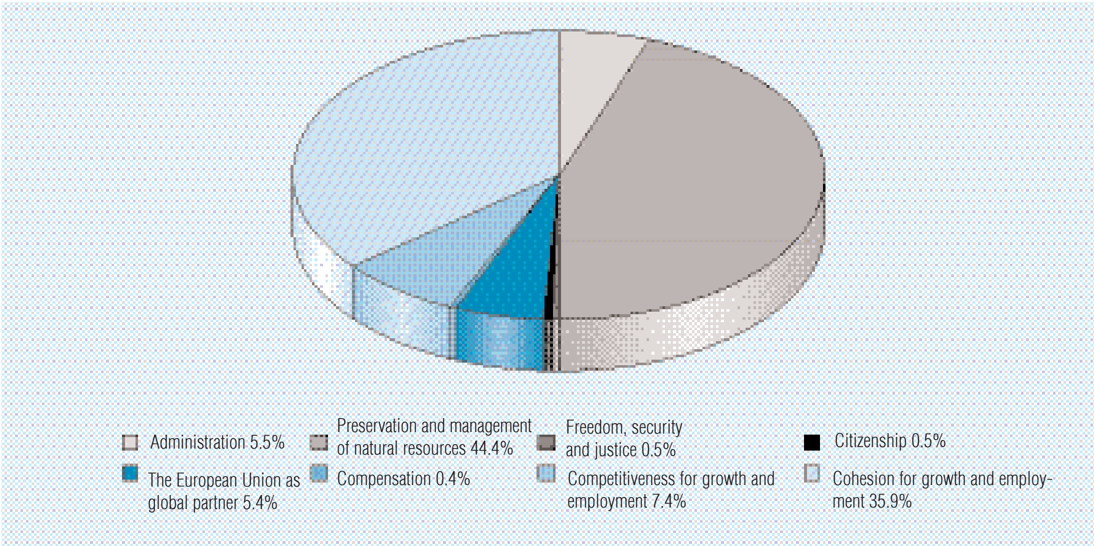
STRUCTURE OF THE 2007 EU BUDGET

The European Union's general budget is implemented in accordance with the provisions contained in the treaties and the Financial Regulation[5]. 2007 is the first budget under the new multi-annual financial framework, known as the *Financial Framework (also referred to as the Financial Perspective)*, which will cover up to 2013 and is the first for the enlarged EU of 27 Member states. For 2007, the annual budget of the European Union amounts to 126.5 billion in commitment appropriations (around 1.08% of the Gross National Income (GNI) of the enlarged EU). The budget enables the EU to fund the activities, programmes and projects as decided by the Member States. *(See Chart 1)*

Although diminished, the largest budgetary allocation is still made to the common agricultural policy. A key priority for the EU is 'Growth and employment' with the budget

Chart 1

EU GENERAL BUDGET 2007



reflecting the agenda established by the Lisbon strategy. A new generation of programmes has been launched to realise a 'European area of freedom, security and justice', and under the umbrella of 'Citizenship' there are a number of programmes aiming to promote a better understanding of the EU and address the day to day concerns of its citizens. In the EU's growing role as 'Global partner' increased amounts are allocated to areas such as humanitarian aid, the Common Foreign and Security policy and the Stability Instrument.

The financial perspective for 2007–2013 adopted on 17 May 2006, sets three main priorities;

❶The integration of the single market into the broader objective of sustainable growth (including policies on competitiveness and cohesion for employment, research and education).

❷The development of the concept of European citizenship (policy directed at freedoms, security and justice).

❸The establishment of a coherent role for Europe as a global player (including external action and pre-accession instruments).

THE BUDGETARY PROCESS

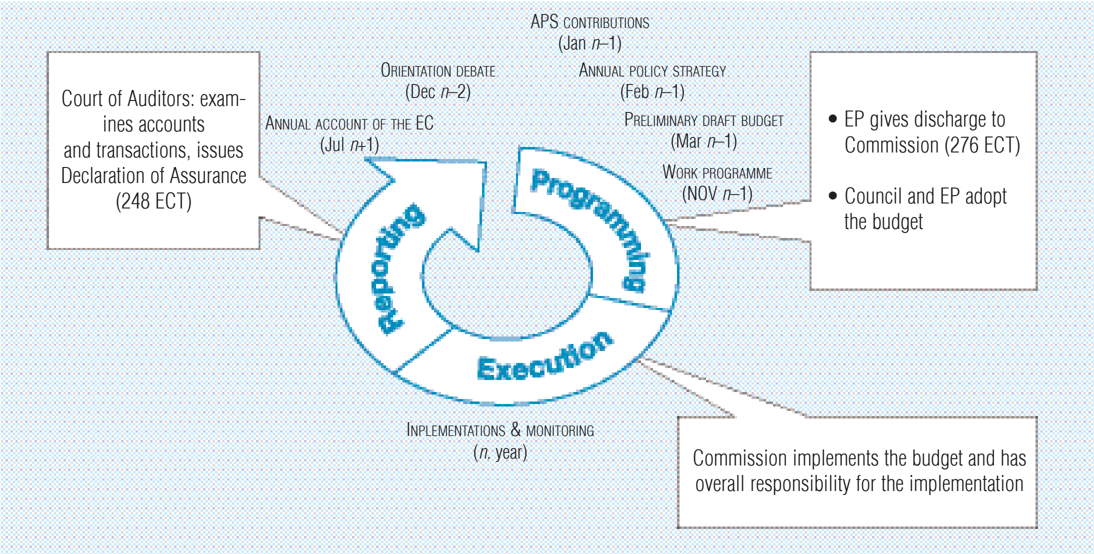
The decision and implementation process of the EU budget involves the European Parliament, the Council of the European Union and the European Commission. The budget implementation and monitoring cycle operates over a three year period. *(See Chart 2)*

Preparation and adoption

The EC Treaties[6] set out the budgetary procedure and identify the two arms of the budgetary authority; the Council of ministers and the European Parliament. The budgetary procedure begins with the drafting of the Budget by the *Commission*. The Commission prepares the preliminary draft budget as part of its strategic programming and planning cycle, the process is intended to enhance the link between policy priorities and the allocation of resources. In adherence to the adopted annual policy strategy resulting from the parliamentary Orientation debate and endorsed by the College (the collective body of Commissioners), the

Chart 2

THE BUDGET CYCLE



Commission establishes a Preliminary Draft Budget (PDB).

The PDB is examined by the *Council* following which the draft budget is produced. Compulsory expenditure, defined as expenditure necessarily resulting from treaties or from acts henceforth adopted in accordance, is agreed by all three institutions (the Commission, the Council, and Parliament), the final decision belongs to the Council.

Once the draft stage is reached *Parliament* begins its work. A first reading may result in amendments to non-compulsory expenditure or *proposed modifications* to compulsory expenditure. The *Council* will then conduct a second reading of the draft budget and may make changes to take into account the amendments or proposed modifications voted by Parliament in its first reading. The draft then goes back to *Parliament* for their second reading where most of the work is carried out by the Committee on Budgets, primarily on non-compulsory expenditure.

If Parliament votes to accept the draft budget, it can then be implemented. If it does not, Parliament can ask for a new draft to be submitted and if necessary provisional measures are implemented to provide for the new budgetary year whilst a third reading is carried out. The whole process is punctuated with 'trialogue' sessions put in place through the IIA to improve communication and co-operation between the three institutions.

Implementation and management

Once the budget has been adopted, implementation by the European Commission begins. The Annual Policy strategy lists the main policy initiatives and outlines the resources allocated to achieving the objectives. The political priorities and key initiatives are then translated operationally in the Annual Management plans of the Commission services. Whilst the European Commission has overall responsibility for the implementation of the budget (EC Treaty, Art 274), more than 80% of expenditure is in fact implemented by the Member States, third countries and other international organisations. Member States co-operate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management.

The EU Financial Regulation defines various management methods to implement the budget in the most efficient and effective way:

❶ *Centralised management*, which is further broken down into '*centralised direct management*', when money is spent directly by the Commission departments, or, '*centralised indirect management*' where the budget is implemented through executive agencies or national public-sector bodies.

❷ *Shared management* where the budget is managed by Member states, for example the European Agricultural Guidance and Guarantee Fund and Structural Funds.

❸ *Decentralised management* where management of the budget is delegated to third countries, this applies to external actions and pre-accession aid.

❹ *Joint management* where implementation is delegated to international organisations.

In the case of shared and decentralised management, the implementation is entrusted to the Member States or third countries and the Commission must be satisfied that the budget will be implemented in accordance with the rules and the principles of sound financial management. To further protect the EU funds, a financial correction mechanism is used to rectify irregularities.

Budgetary Discharge

The cycle ends with the budgetary discharge granted by Parliament, releasing the Commission from any further liability in respect of its management of the budget. The Parliament has the authority to call for the EU institutions and bodies to account for how the budget has been spent and it also examines the European Court of Auditors annual report on the budget's implementation. Parliament decides whether or not to approve the Commission's handling of the budget for the previous financial year.

THE INTERNAL CONTROL AND AUDIT FRAMEWORK

In 2000 the Commission introduced a wide-ranging administrative reform[7]. The white paper on administrative reform proposed five core principles – openness, participation, accountability, effectiveness and coherence. An independent Internal Audit Service was created as well as Internal Audit Capabilities (IAC's) within each Commission service to ensure that internal controls function correctly and are evaluated on a regular and independent basis[8].

The aim was to assign accountability back to the responsible departments. The rules which came into force in 2002 abolished the central ex-ante financial control function; the Directors General as "*Authorising Officers* by delegation", became fully responsible for the transactions made within their field of activity. The Accounting officer is responsible for laying down accounting rules, validating accounting systems and drawing up the institutions financial statements. Each Director-General or Head of Service issues an *annual activity report* which reports on the DG's/Service's environment, its main achievements, and any management and control issues. Upon issuing the report the Authorising officer signs a *declaration* which states that on the basis of his/her own judgement and the information at his/her disposal, (self-assessment, ex post controls, work of internal audit capability, IAS and reports of Court of Auditors) the information in the report provides

- a true and fair view on the state of affairs in the Directorate General or Service and
- the resources used have been employed for their intended purposes and in accordance with the principles of sound financial management and

- controls in place give the necessary guarantees concerning the legality and regularity of the underlying transactions.

The independence of the Internal Audit Service (IAS) is spelt out in the financial regulation and embedded in the IAS charter. The mission of the IAS is to audit the *internal control systems* that exist within the European Commission in order to assess their effectiveness and, more generally, the performance of Commission departments in implementing policies, programmes and actions with a view to bringing about continuous improvement. According to the IAS charter, the service may adopt any audit approach it deems necessary (financial audit, operational audit, integrated audit, informatics audit, etc.) in any area of the European Commission's work, *covering all aspects of internal control.*

The Commission reports annually to the European Parliament and the Council on internal audit work carried out and the follow-up action taken on existing recommendations. In addition to assurance measures provided from within the Commission, the European Court of Auditors also provides budgetary oversight activities. Its main role is to check the financing of the Union's activities and to assure that the EU budget is correctly implemented – in other words, that EU income and expenditure is legal and operating under sound financial management. The Treaty requires the Court of Auditors to provide the European Parliament and the Council with a statement of assurance (DAS) as to the reliability of the accounts and the legality and regularity of the underlying transactions.

THE DEVELOPMENT OF INTERNAL CONTROL – TOWARDS 'SINGLE AUDIT'

As the overall financial framework of the Commission has developed, so has the internal control procedures in place to assure the reliability and regularity of budgetary expenditure. *(See Chart 3)*

In 2004 the European Court of Auditors (ECA) produced an opinion[9] suggesting scope for further improvement regarding the internal control framework of EU funds. The proposal advocated defined minimum requirements of control taking into account cost-benefit proportionality. The ECA proposed that the internal control system should present a chain of control procedures, "with each level having specific defined objectives which take into account the work of others". The ECA further proposed that the Commission be responsible for promoting the improvement of internal control systems in partnership with member states.

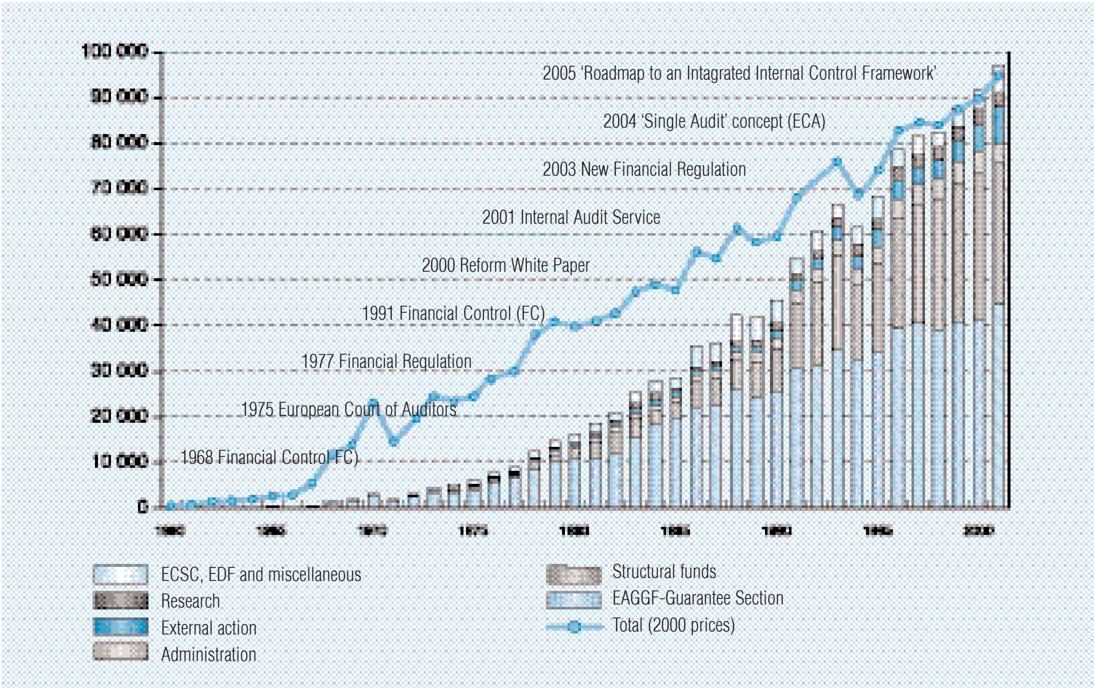
In response to these recommendations the Commission devised the "Roadmap towards an integrated internal control framework"[10] (2005). Taking into account the opinion of the ECA, the roadmap identifies the main actions to be taken in the field of internal control as well as addressing the roles that the Council, European Parliament and the Member States should play in achieving a reliable and integrated internal control framework. In accordance with the ECA opinion, four themes for action were identified for further improvement:

- Simplification and common control principles.
- Management declarations and audit assurance.
- The single audit approach and the prioritising of cost-benefit considerations.
- Sector-specific gaps.

The benefits offered by the Single audit model include the streamlining of audit activities and the establishment of efficient and effective information flows whilst at the same time providing a co-ordinated overview of shared responsibilities such as legality, regularity and effectiveness. The structure minimises the duplication of work and the overall audit expenditure required to derive findings. Within

Chart 3

COMMUNITY EXPENDITURE AND FINANCIAL CONTROL ADVANCEMENTS



the context of the European Community, the single audit concept defines a productive collaboration between the European Commission and the member states' relevant national authority, i.e. local implementation bodies and audit institutions. This is of obvious benefit in areas of shared management with member States which results in many administrative layers; starting with the Commission services, passing through different combinations of Member State central, regional and local administrations, down to the payment of EU aid to individual beneficiaries. In this respect, the model aims to overcome some of the impediments inherent in an environment of decentralisation and deregulation.

On a political level, it is hoped that the implementation of the 'Roadmap' will result in an adequately integrated Community control framework enabling the Commission to obtain a positive Statement of Assurance from the European Court of Auditors.

Notes

[1] Joanna Richardson works in the Internal Audit Service of the European Commission. The views expressed in this article are her own and do not necessarily represent those of the European Commission.

[2] The treaty establishing the European Coal and Steel Community (ECSC)18th April 1951; The Treaty establishing the European Economic Community (EEC) 25th March 1957 (aka Treaty of Rome); The Treaty establishing the European Atomic Energy Community (Euratom) 25th March 1957; The Treaty on the EU, 22th Feb 1992.

[3] Treaty giving the European Parliament wider budgetary powers and establishing a Court of Auditors is signed. Entered into force in June 1977.

[4] OJ L 185, 15.7.1988 p. 33.

5 OJ L 356, 31.12.1977, p. 1–30

6 The Budgetary Treaty of 1970 ("Treaty amending Certain Budgetary Provisions of the Treaties establishing the European Communities and of the Treaty establishing a Single Council and a Single Commission of the European Communities"), Luxembourg on April 1970. The Budgetary Treaty of 1975 ("Treaty amending Certain Financial Provisions of the Treaty establishing the European Communities and of the Treaty establishing a Single Council and a Single Commission of the European Communities"), Brussels July 1975

7 White Paper (COM(2000)200)

8 O.J. 1498 – point 9.9 Conditions for the creation of an internal audit capability in each Commission service

9 Opinion 2/2004 of the Court of Auditors of the European Communities on the 'single audit' model(and a proposal for a Community internal control framework) (2004/C 107/01)

10 Commission communication on a roadmap to an integrated internal control framework: COM (2005) 252

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