

Consolidated statement on the use of EU funds in the UK

For the year ended 31 March 2007

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for the year ending 31 March 2007

Presented by Command of Her Majesty
Ordered by the House of Commons
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Commentary

The background to this Consolidated Statement

1. The Economic Secretary to the Treasury announced to the House of Commons on 20 November 2006 that, as part of ongoing work to improve the accountability of European Commission funds across the EU, HM Treasury would prepare a Consolidated Statement on the use of funds from the budget of the European Communities (EU funds) in the United Kingdom.

2. This arrangement will strengthen the audit and Parliamentary scrutiny of the UK's use of EU funds and should help detect any weaknesses in the UK's management of these funds, which can then be tackled sooner and more effectively. The Government hopes that the European Court of Auditors and the European Commission will be able to take into account the UK's statement and the Comptroller and Auditor General's (C&AG) audit opinion and Report when performing their own audit and control work. Similar initiatives are underway in some other Member States.

Respective responsibilities of the UK Parliament and Devolved Administrations

3. In accordance with the devolution settlement, relations with the European Union are the responsibility of the Parliament and Government of the United Kingdom, as Member State. Responsibility for implementing EU obligations, which concern devolved matters, lies with the relevant devolved administration. The proper administration of European Funds in Wales, Scotland and Northern Ireland is a matter for them and this Consolidated Statement of the use of EU funds is prepared without prejudice to this devolution of responsibilities.

Preparation of the Statement

4. HM Treasury has taken responsibility for performing the consolidation underlying this Statement on the basis of figures provided by the Managing Authorities¹, which remain accountable for the propriety of the reported spending. It is therefore not the intention that the Consolidated statement replaces the reporting of the receipts, payments and balance sheet impact of EU funding by UK Central Government bodies. Such bodies will continue to report the impact of EU funding following the principles laid down in the Government's Financial Reporting Manual (FReM) for the relevant period.

5. The announcement in November 2006 referred to the preparation of a consolidated statement in accordance with International Financial Reporting Standards (IFRS)² adopted by the European Union (EU), in so far as they are applicable. The UK Government has announced that it will move to reporting on an IFRS basis from 2009-10³ and hence the financial reporting of EU funds in the Managing Authorities' individual financial statements will not move to an IFRS basis until that year. Until then, UK Government financial statements will be prepared under UK generally accepted accounting practice (UK GAAP).

6. This is the first UK Consolidated Statement, which has been prepared for the financial year 2006-07. Along with the accompanying Comptroller and Auditor General's Report, it honours the Government's commitment to present an annual consolidated statement of the UK Central Government receipts and use of EU funds, bringing together some of the figures which are currently published in many different reports. For the financial year 2006-07, HM Treasury has worked with the UK Managing Authorities to develop the format and content of a consolidated statement that will assist in achieving the aim of improving the management of EU funds across the UK. HM Treasury has used UK GAAP-based data from the Managing Authorities in compiling the statement.

¹ For the purposes of this Statement, the Managing Authorities comprise the Devolved Administrations and Westminster Departments managing EU funds.

² IFRS includes pronouncements by or endorsed by the International Accounting Standards Board (IASB), including the Framework for the Preparation and Presentation of Financial Statements, the accounting standards – international accounting statements (IAS) and international financial reporting standards (IFRS) – and interpretations thereof issued by the Standards Interpretations Committee (SIC) or its successor, the International Financial Reporting Interpretations Committee (IFRIC).

³ Budget 2008, C103

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The Comptroller and Auditor General's Audit of the 2006-07 Consolidated Statement

7. The Comptroller and Auditor General has audited the work that HM Treasury has carried out for the 2006-07 Consolidated Statement. His Report is published with the Statement.

Internal Audit of Structural Funds

8. All systems are regularly audited by the internal audit sections of the government departments or devolved administrations responsible for the control of structural fund expenditure. In addition, at least 5% of expenditure at project level is subjected to internal audit and verification.

9. The results of those audits are used by management to strengthen procedures during the programme implementations and also at closure to obtain reasonable assurance that the expenditure certified to the Commission is correct.

10. The latest available audits by the internal audit sections in departments or devolved administrations generally reported a positive picture with most management bodies having had an overall level of satisfactory assurance that systems operated adequately. Where this was not the case, action plans were agreed to address any weaknesses.

The UK's Financial Relationship with the EU

11. Member States' contributions to the Budget of the European Communities are made on the basis of the financing system set out in the Own Resources Decision which was agreed by all Member States and incorporated into UK law by virtue of the EC (Finance) Act 2001. The contributions relate to calendar years and are formula based using factors that are in many cases subject to periodic revision over a number of years as better information becomes available. UK contributions to the EU are not covered in the Statement; these are accounted for as part of the Consolidated Fund accounts, and separately audited.

Fund flows from the EU to the UK Government and on to beneficiaries

12. Most EC receipts coming to the UK are paid from the European Commission's account held in the UK, the EC No. 1 account, and administered on behalf of the Commission by the Exchequer Funds and Accounts Team in HM Treasury. These funds are transferred from the EC No. 1 account to the relevant Department via the HM Treasury No. 4 account. Managing Authorities make claims to the EU in Euros. These claims are settled by the Commission in Sterling using exchange rates agreed with the Commission by the Exchequer Funds and Accounts Team in HM Treasury. However, the Structural Funds payments from the Commission, which are in euro, are converted into sterling using the applicable Bank of England rate.

13. Some claims are not settled through the EC No 1 account – for example, payments to Research Councils. The Commission makes these payments direct to the entity concerned using a commercial bank. The final level of receipts from the EC Budget will be affected by the closure process or by any disallowance, both of which may occur several years after funds have been paid out to recipients.

14. Twinning project⁴ receipts that are to be transferred to other member states or to mandated bodies as EU funding for their part in the project are not income of the UK Managing Authority and are therefore excluded from this Statement

⁴ Twinning projects are EU funded projects that support the capacity building in new Member States or the Candidate Countries. They are delivered by the public sector, usually by central government. These are funded through pre-accession funds.

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15. Intervention stocks⁵ are purchased with UK funds and are not incorporated into this Statement but are accounted for in the financial statements of the Department for Environment, Food and Rural Affairs (DEFRA).

Events since 31 March 2007

16. Since 31 March 2007, the following material events have occurred in respect of the programmes reported in this statement.

a) Structural Funds: European Regional Development Fund

(i) On 10 March 2008, the Commission announced financial corrections of £19.8 million in respect of grants under the 2000-2006 ERDF programme in the North West (England). The financial corrections resulted from failure to keep records in accordance with programme regulations. Measures have since been taken to improve record keeping processes in accordance with regulation requirements. The Department for Communities and Local Government (DCLG) originally disclosed a contingent liability of £62 million (see also Note 13 of this Statement) in respect of this potential disallowance in its 2006-07 Resource Accounts. DCLG staff's work to address the EU's concerns has been a major factor in the reduction in the proposed scale of the correction.

(ii) In addition, a disallowance provision of £3.5 million (included in the £23 million provision in note 11) in respect of a project managed by the Scottish Executive crystallised on 3 July 2007 as the recipient is in receivership.

b) Common Agricultural Policy Funding

(i) The Commission issued an Article 11 letter, dated 9 February 2007, notifying their intention to levy financial corrections of £54,989,188 with regard to irregularities in administering the 2004 Arable Area Payment Scheme (AAPS)⁶. This decision was contested by the Department for Environment, Food and Rural Affairs (DEFRA) and the Rural Payments Agency (RPA) and the case was taken to the Conciliation Body (CB) in 2007. The CB's findings were inconclusive and did not cause the EC to change their conclusions. A subsequent Article 11 letter was issued on 15 October 2007, but for a slightly reduced amount of £54,880,328. This financial correction has been included in a proposal for an ad hoc clearance decision, which was discussed at the Agricultural Funds Committee on 19 June 2008 and will be adopted by the Commission in July 2008. A deduction will be recorded in the reimbursement claim submitted by the UK in September 2008 and the cash impact will be in November 2008.

(ii) In 2005, payments under the English Rural Development Programme exceeded the financial ceiling by €795,921⁷. This was subsequently ratified by the EC Ad-hoc Decision 25 and charged to the Rural Payment Agency (RPA) in December 2007 as £583,689.

⁵ Intervention stocks are stocks held by paying agencies in the European Union as a result of intervention buying of commodities subject to market support. Intervention stocks may be released onto the internal markets if internal prices exceed intervention prices; otherwise, they may be sold on the world market.

⁶ The Arable Area Payments Scheme (AAPS) was a scheme introduced as part of a series of measures reforming the Common Agricultural Policy. It offered area payments on eligible land to growers of crops such as cereals, linseed, oilseeds, peas, field beans and hemp. This scheme has since been replaced by the Single Farm Payment Scheme (SPS).

⁷ Within the English Rural Development Programme, ceilings are set for each measure. In 2005 the RPA exceeded the ceilings for some of the measures, although the overall Rural Development ceiling was not exceeded.

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Lessons learned from preparing the first Consolidated Statement

The Format

17. In putting together the first consolidated statement, it has been necessary to develop the format of the primary statements. UK GAAP (and IFRS) is written from the perspective of a reporting entity, whereas the Statement represents a consolidation of a flow of funds – into the UK Government from the EU (the inward flows) and out of the UK Government to beneficiaries (the outward flows) as described in paragraphs 9 and 10.

18. The Managing Authorities are required to account for their inward and outward flows on an accruals basis under UK GAAP (and, from 2009-10, IFRS), recognising expenditure to beneficiaries as it is incurred, with a matching debtor from the EU. That debtor will not be extinguished until such time as the EU approves the claims – or imposes a disallowance – which can be several years after the expenditure has been incurred. In the meantime, as a result of this time lag between inward and outward flows, the UK Exchequer bears the cost of the EU programme.

19. Such an arrangement does not easily lend itself to a ‘traditional’ presentation of the primary statements of an income and expenditure statement, a balance sheet and cash flow statement, since each might contain a combination of EU funds and expenditure supported, temporarily, by the UK Exchequer. Primary statements have nevertheless been developed supported by explanatory narrative to aid the understanding of the figures in the statement. HM Treasury will continue to seek to improve these primary statements through feedback from users and contributors to the consolidated statement.

Accounting for the use of EU funds in the underlying accounts

17. The work undertaken to developing the 2006-07 Statement indicates that the accounting guidance provided in the FReM in respect of funding from the EU needs updating. HM Treasury will be working with Managing Authorities to develop clearer and more comprehensive guidance on the recognition and measurement of EU funding to be incorporated into the 2009-10 FReM.



Nicholas Macpherson
Permanent Secretary HM Treasury

8 July 2008

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For the year ended 31 March 2007

Statement of responsibilities

Statement of the Responsibilities of HM Treasury's Accounting Officer in relation to the Consolidated Statement on the Use of EU Funds in the UK

1. Following the announcement made by the then Economic Secretary to the House of Commons on 20 November 2006, HM Treasury has prepared a UK Consolidated Statement on the use of EU Funds for the financial year 2006-07. The Statement is prepared on an accruals basis and includes an expenditure statement, a balance sheet and a cash flow statement intended to give a true and fair view of the receipt and expenditure of EU Funds by UK central government sector entities.
2. HM Treasury's Accounting Officer has overall responsibility for the preparation of the Statement, which consolidates the EU Funds accounted for by the individual central government sector entities detailed at Note 2. Responsibility for the recording and regularity of underlying transactions rests with the Accounting Officers of the individual entities that account for the receipt and payment of EU monies.
3. In preparing the Statement, HM Treasury's Accounting Officer has, so far as is relevant to this Statement:
 - a) observed the requirements of the Financial Reporting Manual (FRoM);
 - b) applied suitable accounting policies on a consistent basis;
 - c) made judgements and estimates on a reasonable and consistent basis; and
 - d) stated whether applicable accounting standards have been followed and disclosed and explained any material departures in the accounts.
4. Responsibility for the preparation of the returns of expenditure, receipts and other relevant accounting information for the public sector entity accountable for the payment of EU Funds rests with the Accounting Officers of the relevant entity. These Officers are responsible for preparing data capture returns for that body in accordance with the requirements set by the Treasury. In discharging his responsibilities for the preparation of the Statement, HM Treasury's Accounting Officer relies upon the returns provided by those Officers.

CONSOLIDATED STATEMENT OF THE USE OF EU FUNDS IN THE UK For the year ended 31 March 2007

INDEPENDENT AUDITORS REPORT TO THE ECONOMIC SECRETARY TO THE TREASURY

I have audited the Consolidated Statement on the use of EU funds in the UK for the year ended 31 March 2007. These comprise the Expenditure Account the Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Treasury, other Accounting Officers and auditor

HM Treasury's Accounting Officer has overall responsibility for the preparation of this Statement which consolidates the EU Funds accounted for by the individual central government entities detailed in note 2. Responsibility for the recording and regularity of underlying transactions rests with the Accounting Officers of the individual entities that account for the receipt and payment of EU monies. These responsibilities are set out in the Statement of Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the accounting policies outlined in them. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if I have not received all the information and explanations I require for my audit, or if information required by the Financial Reporting Manual, insofar as it is applicable, regarding other transactions is not disclosed.

I read the other information published with the Consolidated Statement and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinions

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Treasury and other Accounting Officers in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Statement, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and are free from material misstatement, whether caused by fraud or error, and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified Audit Opinion

As detailed in my accompanying report the debtor, creditor and cash balances within the balance sheet have not been compiled on a consistent basis and are not materially complete. This has led to material errors in the debtors, creditors, cash and funding figures in the balance sheet, with a

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consequential effect on the expenditure statement and the cash flow statement. In addition, foreign exchange gains and losses within the expenditure statement have not been compiled on a consistent basis and are not materially complete.

In my opinion:

- except for adjustments which may have been required to the balance sheet, expenditure statement and cash flow statement as a result of the application of consistent accounting policies the financial statements give a true and fair view of the state of affairs on the use of EU funding in the UK as at 31 March 2007, and of the expenditures and cashflows for the year then ended;
- the financial statements have been properly prepared in accordance with the Financial Reporting Manual, insofar as it is applicable to the Consolidated Statement.

Audit Opinion on Regularity

In my opinion, in all material respects, the expenditure and funding have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Report

Please see my attached report.

T J BURR
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP

14 July 2008

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Report by the Comptroller and Auditor General

Introduction

1. This report relates to the first UK consolidated national statement on the use of European Union (EU) funds. HM Treasury's Accounting Officer has overall responsibility for the preparation of this consolidated statement. The arrangements for accounting for the use of EU funds are explained in the commentary to the statement. Funds received from the EU and payments made from these funds are accounted for by the relevant UK authorities who receive them and are included in their statutory audited accounts. The Accounting Officers of these authorities are responsible for the recording and regularity of underlying transactions.

2. I have audited this statement to give my opinion on whether it presents a true and fair view and whether the financial transactions conform to the authorities which govern them. My audit relies primarily on the audits of the underlying accounts which have already been carried out. I have not needed to revisit the work performed. This report summarises the results.

The legislative framework

3. The Treaty establishing the European Community (the Treaty) provides the basic legal framework for the Budget of the EU. The Budget includes a number of separate funds, including the European Agricultural Guidance and Guarantee Fund, the European Regional Development Fund (ERDF) and the European Social Fund (ESF). These are governed by secondary legislation made by the Council of the EU (the Council) and the European Commission (the Commission) which has overall responsibility for implementing the budget. The Council regulations and decisions define the eligibility criteria which final beneficiaries have to meet to be entitled to EU funds. They also specify certain control processes which must be implemented by member states. Within the member states, national authorities are responsible for overseeing the implementation of EU funded schemes in accordance with EU legislation. This includes determining whether final beneficiaries have met the eligibility criteria before payment is made. The national authorities also have a financial reporting responsibility to the Commission.

4. My audit is designed to ensure that, in all material respects, correct amounts are paid to eligible beneficiaries who satisfy the criteria. Where the conditions are not met, I consider the element of the transaction which is not in compliance with the regulations to be 'irregular'. Paragraph 12 considers the results of my audit in this area.

5. The UK authorities, in common with other member states, are also required to meet certain procedural and other requirements in EU regulations and decisions. If they do not, the Commission may determine that conditions have not been met and levy a financial correction on the member state. Where this occurs the Commission makes a reduction in EU funding made to the member state for expenditure on programmes. Only the Commission is able to determine whether any breaches have occurred and therefore whether any financial correction is due. Any such shortfall in funding for UK expenditure is made good by the UK taxpayer. I consider that any expenditure met by the UK taxpayer in these circumstances is outside the intentions of the legislative authorities and therefore irregular.

6. These financial corrections are normally made some considerable time after the payments to final beneficiaries under the relevant programme. They normally result from inspections and audit by the EU authorities, sometimes as part of the formal 'closure' of a scheme or multi-annual programme. Hence it can be several years before financial corrections are implemented.

Responsibilities for the preparation of the Consolidated Statement

7. HM Treasury's Accounting Officer has overall responsibility for the preparation of this statement, which consolidates the EU funds accounted for by the individual central government sector entities detailed at note 2 to the statement.

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Qualified True and Fair Opinion

8. Under International Standards on Auditing (UK & Ireland), I am required to give my opinion on whether the statement present a 'true and fair view' of the use of EU funds in the UK. I have qualified my opinion for the reasons set out below.

9. The accounting policies for EU funds are set out in the Financial Reporting Manual (FRoM), which has been adopted by the UK government as the basis for producing its accounts. All UK entities complied, in all material respects, with the FRoM in producing their own financial statements and their interpretation of the guidance was within an acceptable range of professional judgement. However, for the purposes of this consolidated statement they are not consistent with each other and funds have not always been recorded in a consistent manner. For example, the detailed accounting policies on the recognition of EU funding often differ and the same funds may have been accounted for in more than one entity. In particular, some departments have not maintained separate or specific ledger accounts of EU related debtor, creditor and cash balances and foreign exchange differences.

10. As a result, I have been unable to confirm that the debtor, creditor and cash balances within the balance sheet have been compiled on a consistent basis and are materially complete. As a consequence I have also been unable to confirm that the expenditure statement, the cash flow statement and the levels of UK funding set out in the balance sheet show a true and fair view. I am also unable to confirm that the foreign exchange gains and losses within the expenditure statement have been compiled on a consistent basis and are materially complete. I am content that, with the exception of adjustments which may have been required to the balance sheet, expenditure statement and cash flow statement as a result of these matters, the accounts present a true and fair view of the EU funded activities of the UK central government.

Regularity of Payments to Final Beneficiaries

11. My audit included the examination, on a test basis, of evidence that payments by the UK authorities to final beneficiaries in 2006-07 were, in all material respects, in conformity with the authorities which govern them. As a result of the audit, I have been able to confirm that payments complied with these requirements and were, in all material respects, made at appropriate amounts to final beneficiaries who met the eligibility criteria. But I noted a number of procedural and administrative matters which, whilst not providing evidence that individual payments to final beneficiaries were subject to material irregularity, may need to be corrected to avoid the risk of the Commission imposing a financial correction in the future.

Regularity of other transactions

12. Where the Commission determines that certain procedural and legislative requirements have not been complied with it may propose a financial correction. The Commission makes an initial assessment of the consequences of the weakness. It then discusses this with the UK authorities before deciding on the level of the financial correction to be applied. This correction is then made by restricting the level of future funding made available to the UK, with the resulting cost being met by the UK taxpayer.

13. When the Commission first notifies that a financial correction may be necessary, the UK authorities, following the requirements of FRS 12, provide for these amounts. A provision for potential financial corrections of £368.6 million has been included in the statement. These provisions represent a probable outflow of economic benefit but I do not consider these transactions to be irregular at this point. Once the Commission has determined the final correction, this represents a crystallised loss to UK funds which I consider to be irregular.

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14. During the financial year 2006-07, no financial corrections crystallised. As a result I consider there are no material corrections within the statement and I have therefore not qualified my regularity opinion in this respect.

15. In addition, since the balance sheet date, the following provisions and contingent liabilities have crystallised.

- a) On 3 July 2007 a disallowance provision of £3.5 million crystallised in respect of an ERDF project managed by the Scottish Executive, where the recipient is in receivership.
- b) In 2005, payments under the English Rural Development Programme exceeded the maximum payable (known as the financial ceiling) by €795,921. This was subsequently ratified by Ad-hoc Decision 25 and charged to Rural Payments Agency in December 2007 at a sterling amount of £583,689.
- c) On 10 March 2008 the EU announced financial corrections of €24,790,591 (approximately £19.8m) in respect of grants under the 2000-2006 ERDF programme in the North West (England). These financial corrections resulted from a failure to follow required EU procedures and also a failure to keep adequate records. The Department for Communities and Local Government (DCLG) disclosed a contingent liability in their resource accounts for 2006-07 in respect of this potential disallowance.
- d) The Commission issued an 'Article 11' letter, dated 9 February 2007, notifying their proposal to levy financial corrections of £54,989,188 for irregularities in administering the 2004 Arable Area Payment Scheme (AAPS). This decision was contested by the Department for the Environment and Rural Affairs (DEFRA) and the Rural Payments Agency (RPA) and the case was taken to the Conciliation Body (CB) in 2007. The CB's findings were inconclusive and did not cause the Commission to change its conclusions. A subsequent Article 11 letter was issued on 15 October 2007 for a slightly reduced amount of £54,880,328. This financial correction has been included in a proposal for an ad hoc clearance decision, which was discussed at the Agricultural Funds Committee on 19 June 2008 and was adopted by the Commission on 9 July 2008. A deduction will be recorded in the reimbursement claim submitted by the UK in September 2008 and the cash impact will be in November 2008.

16. As these decisions occurred after the balance sheet date, but before the date of my audit signature, I have not considered them irregular in respect of my opinion on this statement.

Results of European Commission inspections in the UK

17. European Union expenditure managed by member states on behalf of the Commission is subject to the Commission's own control inspections, which are usually carried out under the authority of the regulations and decisions that govern the funding scheme.

18. The Commission carried out audits checks in England in 2004 and 2005 which highlighted problems with the UK's management of Structural Fund measures. This led the Commission to formally suspend payments to six of the English regions in April 2007 until it could be confirmed that control systems were working effectively. The suspension has since been lifted across all the regions. However, on 10 March 2008 the Commission confirmed a decision to levy a financial correction of Euro 25 million (£19.8m) in respect of the North West region Objective 2 and Urban programmes. The correction was imposed because the Commission considered that there had been some shortcomings in the Government Office North West's exercising of its supervisory role as Managing Authority which had led to some failures among certain of its delivery partners to comply fully with Article 4 of EC Reg 438/2001.

19. As well as its considerations regarding the six English regions referred to above, the Commission gave an adverse opinion on the functioning of the systems for ERDF in Objective 2

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programmes in Scotland. The adverse opinions arose because of system weaknesses, such as concerns over the monitoring visits. There were also differences in the interpretation of the Regulations. To address the Commission's concerns an Action Plan was agreed which is being progressed to the satisfaction of the Commission.

The Role of the European Court of Auditors

20. The European Court of Auditors (the Court) is responsible for the external audit of the EU Budget. Under the Treaty, the Court is required to examine whether all revenue has been received and all expenditure has been incurred in a lawful and regular manner, and whether financial audit has been sound. The Court is also required to provide the European Parliament and the Council (as the budgetary discharge authority) with a 'Statement of Assurance' as to the reliability of the accounts and the legality and regularity of the underlying transactions.

21. In the Court's report for the financial year ending on 31 December 2006, which overlaps with the first nine months of the financial year covered by this report, the Court highlighted problems with the UK's management of structural measures.

22. On ERDF funding, the Court carried out testing in Merseyside for programmes covering the 2000-2006 period and found that the UK authorities' controls were unsatisfactory or only partially satisfactory. In responding, DCLG concluded that there were some cases of ineligible expenditure, usually because of a lack of a sufficient audit trail. The department noted that the requirements for retention of documents for some 13 years was onerous for small organisations. However, the majority of the Court's findings are not accepted by UK authorities due to differences in interpretation of ERDF regulations.

23. The Court reaches an overall conclusion for the EU and is neither required to give nor has given an opinion on the UK or any other individual member state. However, with regard to the Common Agricultural Policy, the Court's report noted that the UK had detected that some 55% of single farm payment claims contained errors, but the effect of these errors was comparatively small, covering 0.6% of the total land area claimed by the UK. This is below the average error of 0.7% of the total land area of those single payment scheme claims audited by the Court across the EU in 2006. The results of my audit work are consistent with the Court's findings.

Conclusion

24. This statement represents the first consolidated statement of the use of EU funds in the UK, which was compiled from pre-existing audited accounts after the end of the 2006-07 financial year. My audit work has identified a number of accounting and other issues which need to be addressed in order to ensure that the accounts represent a true and fair view. HM Treasury, with the agreement of the other UK authorities, is addressing these issues through further guidance to align the detailed accounting policies and other related accounting matters.

T J BURR
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14 July 2008

CONSOLIDATED STATEMENT OF THE USE OF EU FUNDS IN THE UK For the year ended 31 March 2007

Expenditure Account
For the year ended 31 March 2007

		2006-07
	Note	£000
Gross expenditure on EU supported projects	2	4,873,624
Disallowances met by the UK	10	<u>(228,411)</u>
Expenditure net of disallowances	3	4,645,213
Foreign exchange losses met by the UK		(23,893)
Net EU expenditure		<u>4,621,320</u>

Explanatory Note

The Expenditure Statement shows the EU funded element of amounts paid out by UK Central Government bodies on projects supported wholly or partially by the EU on which the UK anticipates EU funding at the point the payment is made.


Gross expenditure on EU supported projects is recognised in the period in which it becomes payable by UK Central Government to the recipient under the rules of the applicable scheme. The amount shown in the accounts represents the amount paid and payable in sterling during the period to bodies outside the Central Government boundary.

Net EU Expenditure represents the amount receivable from the EU (converted into sterling after disallowances and foreign exchange gains or losses) in respect of amounts paid or payable by the UK on EU supported projects.

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Balance sheet
 As at 31 March 2007

	Note	2006-07 £000
Assets		
Advances to service providers	5	280,267
EU funds receivable	6	3,473,634
		<u>3,753,901</u>
Liabilities		
EU funds received in advance	7	782,905
Amounts payable to beneficiaries	8	1,753,013
Repayable to EU	9	51,479
Disallowances provision	11	378,633
		<u>2,966,030</u>
		<u>787,871</u>
Net Assets		
Financed By		
Temporary UK funding		1,166,504
Less Possible permanent UK funding	11	(378,633)
		<u>787,871</u>



Nicholas Macpherson
 Permanent Secretary HM Treasury
 8 July 2008

Explanatory Note

The consolidated statement shows the flow of funds into the UK from the EU and out of UK Government to beneficiaries. The balance sheet shows those assets and liabilities that stem from such cash flows, e.g. where the UK has issued funds to the final recipient and is awaiting settlement of a claim. The exception being the disallowances provision, which are amounts paid out by the UK for which the UK now believes it is probable that the EU will apply financial corrections, disallowing certain claims.

Temporary UK funding is the cash paid out by the UK Exchequer that will in due course be funded by the EU. Possible permanent UK funding is the element of temporary UK funding for which it is probable that the EU will apply financial corrections. Possible permanent UK Funding represents the funding that will be met by the UK Exchequer if provisions in respect of disallowances crystallise. Possible permanent UK funding will always equal provisions.

As the Consolidated Statement shows funding flows there are no reserves, as there is no trading gain or loss, and there is no taxpayers equity.

CONSOLIDATED STATEMENT OF THE USE OF EU FUNDS IN THE UK
For the year ended 31 March 2007

Cash flow statement
 For the year ended 31 March 2007

	2006-07
	£000
Gross EU expenditure	(4,873,624)
Movement in working capital	
(Increase)/decrease in advances to service providers	(20,204)
Increase/(decrease) in amounts payable to beneficiaries	(716,202)
Increase/(decrease) in amounts repayable to the EU	(815)
Net Cash Outflows	(5,610,845)
Receipts Via Treasury No 4 Account	4,547,589
Increase in temporary UK funding	135,705
Permanent UK funding – foreign exchange losses	23,893
Other receipts (direct from EU)	903,658
Net Cash Inflows	5,610,845

Explanatory Note

The cash flow statement balances the cash paid out by the UK government against the cash received from the EU.

The cash outflows only include that cash paid out on which the UK anticipates EU receipts and is therefore shown net of disallowance provisions and foreign exchange losses.

The EU makes the majority of its payments to the Treasury No 4 account, which the Treasury then pays over to the relevant UK body. However, in some instances the EU will make direct payments to a UK Central Government body as in the case of grants to the Research Council.

CONSOLIDATED STATEMENT OF THE USE OF EU FUNDS IN THE UK

For the year ended 31 March 2007

Notes to the United Kingdom Consolidated Statement

1. Accounting policies

- 1.1. The principal accounting policies adopted in the preparation of the Consolidated Statement are set out below.

Basis of preparation

- 1.2. This statement has been prepared so as to give a true and fair view by consolidating the relevant transactions and balances as recorded by the Managing Authorities in their accounts prepared in accordance with the Financial Reporting Manual (FRM). The consolidated statement is prepared under the historical cost convention.

First year of reporting

- 1.3. This is the first year in which a Consolidated Statement on the use of European Commission funds has been prepared. No comparative information is therefore presented.

Expenditure recognition

- 1.4. Gross expenditure on EU supported projects is recognised in the period in which it becomes payable by UK Central Government to the recipient under the rules of the applicable scheme. The amount shown in the accounts represents the amount paid and payable in sterling during the period to bodies outside the Central Government boundary. Net EU Expenditure represents the amount receivable from the EU (converted into sterling after disallowances and foreign exchange gains or losses) in respect of amounts paid or payable by the UK on EU supported projects.

Foreign currency translation

- 1.5. The Commission makes payments in Euros, with the Managing Authority recognising the receivable in Sterling. Foreign exchange gains and losses occur where the Managing Authority recognises the receivable from the EU at the spot rate and receives the payment from the EU at a different rate. Such gains and losses are recognised in the Expenditure Statement. Any hedging mechanisms used by departments and devolved administrations to mitigate the impact of foreign exchange losses are not included in this statement as they do not impact on the amounts paid out by departments and devolved administrations on EU projects or the funding provided by the EU.

Disallowances provision and contingent liabilities

- 1.6. Probable disallowances arising from financial corrections are recognised, and contingent liabilities disclosed, following the requirements of Financial Reporting Standard (FRS) 12, Provisions, Contingent Liabilities and Assets.

CONSOLIDATED STATEMENT ON THE USE OF EU FUNDS IN THE UK For the year ended 31 March 2007

2. Analysis of Gross expenditure by UK Central Government Departments and Devolved Administrations on EU supported projects

	Agricultural Funding £000	Financial Instrument for Fisheries Guidance £000	European Social Fund £000	European Regional Development Fund £000	Other (Note 4) £000	Total £000
England						
Communities and Local Government				527,854		527,854
Culture, Media and Sport			904	1,051		1,955
Education and Skills			277,202			277,202
Environment, Food and Rural Affairs	2,148,438	3,773			8,282	2,160,493
Forestry Commission	12,783					12,783
Home Office			16,136		4,929	21,065
National Archive					2	2
Trade and Industry					3,244	3,244
Transport					16,886	16,886
Work and Pensions			315,714			315,714
Scotland						
Scottish Executive	453,325	10,926	59,122	141,767		665,140
Wales						
Welsh Assembly Government	258,936	3,193	90,492	137,075		489,696
Northern Ireland						
Northern Ireland Executive	269,200	1,166	40,827	69,264	1,133	381,590
Gross expenditure in the United Kingdom	3,142,682	19,058	800,397	877,011	34,476	4,873,624

The Department for Education and Skills and the Department for Trade and Industry were subject to machinery of government changes in April 2007. Amounts paid out by these departments will, in future, be paid out by the Department for Innovation, Universities and Skills (DIUS).

**CONSOLIDATED STATEMENT ON THE USE OF EU FUNDS IN THE UK
For the year ended 31 March 2007**

3. Analysis of Net expenditure by UK Central Government Departments and Devolved Administrations on EU supported projects

	Agricultural Funding	Financial Instrument for Fisheries Guidance	European Social Fund	European Regional Development Fund	Other (Note 4)	Total
	£000	£000	£000	£000	£000	£000
Gross expenditure in the United Kingdom (note 2)	3,142,682	19,058	800,397	877,011	34,476	4,873,624
Disallowances						
Environment, Food and Rural Affairs	(197,812)					(197,812)
Scottish Executive				(23,000)		(23,000)
Welsh Assembly Government	(7,599)					(7,599)
Net expenditure in the United Kingdom after disallowances	2,937,271	19,058	800,397	854,011	34,476	4,645,213

4. Other Projects

The following projects are included in the 'Other' category in Note 2.

Department or Devolved Administration	Project	£000
Environment, Food and Rural Affairs	Transmissible Spongiform Encephalopathy (TSE) monitoring	2,927
	Scrapie eradication	4,531
	Bovine Spongiform Encephalopathy (BSE) eradication	781
	EU data collection	43
Home Office	European refugee fund	4,929
National Archive	Planets	2
Trade and Industry	Science programmes	3,244
Transport	Trans European Network (TENS)	16,886
Northern Ireland Executive	Other Projects	1,133
Total		34,476

5. Advances to Service Providers

These are amounts paid out by the UK in respect of EU supported projects to non Central Government bodies delivering the project (service providers) in advance of claims from such bodies.

	£000
Communities and Local Government	52,021
Work and Pensions	185,220
Scottish Executive	18,547
Welsh Assembly Government	24,479
Total	280,267

6. EU funds receivable by Department and Devolved Administration

These are amounts paid or payable to service providers against formal claims for which the UK has yet to be reimbursed by the EU.

	£000
Communities and Local Government	504,623
Culture, Media and Sport	1,955
Education and Skills	105,868
Environment, Food and Rural Affairs	1,902,311
Forestry Commission	1,952
Home Office	4,251
Work and Pensions	581,641
Scottish Executive	170,094
Welsh Assembly Government	44,246
Northern Ireland Executive	156,693
Total	3,473,634

7. EU Funds Received in Advance

These are amounts paid by the EU in advance of formal claims from the UK. The contractual terms of EU funding for projects and programmes often provide for such advanced payments to allow projects to commence.

	£000
Communities and Local Government	262,795
Culture, Media and Sport	1,747
Education and Skills	107,791
Environment, Food and Rural Affairs	10,677
National Archive	88
Transport	61
Work and Pensions	278,779
Scottish Executive	120,967
Total	782,905

8. Amounts Payable to Beneficiaries

These are amounts payable to UK service providers and are recognised when claims are received but not yet settled.

	£000
Communities and Local Government	146,447
Culture, Media and Sport	208
Education and Skills	3,997
Environment, Food and Rural Affairs	1,067,140
Forestry Commission	16
Work and Pensions	417,837
Asset Recovery Agency	83
Scottish Executive	50,504
Welsh Assembly Government	66,781
Total	1,753,013

9. Repayable to EU

These are amounts to be returned to the EU resulting from direct action taken by the UK to identify overpayments against programmes.

	£000
Education and Skills	21,876
Forestry Commission	16
Work and Pensions	29,587
Total	51,479

10. Provision - Future Financial corrections (disallowances) as at 31 March 2007

The EU will disallow claims by imposing financial corrections where the service provider fails to meet the conditions of the applicable scheme. In such circumstances the EU will reduce future payment to the UK.

	£000
As at 1 April 2006	150,222
Created during the year	228,411
As at 31 March 2007	378,633

11. Analysis of provision for disallowances by Department and Devolved Administration.

	£000
Department or Devolved Administration	
Environment, Food and Rural Affairs	348,034
Scottish Executive	23,000
Welsh Assembly Government	7,599
Totals	378,633

Establishing the boundary between EU and UK funded expenditure can be a difficult process. The UK Exchequer provides funding to projects in anticipation of such projects being fully funded by the EU. However, failure to meet certain EU rules attaching to EU funding can result in the EU disallowing claims. Although it is standard procedure to recover grants that are found ineligible, this is not always possible and can lead to the UK Exchequer bearing the full or partial cost of a project to which a disallowance has been applied

The disallowance provisions consolidated in the consolidated statement are those recognised by the relevant Departments and Devolved Administrations in their own financial statements.

The resource accounts of the above Department and Devolved Administration provided the following narrative for these provisions:

Environment, Food and Rural Affairs

The provision is in respect of financial corrections on the European Agricultural Guidance and Guarantee Fund (EAGGF, included within Agricultural Funding in this statement), which was replaced during the year by two new funds: the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD). Any amounts disallowed (and hence funded by DEFRA instead) will depend on the assessed severity of the breach of regulations and on subsequent negotiations with the EU in accordance with the Commission's clearance of accounts procedure.

This provision has been recognised on the following basis:

- as covering all cases where the EU has notified that a financial correction is being considered; and
- as representing for Single Farm Payment System (SPS) an appraisal of what the Commission is likely to assess as an appropriate correction based on perceived weaknesses in complying with EU regulations on control requirements.

Scottish Executive

The Provision is in respect of European Union funding repayments that are subject to negotiation.

Welsh Assembly Government

The provision is in respect of EU funding on European programmes, funds and initiatives that is considered likely to be disallowed by the EU.

Adjustments to provisions for disallowances post 2006-07

The ERDF disallowance provision created by the Scottish Executive was reduced by £8.2 million following ongoing discussions with the European Commission in respect of projects in the Highlands and Islands' 1994-99 programme.

12. Contingent Liabilities

Contingent liabilities are disclosed following the requirements of FRS 12 and are those recognised in the Resource Accounts of the relevant Department and Devolved Administration.

Communities and Local Government

DCLG has potential liabilities in respect of a possible fine because of potential irregularities of European Regional Development Fund Programme expenditure, estimated at £62 million.

Education and Skills

DFES has potential liabilities arising from audit work carried out in respect of the delivery of activities funded through European Union initiatives.

Environment, Food and Rural Affairs

DEFRA has a potential liability in respect of late payments attributed to Single Payments Scheme, estimated at £7 million.

Work and Pensions

DWP has a potential liability in respect of claims for the ESF programme that operated during 1994-99 and 2000-06.

The Scottish Executive

The Scottish Executive has a potential liability arising from the liquidation of a recipient of European Social Funds and lack of sufficient records being maintained by this recipient.

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