



HM Treasury

European Union Finances 2017: statement on the 2017 EU Budget and measures to counter fraud and financial mismanagement



European Union Finances 2017: statement on the 2017 EU Budget and measures to counter fraud and financial mismanagement

Presented to Parliament by
the Chief Secretary to the Treasury
by Command of Her Majesty

March 2018



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Chapter 1

Introduction

- 1.1 In 1980, following a recommendation by the Public Accounts Committee (PAC), the government agreed to present an annual statement (statement) to Parliament giving details of the Budget of the European Union (EU Budget).
- 1.2 This statement is the 37th in the series. First, it describes the EU Budget for 2017. It then sets out details, including some forecasts, of the United Kingdom's gross and net contributions to the EU Budget over the calendar years 2011 to 2017 and over the financial years 2011-12 to 2022-23. Details of recent developments in EU financial management and the fight against fraud affecting EU funds are also provided, as is an update on the UK's strategy for using EU funds and minimising disallowance.
- 1.3 In December 2017, the UK agreed on a financial settlement relating to its withdrawal from the EU, enabling Article 50 negotiations to move forward. The UK will honour its share of commitments made during its membership, while retaining access to EU funded programmes for the current EU Budget period. The scope of the financial settlement is detailed in the joint report on the progress of negotiations published by UK and EU negotiators, which can be found on gov.uk¹.
- 1.4 This statement has been prepared on the basis of the UK's current membership of the EU. In this statement, the government makes no further assumptions about the contributions arising from the financial settlement once it becomes legally binding through a Withdrawal Agreement, nor about the UK's future relationship with the EU. This is subject to negotiation.

¹https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/665869/Joint_report_on_progress_during_phase_1_of_negotiations_under_Article_50_TEU_on_the_United_Kingdom_s_orderly_withdrawal_from_the_European_Union.pdf

Chapter 2

Expenditure

2.1 The Multiannual Financial Framework (MFF) sets ceilings for each EU Annual Budget. The current MFF covers the period 2014 to 2020. It was agreed in 2013 and achieved a real terms cut in the payment ceilings for the first time, as well as confirming that the UK's rebate would remain. The 2017 commitment appropriations ceiling was €155.6 billion (£133.2 billion¹) and the payment appropriations ceiling was €142.9 billion (£122.3 billion)². Flexibilities available within the budgetary system enable proposals for the overall level of commitments to be higher than the relevant ceiling. Further information explaining the difference between payment and commitment appropriations can be found in the glossary.

The 2017 EU Budget

2.2 The EU financial year runs from 1 January to 31 December. The 2017 EU Budget for commitment and payment appropriations was agreed under the Slovakian Presidency of the EU³ in the second half of 2016⁴. Negotiations began in June 2016, when the Commission proposed a draft EU Budget for 2017⁵. This proposed total commitment appropriations of €157.7 billion (£135.0 billion) and payment appropriations of €134.9 billion (£115.5 billion) in EU spending (nominal figures). The Commission amended its proposal in October 2016, on the basis of new information that was not available at the time that the draft Budget was drawn up. This resulted in an updated draft EU Budget of €158.9 billion (£136.1 billion) in commitment appropriations and €135.4 billion (£115.9 billion) in payments appropriations⁶.

2.3 The Council adopted its position in September 2016, proposing to reduce the Commission's original proposal to €156.4 billion (£133.9 billion) in commitment appropriations and €133.8 billion (£114.5 billion) in payment

¹ 2017: £1 = €1.16798. This is the 30 December 2016 exchange rate, which is the rate at which all UK VAT-based and GNI-based contributions, and the UK rebate, were converted to sterling throughout 2017.

² Draft General budget of the European Union for the financial year 2017: <http://eur-lex.europa.eu/budget/data/DB/2017/en/SEC00.pdf>

³ Council decision determining the order in which the office of President of the Council shall be held: <http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32007D0005>

⁴ Deal reached on 2017 EU budget: <http://www.consilium.europa.eu/en/press/press-releases/2016/11/17/budget-2017/>

⁵ Commission proposes draft EU budget 2017: http://europa.eu/rapid/press-release_IP-16-2347_en.htm

⁶ Amending Letter No.1 to the Draft General budget of the European Union for the financial year 2017: http://ec.europa.eu/budget/library/biblio/documents/2017/amending_letter_1_com679_en.pdf

appropriations⁷. In October 2016, the European Parliament provided its position, which would have set the level of EU spending in 2017 to €162.4 billion (£139.1 billion) in commitment appropriations and €138.0 billion (£118.2 billion) in payment appropriations⁸.

- 2.4 Following a process of conciliation between the Council and European Parliament, the 2017 EU Budget was formally agreed. The adopted 2017 EU Budget provided for commitment appropriations of €157.9 billion (£135.2 billion). The adopted 2017 EU Budget provided for payment appropriations of €134.5 billion (£115.1 billion)⁹. The payment appropriations for each of the main EU Budget headings are shown in Table 2.A: 2017 EU Budget.
- 2.5 Throughout the negotiations, the UK worked constructively with other member states to ensure budgetary restraint. The UK believed the EU could still go further to cut lower priority spending from the adopted Budget. However, as progress was made, the UK recognised this by abstaining in the vote for the adopted 2017 EU Budget.
- 2.6 Table 2.A also shows various stages of the negotiations during 2016. Figures for previous years' EU Budgets are provided for comparison in Annex C (Tables C.1 and C.2).
- 2.7 Following a series of budget amendments – in-year expenditure and revenue changes to the adopted EU Budget during the year of implementation – a total of €7.7 billion of payment appropriations were deducted from the adopted 2017 EU Budget, mainly due to the slower than expected implementation of some EU programmes: primarily under Heading 1b (European Structural and Investment Funds).
- 2.8 This left a final agreed 2017 EU Budget of €159.8 billion (£136.8 billion) in commitment appropriations and €126.8 billion (£108.5 billion) in payment appropriations¹⁰. Further details on budget amendments and the final agreed 2017 EU Budget can be found in Box 2.A.

⁷ EU Budget 2017: Council sets out its position: <http://www.consilium.europa.eu/en/press/press-releases/2016/09/12/eu-budget-2017-council-sets-out-its-position/>; Draft general budget of the European Union for the financial year 2017: Council position of 19 July 2016: <http://data.consilium.europa.eu/doc/document/ST-11166-2016-INIT/en/pdf>

⁸ Press release: Council cannot accept EP amendments: <http://www.consilium.europa.eu/en/press/press-releases/2016/10/26/eu-2017-budget-council-cannot-accept-ep-amendments/>; European Parliament resolution of 26 October 2016 on the Council position on the draft general budget of the European Union for the financial year 2017: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bTA%2bP8-TA-2016-0411%2b0%2bDOC%2bXML%2bV0%2f%2fEN&language=EN>

⁹ Deal reached on 2017 EU budget: <http://www.consilium.europa.eu/en/press/press-releases/2016/11/17/budget-2017/>; Definitive adoption of the European Union's general budget for the financial year 2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2017:051:FULL&from=EN>

¹⁰ Draft amending budget No. 6/2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0597&from=EN>

Box 2.A: Budget Amendments and the Final Agreed 2017 EU Budget

The final agreed 2017 EU Budget of €126.8 billion in payments is well within the 2017 payments ceiling agreed in the 2013 MFF deal of €142.9 billion.

Table 2.A shows payment appropriations for the adopted 2017 EU Budget. This is the original 2017 EU Budget which was formally agreed by the Council and European Parliament in November 2016. This is prior to any in-year budget amendments.

Table 2.A also shows the final agreed 2017 EU Budget. This includes the effects of draft amending budgets 1-6 approved by the Council and European Parliament. Draft amending budgets are proposals made by the Commission to amend certain aspects of the adopted Budget of a year. These can increase or decrease expenditure in line with updated forecasts of expenditure and revenue. They can also adjust member state contributions. In total, the final agreed 2017 Budget was €7.7 billion lower in payment appropriations than when adopted, primarily due to the slower than expected implementation of EU programmes, and mostly under Heading 1b (European Structural and Investment Funds). Chart 2.A shows the payment appropriations by heading for the final agreed 2017 EU Budget.

The final agreed 2017 EU Budget will be referred to in the text, used in tables and displayed in charts throughout this document, unless stated otherwise.

Table 2.A: 2017 EU Budget

							€ million nominal
Payment Appropriations	Financial Perspective Ceiling ¹	Commission draft 2017 EU Budget ²	Council position ²	European Parliament position ²	Adopted 2017 EU Budget ²	Final Agreed 2017 EU Budget ³	Final Agreed 2016 EU Budget ⁴
1. Smart and Inclusive Growth		56,647	56,116	57,855	56,522	49,394	59,291
<i>1a. Competitiveness for Growth and Jobs</i>		19,298	18,966	19,993	19,321	19,321	17,402
<i>1b. Economic, Social and Territorial Cohesion</i>		37,349	37,150	37,862	37,201	30,073	41,888
2. Sustainable Growth: Natural Resources		55,236	55,038	55,862	54,914	54,121	54,972
3. Security and Citizenship		3,782	3,760	3,862	3,787	3,224	3,022
4. Global Europe		9,290	9,220	9,790	9,483	9,056	10,156
5. Administration		9,324	9,266	9,355	9,395	9,395	8,951
Total Payment Appropriations*	142,906	134,899	133,790	138,029	134,490	126,771	136,642

Note:

*Column totals do not equal the sum of individual items due to rounding and spending not attributable to any heading.

¹ Draft General budget of the European Union for the financial year 2017: <http://eur-lex.europa.eu/budget/data/DB/2017/en/SEC00.pdf>

² EU annual budget life-cycle: figure: http://ec.europa.eu/budget/annual/index_en.cfm?year=2017

³ Draft Amending Budget No. 6/2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0597&from=EN>

⁴ Draft Amending Budget No. 6/2016: <http://eur-lex.europa.eu/budget/data/BR/2016/en/BR06.pdf>

2.9 Details of the levels of payments in the final agreed 2017 EU Budget are as follows (all figures are nominal)¹:

- **Heading 1: Smart and Inclusive Growth.** Expenditure in this area includes research and development, education and training, employment and social policy. Payments for Heading 1 overall were set at €49.4 billion (£42.3 billion).
- Payments towards research, learning, and innovation (Heading 1a) were set at €19.3 billion (£16.5 billion). Payments toward fostering regional growth and employment (Heading 1b) were set at €30.1 billion (£25.7 billion).
- **Heading 2: Sustainable Growth: Natural Resources.** Expenditure in this area includes spending on the Common Agricultural Policy, fisheries, rural development, and measures aiming to contribute to food quality and a cleaner environment. Payments in this area were set at €54.1 billion (£46.3 billion).
- **Heading 3: Security and Citizenship.** Expenditure in this area includes immigration, migration, security, and fundamental rights and justice. Payments for Heading 3 overall in 2017, excluding those associated with the European Union Solidarity Fund, were set at €3.2 billion (£2.8 billion).
- **Heading 4: Global Europe.** Expenditure in this area is focused on EU foreign policy and international development. Payments for Heading 4 were set at €9.1 billion (£7.8 billion).
- **Heading 5: Administration.** Expenditure for Heading 5 is on the functioning of the EU institutions and includes remuneration and allowances for staff and members, pension costs, and rent and other building costs. Payments for 2017 under Heading 5 were set at €9.4 billion (£8.0 billion).

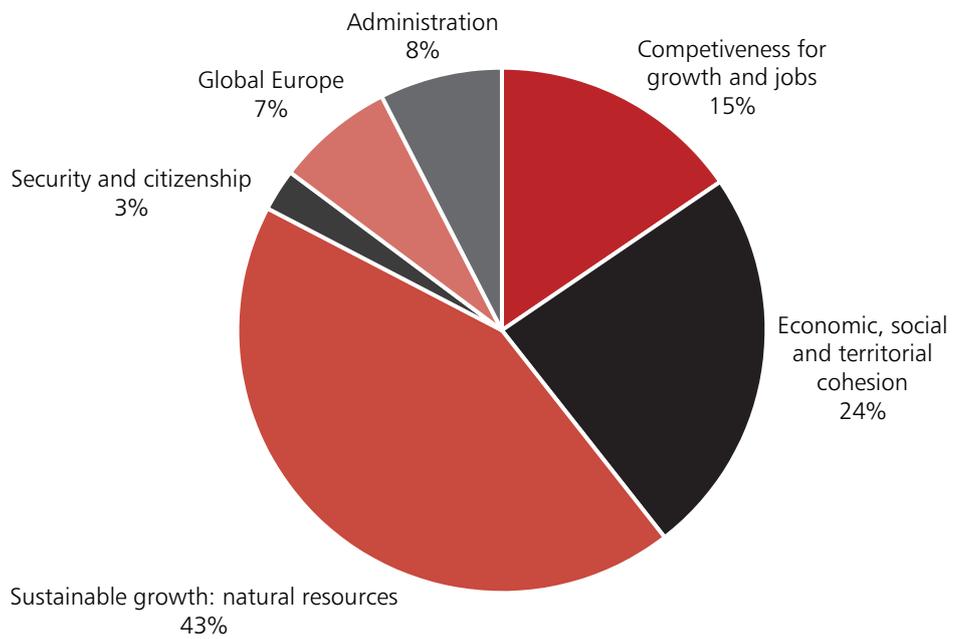
2.10 For 2018, the adopted EU Budget was agreed in November 2017 with commitment appropriations of €160.1 billion (£142.1 billion²) and payment appropriations of €144.7 billion (£128.4 billion)³. The 2018 EU Budget will be covered in detail in the next EU Finances statement.

¹ Draft Amending Budget No. 6/2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0597&from=EN>

² 2018: £1 = €1.11271. This is the 29 December 2017 exchange rate, which is the rate at which all UK VAT-based and GNI-based contributions, and the UK rebate, are being converted to sterling throughout 2018.

³ EU budget for 2018: <http://www.consilium.europa.eu/en/policies/eu-annual-budget/2018/>

Chart 2.A: Final Agreed 2017 EU Budget – payment appropriations by budget heading



Source: Draft Amending Budget No. 6/2017:

<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0597&from=EN>

Chapter 3

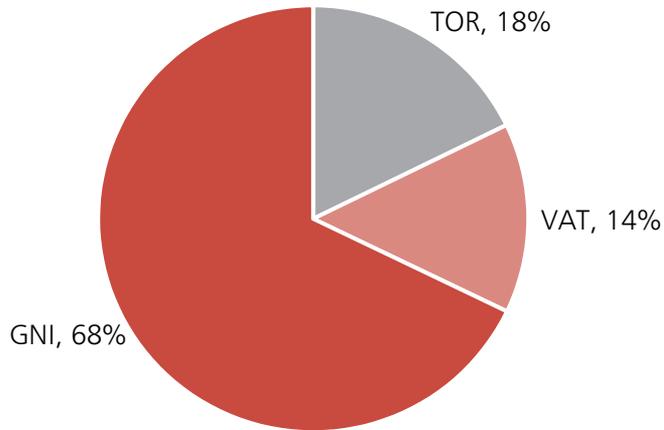
Contributions to the EU Budget

EU revenue

- 3.1 The Own Resources Decision provides for three sources of EU revenue: customs duties and sugar levies known as Traditional Own Resources (TOR); contributions based on VAT; and GNI-based contributions. A more detailed explanation can be found in the glossary.
- 3.2 Chart 3.A shows a breakdown of how the 2017 EU Budget was financed by EU member states¹. The key points to note for the 2017 EU Budget are:
- TOR is €20.5 billion (£17.6 billion) and the UK's share is 15.3%. In 2016, outturn revenue from this source was €20.1 billion (£16.5 billion), of which the UK's share was 15.7%.
 - VAT-based contributions are €16.6 billion (£14.2 billion) and the UK's share is 20.0%. In 2016, total VAT-based contributions were €15.9 billion (£13.0 billion), of which the UK's share was 20.9%.
 - GNI-based contributions are €78.4 billion (£67.1 billion) and the UK's share is 15.4%. In 2016, GNI-based contributions were €95.6 billion (£78.3 billion) with a UK share of 16.0%.
 - The estimated value of the UK's rebate in 2017 is €5.0 billion (£4.3 billion) compared with €5.9 billion (£4.8 billion) in 2016. A detailed explanation of how the UK rebate is calculated, and how it operates, can be found in Annex 1: the glossary.

¹ Estimates are sourced from the Amending Budget No. 6/2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018B0091&from=EN>; Outturns are sourced from the European Commission's 2016 EU Budget Financial Report: <http://ec.europa.eu/budget/library/figures/internet-tables-all.xls>

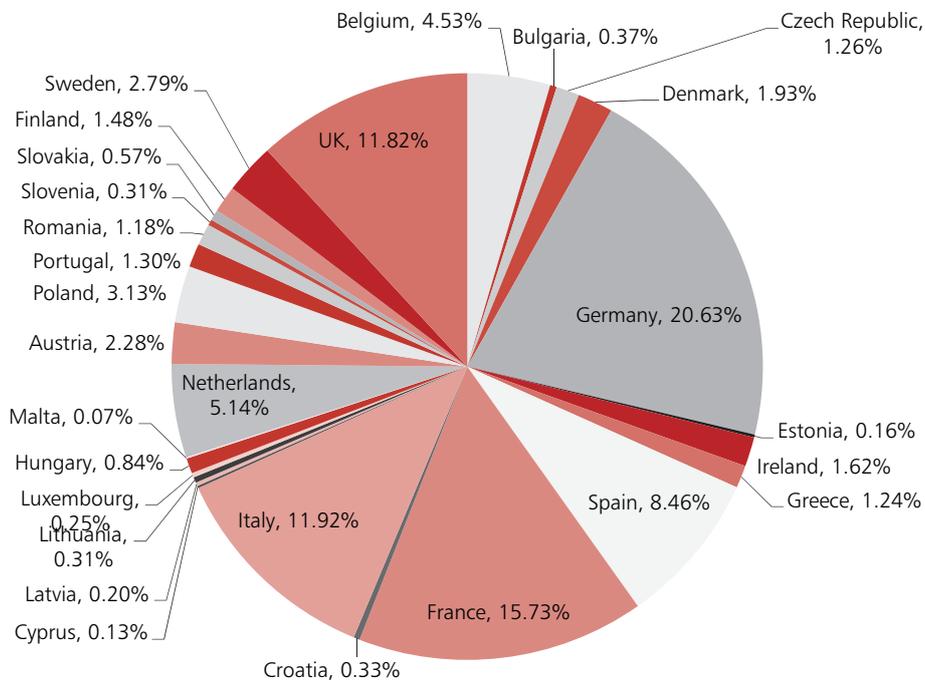
Chart 3.A: 2017 EU Budget Revenue



Source: Amending Budget No. 6/2017:
<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018B0091&from=EN>

3.3 Chart 3.B shows each member state’s share of financing the 2017 EU Budget after taking account of the UK rebate.

Chart 3.B: EU Budget revenue 2017 – percentage share after rebates by member state



Source: Amending Budget No. 6/2017:
<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018B0091&from=EN>

The UK's net contribution

3.4 Table 3.A shows the UK's gross payments, rebate, public sector receipts and net public sector contributions to the EU Budget for calendar years 2011 to 2017. The figures for 2017 include estimates; those for earlier years are outturns.

Table 3.A: Gross payments, rebate and receipts (calendar years)

	£ million						
	2011	2012	2013	2014	2015	2016	2017
Gross contribution ¹	15,357	15,746	18,135	18,778	19,560	16,996	18,625
Less: UK rebate	-3,143	-3,110	-3,674	-4,416	-4,914	-3,878	-5,633
Less: Public sector receipts	-4,132	-4,169	-3,996	-4,583	-3,883	-3,492	-4,084
Net public sector contribution²	8,082	8,467	10,465	9,779	10,763	9,626	8,909

Notes:

¹ Gross payment figures include Traditional Own Resources payments at 75% up to September 2016 and 80% thereafter. The remainder is retained by the UK. The UK's gross payments are automatically corrected to account for the rebate, meaning the UK only pays the post-rebate amount.

² Due to rounding, totals may not exactly correspond to the sum of individual items.

Source: HM Treasury calculations.

3.5 The fluctuation in the UK's net public sector contribution to the EU Budget is due to the nature of the Own Resources system, and consequential fluctuations in the UK rebate, as well as variations in public sector receipts and the exchange rate. For further details, refer to the Annex A, the glossary, and Annex B, the Technical Annex.

3.6 UK public sector receipts in 2017, mainly from the European Agricultural Guarantee Fund (EAGF), European Agricultural Fund for Rural Development (EAFRD) and the Social and Regional Development Funds, are worth around £4.1 billion. The majority of these receipts will either be paid to, or used in support of, the private sector but are channelled through government departments or agencies.

The EU makes some payments directly to the private sector, for example to carry out research activities. These payments do not appear in public sector accounts. It is estimated that in 2015, these receipts were worth £1.5 billion (see Annex B). These payments are not included in Table 3.A or Tables 3.C to 3.F, which provide data only on receipts channelled through the public sector.

3.7 The Commission also publishes outturn data on all member states' contributions to the EU Budget and their receipts in previous years. These give a figure for UK's net contribution that is different from the numbers derived from the OBR's forecasts and UK data. The main reason for this

difference is that the Commission's numbers take into account all of the UK's receipts and include those that go directly to UK-based recipients, such as funding for research paid directly to UK universities.

- 3.8 Table 3.B sets out the Commission figures for the UK's gross contributions and receipts and the implied net contribution. They are taken from the Commission's latest financial report.

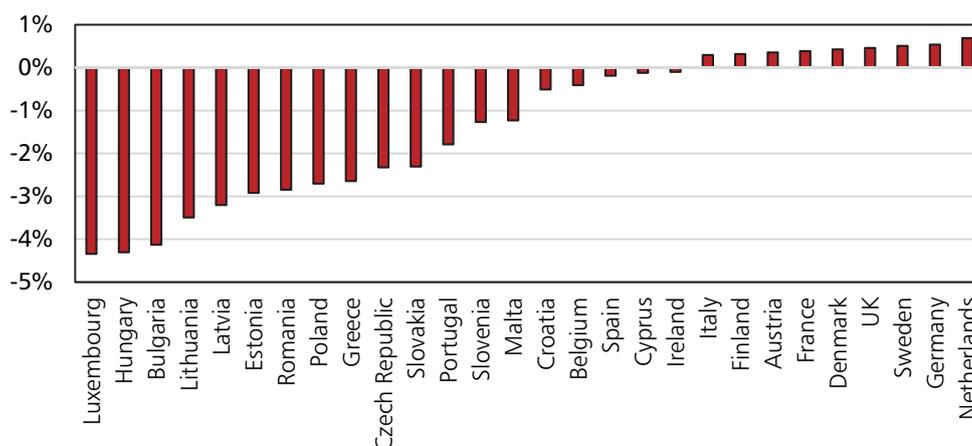
Table 3.B: EU Commission Financial Report data (calendar years)

	Gross contribution post rebate (€ billion)	Total public and private receipts (€ billion)	Net contribution (€ billion)	Net contribution (£ billion)
2012	16.18	6.93	9.24	7.50
2013	17.07	6.31	10.76	9.13
2014	14.07	6.98	7.09	5.71
2015	21.41	7.46	13.95	10.13
2016	16.62	7.05	9.57	7.84
Average	17.07	6.95	10.12	8.06

Source: 2016 EU Budget Financial Report, European Commission.

- 3.9 Figures for 2016 include a redistribution of total contributions across the member states following the implementation of the 2014 Own Resources Decision agreed in 2013 as part of the 2014 to 2020 MFF agreement. The new Decision required ratification by all member states in accordance with their own constitutional requirements before it could enter into force. The Decision was ratified by the UK Parliament through the EU (Finances) Act 2015. The redistribution has been fully anticipated in OBR forecasts since December 2013.
- 3.10 In accordance with a commitment to the Public Accounts Committee (PAC), the Technical Annex of this document explains the main differences in respect of calendar year 2015 between the government's figures and those which can be derived from the European Commission's EU Budget Financial Report.
- 3.11 Chart 3.C shows how the UK's net position compares with those of other member states.

Chart 3.C: Average net contribution as % of GNI by for the years 2012-2016



Source: 2016 EU Budget Financial Report, European Commission.

Financial year transactions

3.12 The EU financial year runs from 1 January to 31 December, whereas the UK's runs from 1 April to 31 March. Table 3.C gives a breakdown of the UK's transactions with the EU on a financial year basis between 2011-12 and 2016-17.

3.13 Payments to the EU Budget are scheduled on a monthly basis, though the Commission can request earlier contributions from member states of VAT-based and GNI-based contributions and the UK rebate, to take account of frontloaded CAP or European Structural and Investment Funds payments, which take place in the first months of the calendar year.

Table 3.C: Gross contribution, rebate and public sector receipts (financial years – outturn)

	£ million					
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Gross contribution ¹	15,700	16,871	18,208	18,733	17,635	16,926
Less: UK rebate	-3,516	-3,172	-4,130	-4,811	-4,068	-4,757
Less: Public sector receipts	-4,771	-4,022	-3,856	-4,690	-2,811	-4,081
Net public sector contribution²	7,413	9,678	10,223	9,231	10,756	8,088

Notes:

¹ Gross payment figures include Traditional Own Resources payments at 75% up to September 2016 and 80% thereafter. The remainder is retained by the UK. The UK's gross payments are automatically corrected to account for the rebate, meaning the UK only pays the post-rebate amount.

² Due to rounding, totals may not exactly correspond to the sum of individual items.

Source: HM Treasury calculations.

- 3.14 The Office for Budget Responsibility (OBR) forecasts the UK's contributions to the EU Annual Budget in future years. No assumptions have been made in this statement about the UK's exit from the EU, any future relationship the UK might have with the EU nor any financial implications of the UK leaving the EU. Instead, this statement reproduces the forecast adopted by the OBR in their March 2018 Economic and Fiscal Outlook. The OBR forecasts a sum equivalent to UK contributions past the point of the UK's exit from the EU, up to the end of the forecast period (i.e. 2022-23), under the fiscally neutral assumption that any post-exit contributions will be used for spending elsewhere. The OBR splits its estimate of post-exit contributions between flows associated with a financial settlement and assumed spending in lieu of EU transfers. The assumptions underlying its forecasts can be found in the OBR's March 2018 Economic and Fiscal Outlook.
- 3.15 Table 3.D provides a breakdown of the OBR's latest forecast for UK transactions with the EU over the period 2017-18 to 2022-23. Tables 3.E (outturn figures) and 3.F (forecast) provide a more detailed breakdown of UK receipts by major programmes from the EU Budget over the periods 2011-12 to 2016-17 (outturn) and 2017-18 to 2022-23 (forecast).

Table 3.D: OBR forecast of gross contribution, rebate and receipts (financial years)

	£ million					
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Gross contribution ¹	17,438	20,323	22,458	21,732	21,626	21,516
Less: UK rebate	-4,631	-4,411	-4,634	-4,763	-4,757	-4,764
Less: Public sector receipts	-4,506	-5,107	-5,604	-6,125	-6,005	-6,053
Net public sector contribution²	8,301	10,805	12,221	10,845	10,864	10,698

Source: March 2018 Economic and Fiscal Outlook, Office for Budget Responsibility.

Table 3.E: Public sector receipts from the EU Budget (financial years – outturn)

	£ million					
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
European Agriculture Guarantee Fund	2,973	2,956	2,602	2,513	1,318	3,057
European Agricultural Fund for Rural Development	462	298	638	393	619	367
Social Fund	552	366	249	371	543	268
Regional Development Fund	709	327	275	1,308	297	237
Other Receipts	74	75	92	105	34	151
Total	4,771	4,022	3,856	4,690	2,811	4,081

Source: HM Treasury calculations.

Table 3.F: OBR forecast of public sector receipts from the EU Budget (financial years)

	£ million					
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
European Agriculture Guarantee Fund	2,839	2,738	2,612	2,851	2,934	2,965
European Agricultural Fund for Rural Development	659	775	972	1,051	990	997
Social Fund	194	505	640	706	661	664
Regional Development Fund	482	857	1,082	1,184	1,111	1,117
Other Receipts	332	232	296	332	309	311
Total	4,506	5,107	5,604	6,125	6,005	6,053

Source: March 2018 Economic and Fiscal Outlook, Office for Budget Responsibility.

Chapter 4

Financial Management and anti-fraud issues

- 4.1 This chapter provides an overview of the annual reports – relating to financial management and anti-fraud issues – published in 2016 and concerning the 2015 EU budget. First, the European Court of Auditors (ECA) annual report that holds the Commission and member states to account for their management of the EU Budget. This report assesses the implementation of the EU Budget and identifies examples of irregular management or expenditure. Second, the Commission’s annual ‘Fight Against Fraud’ report details the actions taken by the Commission and member states to counter fraud affecting EU funds. The report also highlights areas that are most at risk of fraud and in need of targeted action at both EU and national level.

European Court of Auditors’ annual report on the 2015 EU Budget

- 4.2 The ECA is the EU’s independent auditor and is responsible for assessing the accounts and payments of EU Institutions. The ECA is required to provide the European Parliament and Council with an annual report on the implementation of the EU Budget¹. This report assesses the fairness and accuracy of the EU budget accounts and the regularity of the underlying transactions (the level of error). The report also contains targeted recommendations to address identified errors and weaknesses. It includes a Statement of Assurance (usually referred to as the ‘DAS’, from the French ‘Déclaration d’Assurance’) which confirms whether the EU accounts are complete and accurate, and whether income and expenditure have been managed in accordance with all contractual and legal obligations. The report forms an essential element in the European Parliament’s oversight of the Commission’s management of the EU Budget.
- 4.3 The ECA’s report also launches the annual ‘discharge’ process, the procedure whereby the European Parliament, acting on a recommendation from the Council, decides whether to release the Commission from its responsibility for the management of the Budget for the year in question.
- 4.4 The ECA’s report on the 2015 EU budget was published on 13 October 2016. As in previous years, it provided an assessment of each EU Budget

¹ The European Court of Auditors’ annual report on the 2015 EU Budget can be found at:
<https://www.eca.europa.eu/Lists/ECADocuments/annualreports-2015/annualreports-2015-EN.pdf>

area and offered conclusions based mainly on: testing the regularity of transactions; the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved; and a review of the performance of the EU Budget.

ECA's Statement of Assurance

- 4.5 In the ECA's opinion, the 2015 EU budget accounts were reliable and gave a fair presentation of the financial position and the results of operations and cash flows for the year.
- 4.6 The ECA found EU revenue underlying the 2015 accounts to be legal and regular in all material aspects, as they have done in every year since 2007.
- 4.7 The ECA found that payments (EU spending) continued to be affected by material error with an estimated error rate of 3.8%² for the 2015 EU Budget as a whole, a small decrease from 4.4% for the 2014 budget.
- 4.8 The ECA considers an estimated error rate above 2% to be material. The ECA's estimate of the level of error is not a measure of fraud, inefficiency or waste. It is an estimate of the money that should not have been paid out because it was not used in accordance with the relevant rules and regulations. This can include payments for expenditure which was ineligible or for purchases without proper application of public purchasing rules. Supervisory and control systems were found to be partially effective in most cases, highlighting the need for further improvements.
- 4.9 All individually assessed areas of EU spending were affected by material error, with the exception of administrative expenditure. In light of these findings, for the twenty-second consecutive year, the ECA granted a qualified DAS with regards to the legality and regularity of the transactions underlying the EU Budget accounts.
- 4.10 In their report, the ECA provide specific assessments for revenue and expenditure policy groups as follows:
- **Chapter 2 – Budgetary and Financial Management:** This covers the key budgetary and financial management issues which arose in 2015. These include overall levels of spending, the relationship with budgetary and Multiannual Financial Framework (MFF) ceilings, levels of unpaid payment claims, levels of outstanding commitments and levels of cash held in financial instruments. The ECA recommended that the Commission:
 - act to reduce the level of outstanding commitments by closing 2007 to 2013 programme faster (where appropriate), reducing cash held by fiduciaries and compiling payment plans and forecasts for areas where outstanding commitments are significant;

² The European Court of Auditors' annual report on the 2015 EU Budget can be found at: <https://www.eca.europa.eu/Lists/ECADocuments/annualreports-2015/annualreports-2015-EN.pdf> (paragraph 1.19(b))

- prepare and publish an annually updated cash flow forecast, spanning a seven to ten-year period, covering budgetary ceilings, payment needs, capacity constraints and potential decommitments;
 - consider the capacity constraints in member states to ensure that funds are used efficiently;
 - recover unused cash balances in financial instruments under shared management and remaining unused funds in indirect management financial instruments from the previous MFF from which the eligibility period has expired; and
 - re-evaluate the ex-ante assessment for the Connecting Europe Facility (CEF) debt instrument in light of the creation of the European Fund for Strategic Investment (EFSI) and consider the impact of EFSI on other EU programmes and financial instruments.
- **Chapter 3 – Getting Results from the EU Budget:** The theme of this chapter is performance. It covers the Commission’s reporting on performance, the management plans of selected directorate-generals (DGs) and the reporting by the Commission to the European Parliament and Council. This chapter has three parts: the first on Horizon 2020 performance; the second on Performance and Reporting by Directorates General implementing the ‘Natural Resources’ section of the budget; and the third on the Results of the Court’s Audit on Performance. The ECA concluded that:
 - while there are high level links between Horizon 2020 and the EU’s main strategy, Europe 2020, the indicators shared by Horizon 2020 and Europe 2020 are of limited use in tracking how well Horizon 2020 contributes to the Europe 2020 strategy;
 - the links between the Commission’s ten political priorities and Europe 2020/Horizon 2020 need clarification as they overlap but are not identical and it is not clear which set of priorities Horizon 2020 should be aligned with;
 - further developments to the legal framework of Horizon 2020 are needed to improve performance management such as baselines, milestones and targets;
 - proposals and grant agreement objectives were generally SMART³ when required by the Commission and grant agreements require beneficiaries to report information on key performance indicators to the Commission, but use of the concept of ‘expected impact’ rather than the narrower concept of ‘expected result’ means there is a risk that the information provided is too broad;
 - the Commission is limited in its ability to monitor and report on Horizon 2020’s performance as there are weaknesses in the monitoring and reporting system; and

³ Specific, measurable, achievable, relevant and time-bound.

- the Commission does not always abide by its definitions of terms such as 'inputs', 'outputs', 'results' and 'impacts' and this creates problems in translating legislation into individual work programmes.

The ECA recommended that the Commission should:

- translate the high-level Horizon 2020 legislation objectives into operational objectives at work programme levels so that they can be used effectively to drive performance;
 - clarify the links between the Europe 2020 strategy (2010 to 2020), the MFF (2014 to 2020), and the Commission priorities (2015 to 2019) to enable it to report effectively on how the budget contributes towards the Europe 2020 objectives; this could be done through the strategic planning and reporting process (2016 to 2020); and
 - use the terms 'input', 'output', 'result' and 'impact' consistently and in line with its better regulation guidelines.
- **Chapter 4 – Revenue:** This covers the revenue through which the EU finances its budget. For 2015 the ECA concluded that member states' payments of TOR, VAT and GNI based resources and other revenue were all free from material error. The error rate for transactions tested was found to be nil. The examined supervisory and control systems for GNI and VAT-based own resources and other revenue were assessed as effective. The examined systems for TOR were also assessed as effective overall. However, key internal controls in member states visited were assessed as only partially effective.

The ECA recommended that the Commission should:

- take steps to ensure that economic operators receive the same treatment regarding the time limits of debt notifications in all member states;
 - provide member states with guidance to improve their management of items recorded in the B accounts;
 - ensure that member states correctly declare and make available the amounts collected from customs duties in their quarterly statements;
 - facilitate the recovery of customs debts by member states where the debtors are not based in an EU member state; and
 - improve checks on the calculations of the European Economic Area (EEA) and the European Free Trade Area (EFTA) contributions and correction mechanisms.
- **Chapter 5 – 'Competitiveness for growth and jobs':** This chapter covers spending on research and innovation, enhancing education systems, promoting employment, ensuring a digital single market, promoting renewable and efficient energy, transport and improving the business environment particularly for small and medium-sized enterprises (SMEs). The ECA found that the error rate in this area was 4.4% (down from 5.6%

in 2014). The main source of error was reimbursement of ineligible personnel costs. The ECA recommended that the Commission:

- uses all information available to prevent, detect and correct errors before reimbursement, while national authorities and independent auditors should do the same;
 - issues guidance to beneficiaries on the specific differences in Horizon 2020 compared to the Seventh Research Framework Programme and similar programmes;
 - issues common guidelines to implementing bodies to ensure consistent treatment of beneficiaries when applying audit recommendations for the recovery of ineligible costs; and
 - monitors the implementation of corrections which have been extrapolated based on ex-post audits of reimbursed costs under the Seventh Research Framework Programme.
- **Chapter 6 – ‘Economic, social and territorial cohesion’:** This covers the European Regional Development Fund (ERDF), the Cohesion Fund (CF), the European Social Fund (ESF) and the Fund for European Aid to the Most Deprived (FEAD). Funding in this area aims to reduce development disparities between different regions, restructure declining industrial areas, diversify rural areas and encourage cross-border, transnational and inter-regional cooperation. The ECA identified the most prevalent cause of error as including ineligible costs in expenditure declarations. The overall error rate across this MFF heading area was 5.2% (down from 5.7% in 2014). The ECA recommended that the Commission should:
 - reconsider the design and delivery mechanism for European Structural and Investment (ESI) funds when making its legislative proposal for the next programming period, taking account of the suggestions of the high-level simplification group;
 - use the experience gained in the 2007 to 2013 programming period and should report on an analysis of national eligibility rules for the 2014 to 2020 period in order to provide guidance to member states on how to simplify and avoid unnecessarily complex and/or burdensome rules;
 - submit a legislative proposal to amend Regulation (EC) No 1083/2006 regarding the extension of the eligibility period for financial instruments under shared management in order to provide legal certainty to member states;
 - clarify to member states the notion of recoverable VAT for the 2014 to 2020 programming period in order to avoid different interpretations; and
 - ensure that all expenditure related to ERDF and ESF financial instruments for the 2017 to 2013 programming period are included early enough in the closure declarations for the audit authorities to carry out their checks.

- **Chapter 7 – ‘Natural resources’:** This covers assessments of the European Agricultural Guarantee Fund (EAGF) (one of the two main instruments of the Common Agricultural Policy (CAP) of the EU) and for other spending including rural development, environment, climate action and fisheries. The ECA estimated the error rate as 2.9% (down from 3.6% in 2014). The most significant cause error was overstatement of the area of land eligible for support. The ECA recommended that the Commission:
 - continues to follow up on cases where national legislation is not compliant with EU legislation using all legal means at its disposal;
 - monitors annually the results of the Land Parcel Identification System (LPIS) quality assessments performed by member states and check that all member states with negative assessments take remedial action;
 - ensures that all member states’ action plans addressing errors in rural development include effective actions on public procurement;
 - monitors and supports certification bodies in improving their work and methodology on the legality and regularity of expenditure;
 - updates DG Agriculture and Rural Development (DG AGRI) audit manual to include detailed audit procedures and documentation requirements for checking data supplied by member states; and
 - improves the compliance of DG Maritime Affairs and Fisheries (DG MARE) conformity audits with international auditing standards.
- **Chapter 8 – ‘Global Europe’ and ‘Security and Citizenship’** This covers payments in the fields of: external relations; development and humanitarian aid; measures for EU candidate and accession countries and expenditure related to regional policy; rural development; research; other internal policies as well as on migration; security; the food and feed programme; and the Creative Europe programme. The ECA found that the estimated error rate for Global Europe is 2.8% (up from 2.7% in 2014). Claims for expenditure not incurred and ineligible expenditure were the most significant types of error. The ECA does not calculate an error rate for ‘Security and Citizenship’ as there are too few transactions for it to take a representative sample. The ECA recommends that:
 - DG International Cooperation and Development (DG DEVCO) and DG Neighbourhood and Enlargement Negotiations (DG NEAR) enhance the expenditure verifications contracted by beneficiaries by introducing new measures such as use of a quality grid to check the work performed by beneficiary contracted auditors;
 - DG NEAR ensures that funding channelled through a twinning instrument accords with the non-profit rule and adheres to the principle of sound financial management; and
 - DG NEAR revises the residual error rate (RER) methodology to provide statistically accurate information on the amount at risk for payments made under IPA indirect management.

- **Chapter 9 – ‘Administration’:** This covers the administrative and other expenditure of EU institutions and bodies. Expenditure in this area includes human resources (salaries, allowances and pensions), which account for 60% of the spending in this policy group, in addition to expenditure on buildings, equipment, energy, communications and information technology, which accounts for the remainder. The results of the ECA audits of the EU agencies and other decentralised bodies are reported in specific annual reports, which are published separately. The ECA concluded that payments were not affected by material error (estimated error rate of 0.6%) but noted weaknesses in checks carried out by the European Parliament on political parties’ expenditure and a small number of errors relating to calculating staff costs and managing family allowances. The ECA recommended that:
 - the European Parliament reviews its framework for implementing budget appropriations allocated to political groups and provides better guidance on the rules for authorisation and settlement of expenditure and for procurement procedures;
 - the Commission improves its monitoring systems for updating the personal situation of staff which can have an impact on the calculation of family allowances;
 - the European External Action Service (EEAS) ensures that all steps in the procedures for selecting local agents to delegations are properly documented; and
 - the EEAS improves its guidance on design, co-ordination and execution of procurement procedures for contracts worth less than €60,000.

Council recommendation to the European Parliament on Discharge

- 4.11 On 21 February 2017, the Council noted both the ECA’s Statement of Assurance on the implementation of the EU Budget for the financial year 2015 and the ECA’s analysis of the audit findings and conclusions⁴. The Council stressed the importance of independent audits carried out at EU level and strongly supported the ECA’s work and audit findings.
- 4.12 However, the Council remained concerned that payments from the EU budget continued to be materially affected by error, and reiterated its desire to see year-on-year improvements in financial management systems and the estimated level of error across all policy areas. The Council also stated that simplification of rules is key to achieving a lower error rate and invited the Commission and member states to use the simplification options available.
- 4.13 In its conclusions responding to the ECA’s Statement of Assurance, the Council made a number of recommendations⁵. The Council:

⁴ <http://data.consilium.europa.eu/doc/document/ST-6475-2017-INIT/en/pdf>

⁵The Draft Council recommendation can be found at: http://www.europarl.europa.eu/cmsdata/114560/st05876-ad01_en17.pdf

- regretted that the Commission and national authorities did not make full use of the available information to prevent, detect and correct a significant proportion of errors, which would have substantially reduced the estimated level of error across all chapters of expenditure;
- called on the Commission to continue to implement all available corrective measures and encouraged the ECA and the Commission to work together to ensure that they have consistent approaches on the evaluation of how financial corrections affect the estimated amount at closure and that they provide comparable data;
- invited the Commission and member states to take full advantage of simplification options when implementing programmes under the current legal framework;
- called on member states to continue to co-operate with the Commission and to prioritise improving the quality of first level checks to detect, prevent and correct errors;
- called on the Commission to ensure that all available information on financial instruments under shared management is shared transparently;
- encouraged the ECA, the Commission and member states to improve the exchange of information on audit results to ensure efficient application of the 'Single Audit' principle;
- called on the Commission to consider capacity constraints in member states in its budgetary and financial management in order to avoid the underutilisation of funds;
- called on the Commission to prepare and publish a long-term, transparent cash flow forecast;
- invited the ECA to extend its review of the performance of programmes and projects in the 'Economic, Social and Territorial cooperation' and 'Natural Resources' policy areas across all policy areas; and
- invited the Commission to continue to promote the use of simplified cost options, particularly in areas where the ECA found the most instances of error.

4.14 On 21 February 2017, Sweden, the Netherlands and the UK voted against the Council's recommendation on discharge in order to highlight the need for further improvements in budgetary management. Sweden and the Netherlands also submitted a joint counter-statement calling for progress in key areas, including systematically evaluating the efficiency, EU added value and contribution to EU-priorities of each area of the EU Budget⁶.

⁶ <http://data.consilium.europa.eu/doc/document/ST-6554-2017-INIT/en/pdf>

The European Parliament takes a final decision on whether to discharge the EU Budget.

- 4.15 On 27 April 2017, the European Parliament formally approved the discharge of the EU budget accounts for 2015 and issued their Resolution⁷. It did so having considered the ECA's report, the Commission's response, and the recommendation of the Council.

UK government's response to the European Commission's questionnaire on ECA findings

- 4.16 The ECA report included examples of specific issues identified in individual member states, including the UK. These examples are used to illustrate the issues raised in the report. The Commission sends a questionnaire to member states so that they can respond to all ECA findings. The Treasury coordinates a cross-Whitehall response with individual departments, providing detail on areas where they are mentioned or that are relevant to them. This could involve giving detail of how the UK addresses such problems, noting that sanctions were applied or highlighting ongoing work. The Treasury also ensures that relevant views from departments are fed into working group discussions with other member states and the Commission on the substance of the report.
- 4.17 In all cases where weaknesses were identified, the relevant UK authorities engaged with the Commission and the ECA and, where appropriate, took steps to strengthen national systems and processes. Below is an example of two such cases.

Audit Finding: irregular payments due to incorrect eligibility data in the LPIS.

UK response: These issues are addressed by the English Authorities' Land Parcel Identification System (LPIS) action plan, which is on-going and monitored by the Commission.

Audit Finding: Deficiencies in administrative cross-checks.

UK response: Northern Ireland Authorities accept the Court's finding, but believe that there was no risk to the fund. Validation software has now been updated to avoid future issues.

Fight against Fraud Report 2015

- 4.18 The protection of the EU's financial interests and the fight against fraud are areas of shared responsibility between the Commission and member states. Each year, the Commission, in cooperation with member states, issues a report on details of irregularities, the latest statistics on fraud and recent measures taken to reduce irregularities and fraud. This report is required

⁷ Discharge 2015: EU general budget 2015 – European Parliament can be found at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP/TEXT+TA+P8-TA-2017-0146+0+DOC+XML+V0//EN>

under Article 325 (5) of the Treaty on the Functioning of the European Union (TFEU), and is sent to the Parliament and Council.

4.19 As in previous years, the report summarises and evaluates measures taken by the Commission and member states to counter fraud and irregularities in relation to EU Budget funds. The report also includes both the latest information on irregularities detected by control systems and suspected fraud (with a distinction made between fraud and other irregularities), and on measures taken to deal with them. The 2015 report⁸, published on 14 July 2016, covers:

- anti-fraud policies at the EU level;
- detection and reporting of fraudulent and non-fraudulent irregularities that affect the EU budget; and
- measures taken by member states to counter fraud and other illegal activities which affect the EU's financial interests.

4.20 The report is accompanied by six Commission Staff Working Papers: (i) Implementation of Article 325 TFEU by the member states in 2015; (ii) Statistical Evaluation of Irregularities reported for 2015; (iii) Follow-up recommendations to the Commission report on the protection of the EU's financial interests - Fight Against Fraud 2014; (iv) Methodology regarding the statistical evaluation of reported irregularities for 2015; (v) Annual overview with information on the results of the Hercule III programme in 2015; and (vi) Implementation of the Commission Anti-Fraud Strategy (CAFS).

4.21 Member states are required to report irregularities and suspicions of fraud affecting the EU's financial interests in the areas where they implement the Budget.

Irregularities reported as fraudulent

4.22 In 2015, a total of 1,461 irregularities were reported as fraudulent (suspected and established fraud), of which 849 were related to expenditure and 612 were related to revenue (for example, customs fraud). The estimated financial impact of irregularities reported as fraudulent was €637.2 million (£462.6 million)⁹. Revenue (e.g. customs) was the policy area with the highest number of irregularities reported as fraudulent. However, Cohesion policy accounted for the highest value of suspected fraudulent transactions, at 0.96% of the total amounts involved.

Other irregularities (not reported as fraudulent)

4.23 In 2015, a total of 20,888 irregularities were reported as non-fraudulent. The estimated financial impact of these irregularities was €2.6 billion (£1.9 billion).

⁸ The 2015 Fight Against Fraud Report can be found at: https://ec.europa.eu/anti-fraud/sites/antifraud/files/pifreport_2015_en.pdf

⁹ 2015: £1 = €1.37741. This is the 2015 average exchange rate.

Recommendations

- 4.24 The report considers the actions taken by the Commission in 2015 to counter fraud, including use of financial corrections and preventive measures where fraud was suspected. OLAF made 98 recommendations to national authorities, recommending that approximately €888 million (£645 million) should be recovered.
- 4.25 The report's recommendations called for all member states to:
- balance trade facilitation and the protection of the EU's financial interests by sharing best practice, incorporating information received through EU information sharing and reporting systems into risk management and to co-operate closely and exchange information over post-clearance controls and audits across borders;
 - adapt customs control strategies by: amending their yearly planning of staff and resources needed for verification of information received by voluntary admission, taking account of the types of irregularities revealed by voluntary admissions and extending customs controls to other economic operators with similar businesses or operations to those which have made voluntary admissions;
 - improve quality control of information submitted via the Irregularity Management System (IMS); and
 - plan and focus their audits and control activities based on risk analysis and to use systems and tools such as Arachne, IMS and the Fraud Risk Assessment Tool more systematically and efficiently.

Sixteenth Report of the European Anti-Fraud Office (1 January to 31 December 2015)

- 4.26 The European Anti-Fraud Office (OLAF) is an administrative investigative service of the EU, with the remit of combating fraud, corruption and other illegal activities affecting the EU, including serious misconduct within the EU institutions that has financial consequences. It aims to ensure that EU taxpayers' money is spent appropriately and that the EU is not being deprived of its due revenue.
- 4.27 OLAF's operational activities are independent from the European Commission and its internal (within the EU) and external (outside the EU) investigations are conducted in full independence. It investigates cases of fraud and provides assistance to the Commission and EU bodies and national authorities in their fight against fraud. It works closely with national authorities' investigation services, police, legal and administrative authorities to counter fraud. It also supports the Commission in developing anti-fraud measures.
- 4.28 Every year, the OLAF Director publishes a report on the activities of the Office over the previous year. The sixteenth report, issued in April 2016, gave a

summary of OLAF's achievements in 2015, supported by statistics and case studies.¹⁰

4.29 The following statistics were reported for 2015:

- 1,372 items of information were received in 2015 from public and private sources;
- 219 investigations were opened in 2015;
- 364 recommendations were issued in 2015;
- structural funds accounted for the highest number of investigations; and
- €187.3 million (£136.0 million) was recovered in total as a result of OLAF's investigations.

4.30 In the policy field, OLAF continued to actively engage in a number of projects, including:

- overall EU strategy against the illicit tobacco trade;
- contributing to legislative proposals to develop the EU's anti-fraud policy; and
- providing financial support to improve member states' capacity to fight fraud through the Hercule III programme.

4.31 In 2015, OLAF operated on an administrative budget of €57.7 million (£41.9 million).

¹⁰ OLAF's sixteenth activity report can be found at: https://ec.europa.eu/anti-fraud/sites/antifraud/files/olaf_report_2015_en.pdf

Chapter 5

Government strategy on using EU funds in the UK: an update

- 5.1 The government is fully committed to maintaining the greatest possible transparency on the use of EU funds at a cross-government level. The 2016 annual statement, as part of The Treasury's response to recommendations from the Public Accounts Committee (PAC)¹, set out the government's strategy on using EU funds in the UK.
- 5.2 This year, this chapter summarises the strategy, including updates where relevant, and sets out how the government is performing in its efforts to minimise disallowance. It also highlights the assurances provided by the government to provide certainty to recipients of EU funds whilst the UK remains a member state.
- 5.3 Where relevant, this chapter focuses on Common Agricultural Policy and European Structural and Investment Funds as collectively they constitute the vast majority of UK public sector receipts from the EU budget (in 2016-17, they accounted for 96% of UK public sector receipts)².
- 5.4 In accordance with the devolution settlement, relations with the EU are the responsibility of Parliament and the government of the United Kingdom, as the member state. Responsibility for implementing EU obligations relating to devolved matters lies with the devolved administrations. The proper administration of EU Funds in Northern Ireland, Scotland and Wales is a matter for the relevant devolved administration, including in relation to disallowance. This chapter and Annex D have been prepared with the main focus on English government departments and without prejudice to the devolution of these responsibilities.
- 5.5 Annex D contains detailed information relating to the use of EU funds within the UK with data collated from a variety of publications, including departmental annual reports and accounts. Where relevant, key data set out in Annex D will be highlighted in this chapter, including on disallowance.

¹ PAC report on the financial management of the EU budget in 2014 can be found at:
<https://publications.parliament.uk/pa/cm201516/cmselect/cmpubacc/730/730.pdf>;

The government response can be found at:

<https://www.gov.uk/government/publications/treasury-minutes-november-2016>

² HMT figures, derived from Table 3.E. The Home Office, for example, also manages EU funds. However, disallowance relating to those funds are not material to Home Office accounts. As set out in table 5.B, as at 31 March 2017 there were no disallowance provisions relating to 'Other' funds.

Government strategy for using EU funds

- 5.6 The UK continues to have all of the rights, obligations and benefits that membership of the EU brings, with respect to the EU Budget, up until the point the UK leaves. While the UK remains a member state, the government's overall approach to the EU Budget continues to be to:
- minimise UK contributions to the Budget by arguing for budgetary restraint at European level;
 - maximise the value for money and impact of all EU spending by constructively engaging in European-level discussions on how funds are spent; and
 - maximise the value for money and impact of EU spending that takes place in the UK by implementing clear strategies relating to the use of EU funds.
- 5.7 Ultimate responsibility for implementing the EU Budget lies with the European Commission. But in practice, some 80% of the EU Budget is spent under what is known as 'shared management', with individual EU countries distributing funds and managing expenditure in accordance with agreements between member states and the European Commission, as well as related legislation adopted by the EU and member states. Further information on the auditing arrangements for the main shared management funds can be found in Annex D.
- 5.8 Reflecting the different nature of the various funds in place, the government has a series of strategies in place for the effective management of each of the main EU funds in the UK. Where relevant for national allocations of EU funds, strategy documents are agreed with the Commission at the beginning of the programming period, setting out intended results and priorities to achieve maximum value for money. These are agreed in line with both EU and clearly defined domestic priorities, and typically reviewed at the mid-point of each programming period to reflect the latest outlook on economic and social positions.

Table 5.A: UK allocations for key EU funds under “shared management”

Fund	2014-20 allocation (€ billion)	2014-20 allocation (£ billion) ³
European Agricultural Guarantee Fund (EAGF) or Pillar 1 of Common Agricultural Policy ⁴	22.7	20.1
European Regional Development Fund (ERDF) + European Social Fund (ESF) ⁵	10.8	9.6
European Agricultural Fund for Rural Development (EARDF) ⁶	5.2	4.6
European Maritime and Fisheries Fund (EMFF)	0.2	0.2

5.9 Common Agricultural Policy (CAP) Pillar 1, funded through the European Agricultural Guarantee Fund (EAGF), primarily involves direct payments to farmers and is the largest source of UK receipts. CAP in England is overseen by the Department for Environment, Food and Rural Affairs (DEFRA). The Commission does not require strategic programming for EAGF, but DEFRA’s policy approach in England is set out in a series of formal consultation responses, which take full account of the interests of the industry and other relevant stakeholders, and reflects the government’s overall approach set out above.⁷ DEFRA’s overall approach for using CAP receipts continues to be based on commitments to:

- implement CAP in England in a way that, wherever possible, supports a resilient and competitive English farming sector;
- simplify, wherever possible, the rules that farmers and other CAP beneficiaries must adhere to;
- strengthen how the sector delivers outcomes for the public good, primarily through rural development funds targeted at improving the environment and growing the rural economy; and
- minimise overall implementation costs to government and the sector.

³ 2018: £1 = €1.11271. This is the 29 December 2017 exchange rate, which is the rate at which all UK VAT-based and GNI-based contributions, and the UK rebate, are being converted to sterling throughout 2018.

⁴ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0671&from=EN>; <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0994&from=EN>; <http://data.consilium.europa.eu/doc/document/ST-14561-2014-ADD-1/en/pdf>

⁵ European Structural and Investment Funds: UK Partnership Agreement: <https://www.gov.uk/government/publications/european-structural-and-investment-funds-uk-partnership-agreement>

⁶ <http://data.consilium.europa.eu/doc/document/ST-14561-2014-ADD-1/en/pdf>

⁷ <https://www.gov.uk/government/consultations/common-agricultural-policy-reform-implementation-in-england>

- 5.10 European Structural and Investment Funds (ESIFs), which include the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agricultural Fund for Rural Development (EAFRD, sometimes referred to as the second pillar of Common Agricultural Policy) and the European Maritime and Fisheries Fund (EMFF), make up the second largest proportion of UK public sector receipts from the EU and involve investment in the real economy by supporting job creation and economic growth. The UK Partnership Agreement⁸ sets out the plans and priorities for the deployment of these funds to complement EU and UK objectives on sustainable jobs and growth, and again reflects the government's overall approach set out above. The Agreement was formed by working closely with devolved administrations and with Local Enterprise Partnerships (LEPs) in England. For the 2014-20 programming period, the UK decided that the overall objectives for ESIFs would include:
- promoting sustainable and quality employment, and supporting labour mobility;
 - increasing the competitiveness of small and medium-sized enterprises (SMEs) and support entrepreneurship;
 - improving the commercialisation of research and development, including through encouraging more firms to innovate;
 - contributing towards improving access to, use of and quality of information and communications technology including improving superfast broadband infrastructure;
 - developing infrastructure, supporting low carbon transport solutions particularly in urban areas, encouraging technological innovation and promoting energy efficiency; and
 - improving infrastructure in less developed regions where poor connectivity contributes to market failure.
- 5.11 Underpinning the Partnership Agreement are detailed Operational Programmes setting out the strategy and priorities for each fund in each of the constituent nations along with information about management and delivery. UK management of ESIFs has promoted value for money by: setting consistent performance management standards across different programmes; establishing a strategic framework for investments; and prioritising local needs. For example, the ESF and ERDF Programmes include a requirement for applicants to demonstrate quantitative and qualitative aspects of value for money at the outline and full application stages and through ongoing contract management arrangements over the lifetime of the project.
- 5.12 The Department for Business, Energy and Industrial Strategy (BEIS) has overall policy responsibility for ESIFs across the UK and was responsible for negotiating the UK's Partnership Agreement with the Commission on behalf

⁸ <https://www.gov.uk/government/publications/european-structural-and-investment-funds-uk-partnership-agreement>

of all the UK's Managing Authorities, including the devolved administrations. Managing Authorities are responsible for negotiating and implementing individual Operational Programmes for each Fund. For England, the Managing Authorities are: Ministry of Housing, Communities and Local Government (MHCLG) for ERDF; Department for Work and Pensions (DWP) for ESF, and DEFRA for EAFRD. The Marine Management Organisation (MMO) manages the EMFF for the whole of the UK.

- 5.13 Annex D sets out historical information on the levels of EU expenditure in the UK between 2010-11 and 2016-17 and breaks down this information by fund and, where possible, between England and the devolved administrations.

Government strategy for minimising disallowance

- 5.14 As part of their oversight of EU Budget spending, the Commission can impose financial corrections on member states for failing to apply EU Regulations correctly in managing and administering EU schemes. In such circumstances, the EU reduces the amount paid to the member state. These corrections are known as 'disallowance'.
- 5.15 The government has taken, and will continue to take, the issue of disallowance very seriously, especially in those areas that constitute a material element of public spending in that policy area, such as CAP. As set out in the November 2016 response to the PAC, the Treasury exercises close oversight of the disallowance incurred by departments. For example, the Treasury coordinates the annual UK response to the European Court of Auditors (ECA) audit findings and, for financial errors identified by the ECA, departments are required to respond to every case and implement any required follow-up actions. Errors identified by the ECA do not necessarily lead to actual disallowance, but the ECA's findings are often followed up by the European Commission's conformity audits. The European Commission is the only actor that can apply a financial correction.
- 5.16 The government strategy for managing down disallowance risks consists of:
- clear central oversight and clear lines of accountability through the Treasury to departments;
 - focussing efforts and investment on early identification of risks and sharing best practice if appropriate; and
 - engagement at departmental level with the European Commission to advance the simplification agenda.
- 5.17 Robust governance and accountability arrangements are an integral part of the government's strategy for managing down the risk of financial corrections. Individual departments are accountable for developing and implementing strategies for managing expenditure risks. As part of this, departments ensure all checks on EU spending are robust, monitoring the results of audits to inform improvements. Departments and agencies managing EU funds within England have been asked to identify the main areas where they risk disallowance being imposed and implement measures to address these. Appropriate measures will vary between departments and

funds, but below are examples of how DEFRA and BEIS, who have oversight of the majority of public sector EU funds in the England, are minimising the risk of disallowance.

CAP

5.18 Historically, no member state has achieved zero disallowance under the CAP regime, illustrating the complexity of the schemes and the challenges and costs of complying with them. However, DEFRA are committed to making substantive progress and taking cost-effective action to minimise disallowance. DEFRA's strategy remains focused on the following areas:

- Assessing risk and prioritising actions: DEFRA maintain an up-to-date picture of how they are meeting EU requirements in order to assess disallowance risks for each scheme – a range of sources are used to do this, including any emerging Commission guidance on the scheme rules. This process aims to identify risks early and before they are detected by Commission auditors. Efforts are focused on the Basic Payment Scheme, cross compliance, Pillar 2, and Fruit and Vegetable Aid Scheme, as these are the main areas of risk. Mitigation measures are then focussed on addressing the major causes of possible disallowance and prioritised on the basis of their likely impact, as well as how they fit with wider government policy. The priorities are regularly updated, so as to reflect the latest information, and to ensure efforts continue to be well targeted.
- Cost-effective investments: DEFRA invest in mitigation measures where they are likely to save more in disallowance than they cost in implementation. For example, the quality of mapping data, used to administer CAP payments, has historically been the biggest cause of disallowance. DEFRA are therefore investing in improving the mapping of data, such as through the use of additional satellite imagery, in order to minimise disallowance. DEFRA has also continued to make improvements to its IT systems through the CAP Delivery Programme. This year, DEFRA have made investments in the ongoing development of their payment systems to improve claim processing and compliance with EU requirements. Further, any new or amended EU regulations will be implemented in the most cost-effective way possible, taking account of disallowance risks and the views of stakeholders.
- Continued EU engagement: The CAP is governed by complex rules, which drive up the risk and incidence of disallowance. DEFRA are continuing to engage constructively with the Commission's simplification exercise and will continue to argue against new measures which would not be cost effective to implement. DEFRA also challenge the Commission's proposals for disallowance where it believes that the proposals are disproportionate relative to the risk to the fund, often resulting in lower disallowance being applied. DEFRA also engages with other member states, exchanging information about the scope and outcome of EU audits in order to improve assessment of disallowance risks, such as through the Learning Network of EU CAP Paying Agencies.

5.19 Progress in implementing DEFRA's disallowance strategy is overseen by the Department's Disallowance Steering Group, which meets monthly, and

changes will continue to be made as necessary. It is important to note that the impacts of mitigating actions can take time to flow through to results and will not always be immediately visible. DEFRA recognises that minimising disallowance requires a range of actions, and continues to engage with the rest of government, the European Commission and other member states on best practice.

ESIFs

- 5.20 BEIS works with the Managing Authorities (including DCLG, DWP and DEFRA) and the devolved administrations to ensure that the ESIFs are managed appropriately. Managing Authorities must demonstrate that they comply with certain criteria set out in the ESIFs regulations. For example, they must demonstrate that they have arrangements to train those involved in implementation on state aid and public procurement law, since failure to comply with these areas is a major cause of error. In order to ensure compliance with the EU rules, and minimise disallowance, a range of measures have been implemented, such as administrative simplification.
- 5.21 BEIS and Managing Authorities have put in place an early warning system to identify potential disallowance quickly using the Partnership Agreement Programme Board. This helps to share expertise between the Managing Authorities and BEIS and to identify lessons learnt. The frequency of Partnership Agreement Programme Board meetings has recently been increased from biannually to quarterly, increasing the engagement between Managing Authorities across the UK and opportunities to share best practice in implementation. In addition, Managing Authorities are drawing on the experiences from previous programming periods to counteract the risk of disallowance. These include a strengthening of administrative and on-the-spot control checks and checking all expenditure prior to paying out to beneficiaries or reclaiming it from the Commission.
- 5.22 Projects are risk assessed and scored as part of approval, and, in most Managing Authorities, a control plan is put in place with higher risk scores leading to more intensive scrutiny. Verification checks of expenditure vary between the Managing Authorities, but typically include desk checks, site visits and expenditure checks by the Certifying Authority – which is responsible for guaranteeing the accuracy and honesty of statements of expenditure and requests for payments before they are sent to the European Commission.
- 5.23 All types of verifications are carried out before expenditure is certified to the Commission for re-imbusement and they must be sufficient to guarantee that the expenditure certified is legal and regular. The Certifying Authority also independently review verification activities to ensure the Managing Authority has completed verifications as per their strategy.
- 5.24 Across all funds, a range of networks exist to share learning and best practice both between UK authorities and with other member states, and the UK will continue to participate in these while an EU member state. In addition to domestic efforts, the UK will continue to engage with the EU until exit. This includes working on the rules governing EU expenditure. The UK continues to push for simplified rules across all areas of EU expenditure.

Many errors in EU spending are due to the complexities of the regulations governing different programmes, therefore simplifying the rules will reduce the number of errors and reduce the disallowance incurred.

Information on disallowance

- 5.25 As set out in last year's statement, government departments publish information about possible disallowance in their departmental annual accounts and reports. A disallowance provision is recognised in departmental accounts where there is a past event (for example an ineligible payment or a failure to comply with the regulations) which is likely to lead to the EU disallowing expenditure and not reimbursing the UK. The Treasury monitors disallowance provisions.
- 5.26 Tables 5.B and 5.C sets out data from the 2016-17 and 2015-16 departmental accounts respectively including: provisions for future corrections added to departmental accounts over the course of the relevant financial year; provisions 'released' by departments during the year, which is the value of provisions no longer expected to materialise into actual disallowance; and provisions 'utilised' in year, which is the value of provisions that are expected to materialise within 12 months (they are no longer a future long-term liability, but are expected to be imposed by the European Commission). The updated data set out in Table 5.B is discussed in more detail in the next section of this chapter.
- 5.27 Whilst information on disallowance provisions can, to some extent, indicate levels of likely disallowance, it is important to note that this information cannot be used to identify trends or measure the success of related strategies because:
- disallowance provisions added to Statements of Financial Position in any given year can relate to activity that has taken place in a number of previous years;
 - disallowance can be challenged by departments and are sometimes successfully overturned;
 - as set out earlier in this chapter, disallowance is often illustrative of the complexity of the regulations governing EU funds rather than any misuse of funds, and disallowance may increase temporarily following the introduction of new scheme rules;
 - figures may not be directly comparable across funds, due to the different ways in which funds work and different levels of complexity of the various programmes; and
 - there may be a lag between action being taken by a department to reduce disallowance and the effect being observable.
- 5.28 Annex D sets out historical information on disallowance and provisions for them. In subsequent annual statements, the government will continue to provide updates on how the government is performing against the strategies above, including in its efforts to minimise disallowance. In doing so, the Treasury will draw on the information which departments already publish.

Updates on performance and minimising disallowance

- 5.29 At European level, on-going UK engagement with the EU institutions and member states has led to a range of UK proposals on simplification and harmonisation being included in the Commission's proposed changes to EU regulations. Some of these changes are likely to take effect before the UK leaves the EU and support the effective use of EU funds in the UK. At the domestic level, progress in using EU funds in this programming period is being made, and initial updates on how departments are minimising disallowance is available.
- 5.30 DEFRA has been delivering CAP Pillar 1 in line with the key principles highlighted above since the beginning of the 2014-2020 programming period. For example, in implementing greening requirements, which set out environmental and ecological conditions for the use of funds, DEFRA has taken advantage of the discretion member states have to implement EU rules flexibly, and has provided a package of options which give farmers a choice over how they comply with the rules.⁹
- 5.31 In relation to disallowance, the overall success of DEFRA's strategy in reducing these will not be known until the Commission concludes audits on CAP expenditure for the relevant 2015-20 period. So far none of these audits have concluded. However, in the last year, DEFRA have been successful in reducing the disallowance in relation to the Rural Development Programme for England for the financial year 2013-14: the Commission's initial proposal was for a disallowance of €22.5 million, but this was reduced to €2.3 million due to DEFRA's challenge. DEFRA will continue to challenge disallowance proposals as needed.
- 5.32 As demonstrated by the data in Table 5.B, a significant portion of provisions in 2016-17 continues to be related to agricultural policy funding and the portion has indeed increased as at the Statement of Financial Position (Balance Sheet) date of the 31 March 2017 – largely due to the size of the fund and the complexity of the regulations. Disallowance was expected to be high for CAP years 2015 and 2016 due to the implementation of new CAP arrangements, which were complex and subject to an unknown Commission approach. The new provisions entered in 2016-17 are in respect of Basic Payment Scheme audits primarily relating to entitlements (required by farmers claiming direct payments), as well as in relation to area aids and cross compliance (rules for farmers and land managers claiming direct payments). The provisions were previously published in Chapter 3 of DEFRA's Annual Report and Accounts for 2016/17¹⁰. Following engagement with the Commission, DEFRA believe that the final disallowance associated with the audit of 2015-16 Basic Payment Scheme entitlements will be less than the original forecast which informed the provisions made. The current CAP

⁹ <https://www.gov.uk/government/news/cap-greening-criteria-announced>

¹⁰ <https://www.gov.uk/government/publications/defras-annual-report-and-accounts-2016-to-2017>

disallowance strategy reflects the latest intelligence from these processes and will continue to be updated.

- 5.33 At the mid-point of the 2014-20 ESIFs, all of the UK's ESIFs programmes were progressing well. According to European Commission data, the United Kingdom had the fourth highest rate of financial resources allocated to selected projects across all member states. The total payments to the UK across all ESIFs has also been above the EU average for each of 2015, 2016 and 2017.¹¹ In addition, as at the end of November 2017, all but one of the UK's Managing Authorities had been formally designated. At the mid-way point, ESF had approximately half of the England allocation committed, funding 450 projects. For ERDF, as of the end of October 2017, 470 projects had been contracted valuing £1,246 million (meaning approximately 43% of the programme had been contracted).
- 5.34 Although it is early days in terms of verification activity, during calendar year ending 2017, on-the-spot verification activities identified some issues with plans relating to cross cutting themes in ESF and data retention in ERDF and ESF. Cross-cutting themes and document retention guidance was issued in February 2017 and all verification managers ensure project managers understand these Regulatory requirements. In terms of disallowance, the ESIFs strategy is working effective at this stage. Table 5.B shows that in 2016-17 there were some – relatively small – disallowance provisions relating to the European Social Fund.

Certainty for beneficiaries of EU funds

- 5.35 The government has been clear that British businesses, farmers and other organisations can continue to apply for EU funds and benefit from them while the UK remains a member state. In October 2016, the Chancellor announced that the government will guarantee ESIFs projects, including agri-environment schemes, which are signed while the UK remains a member state, even if projects run on after the UK has left the EU¹².
- 5.36 Funding for ESIFs projects in England will be honoured by the government if they are good value for money and are in line with domestic priorities. Government departments will take responsibility for allocating money to projects in line with these conditions. Where the devolved administrations sign up to ESIFs projects under their current EU budget allocation prior to the UK's exit from the EU, the government will ensure they are funded to meet these commitments.
- 5.37 In the non-ESIFs funding streams, the Chancellor guaranteed that the current level of agricultural funding under Common Agricultural Policy Pillar 1 will be upheld until 2020, as part of the transition to new arrangements. Earlier in 2016¹³, the Chancellor also provided assurances that UK businesses and universities should continue to bid for competitive EU funds while the UK remains a member of the EU and the government will work with the

¹¹ European Structural and Investment Funds data: <https://cohesiondata.ec.europa.eu/countries>

¹² <https://www.gov.uk/government/news/further-certainty-on-eu-funding-for-hundreds-of-british-projects>

¹³ <https://www.gov.uk/government/news/chancellor-philip-hammond-guarantees-eu-funding-beyond-date-uk-leaves-the-eu>

Commission to ensure payment when funds are awarded. The Treasury will underwrite the payment of such awards, even when specific projects continue beyond the UK's departure from the EU.

- 5.38 More recently, the UK's withdrawal negotiations has provided further certainty for UK beneficiaries. As set out in the joint report on progress during phase 1 of negotiations under Article 50 on the United Kingdom's orderly withdrawal from the European Union¹⁴, following withdrawal from the Union the UK will continue to participate in the Union programmes financed by the MFF 2014-2020 until their closure. Entities located in the UK will be fully entitled to participate in such programmes.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/665869/Joint_report_on_progress_during_phase_1_of_negotiations_under_Article_50_TEU_on_the_United_Kingdom_s_orderly_withdrawal_from_the_European_Union.pdf

Table 5.B: Provisions in England and devolved administrations (DAs) for future financial corrections 2016-17

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England ¹	DAs ²	England ³	DAs ⁴	England ⁵	DAs ⁶	England	DAs	England	DAs
As at 1 April 2016	-17,638	-1,012	0	-14,332	0	-1,198	0	0	-17,638	-16,542
Created during the year	-229,572	-120	0	0	0	0	0	0	-229,572	-120
Released in year	0	0	0	0	0	1,198	0	0	0	1,198
Utilised	2,772	1,012	0	13,332	0	0	0	0	2,772	14,344
As at 31 March 2017	-244,438	-120	0	-1,000	0	0	0	0	-244,438	-1,120
Total UK as at 31 March 2017	-244,558		-1,000		0		0		-245,558	

Notes:

In England: agricultural funding is primarily the responsibility of the Department for Environment, Food & Rural Affairs (the European Maritime and Fisheries Fund, included in agricultural funding figures, is the responsibility of the Marine Management Organisation, an executive non-departmental public body sponsored by DEFRA); the European Social Fund is the responsibility of the Department for Work and Pensions; the European Regional Development Fund is the responsibility of Department for Communities and Local Government. 'Other' contains small funds, such as the Asylum, Migration, and Integration Fund (AMIF), which is the responsibility of the Home Office. As at 31 March 2017, there were no provisions relating to 'Other' funds).

The DAs are responsible for implementing EU obligations relating to devolved matters.

¹ <https://www.gov.uk/government/publications/defras-annual-report-and-accounts-2016-to-2017> (this includes the European Maritime and Fisheries Fund)

² <https://beta.gov.scot/publications/scottish-government-consolidated-accounts-year-ended-31-march-2017/> (included in Other Provisions' aggregate of note 12.a of the accounts)

³ <https://www.gov.uk/government/publications/dwp-annual-report-and-accounts-2016-to-2017> (no provisions reported)

⁴ <https://beta.gov.scot/publications/scottish-government-consolidated-accounts-year-ended-31-march-2017/>

⁵ <https://www.gov.uk/government/publications/dclg-annual-report-and-accounts-2016-to-2017> (no provisions reported)

⁶ <https://beta.gov.scot/publications/scottish-government-consolidated-accounts-year-ended-31-march-2017/>

Table 5.C: Provisions in England and devolved administrations (DAs) for future financial corrections 2015-16 (restated)

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England ⁷	DAs ⁸	England ⁹	DAs ¹⁰	England ¹¹	DAs ¹²	England ¹³	DAs	England	DAs
As at 1 April 2015	-64,513	0	0	0	0	-1,198	-632	0	-65,145	-1,198
Created during the year	-17,224	-1,012	0	-14,332	0	0	0	0	-17,224	-15,344
Released in year	0	0	0	0	0	0	335	0	335	0
Utilised	64,099	0	0	0	0	0	297	0	64,396	0
As at 31 March 2016	-17,638	-1,012	0	-14,332	0	-1,198	0	0	-17,638	-16,542
Total UK as at 31 March 2016	-18,650		-14,332		-1,198		0		-34,180	

Note:

As at 31 March 2016, there were no provisions relating to 'Other' funds (as at 1 April 2015, provisions relating to 'Other' funds represented less than 1% of all disallowance provisions).

⁷ <https://www.gov.uk/government/publications/defras-annual-report-and-accounts-2015-to-2016> (this includes the European Maritime and Fisheries Fund)

⁸ <http://www.gov.scot/Resource/0050/00506453.pdf> (included in 'other provisions' aggregate)

⁹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/534933/dwp-annual-report-and-accounts-2015-2016.pdf (no provisions reported)

¹⁰ <http://www.gov.scot/Resource/0050/00506453.pdf>

¹¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/536593/56046_DCLG_ARA_Web_only.pdf (no provisions reported)

¹² <http://www.gov.scot/Resource/0048/00486683.pdf> (restatement of prior year figure and included in 'other provisions' aggregate in 2014-15 accounts)

¹³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/539638/HO_AR_16_gov.pdf (restatement of prior year figure and included in overall departmental provisions' aggregate)

Annex A

Glossary

Commitment and payment appropriations

- A.1 The EU Budget distinguishes between appropriations for commitments and appropriations for payments. Commitment appropriations are the total cost of legal obligations that can be entered into during the current year, for activities that, in turn, will lead to payments in current and future years. Payment appropriations are the amounts of money that are available to be spent during the year, arising from commitments in the Budgets for the current or preceding years. Unused payment appropriations may, in some circumstances, be carried forward into the following year.

Discharge procedure

- A.2 The ECA's annual report is subject to consideration by the budgetary authority (Council and European Parliament) under the "discharge procedure" set out in Article 319 of the Treaty on the functioning of the EU¹. In particular, it considers how the budget for the year in question was implemented. The European Parliament, acting on a recommendation from the Council, considers whether to grant the Commission a discharge in respect of the budget in question, thus bringing the budgetary process for that year to a formal close. The Commission is obliged under Article 319 (3) of the Treaty on the functioning of the EU to take "all appropriate steps" to act on comments made by the European Parliament and by the Council during the discharge process. It must also report back to the budgetary authority on follow-up actions taken in response to Parliament and Council's recommendations.

Error in EU Budget expenditure

- A.3 The European Court of Auditors (ECA), established to audit the EU's finances, provide annual statements on the legality and regularity of the transactions underlying EU spending. A summary of the statement for Budget year 2015 is set out in chapter 4. As part of their statement, the ECA estimates the level of error present in EU Budget expenditure, due to it not being used in accordance with EU rules. Whilst the ECA calculate error rates for the EU Budget as a whole, they are clear that they only sample a limited number of transactions in each member state and the "relative frequency of

¹ Consolidated Version of the Treaty on the Functioning of the European Union: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=en>

error in samples drawn in different member states cannot be a guide to the relative level of error in different member states". The errors identified by the ECA do not necessarily lead to actual disallowance. More information on disallowance in the UK is contained in chapter 5.

European Structural and Investment Funds

A.4 European Structural and Investment Funds (ESIFs) are intended to resolve structural economic and social problems. For the 2014-20 programming period, the Common Provisions Regulation sets out the guiding principles for administering the funds. At present, these funds are:

- the European Regional Development Fund (ERDF), which promotes economic and social cohesion within the EU through the reduction of imbalances between regions or social groups;
- the European Social Fund (ESF), which promotes the EU's employment objectives by providing financial assistance for vocational training, retraining and job creation schemes;
- the European Agricultural Fund for Rural Development (EAFRD), which contributes to the structural reform of the agriculture sector and to the development of rural areas;
- the European Maritime and Fisheries Fund (EMFF), the specific fund for the structural reform of the fisheries sector; and
- the Cohesion Fund (CF), which supports member states with GDP that is less than 90% of the European average, financing environmental and trans-European transport projects.

Flexibility Instrument

A.5 The Flexibility Instrument was established under paragraph 24 of the 1999 Inter-institutional Agreement² and amended as part of the Mid-Term Review of the MFF³. This allows for expenditure in any given Budget year of up to €600 million (2011 prices) above the MFF ceilings established for one or more Budget headings. The amount available is also increased annually by the amount of EU Solidarity Fund and EU Globalisation Adjustment Fund allocations which lapse (or are unused) in the previous year. Any portion of the Flexibility Instrument unused at the end of one year may be carried over for up to three subsequent years. The Flexibility Instrument is intended 'to allow the financing, for a given financial year, of clearly identified expenditure which could not be financed within the limits of the ceilings available for one or more other headings'.⁴ It may only be used after all possibilities for reallocating existing appropriations have been exhausted.

² Inter-institutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:31999Y0618\(02\)](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:31999Y0618(02))

³ Amending regulation: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1123&from=EN>

⁴ Regulation laying down the multiannual financial framework for the years 2014-2020: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013R1311>

Both arms of the budgetary authority must agree to a mobilisation of the Flexibility Instrument following a proposal from the Commission.

Fraud and irregularity

- A.6 **Fraud** covers intentional acts or omissions, in respect of both expenditure and revenue, which involve the use or presentation of false, incorrect or incomplete statements or documents, or specific non-disclosure of information, or misapplication of funds or benefits.
- A.7 **Irregularity** (as defined by Council Regulation 2988/95) covers ‘any infringement of a provision of Community law’ caused by an act or omission which leads to reduction in EU revenue, or loss or misspending of EU funds. Irregularities are distinct from fraud in that they are financial errors as opposed to intentional, criminal misuse of funds. For example, a genuine payment made after the closing date for claims represents an irregularity; but import of goods under false papers is fraud.

Inter Institutional Agreement (IIA)

- A.8 The IIA is a politically and legally binding agreement that clarifies the EU’s budgetary procedure. The Council and the European Parliament have joint responsibility for deciding the EU Budget on the basis of proposals from the Commission. The IIA sets out the way in which the three institutions will exercise their responsibilities and their respect for the revenue ceilings that are laid down in the Own Resources Decision. In particular, it provides for the annual EU Budget to be set in the context of an MFF.

Own Resources

- A.9 The Own Resources Decision lays down three sources of EU revenue, or ‘Own Resources’:
- customs duties, including those on agricultural products, in respect of trade with non-member countries and levies on sugar production within the Union. These are collectively known as “Traditional Own Resources” (TOR);
 - contributions based on VAT: Essentially, the VAT resource is the amount yielded by applying a notional rate of 1% to a hypothetical harmonised VAT base, assuming an identical range of goods and services in each member state. The VAT base is calculated on the basis of a notional harmonised rate and reflects finally taxed expenditure across the EU. The base is capped at 50% of the member state’s GNI. A call-up rate is applied to produce a member states’ VAT-based contribution. This is currently 0.3%, except otherwise noted in the Own Resources Decision; and
 - GNI-based contributions: the amount due is calculated by taking the same proportion of each member state’s GNI. As EU budgets must balance, revenue must equal expenditure. The GNI-based resource is the Budget-balancing item; it covers the difference between total expenditure in the

Budget and the revenue from the other resources, subject to the overall Own Resources ceiling.

Sterling figures

A.10 The figures referred to in pounds sterling for 2010-16 in this document are based on actual Sterling cash receipts, or payments where these took place and are known. Elsewhere, the appropriate annual average sterling/euro exchange rate has been used to convert Euro figures into Sterling⁵. The 2017 Euro figures have been converted into Sterling using the Sterling/Euro exchange rate on 30 December 2016, namely £1 = €1.16798 (regulations state that VAT-based and GNI-based payments will be made using the exchange rate on the last working day of the preceding year). However, there may be some exceptions, for example where figures have previously been published at a different exchange rate, but these are noted where necessary.

UK rebate

A.11 The UK's GNI-based contributions are abated (reduced) according to a formula set out in the Own Resources Decision. Broadly, this is equal to 66% of the difference between what the UK contributes to the EU Budget and its receipts from the EU Budget, subject to the following points:

- the rebate applies only in respect of spending within the EU;
- the UK's contribution is calculated as if the Budget were only financed by TOR and VAT-based contributions;
- the rebate is deducted from the UK's GNI-based contribution a year in arrears, e.g. the rebate in 2015 relates to UK payments and receipts in 2014; and
- since 2011 the UK's contributions to non-agricultural expenditure in member states that have acceded to the EU in or after 2004 are not abated – this reflects the agreement by the UK government in 2005 to “disapply” the UK rebate on non-agricultural expenditure in new member states.

A.12 The formula for the calculation of the rebate is set out in the Own Resources Decision and in a Working Methods Paper first published in 1988 and revised in 1994, 2000, 2007 and 2014.

A.13 The Commission is directly and solely responsible for calculating the UK's rebate. It calculates the rebate on the basis of a forecast of contributions to the EU Budget and the UK's receipts from it. This is subsequently corrected in the light of outturn figures.

⁵ The annual average rate for 2010 is £1 = €1.166206; the annual average rate for 2011 is £1 = €1.152493; the annual average rate for 2012 is £1 = €1.233211; the annual average rate for 2013 is £1 = €1.177910; the annual average rate for 2014 is £1 = €1.240977; the annual average rate for 2015 is £1 = €1.377415; the annual average rate for 2016 is £1 = €1.220286.

- A.14 Corrections may be made for up to three years after the year in respect of which the rebate relates, with a final calculation then being made in the fourth year, e.g. a final calculation of the rebate in respect of 2015 will take place in 2019.
- A.15 The effect of the rebate is to reduce the amount of the UK's monthly GNI-based payments to the EU Budget. It does not involve any transfer of money from the Commission or other member states to the Exchequer.

Annex B

Technical annex

Explanation of the difference between the government's cash flow outturn for the UK's net contribution for 2015 and the figures in the European Commission's EU Budget 2015 Financial Report

- B.1** As set out in Chapter 3, paragraph 3.10, there is a difference between the UK government's figures for the cash flow outturn for the UK's net contribution for 2015 and the figures in the European Commission's EU Budget 2015 Financial Report. An explanation for this difference is set out in Table B.1, Table B.2 and paragraphs B.3 to B.4.
- B.2** When converted at the average exchange rate for 2015 of £1 = €1.377415, the figures on cash flow outturn for the UK's net contribution for 2015 in the European Commission's EU Budget 2015 Financial Report break down as set out in Table B.1.

Table B.1: Cash flow outturn for the UK's net contribution for 2015 in the European Commission's EU Budget 2015 Financial Report

	(€ million)	(£ million)
UK gross contribution before rebate	27,493	19,960
UK rebate	-6,084	-4,417
UK receipts	-7,458	-5,414
UK net contribution	13,952	10,129

Source: European Commission's EU Budget 2015 Financial Report, HM Treasury calculations.

- B.3** The government's figure for the UK's net contribution in 2015 is £10,763 million.
- B.4** A number of factors contribute to the difference between the two net contribution figures. The probable main causes for the difference are as follows:
- the UK figure includes only transactions between the EU Budget and the UK public sector, whereas the European Commission's figures include

receipts paid direct to the UK private sector. It is estimated that this accounted for around £1,531 million of the difference in 2015;

- the UK's outturn figure is based on cash flow within the calendar year, whereas the European Commission figures attempt to match transactions to a particular EU Budget. When reconciling there may be other factors such as the exchange rate that can lead to differences between the outturns;
- Amending Budgets No.s 2/2014 to 7/2014 were adopted very near the end of 2014 which meant that associated changes were not implemented until 2015. The result of which leads to the government's figures being some £1,247 million lower than if the Amending Budget changes had been implemented in 2014;
- Amending Budget No. 8/2015 was adopted very near the end of 2015 which meant that associated changes were not implemented until 2016. The result of which leads to the government's figures being some £469 million higher than if the Amending Budget changes had been implemented in 2015; and
- the UK government outturn accrues the UK's adjustment in respect of the 2014 GNI and VAT adjustment, i.e. the outturn incorporates both the UK's gross adjustment and the repayments made to the UK made via subsequent amending budgets, into 2014 outturn. The UK's rebate was also applied to our net adjustments, but the rebate paid to the UK is included in the overall rebate line for 2015, the same year that the net adjustment was actually paid following its deferral.

These factors are set out in Table B.2.

Table B.2: Reconciliation of the UK government's cash flow outturn figures for the UK's net contribution for 2015 with the figures in the European Commission's EU Budget 2015 Financial Report

	(£ million)
UK government outturn for 2015	10,763
Private sector receipts	-1,531
Late implementation, in February 2015, of Amending Budgets Nos. 2/2014 - 7/2014	1,247
Late implementation, in January 2016, of Amending Budget No 8/2015	-469
2014 surcharge accrual	1,631
UK cash flow figure adjusted to reflect main differences compared to European Commission's figure	11,641
European Commission figure for 2015 outturn	10,129
Net difference due to other factors (e.g. exchange rate)	1,512

Source: HM Treasury calculations and 2015 EU Budget Financial Report, European Commission.

Annex C

Tables

C.1 This annex includes tables that supplement data presented in the main text.

Table C.1: Expenditure on the EU Budget Commitments and Payments by Heading in years 2010-2017 (€ million)

€ million																
Appropriations	Commitments								Payments							
	2010	2011	2012	2013	2014	2015	2016	2017	2010	2011	2012	2013	2014	2015	2016	2017
1 Smart and Inclusive Growth	64,250	64,505	68,142	70,749	63,986	77,955	69,841	75,399	48,800	53,994	60,287	69,127	65,863	66,854	59,291	49,393
<i>1a Competitiveness for Growth and Jobs</i>	<i>14,863</i>	<i>13,521</i>	<i>15,389</i>	<i>15,641</i>	<i>16,484</i>	<i>17,552</i>	<i>19,010</i>	<i>21,312</i>	<i>11,339</i>	<i>11,604</i>	<i>11,971</i>	<i>12,612</i>	<i>11,857</i>	<i>15,729</i>	<i>17,402</i>	<i>19,321</i>
<i>1b Economic, social and territorial cohesion</i>	<i>49,387</i>	<i>50,984</i>	<i>52,753</i>	<i>55,108</i>	<i>47,502</i>	<i>60,403</i>	<i>50,831</i>	<i>54,087</i>	<i>37,461</i>	<i>42,390</i>	<i>48,504</i>	<i>56,473</i>	<i>54,006</i>	<i>51,125</i>	<i>41,888</i>	<i>30,073</i>
2 Sustainable Growth: natural resources	59,499	58,659	59,850	60,102	59,191	63,877	62,470	58,569	57,020	55,794	58,016	58,036	55,959	55,979	54,972	54,121
3 Security and Citizenship	1,754	2,098	2,754	2,197	2,172	2,522	4,292	4,284	1,440	1,713	2,214	1,699	1,660	1,927	3,022	3,224
4 Global Europe	8,141	8,759	9,404	9,315	8,423	8,711	9,167	10,437	7,788	7,053	6,777	6,743	6,925	7,478	10,156	9,056
5 Administration	7,908	8,173	8,280	8,431	8,405	8,660	8,951	9,395	7,907	8,172	8,278	8,429	8,406	8,659	8,951	9,395
TOTAL	141,552	142,194	148,428	152,048	142,690	162,273	155,277	159,831	122,955	126,727	135,758	144,451	139,034	141,280	136,642	126,771

Notes:

1. 2010-16 include all agreed Amending Budgets.

2. Column totals do not necessarily equal the sum of individual items due to rounding errors and spending not attributable to any heading.

Sources: Figures for 2010 to 2016 are taken from the European Commission's Reports on budgetary and financial management; Figures for 2017 are taken from the Draft Amending Budget No. 6/2017: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0597&from=EN>

Table C.2: Expenditure on the EU Budget Commitments and Payments by Heading in years 2010-2017 (£ million)

Appropriations	£ million															
	Commitments								Payments							
	2010	2011	2012	2013	2014	2015	2016	2017	2010	2011	2012	2013	2014	2015	2016	2017
1 Smart and Inclusive Growth	55,093	55,970	55,256	60,063	51,561	56,595	57,233	64,555	41,845	46,850	48,886	58,686	53,074	48,536	48,588	42,289
<i>1a Competitiveness for Growth and Jobs</i>	<i>12,745</i>	<i>11,732</i>	<i>12,479</i>	<i>13,279</i>	<i>13,283</i>	<i>12,743</i>	<i>15,578</i>	<i>18,247</i>	<i>9,723</i>	<i>10,069</i>	<i>9,707</i>	<i>10,707</i>	<i>9,555</i>	<i>11,419</i>	<i>14,261</i>	<i>16,542</i>
<i>1b Economic, social and territorial cohesion</i>	<i>42,348</i>	<i>44,238</i>	<i>42,777</i>	<i>46,785</i>	<i>38,278</i>	<i>43,852</i>	<i>41,655</i>	<i>46,308</i>	<i>32,122</i>	<i>36,781</i>	<i>39,331</i>	<i>47,943</i>	<i>43,519</i>	<i>37,117</i>	<i>34,326</i>	<i>25,748</i>
2 Sustainable Growth: natural resources	51,019	50,897	48,532	51,024	47,697	46,375	51,193	50,146	48,894	48,412	47,045	49,270	45,093	40,641	45,048	46,337
3 Security and Citizenship	1,504	1,820	2,233	1,865	1,750	1,831	3,517	3,668	1,235	1,486	1,795	1,442	1,338	1,399	2,476	2,761
4 Global Europe	6,981	7,600	7,626	7,908	6,787	6,324	7,512	8,936	6,678	6,120	5,495	5,725	5,580	5,429	8,323	7,754
5 Administration	6,781	7,092	6,714	7,158	6,773	6,287	7,335	8,043	6,780	7,091	6,713	7,156	6,774	6,286	7,335	8,043
TOTAL	121,378	123,379	120,359	129,083	114,982	117,810	127,246	136,844	105,432	109,959	110,085	122,633	112,036	102,569	111,975	108,538

Notes:

1. 2010-16 includes all agreed Amending Budgets.
2. Column totals do not necessarily equal the sum of individual items due to rounding errors and spending not attributable to any heading.

Source: Sterling figures are derived from the corresponding euro amounts in Table C.1 converted at the appropriate exchange rate (see Annex 1: Glossary).

Table C.3: United Kingdom contributions to, rebate, and public sector receipts from the EU Budget

	€ million							£ million						
	2011	2012	2013	2014	2015	2016	2017	2011	2012	2013	2014	2015	2016	2017
GROSS CONTRIBUTIONS														
Sugar levies	9	13	11	2	10	9	10	8	10	9	2	7	7	9
Customs Duties	2,554	2,703	2,557	2,775	3,192	2,997	3,695	2,216	2,192	2,171	2,236	2,318	2,456	3,163
VAT-based contributions	2,505	2,811	2,761	2,963	3,665	3,266	3,551	2,174	2,279	2,344	2,388	2,661	2,677	3,040
GNI-based contributions	12,588	14,012	15,899	15,539	19,288	14,468	14,196	10,922	11,362	13,497	12,521	14,003	11,856	12,154
VAT & GNI adjustments	42	-121	134	2,024	786	-	302	36	-98	114	1,631	571	-	258
United Kingdom rebate	-3,623	-3,835	-4,328	-5,481	-6,768	-4,732	-6,579	-3,143	-3,110	-3,674	-4,416	-4,914	-3,878	-5,633
Total Contributions	14,076	15,583	17,034	17,822	20,174	16,008	15,175	12,214	12,636	14,461	14,362	14,646	13,118	12,993
PUBLIC SECTOR RECEIPTS														
EAGF	3,073	3,395	3,236	3,395	3,251	2,766	3,175	2,667	2,753	2,747	2,736	2,361	2,267	2,719
EAFRD	483	359	729	529	637	488	739	419	291	619	426	462	400	633
European Regional Development Fund	698	540	350	1,311	625	439	334	605	438	297	1,057	454	360	286
European Social Fund	448	721	290	331	780	376	165	389	585	246	266	566	308	142
Other Receipts	60	126	102	122	55	192	356	52	102	86	98	40	157	304
Total Receipts	4,762	5,141	4,707	5,688	5,348	4,261	4,770	4,132	4,169	3,996	4,583	3,883	3,492	4,084
Net Contributions	9,315	10,442	12,327	12,135	14,825	11,747	10,405	8,082	8,467	10,465	9,779	10,763	9,626	8,909

Notes:

1. For all years, the amounts for the UK's gross contribution in this table reflect payments made during the calendar year, not payments to particular EU Budgets. Prior to 2010, the Sugar Levies row also includes figures for duties on agricultural products.
2. Euro figures in this table have been converted from sterling using the appropriate exchange rate (see glossary). Because of rounding, the column totals do not necessarily equal the sum of the individual items.
3. The VAT and GNI adjustment figure for 2014 include the UK's net adjustment, i.e. the figure incorporates both the UK's gross adjustment and the repayments made to the UK made via subsequent amending budgets. The UK's rebate was also applied to our net adjustments, but the impact of our rebate is not shown in the VAT and GNI line. For the 2014 adjustment, the rebate paid to the UK is included in the overall rebate line for 2015, the same year that the net adjustment was actually paid following its deferral. For the 2015 adjustment, details were set out in a letter to the Parliamentary Scrutiny Committees: <http://europeanmemoranda.cabinetoffice.gov.uk/files/2015/10/DOC211015-21102015124206.pdf>. Figures for the VAT and GNI adjustments outside 2014 refer to the gross adjustment, as in those years there were no specific amending budgets to make the repayments.

Source: Office for Budgetary Responsibility and HM Treasury.

Annex D

Report on the use of EU funds in the UK

Background

- D.1 This annex is linked to, and has cross references with, Chapter 5 on the government strategy for using EU funds in the UK: an update. As part of ongoing work to improve the accountability for, and transparency of, EU funds, this annex is produced to collate and present data from a variety of publications on the use of EU funds in the UK.
- D.2 The publication of this report strengthens Parliamentary scrutiny of the financial relationship between the EU and the UK government. It is compiled by working with the NAO, Paying Agencies and Managing Authorities. The Report draws on well-established data collection and assurance systems and processes to raise the quality of the financial information collected, as well as improving the consistency of accountancy policies applied.
- D.3 The government is committed to maintaining the greatest possible transparency on the use of EU funds at an aggregated level by publishing information such as this.

Responsibilities of the UK Parliament and devolved administrations

- D.4 As highlighted in Chapter 5, in accordance with the devolution settlement, relations with the EU are the responsibility of Parliament and the government of the United Kingdom, as a member state. Responsibility for implementing EU obligations relating to devolved matters lies with the devolved administrations. The proper administration of EU Funds in Northern Ireland, Scotland and Wales is a matter for the relevant devolved administration. This report is prepared without prejudice to the devolution of responsibilities.

Preparation of the report

- D.5 The Treasury has assumed responsibility for developing the format of this report and for collating the financial data provided by Paying Agencies and Managing Authorities which it includes. Managing Authorities are the bodies which have responsibility for managing the payment of EU programme funds to final beneficiaries in the UK.

- D.6 Paying Agencies and Managing Authorities, however, remain accountable for the propriety of the reported spending, which is publicly disclosed in their annual report and accounts and is subject to external audit. This report therefore brings together financial information relating to the use of EU funds by the UK but does not replace individual accountabilities. The Comptroller and Auditor General (C&AG) has not been invited to audit this report although the individual annual report and accounts from which the source data is collated are audited by the C&AG.
- D.7 By bringing together this financial information, the report supports greater scrutiny of the UK's management of EU funds and of the financial relationship between the UK and the EU.

Boundary of the report

- D.8 The report shows expenditure on co-managed EU schemes in the UK and the corresponding income due from the EU. The main schemes for which the EU and UK share management responsibility are the disbursement of Common Agricultural Policy Funds and the European Structural and Investment Funds, where the UK pays beneficiaries on behalf of the EU.
- D.9 The report excludes:
- amounts received from the EU where UK central government is the beneficiary;
 - amounts in respect of commercial contracts awarded to UK central government bodies by the EU;
 - financial support for twinning projects where EU funding is transferred to other member states or to mandated bodies for their part in the project¹ – those transactions are not reported as income and expenditure of the relevant Managing Authority; and
 - the purchase of intervention stocks with UK funds which are accounted for in the financial statements of the Department for Environment, Food and Rural Affairs (DEFRA)².

Management of EU funded schemes

- D.10 The Treaty establishing the EU provides the basic framework for its Budget. The Budget includes a number of separate funds, including the European Agricultural Guarantee Fund (EAGF), the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agricultural Fund for Rural Development (EAFRD and sometimes referred to as the second pillar of Common Agricultural Policy) and the European Maritime and Fisheries Fund (EMFF).

¹ 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.

² Intervention stocks are stocks held by paying agencies in the EU 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.

- D.11 These schemes are overseen by the European Commission. Responsibility for financial reporting to the Commission falls to national authorities who are responsible for the co-management of schemes with Managing Authorities.
- D.12 The Commission can impose disallowance on Managing Authorities for failing to correctly apply EU Regulations in managing and administering EU schemes. In such circumstances the EU reduces the amount paid to the UK.

(a) Agricultural Policy Funds

- D.13 The Single Payment Scheme (SPS) was the main agricultural subsidy scheme in the EU, funded by the EAGF. It was replaced by the Basic Payment Scheme in January 2015.
- D.14 Under EU Regulation 907/2014, each paying agency must have an internal audit service independent of the other departments that reports directly to the Head of the paying agency. Paying agencies are the bodies of a member state responsible for disseminating payments of EU funds to approved programmes, keeping accurate information on these payments and guaranteeing that EU legislation is complied with. The internal audit services are required to verify that the procedures adopted by the agency are adequate to ensure compliance with Union rules and that accounts are accurate, complete and timely.
- D.15 The Certification Body for the agricultural funds are appointed external auditors that report on: whether the annual accounts of the paying agencies are in all material respects true, complete and accurate; that internal control procedures have operated satisfactorily; the legality and regularity of expenditure and; the assertions made in the annual Management Declarations made by the heads of paying agencies. The Certification Body reports have confirmed that internal audit units in all the UK paying agencies operate to a high standard, although they have in turn highlighted issues that require appropriate remedial action to avoid disallowance.

(b) European Structural and Investment Funds

- D.16 The European Structural and Investment Funds are the financial tools set up to implement cohesion policy in the EU, and include ERDF, ESF, EAFRD and EMFF. For more details on these programmes please refer to the Glossary of this document.
- D.17 The Managing Authorities are responsible for the control of European Structural and Investment Fund expenditure. Working alongside each fund's Managing Authority, the fund's Certifying Authority ensures that all systems are subject to regular examination by the Audit Authority. The Audit Authority results strengthen procedures during the implementation of programmes and provide assurance as to the accuracy, completeness and regularity of expenditure, certified to the European Commission.

Timing of expenditure and the related EU funding

- D.18** Managing Authorities are required to account for expenditure on EU-funded schemes and the related funding from the EU on an accruals basis under International Financial Reporting Standards (IFRS) as applied to the public sector context by the Government Financial Reporting Manual (FRM). By contrast, the public sector receipts in Table C.3 are reported on a cash basis.
- D.19** There is normally a time lag between payment to beneficiaries and settlement of claims by the EU. The UK Exchequer therefore bears the cost of the programme until EU funding is received. Expenditure is recognised as it is incurred, with a matching receivable (debtor) from the EU. The receivable is extinguished when the EU approves the subsequent claim and the release of funds to the UK.
- D.20** The final settlement of claims by the EU may give rise to adjustments following the closure process or disallowance (see paragraphs D.33 to D.35 below). The European Commission may make such adjustments several years after funds have been paid out by Managing Authorities to recipients. The Expenditure Statement below also includes provisions for possible future adjustments. A provision is made where it is probable that the EU will disallow expenditure and not reimburse the UK (see paragraph D.32 below).

Management of EU funded schemes

Expenditure on EU funded schemes

- D.21** This section of the document covers the expenditure on EU funded schemes between 2010-11 and 2016-17.
- D.22** The Expenditure Statement (Table D.1) 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.
- D.23** 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 relevant scheme. The amount shown in the Expenditure Statement represents the amount paid and payable in Sterling during the period to beneficiaries.
- D.24** Net expenditure represents the amount receivable from the EU in respect of amounts paid or payable by the UK on EU supported projects, after taking account of provisions for disallowance, foreign exchange gains or losses and withdrawals from claims.
- D.25** The Statement of Assets and Liabilities (Table D.2) shows those assets and liabilities that stem from cash flows, where, for example, the UK has paid a claim from a beneficiary and is awaiting reimbursement from the EU. The disallowance provision relates to amounts paid out by the UK for which it believes it probable that the EU will apply financial corrections and not fully reimburse the UK.

- D.26 The Expenditure Statement (Table D.1) shows gross expenditure on EU-supported schemes from 2010-11 to 2016-17. After allowing for foreign exchange variations and adjustments to claims, the amount reimbursable by the EU (i.e. net expenditure) was £4.3 billion in 2010-11, £4.7 billion in 2011-12, £4.2 billion in 2012-13, £4.4 billion in 2013-14, £4.3 billion in 2014-15, £3.8 billion in 2015-16, and £3.5 billion in 2016-17, the balance being met by the UK Exchequer. Prior years have been restated where necessary to amend previously published figures in order to reflect the correction of errors, new information that has arisen or a change in accounting policy. A breakdown of expenditure by scheme is provided in Tables D.3 to D.9.
- D.27 In recognition of likely future funding adjustments, Managing Authorities made new provisions totalling £229.7 million in 2016-17, against claims for reimbursement from the EU. After allowing for the use of provisions following the crystallisation of adjustments, total provisions at 31 March 2017 amounted to £245.6 million, over £67.7 million more than the corresponding figure at the end of the 2010-11 financial year. A breakdown of the movement in provisions by scheme is provided in Tables D.10 to D.16.

Expenditure Statement

Table D.1: Expenditure Statement for the years ended 31 March 2011 to 31 March 2017 (prior years restated) (£ thousand)

	£ thousand						
	2011-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17*
Gross expenditure on EU supported projects	4,397,505	4,773,977	4,216,794	4,345,271	4,254,226	3,795,783	3,711,591
Provisions created in year	-75,006	-92,647	-34,850	-1,832	-21,459	-32,568	-229,692
Provisions released in year	19,856	22,817	10,495	60,452	11,770	335	1,198
Realised forex gain/(loss)	-35,739	-23,617	114,930	2,019	-30,005	-12,012	2,491
Unrealised forex gain/(loss)	2,779	51,182	-102,488	-13,637	51,733	1,055	-4,158
Withdrawn from EU claim	-49,743	-18,063	-35,841	-8,036	1,171	2,858	-21,933
Net expenditure reimbursable by the EU	4,259,652	4,713,649	4,169,040	4,384,237	4,267,436	3,755,451	3,459,497

Note:

* 2016-17 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements.

Table D.2: Statement of Assets and Liabilities as at 31 March 2011 to 31 March 2017 (prior years restated)

	£ thousand						
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17*
Assets							
Advances to beneficiaries	219,642	25,594	17,340	26,143	24,788	26,640	42,262
EU funds receivable	1,931,886	1,763,336	1,763,235	2,314,084	1,622,625	2,146,918	1,219,556
Other assets	1,798	254,299	207,990	258,436	281,893	484,815	405,412
	2,153,326	2,043,229	1,988,565	2,598,663	1,929,306	2,658,373	1,667,230
Liabilities							
EU funds paid on account	-1,938,419	-1,860,340	-997,802	-655,634	-530,013	-574,869	-379,520
Amounts payable to beneficiaries	-140,863	-183,401	-186,053	-148,459	-73,928	-328,505	-395,885
Repayable to EU	-3,525	-2,697	-238,694	-543,684	-737,127	-685,287	-645,931
Provision for disallowance	-177,886	-212,390	-214,681	-100,154	-5,585	-34,180	-245,558
Other liabilities	-24,607	-66,734	285	517	517	-2,885	-151
	-2,285,300	-2,325,562	-1,636,945	-1,447,414	-1,346,136	-1,625,726	-1,667,045
Net Assets / (Liabilities)	-131,974	-282,333	351,620	1,151,249	583,170	1,032,647	185

Note:

* 2016-17 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements.

Accounting policies

Basis of preparation

- D.28 This report has been prepared by collating the relevant transactions and balances as recorded by the Managing Authorities in their financial statements. Their financial statements have been prepared in accordance with the FReM. This report is prepared under the historical cost convention which is an accounting method that, for the purposes of the Statement of Financial Position (Balance Sheet), values assets at the price paid for them at the time they were acquired.

Expenditure recognition

- D.29 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 relevant scheme. The amount shown in these accounts represents the amount paid and payable in Sterling during the period by Managing Authorities. Net EU expenditure represents the amount receivable from the EU (converted into sterling after disallowance and foreign exchange gains or losses) in respect of amounts paid or payable by the UK on EU supported projects.

Foreign currency translation

- D.30 The European Commission makes payments in Euros, with the Managing Authority recognising the receivable in Sterling in line with the requirements of International Accounting Standard (IAS) 21 *The Effects of Changes in Foreign Exchange Rates*.

The Effects of Changes in Foreign Exchange Rates

- D.31 Foreign exchange gains and losses are realised where there are variations in exchange rates between payments incurred and reimbursements. For example, for ERDF, ESF and EMFF, there is often an exchange rate difference due to the lag between the date when EU funding is paid out by the Managing Authority and the date when this payment is subsequently checked and registered by the Certifying Authority, on which basis the EU reimburses the expenditure incurred. Such gains and losses are recognised in the Expenditure Statement (Table D.1). Unrealised gains and losses arising from the revaluation of assets and liabilities at the exchange rate current at the Statement of Financial Position date, also reported in the Expenditure Statement, are reported in the accounts of Managing Authorities within the Statement of Changes in Taxpayers' Equity. Any hedging mechanisms used to mitigate the impact of foreign exchange losses are not included in this report as they do not impact on the amounts paid out on EU projects or the funding provided by the EU.

Disallowance provision and contingent liabilities

D.32 Probable disallowance arising from financial corrections are recognised in accordance with the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. A provision is recognised where there is a past event – for example an ineligible payment or a failure to comply with the regulations governing a scheme – which will probably lead to the EU disallowing expenditure and not reimbursing the UK. Managing Authorities are responsible for estimating the value of any provisions required.

Analysis of Net Expenditure by EU Scheme

Table D.3: Analysis of Net Expenditure by EU Scheme 2010-2011 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
Gross expenditure in the United Kingdom	3,312,286	561,330	484,584	39,305	4,397,505
Total disallowance provided for	-67,419	0	-7,122	-465	-75,006
Total disallowance released	11,585	0	5,973	2,298	19,856
Total foreign exchange gains/(losses) (restated)	-17,877	-7,193	-6,906	-984	-32,960
Total withdrawn from EU claim (restated)	-1,171	-1,999	-46,573	0	-49,743
Net expenditure reimbursable by EU	3,237,404	552,138	429,956	40,154	4,259,652

Table D.4: Analysis of Net Expenditure by EU Scheme 2011-2012 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
Gross expenditure in the United Kingdom	3,695,178	470,955	574,501	33,343	4,773,977
Total disallowance provided for	-90,049	-1,696	0	-902	-92,647
Total disallowance released	1,300	0	21,398	119	22,817
Total foreign exchange gains/(losses) (restated)	3,798	4,727	19,215	-175	27,565
Total withdrawn from EU claim (restated)	0	20	-18,083	0	-18,063
Net expenditure reimbursable by EU	3,610,227	474,006	597,031	32,385	4,713,649

Table D.5: Analysis of Net Expenditure by EU Scheme 2012-13 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
Gross expenditure in the United Kingdom	3,234,417	321,054	604,264	57,059	4,216,794
Total disallowance provided for (restated)	-34,616	0	0	-234	-34,850
Total disallowance released (restated)	10,427	0	0	68	10,495
Total foreign exchange gains/(losses) (restated)	11,333	105,101	-1,338	-166	114,930
Total withdrawn from EU claim (restated)	-666	-100,252	-2,075	505	-102,488
Net expenditure reimbursable by EU	3,220,895	325,903	600,851	57,232	4,204,881

Table D.6: Analysis of Net Expenditure by EU Scheme 2013-14 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
Gross expenditure in the United Kingdom	3,356,609	347,699	589,193	51,770	4,345,271
Total disallowance provided for (restated)	-1,190	0	0	-642	-1,832
Total disallowance released (restated)	59,686	0	0	766	60,452
Total foreign exchange gains/(losses) (restated)	3,931	-2,059	-15,061	1,571	-11,618
Total withdrawn from EU claim (restated)	0	0	-7,012	-1,024	-8,036
Net expenditure reimbursable by EU	3,419,036	345,640	567,120	52,441	4,384,237

Table D.7: Analysis of Net Expenditure by EU Scheme 2014-15 (restated)

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
Gross expenditure in the United Kingdom	2,047,918	1,062,112	304,154	100,116	461,803	232,840	32,491	12,792	2,846,366	1,407,860
Total disallowance provided for (restated)	-18,123	-3,336	0	0	0	0	0	0	-18,123	-3,336
Total disallowance released (restated)	9,498	1,154	0	0	0	0	1,118	0	10,616	1,154
Total foreign exchange gains/(losses) (restated)	-408	-240	21,326	2,992	-8,939	6,547	372	78	12,351	9,377
Total withdrawn from EU claim (restated)	0	0	0	-27	6,057	-4,746	-113	0	5,944	-4,773
Net expenditure reimbursable by EU	2,038,885	1,059,690	325,480	103,081	458,921	234,641	33,868	12,870	2,857,154	1,410,282
Total Net expenditure reimbursable by EU	3,098,575		428,561		693,562		46,738		4,267,436	

Table D.8: Analysis of Net Expenditure by EU Scheme 2015-16

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
Gross expenditure in the United Kingdom	1,694,956	930,427	516,839	102,543	299,781	169,221	71,882	10,134	2,583,458	1,212,325
Total disallowance provided for	-17,224	-1,012	0	-14,332	0	0	0	0	-17,224	-15,344
Total disallowance released	0	0	0	0	0	0	335	0	335	0
Total foreign exchange gains/(losses)	1,939	1,851	-4,879	-5,422	1,909	-8,478	2,123	0	1,092	-12,049
Total withdrawn from EU claim	0	0	0	-1,562	6,854	-1,616	-818	0	6,036	-3,178
Net expenditure reimbursable by EU	1,679,671	931,266	511,960	81,227	308,544	159,127	73,522	10,134	2,573,697	1,181,754
Total Net expenditure reimbursable by EU	2,610,937		593,187		467,671		83,656		3,755,451	

Table D.9: Analysis of Net Expenditure by EU Scheme 2016-17*

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
Gross expenditure in the United Kingdom	2,212,301	1,022,627	25,185	59,932	310,706	51,006	17,732	12,102	2,565,924	1,145,667
Total disallowance provided for	-229,572	-120	0	0	0	0	0	0	-229,572	-120
Total disallowance released	0	0	0	0	0	1,198	0	0	0	1,198
Total foreign exchange gains/(losses)	-4,419	-1,577	0	-1,236	6,551	-3,010	243	1,781	2,375	-4,042
Total withdrawn from EU claim	0	0	0	-11,130	-3,485	-7,318	0	0	-3,485	-18,448
Net expenditure reimbursable by EU	1,978,310	1,020,930	25,185	47,566	313,772	41,876	17,975	13,883	2,335,242	1,124,255
Total Net expenditure reimbursable by EU	2,999,240		72,751		355,648		31,858		3,459,497	

Note:

*2016-17 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements.

Provisions for future financial corrections (disallowance)

- D.33 As previously stated in Chapter 5, disallowance or financial corrections are imposed by the European Commission on member states for failing to correctly apply EU Regulations in managing and administering EU schemes. In such circumstances the EU reduces the amount paid to the UK.
- D.34 The European Commission may identify erroneous payments or deficiencies in the administration of schemes, and consequently can disallow expenditure. In the case of perceived systematic deficiencies, the European Commission can impose flat-rate disallowance at the rate of 2%, 3%, 5%, 7% or 10% (or higher in some circumstances) of annual expenditure, depending on the severity of the failings. The EU will not reimburse the UK for the expenditure incurred. The costs then fall on the Exchequer, unless the amount can be recovered from the beneficiary. The ultimate financial impact on the UK taxpayer will, however, be less than this, due to the operation of the rebate system. For more details on the rebate system please see the Glossary of this document.
- D.35 As set out in Chapter 5, table D.9 shows that a significant portion of provisions in 2016-17 continues to be related to agricultural policy funding and the portion has indeed increased as at the Statement of Financial Position (Balance Sheet) date of the 31 March 2017 – largely due to the size of the fund and the complexity of the regulations. Disallowance was expected to be high for CAP years 2015 and 2016 due to the implementation of new CAP arrangements, which were complex and subject to an unknown Commission approach. The new provisions entered in 2016-17 are in respect of Basic Payment Scheme audits primarily relating to entitlements (required by farmers claiming direct payments), as well as in relation to area aids and cross compliance (rules for farmers and land managers claiming direct payments). The provisions were previously published in Chapter 3 of DEFRA's Annual Report and Accounts for 2016/17. Following engagement with the Commission, DEFRA believe that the final disallowance associated with the audit of 2015-16 Basic Payment Scheme entitlements will be less than the original forecast which informed the provisions made. The current CAP disallowance strategy reflects the latest intelligence from these processes and will continue to be updated. In 2016-17, there were also some – relatively small – disallowance provisions relating to the European Social Fund.

Table D.10: Provisions for future financial corrections 2010-11 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
As at 1 April 2010	-259,150	-33,795	-62,904	-3,518	-359,367
Created during the year	-67,419	0	-7,122	-465	-75,006
Released in year	11,585	0	5,973	2,298	19,856
Utilised	180,009	33,795	22,555	272	236,631
As at 31 March 2011	-134,975	0	-41,498	-1,413	-177,886

Table D.11: Provisions for future financial corrections 2011-12 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
As at 1 April 2011	-134,975	0	-41,498	-1,413	-177,886
Created during the year	-90,049	-1,696	0	-902	-92,647
Released in year	1,300	0	21,398	119	22,817
Utilised	29,170	1,696	4,336	124	35,326
As at 31 March 2012	-194,554	0	-15,764	-2,072	-212,390

Table D.12: Provisions for future financial corrections 2012-13 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
As at 1 April 2012	-194,554	0	-15,764	-2,072	-212,390
Created during the year	-34,616	0	0	-234	-34,850
Released in year	10,427	0	0	68	10,495
Utilised	21,924	0	140	0	22,064
As at 31 March 2013	-196,819	0	-15,624	-2,238	-214,681

Table D.13: Provisions for future financial corrections 2013-14 (restated)

	£ thousand				
	Agricultural Policy Funding	European Social Fund	European Regional Development Fund	Other	Total
As at 1 April 2013	-196,819	0	-15,623	-2,238	-214,680
Created during the year	-1,190	0	0	-642	-1,832
Released in year	59,686	0	0	766	60,452
Utilised	78,707	0	13,304	234	92,245
As at 31 March 2014	-59,616	0	-2,319	-1,880	-63,815

Table D.14: Provisions for future financial corrections 2014-15 (restated)

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
As at 1 April 2014	-83,829	-12,050	0	0	0	-2,319	-1,880	0	-85,709	-14,369
Created during the year	-18,123	-3,336	0	0	0	0	0	0	-18,123	-3,336
Released in year	9,498	1,154	0	0	0	0	1,118	0	10,616	1,154
Utilised	27,941	7,536	0	0	0	856	0	0	27,941	8,392
As at 31 March 2015	-64,513	-6,696	0	0	0	-1,463	-762	0	-65,275	-8,159
Total as at 31 March 2015	-71,209		0		-1,463		-762		-73,434	

Table D.15: Provisions for future financial corrections 2015-16 (restated)

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
As at 1 April 2015	-64,513	0	0	0	0	-1,198	-632	0	-65,145	-1,198
Created during the year	-17,224	-1,012	0	-14,332	0	0	0	0	-17,224	-15,344
Released in year	0	0	0	0	0	0	335	0	335	0
Utilised	64,099	0	0	0	0	0	297	0	64,396	0
As at 31 March 2016	-17,638	-1,012	0	-14,332	0	-1,198	0	0	-17,638	-16,542
Total as at 31 March 2016	-18,650		-14,332		-1,198		0		-34,180	

Table D.16: Provisions for future financial corrections 2016-17*

	£ thousand									
	Agricultural Funding		European Social Fund		European Regional Development Fund		Other		Total	
	England	DAs	England	DAs	England	DAs	England	DAs	England	DAs
As at 1 April 2016	-17,638	-1,012	0	-14,332	0	-1,198	0	0	-17,638	-16,542
Created during the year	-229,572	-120	0	0	0	0	0	0	-229,572	-120
Released in year	0	0	0	0	0	1,198	0	0	0	1,198
Utilised	2,772	1,012	0	13,332	0	0	0	0	2,772	14,344
As at 31 March 2017	-244,438	-120	0	-1,000	0	0	0	0	-244,438	-1,120
Total as at 31 March 2017	-244,558		-1,000		0		0		-245,558	

Note:

*2016-17 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements.

Research programme grant receipts

- D.36 The Framework Programme for Research and Innovation (currently Horizon 2020) is the EU's primary mechanism for supporting transnational collaborative research and technological development. The current programme runs from 2014 to 2020 and, following the establishment of the European Fund for Strategic Investments, has an overall budget of €74.8 billion (£66.4 billion²) (excluding the Euratom programme).
- D.37 The UK government does not manage any of the Horizon 2020 funding, which is awarded directly to programme participants.
- D.38 Horizon 2020 activities are split into three main areas: Excellent science, Industrial leadership and Societal challenges.
- D.39 The Department for Business, Energy and Industrial Strategy released the latest statistics on UK participation in Horizon 2020 in December 2017¹ which shows that, as of September 2017, UK organisations have been awarded a total of €3.9 billion (£3.5 billion²), which accounts for 15.1% of the EU funding so far awarded under Horizon 2020 (excluding Euratom). These receipts are not included in the above tables, which provide data on public sector receipts only.

¹ <https://www.gov.uk/government/statistics/uks-participation-in-horizon-2020-september-2017>

² 2018: £1 = €1.11271. This is the 29 December 2017 exchange rate, which is the rate at which all UK VAT-based and GNI-based contributions, and the UK rebate, are being converted to sterling throughout 2018.

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