HM Treasury

European Union Finances 2018:

statement on the 2018 EU Budget and measures to counter fraud and financial mismanagement

CP 114

June 2019

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Statement on the 2018 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

June 2019

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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 38th in the series. First, it describes the EU Budget for 2018. 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 2018 and over the financial years 2012-13 to 2023-24. 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 Annex E provides an analysis of the financial settlement, as well as the broader fiscal impacts of EU exit.

Chapter 2

Expenditure

2.1 The Multiannual Financial Framework (MFF) sets ceilings for each EU Annual Budget. The current MFF covers the period 2014-20. It was agreed in 2013 and achieved a real terms cut in the payment ceilings for the first time. The 2018 commitment appropriations ceiling was €159.5 billion (£141.5 billion)[1] and the payment appropriations ceiling was €154.6 billion[2]. (£137.1 billion). 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 payments and commitments appropriations can be found in the Glossary.

The 2018 EU Budget

2.2 The EU financial year runs from 1 January to 31 December. The 2018 EU Budget for commitment and payment appropriations was agreed under the Estonian Presidency of the EU[3] in the second half of 2017[4] . Negotiations began in May 2017, when the Commission proposed a draft EU Budget for 2018[5] . This proposed total commitment appropriations of €160.6 billion (£142.5 billion) and payment appropriations of €145.4 billion (£129.0 billion) in EU spending (nominal figures). The Commission amended its proposal in October 2017, on the basis of new information, such as updates to expenditure and revenue. This resulted in an updated draft EU Budget of €160.3 billion (£142.2 billion) in commitment appropriations and €145.3 billion (£128.8 billion)[6] in payments appropriations.

2.3 The Council adopted its position in July 2017, proposing to reduce the Commission's original proposal to €158.9 billion (£141.0 billion) in

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1 2018: £1 = €1.1271035. 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, were converted to sterling throughout 2018.

2 Draft general budget of the European Union for the financial year 2018: http://eur-lex.europa.eu/budget/data/DB/2018/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 2018 EU budget: https://www.consilium.europa.eu/en/press/press-releases/2017/11/18/2018-eu-budget-agreement-reached/

5 Commission proposes draft EU budget 2018: http://europa.eu/rapid/press-release_IP-17-1429_en.htm

6 Amending letter no.1 to the draft general budget 2018: https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/com-2017-615_2017_en.pdf

commitment appropriations and €144.4 billion[7] (£128.1 billion) in payment appropriations. In October 2017, the European Parliament provided its position, which would have set the level of EU spending in 2018 to €162.6 billion (£144.3 billion) in commitment appropriations and €146.7 billion[8] (£130.2 billion) in payment appropriations.

2.4 Following a process of conciliation between the Council and European Parliament, the 2018 EU Budget was formally agreed. The adopted 2018 EU Budget provided for commitment appropriations of €160.1 billion (£142.1 billion and for payment appropriations of €144.7 billion (£128.4 billion)[9]. The payment appropriations for each of the main EU Budget headings are shown in Table 2.A: 2018 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, rather than voting against, in the vote for the adopted 2018 EU Budget.

2.6 Table 2.A also shows various stages of the negotiations during 2017. 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 €583 million of commitment appropriations and €87 million of payment appropriations were added to the adopted 2018 EU Budget, mainly due to mobilisation of the European Union Solidarity Fund, to respond to major natural disasters in Europe, and budget contributions to the EU Facility for Refugees in Turkey, to help people who have fled the conflict in Syria and now live in Turkey.

2.8 This left a final agreed 2018 EU Budget of €160.7 billion (£142.6 billion) in commitment appropriations and €144.8 billion[10] (£128.4 billion) in payment appropriations. Further details on budget amendments and the final agreed 2018 EU Budget can be found in Box 2.A.

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7 EU Budget 2018: Council sets out its position: https://www.consilium.europa.eu/en/press/press-releases/2017/07/12/eu-budget-position/; Draft general budget of the European Union for the financial year 2018: Council position of 7 July 2017: https://data.consilium.europa.eu/doc/document/ST-10939-2017-INIT/en/pdf

8 Press release: Council cannot accept EP amendments: https://www.consilium.europa.eu/en/press/press-releases/2017/10/25/2018-eu-budget-council-cannot-accept-ep-amendments/; European Parliament resolution of 25 October 2017 on the Council position on the draft general budget of the European Union for the financial year 2018: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2017-0408+0+DOC+XML+V0//EN

9 Deal reached on 2018 EU budget: https://www.consilium.europa.eu/en/press/press-releases/2017/11/18/2018-eu-budget-agreement-reached/; Definitive adoption of the European Union's general budget for the financial year 2018: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2017:051:FULL&from=EN

10 Draft amending budget No. 6/2018: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019B0259&from=EN

Box 2.A: Budget Amendments and the Final Agreed 2018 EU Budget

The final agreed 2018 EU Budget of €144.8 billion in payments is well within the 2018 payments ceiling agreed in the 2013 MFF deal of €154.6 billion.

Table 2.A shows payment appropriations for the adopted 2018 EU Budget. This is the original 2018 EU Budget which was formally agreed by the Council and European Parliament in November 2017. This is prior to any in-year budget amendments.

Table 2.A also shows the final agreed 2018 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 2018 Budget was €87 million in payment appropriations higher than when adopted, primarily due to mobilisation of the European Union Solidarity Fund and budget contributions to the EU Facility for Refugees in Turkey. Chart 2.A shows the payment appropriations by heading for the final agreed 2018 EU Budget.

The final agreed 2018 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: 2018 EU Budget

€ million nominal

Payment Appropriations	Financial Perspective Ceiling[1]	Commission draft 2018 EU Budget[2]	Council position[2]	European Parliament position[2]	Adopted 2018 EU Budget[2]	Final Agreed 2018 EU Budget[3]	Final Agreed 2017 EU Budget[4]
1. Smart and Inclusive Growth		66,578	66,416	67,795	66,624	66,623	49,394
1a. Competitiveness for Growth and Jobs		20,082	19,892	20,794	20,097	20,097	19,322
1b. Economic, Social and Territorial Cohesion		46,763	46,523	47,001	46,527	46,527	30,073
2. Sustainable Growth: Natural Resources		56,360	56,089	56,435	56,084	56,041	54,121
3. Security and Citizenship		2,964	2,944	3,046	2,981	2,981	3,224
4. Global Europe		8,951	8,931	9,100	8,906	8,906	9,056
5. Administration		9,685	9,630	9,717	9,666	9,666	9,395
Total Payment Appropriations	**154,565**	**145,157**	**144,430**	**146,712**	**144,681**	**144,768**	**126,771**

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 2018 https://eur-lex.europa.eu/budget/data/DB/2018/en/SEC00.pdf

[2] EU annual budget life-cycle: figure: http://ec.europa.eu/budget/graphs/annual_life_cycle.html

[3] Draft amending budget No. 6/2018: https://ec.europa.eu/info/sites/info/files/about_the_european_commission/eu_budget/com-2018-704_2018_en.pdf

[4] Draft amending budget No. 6/2017: https://eur-lex.europa.eu/budget/data/BR/2017/en/BR06.pdf

2.9 Details of the levels of payments in the final agreed 2018 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 €20.1 billion (£17.8 billion). Payments toward fostering regional growth and employment (Heading 1b) were set at €46.5 billion (£41.3 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 €56.1 billion (49.7 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 2018, excluding those associated with the European Union Solidarity Fund, were set at €3.0 billion (£2.6 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 €8.9 billion (£7.9 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 2018 under Heading 5 were set at €9.7 billion (£8.6 billion).

2.9.1 For 2019, the adopted EU Budget was agreed in December 2018 with commitment appropriations of €165.6 billion[2] (£146.9 billion)[3] and payment appropriations of €148.2 billion (£131.5 billion).

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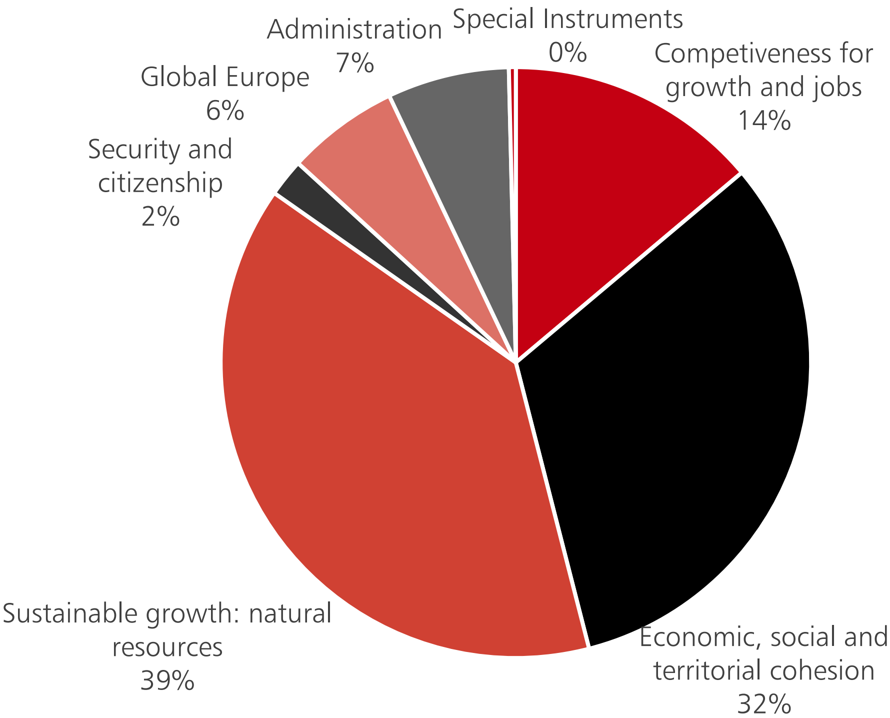
[1] Draft amending budget No. 6/2018 (includes amending budgets 1-6): http://eur-lex.europa.eu/budget/data/BR/2018/en/BR06.pdf

[2] EU budget for 2019: https://eur-lex.europa.eu/budget/data/General/2019/en/GenRev.pdf

[3] 2019: £1 = €1.11791. This is the 31 December 2018 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.

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



Source: Amending Budget No.6/2018:
http://eur-lex.europa.eu/budget/data/BR/2018/en/BR06.pdf

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 which together are known as Traditional Own Resources (TOR); contributions based on VAT; and GNI-based contributions. A more detailed explanation can be found in the Glossary.

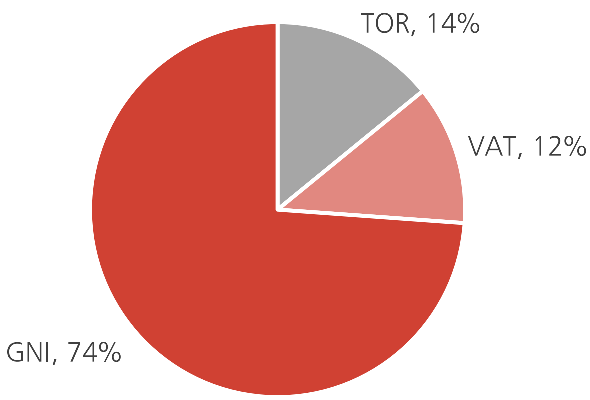
3.2 Chart 3.A shows a breakdown of how the 2018 EU Budget was financed by EU member states. The key points to note for the 2018 EU Budget are[1]:

- TOR is €20.1 billion (£17.8 billion) and the UK's share is 15.7%. In 2017, outturn revenue from this source was €20.5 billion (£17.9 billion), of which the UK's share was 15.6%;
- VAT-based contributions are €17.1 billion (£15.2 billion) and the UK's share is 18.7%. In 2017, total VAT-based contributions were €16.9 billion (£14.9 billion), of which the UK's share was 18.8%;
- GNI-based contributions are €105.1 billion (£93.3 billion) and the UK's share is 14.7%. In 2017, GNI-based contributions were €77.9 billion (£68.3 billion) with a UK share of 15.6%; and
- The estimated value of the UK's rebate in 2018 is €5.0 billion (£4.5 billion) compared with €4.9 billion (£4.3 billion) in 2017. A detailed explanation of how the UK rebate is calculated, and how it operates, can be found in the Glossary.

3.3 Chart 3.B shows each member state's share of financing the 2018 EU Budget after taking account of the UK rebate.

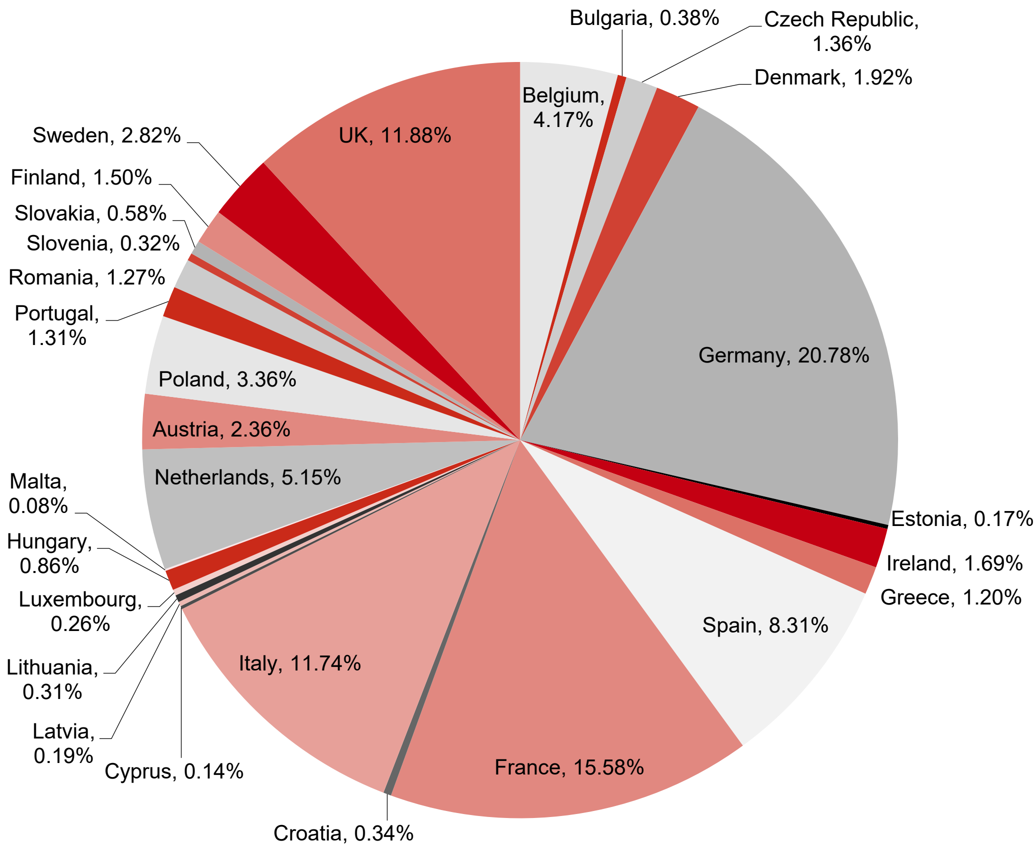
[1] Estimates are sourced from the European Commission's Draft Amending Budget 6 to the 2018 budget. https://ec.europa.eu/info/publications/amending-budget-no-6-2018_en. Outturns are sourced from the European Commission's 2017 EU Budget Financial Report. https://publications.europa.eu/en/publication-detail/-/publication/c48c1c91-cdc8-11e8-9424-01aa75ed71a1

Chart 3.A: 2018 EU Budget Revenue



Source: Draft Amending Budget 6 to the 2018 Budget, European Commission. https://ec.europa.eu/info/publications/amending-budget-no-6-2018_en

Chart 3.B: EU Budget revenue 2018 – percentage share after rebates by member state



Source: Draft Amending Budget 6 to the 2018 Budget, European Commission. https://ec.europa.eu/info/publications/amending-budget-no-6-2018_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 2012 to 2018. The figures for 2018 include estimates, those for earlier years are outturns.

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

	£ million						
	2012	2013	2014	2015	2016	2017	2018
Gross contribution[1]	15,746	18,135	18,778	19,560	16,996	18,625	17,445
Less: UK rebate	-3,110	-3,674	-4,416	-4,914	-3,878	-5,633	-4,247
Less: Public sector receipts	-4,169	-3,996	-4,583	-3,883	-3,492	-4,084	-4,273
Net public sector contribution[2]	**8,467**	**10,465**	**9,779**	**10,763**	**9,626**	**8,909**	**8,925**

[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 technical annex and the Glossary.

3.6 UK public sector receipts in 2018, 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 £2.7 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.

3.7 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 2016 these receipts were worth £2.3 billion (see Technical Annex B). These payments are not included in Table 3.A or Tables 3.C-F, which provide data only on receipts channelled through the public sector.

3.8 The Commission also publish outturn data on all member states' contributions to the EU Budget and their receipts in previous years. These give a figure for the 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.

3.9 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)

				£ billion / € billion
	Gross contribution post rebate (€ billion)	Total public and private receipts (€ billion)	Net contribution (€ billion)	Net contribution (£ billion)
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
2017	13.76	6.33	7.43	6.51
Average	**16.59**	**6.83**	**9.76**	**7.87**

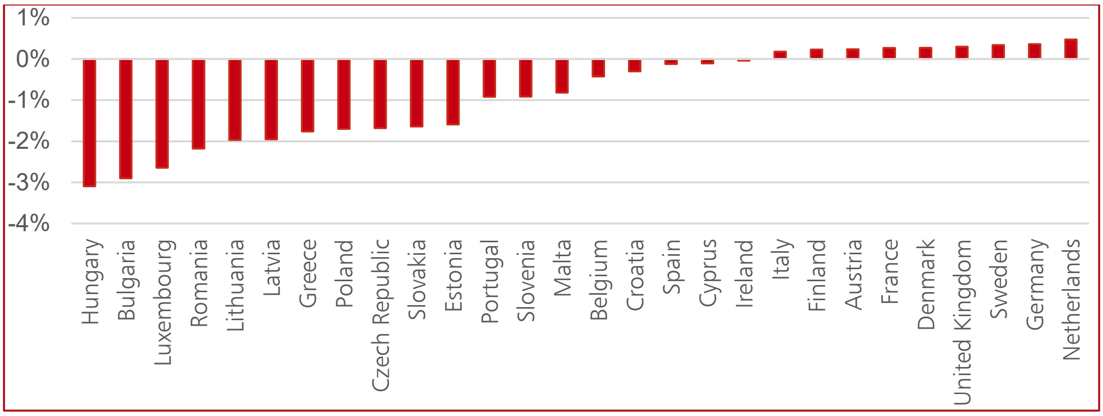
Source: 2017 EU Budget Financial Report, European Commission

3.10 Figures for 2017 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 2014-20 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.

3.11 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 2016 between the government's figures and those which can be derived from the European Commission's EU Budget Financial Report.

3.12 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 country for the years 2013-2017



Source: 2017 EU Budget Financial Report, European Commission.

Financial year transactions

3.13 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 UK financial year basis between 2011-12 and 2017-18.

3.14 Payments to the EU Budget are scheduled on a monthly basis, but 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
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Gross contribution[1]	16,871	18,208	18,733	17,635	16,926	17,450
Less: UK rebate	-3,172	-4,130	-4,811	-4,068	-4,757	-4,547
Less: Public sector receipts	-4,022	-3,856	-4,690	-2,811	-4,081	-4,130
Net public sector contribution[2]	**9,678**	**10,223**	**9,231**	**10,756**	**8,088**	**8,773**

[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 over the gross post-rebate amount.

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

Source: HM Treasury calculations

3.15 The Office for Budget Responsibility (OBR) forecasts the UK's contributions to the EU Annual Budget in future years, and the UK's contribution arising from the financial settlement. This statement reproduces the forecast adopted by the OBR in their March 2019 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. 2023-24), 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 their forecasts can be found in the OBR's March 2019 Economic and Fiscal Outlook.

3.16 Table 3.D provides a breakdown of the OBR's latest forecast for UK transactions with the EU over the period 2018-19 to 2023-24. 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 2012-13 to 2017-18 (outturn) and 2018-19 to 2023-24 (forecast).

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

£ million

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Gross contribution[1]	20,197	20,433	21,145	21,430	21,397	21,597
Less: UK rebate	-4,662	-4,319	-4,251	-4,567	-4,656	-4,670
Less: Public sector receipts	-4,993	-5,147	-5,938	-5,905	-5,980	-6,088
Net public sector contribution[2]	**10,541**	**10,967**	**10,956**	**10,957**	**10,762**	**10,838**

[1] The UK's gross payments are automatically corrected to account for the rebate, meaning the UK only pays over the gross post-rebate amount.

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

Source: Economic & Fiscal Outlook March 2019, Office for Budgetary Responsibility https://obr.uk/efo/economic-fiscal-outlook-march-2019/

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

						£ million
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
EAGF	2,956	2,602	2,372	1,318	3,057	2,728
EAFRD	298	638	543	619	367	536
Social Fund	366	249	368	543	268	223
Regional Development Fund	327	275	1,305	297	237	337
Other Receipts	75	92	105	34	151	306
Total	**4,022**	**3,856**	**4,683**	**2,811**	**4,081**	**4,130**

Source: HM Treasury calculations

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

						£ million
	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
EAGF	2,710	2,745	2,576	3,010	3,037	3,085
EAFRD	716	762	990	925	933	948
Social Fund	478	508	660	617	622	632
Regional Development Fund	803	855	1,111	1,038	1,047	1,063
Other Receipts	224	238	309	289	291	296
Total	**4,931**	**5,107**	**5,646**	**5,879**	**5,930**	**6,025**

Source: Economic & Fiscal Outlook March 2019, Office for Budgetary Responsibility https://obr.uk/efo/economic-fiscal-outlook-march-2019/

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 2017 and concerning the 2016 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. Third, the Seventeenth Report of OLAF, the European Anti-Fraud Office summarises the activities of the Office during 2016.

European Court of Auditors' annual report on the 2016 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 Budget[1]. 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.

1 The European Court of Auditors' annual report on the 2016 EU Budget can be found at: https://www.eca.europa.eu/Lists/ECADocuments/annualreports-2016/annualreports-2016-EN.pdf

4.4 The ECA's report on the 2016 EU budget was published on 28 September 2017. As in previous years, it provided an assessment of each EU Budget 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 2016 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 2016 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 3.1% for the 2016 EU Budget as a whole: a decrease from 3.8% for the 2015 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. 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 first time since the DAS was introduced in 1994, 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 2016. 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:
    - take into account the growth in outstanding commitments in its forecast of payment appropriations for the next MFF in order to help ensure an orderly balance between commitment and payments appropriations;
    - together with the European Parliament and Council, ensure a consistent approach to the issue of whether special instruments are

counted within the ceilings for payment appropriations in the next MFF;

- for management and reporting purposes, establish a way of recording EU budgetary expenditure that will make it possible to report on all funding related to the refugee and migration crisis;
- invite the European Parliament and the Council, in the context of the debate on the future of Europe, to consider how the EU budgetary system could be reformed to provide a better balance between predictability and responsiveness as well as how best to ensure overall funding arrangements are no more complex than necessary to meet EU policy objectives and guarantee accountability, transparency and ease of audit

- 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 directorates-general (DGs) and the reporting by the Commission to the European Parliament and Council. This chapter has three parts: the first on performance reporting; the second on the results of the ECA's performance audits; and the third on the follow-up of the ECA's recommendations. The ECA recommended that the Commission should:
  - streamline performance reporting;
  - better balance performance reporting by clearly presenting information, in its core performance reports, on the main challenges to achieving results;
  - further improve the user-friendliness of its performance reporting by making greater use of methods and tools such as graphics, summary tables, colour-coding, infographics and interactive web-sites;
  - better demonstrate that evaluation results are well used;
  - indicate in core performance reports whether, to the best of their knowledge, the performance information provided is of sufficient quality; and
  - make performance information more easily accessible by developing a dedicated web portal and search engine.
- Chapter 4 – Revenue: This covers the revenue through which the EU finances its budget. For 2016 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. However, the examined systems for TOR were assessed as only partially effective. There remain some concerns regarding the calculation of Member States' contributions to the EU budget.

  The ECA recommended that the Commission should:

- analyse in cooperation with Member States, all the potential implications of activities of multinational companies on the estimation of GNI, and provide guidance to them on how to deal with these activities when compiling GNI data; and
- confirm that R&D assets have been correctly recorded in Member States' national accounts.

- **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 4.1% (down from 4.4% in 2015). The main source of error was reimbursement of ineligible personnel costs. The ECA recommended that the Commission:
  - further streamline the Horizon 2020 rules and procedures to reduce the legal uncertainty, by making increased use of the simplified cost options (such as unit costs, lump sums, flat-rate financing and prizes) in the revised Financial Regulation;
  - take a consistent approach towards the calculation of error rates and the overall amounts at risk; and
  - reduce the time taken to close ex-post audits and improve internal processes for planning, monitoring and reporting audits.
- **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 causes of error as the inclusion of ineligible costs in beneficiaries' declarations, the selection of ineligible projects, activities or beneficiaries, and the infringement of public procurement legislation. The overall error rate across this MFF heading area was 4.8% (down from 5.2% in 2015). The ECA recommended that the Commission should:
  - pay particular attention to areas in which there is a higher risk of ineligible expenditure or of the disclosure of inaccurate information that may lead to an over-reimbursement when closing the 2007-2013 programmes;
  - address issues for the 2014-2020 period that may prevent a reliable calculation of the residual rate;
  - when considering the design and delivery mechanism for the ESI funds post-2020, strengthen the programme focus on performance and simplify the mechanism for payments by encouraging, as appropriate, the introduction of further measures linking the level of payments to performance instead of simply reimbursing costs.

- **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 2.5% (down from 2.9% in 2015). The most significant causes of error were ineligible beneficiaries, activities, projects and expenditure items. The ECA recommended that the Commission:
  - review the approach taken by paying agencies to classify and update land categories in their LPIS and to perform the required cross-checks, in order to reduce the risk of error in the greening payment;
  - provide guidance and disseminate best practices among national authorities to ensure that their checks identify links between applicants and other stakeholders involved in the supported projects.
- **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 2.1% (down from 2.8% in 2015). 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 the Commission:
  - work together with the audit authorities in pre-accession beneficiary countries to improve their competence, particularly by organising seminars, setting up networks and using the tools available, such as twinning or technical assistance;
  - develop risk indices to improve the assessment based on the internal control templates, so as to better measure the impact of errors;
  - properly disclose the scope of the RER study and the estimated lower and upper error limits in its next AAR;
  - improve the calculation of the 2017 corrective capacity by addressing the shortcomings identified.
- **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 0.2%, down from 0.6% in 2015) and their

examination of system did not reveal any significant weaknesses. The ECA recommended that the European Parliament:

- reviews its framework for monitoring the implementation of budget appropriations allocated to political groups. It should also provide better guidance to political groups and monitor more effectively how they apply the rules for authorising and settling expenditure, and how they carry out procurement procedures.

Council recommendation to the European Parliament on Discharge

4.11 On 20 February 2018, the Council noted both the ECA's Statement of Assurance on the implementation of the EU Budget for the financial year 2016 and the ECA's analysis of the audit findings and conclusions. 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 recommendations[2]. The Council:

- called on the Commission to continue, where appropriate, the implementation of all available corrective measures to protect the EU budget;
- encouraged the ECA and the Commission to continue working together in order to converge their approaches in the evaluation of the impact of financial correction on the estimated amount at risk at closure and to provide comparable data;
- called on the Commission to continue improving its capacity to anticipate and predict expected needs thereby limiting, when possible, the recourse to amending budgets or the mobilisation of special instruments in full compliance with the legal framework;
- called on the Commission to anticipate an orderly disbursement of payments in order to avoid any shortage of appropriations as a result of the lower than expected submission of claims for European Structural and Investment Funds by the authorities of Member States;
- called on the Commission to continue the monitoring of the increasing outstanding commitments (RAL), and to ensure an orderly balance between commitment and payment appropriations;

[2] The Draft Council recommendation can be found at: http://data.consilium.europa.eu/doc/document/ST-5940-2018-ADD-1/en/pdf

- called on the Commission to closely monitor the development and associated financial risk of the increasing financial exposure of the EU budget due to long-term liabilities, guarantees and legal obligations;
- invited the Commission to establish a comprehensive reporting structure on the use of funds tackling the refugee and migration crisis;
- called on the Commission to improve the transparency, simplicity and accountability of all the EU budgetary instruments; and
- called on the Commission and national competent authorities to make additional efforts to ensure the regularity and sound financial management of EU funds, to take full advantage of all possibilities of simplification and to avoid unnecessary layers of complexity or administrative burdens that do not add value to the results set to be achieved.

4.14 On 20 February 2018, the European Council voted to recommend that the European Parliament discharge the Commission from its responsibility for implementing the EU budget in 2016. 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 the reduction of error rates for reimbursement payments and the simplification of complex rules surrounding EU budget expenditure.

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

4.15 On 18 April 2018, the European Parliament formally approved the discharge of the EU budget accounts for 2016 and issued their Resolution.[3] 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 co-ordinates 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

3 Discharge 2016: EU general budget 2016 – European Parliament can be found at: http://www.europarl.europa.eu/cmsdata/147821/European%20Commission%20-%20P8_TA-PROV(2018)0121%20(part%20I).pdf

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.

4.18 *Audit Finding:* irregular payments due to incorrect eligibility data in the Land Parcel Identification System (LPIS).

4.19 *UK response:* These issues are addressed by the English Authorities' LPIS action plan, which is on-going and monitored by the Commission.

4.20 *Audit Finding:* Deficiencies in administrative cross-checks.

4.21 *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 2016

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

4.23 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 2016 report[4], published on 20 July 2017, 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.

4.24 The report is accompanied by five Commission Staff Working Papers: (i) Implementation of Article 325 TFEU by the member states in 2016; (ii) Statistical Evaluation of Irregularities reported for 2016; (iii) Follow-up recommendations to the Commission report on the protection of the EU's financial interests - Fight Against Fraud 2015; (iv) Early Detection and Exclusion System (EDES) – Panel referred to in Article 108 of the Financial

4 The 2016 Fight Against Fraud Report can be found at: https://ec.europa.eu/anti-fraud/sites/antifraud/files/1_act_part1_v2_en.pdf

Regulation; and (v) Annual overview with information on the results of the Hercule III programme in 2016.

4.25 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

4.26 In 2016, a total of 1,410 irregularities were reported as fraudulent (suspected and established fraud). The estimated financial impact of irregularities reported as fraudulent was €391 million (£320 million)[5]. 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 61.76% of the total amounts involved.

Other irregularities (not reported as fraudulent)

4.27 In 2016, a total of 17,670 irregularities were reported as non-fraudulent. The estimated financial impact of these irregularities was €2.97 billion (£2.43 billion).

Cases of undervaluation detected in the United Kingdom affecting TOR revenue

4.28 In November 2016, the Commission's inspection of the UK regarding TOR alleged significant weaknesses in the management and control of undervalued imports of textiles and footwear.

4.29 An OLAF investigation which concluded in 2017 alleged that appropriate measures were not taken to prevent systematically undervalued imports of textiles and footwears from China from entering the EU through the UK.

4.30 These elements led the Director-General for Budget to make a reservation in the 2016 Annual Activity report on the inaccuracy of the TOR amounts transferred to the EU budget by the UK since 2013.

4.31 The Commission started an infringement procedure in March 2018 in relation to alleged duty losses due to undervaluation fraud and has now referred the infringement to the European Court of Justice. The Government takes these allegations extremely seriously and will continue to deal with the infringement procedure through the appropriate channels. The Government intends to strongly contest the case and does not recognise the Commission's estimate of alleged evaded duty. It will continue to cooperate closely with the Commission and OLAF on customs fraud.

Recommendations

4.32 The report considers the actions taken by the Commission in 2016 to counter fraud, including use of financial corrections and preventive measures where fraud was suspected. OLAF made 71 recommendations to national

[5] 2016: £1 = €1.2202860 This is the 2016 average exchange rate.

authorities, recommending that approximately €103.7 million (£85 million) should be recovered from all EU Member States.

4.33 The report's recommendations called for all member states to:

- review their management and control strategy regarding customs valuation, with a view to protecting the EU's financial interests;
- fully transpose Directives 2014/23/EU, 2014/24/EU and 2014/25/EU and put their implementation high on the political agenda; enforce the new Directives with a focus on transparency and integrity in public procurement, prevention and detection of fraud and corruption and better monitoring of public procurement systems; make use of the possibilities offered by simpler rules and fully realise the potential of e-procurement, which will become mandatory by October 2018;
- provide information about the location and, for cohesion and fisheries policies, the priority area of the measures/projects affected when reporting irregularities;
- take into account the findings of the report in their fraud risk assessments for the programming period 2014-2020 and to pay particular attention to the priorities highlighted and to interventions which are similar in scope and nature; increase their attention and cooperation in view of the low detection results for ETC programmes and considering the increasing threat of transnational fraud; review their fraud risk assessments in relation to market support measures, taking into account the information highlighted in the report.

Seventeenth Report of the European Anti-Fraud Office (1 January to 31 December 2016)

4.34 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.

4.35 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.

4.36 Every year, the OLAF Director publishes a report on the activities of the Office over the previous year. The seventeenth report, issued in April 2017, gave a summary of OLAF's achievements in 2016, supported by statistics and case studies.[6]

4.37 The following statistics were reported for 2016:

- 1,136 items of information were received in 2016 from public and private sources;
- 219 investigations were opened in 2016;
- 346 recommendations were issued in 2016;
- structural funds accounted for the highest number of investigations; and
- OLAF recommended the recovery of €631.1 million (£517.2 million) as a result of investigations in 2016.

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

- reaching agreement on the Protection of the Financial Interests of the Union (PIF) directive;
- contributing to the establishment of a European Public Prosecutor's Office;
- implementing the Hercule III programme; and
- evaluating the OLAF regulation no 883/2013.

4.39 In 2016, OLAF operated on an administrative budget of €58.9 million (£48.3 million).

[6] OLAF's sixteenth activity report can be found at: http://g8fip1kplyr33r3krz5b97d1.wpengine.netdna-cdn.com/wp-content/uploads/2017/05/OLAF-2016.6919_web.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 2017 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 prepares to leave the EU.

5.3 This chapter focuses predominantly 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 2017-18, they accounted for 96.3% of UK public sector receipts[2]). The UK private sector also receives a significant amount of funding through programmes directly manged by the European Commission, such as Horizon 2020. As of September 2018[3], UK organisations have been awarded a total of €5.1 billion (£3.5 billion[4]), which accounts for 15.8% of the EU funding so far awarded under Horizon 2020 (excluding Euratom).

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

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[1] 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 2018 there were no disallowance provisions relating to 'Other' funds.

[3] https://www.gov.uk/government/statistics/uk-participation-in-horizon-2020-may-2018

[4] 2018: £1 = €1.11271035. 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.

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.

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, 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 midpoint 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)[5]
European Agricultural Guarantee Fund (EAGF) or Pillar 1 of Common Agricultural Policy[6]	22.7	20.1
European Regional Development Fund (ERDF) + European Social Fund (ESF)[7]	10.8	9.6
European Agricultural Fund for Rural Development (EARDF)[8]	5.2	4.6
European Maritime and Fisheries Fund (EMFF)[9]	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.[10] 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.

[5] 2018: £1 = €1179055. This is the 31st December 2018 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 2019.

[6] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0671&from=EN ; https://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

[7] European Structural and Investment Funds: UK Partnership Agreement: https://www.gov.uk/government/publications/europeanstructural-and-investment-funds-uk-partnership-agreement

[8] http://data.consilium.europa.eu/doc/document/ST-14561-2014-ADD-1/en/pdf

9. https://www.gov.uk/guidance/european-maritime-and-fisheries-fund-emff-uk-managing-authority-ukma

[10] 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 Agreement[11] 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 entrepreneurism;
- 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 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.

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

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 March 2011 – March 2018 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 DEFRA implemented its Disallowance Strategy in 2014 to manage the ongoing risk of disallowance. The strategy was reviewed in 2016 and again following the EU Exit referendum to ensure that the strategy still delivers value for money in light of EU Exit.

5.19 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. The main causes of disallowance under the previous CAP scheme were late payment to farmers, poor mapping data, and shortcomings in cross-compliance controls. Late payments resulted in a penalty of €85 million (£58 million) in 2006, but this issue was resolved from 2007 onwards. Since then, mapping deficiencies have become the predominant ongoing focus to reduce disallowance.

5.20 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:

5.21 The Land Parcel Identification System (mapping)

- The strategy has proven to be particularly effective operationally in relation to the Land Parcel Information System (LPIS). The LPIS is the main control for area based subsidies and has, and continues to be, the subject of much audit scrutiny by the Commission, ECA and Certifying Body. The accuracy of the LPIS (maps) has historically been the main cause of disallowance.
- Work to improve the LPIS began following the 2014 Area Aids Audit in which DEFRA received an €81.5m correction for the 2012 and 2013 scheme years. The Commission have subsequently closed the formal Action Plan of improvements to LPIS and the improvements were reflected in pass to the LPIS Quality Assurance exercise.
- As a result of the investment, the disallowance risk was reduced in relation to mapping to under £25m per year, reducing our potential disallowance by over €105m.

5.22 Continued EU engagement:

- The CAP is governed by complex rules, which drive up the risk and incidence of disallowance. Where possible, DEFRA are continuing to engage constructively with the Commission's simplification exercise and will continue to work with the Commission to highlight 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.

5.23 Progress in implementing DEFRA's disallowance strategy is overseen by the Department's Disallowance Steering Group, which meets monthly. It is important to note that the impacts of mitigating actions can take time to crystallise. DEFRA, along with the rest of government, continues to engage with the European Commission and other member states on best practice.

ESIFs

5.24 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 ESIF's regulations.

5.25 BEIS and Managing Authorities have put in place an early warning system to identify potential disallowance quickly using the Partnership Agreement Programme Board. This allows for the sharing of expertise between the Managing Authorities and BEIS and to identify lessons learnt. We have increased the frequency of Partnership Agreement Programme Board meetings 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.

5.26 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.

5.27 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

5.28 As set out in previous statements, 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.

5.29 Tables D.3 and D.4 in Annex D set out data from the 2016-17 and 2017-18 departmental accounts respectively. These include:

- 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 D.4 is discussed in more detail in the next section of this chapter.

5.30 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.

5.31 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. The UK's departure from the EU will alter the way we manage our financial relationship with the EU, however we will continue to have robust audit arrangements under the withdrawal agreement and provide updates which department already publish.

Update on performance and minimising disallowance

5.32 At European level, ongoing 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.

5.33 DEFRA have 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.

5.34 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. DEFRA will continue to challenge disallowance proposals as needed.

5.35 As demonstrated by the data in Table D.4, a significant portion of provisions in 2017-18 continue to be related to agricultural policy funding. This has – largely due to the size of the fund and the complexity of the regulations. The new provisions 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). With relation to the table on CAP disallowance the provisions were previously published in DEFRA's Annual Report and Accounts for 2017/18[12]. Following engagement with the Commission, DEFRA believe that the final disallowance associated with the 2018 audit year 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.

12 https://www.gov.uk/government/publications/defras-annual-report-and-accounts-2017-to-2018

5.36 Although it is early days in terms of verification activity, during calendar year ending 2018, 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 2018 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 D.4 shows that in 2017-18 there were some – relatively small – disallowance provisions relating to the European Social Fund of £1,000.

Certainty for beneficiaries of EU funds

5.37 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 EU.

5.38 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.

5.39 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 2016, 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 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.

5.40 The UK's Withdrawal Agreement provides 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 Union, 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.

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 EU[1]. 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 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

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

ECA do not necessary 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), often referred to as Structural Funds, 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 Agreement[2] and amended as part of the Mid-Term Review of the MFF[3]. 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

[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)

[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

possibilities for reallocating existing appropriations have been exhausted. 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 2010-17 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 Sterling[5]. The 2018 Euro figures have been converted into Sterling using the Sterling/Euro exchange rate on 29th December 2017, namely £1=€1.12171035 (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.

[5] 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; the annual average rate for 2017 is £1 = €1.1413.

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.

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 2016 and the figures in the European Commision's EU Budget 2016 Financial Report

B.1 As set out in Chapter 3, paragraph 3.8, there is a difference between the UK government's figures for the cash flow outturn for the UK's net contribution for 2016 and the figures in the European Commission's EU Budget 2016 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 with the average exchange rate for 2016 of £1= €1.2202860, the figures on cash flow outturn for the UK's net contribution for 2016 in the European Commission's EU Budget 2016 Financial Report break down as set out in Table B.1.

Table B.1: Cash flow outturn for the UK's net contribution for 2016 in the European Commission's EU Budget 2016 Financial Report

	(€ million)	(£ million)
UK gross contribution before rebate	22,492	18,432
UK rebate	-5,870	-4,810
UK receipts	-7,052	-5,779
UK net contribution	**9,570**	**7,842**

Source: European Commission's EU Budget 2016 Financial Report, HM Treasury calculations

B.3 The government's figure for the UK's net contribution in 2016 is £9,626 million.

B.4 A number of factors contribute to the difference between the two net contribution figures. The 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 £2,287 million of the difference in 2016;

- 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 Budget Nos. 6/2015 and 7/2015 were adopted on the 14th of October, and Amending Budget 8/2015 was adopted on the 25th November. This meant that some associated changes were not implemented until 2016. This results in the government's figures being some £1,200 million lower than if the Amending Budget changes had been implemented in 2015;
- In 2016 Amending Budgets 4/2016, 5/2016 and 6/2016 were adopted on the 1st of December. This meant that associated changes were not implemented until 2017. The result of which leads to the government's figures being some £944 million higher than if the Amending Budget changes had been implemented in 2016.

B.5 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 2016 with the figures in the European Commission's EU Budget 2016 Financial Report

	(£ million)
UK government outturn for 2016	9,626
Private sector receipts	-2,287
Late implementation, in January 2016, of Amending Budgets Nos. 6/2015 - 8/2015	1,200
Late implementation, in January 2017, of Amending Budget Nos. 4/2016 - 6/2016	-943
UK cash flow figure adjusted to reflect main differences compared to European Commission's figure	**7,596**
European Commission figure for 2016 outturn	**7,842**
Net difference due to other factors (e.g. exchange rate)	**-246**

Source: HM Treasury calculations and 2016 EU Budget Financial Report, European Commission

Annex C
Tables

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

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Table C.1: Expenditure on the EU Budget Commitments and Payments by Heading in years 2011-2018 (€ million)

Appropriations	Commitments								Payments							
	2011	2012	2013	2014	2015	2016	2017	2018	2011	2012	2013	2014	2015	2016	2017	2018
1 Smart and Inclusive Growth	64,505	68,142	70,749	63,986	77,955	69,841	75,399	77,532	53,994	60,287	69,127	65,863	66,854	59,291	49,393	66,663
1a Competitiveness for Growth and Jobs	13,521	15,389	15,641	16,484	17,552	19,010	21,312	22,000	11,604	11,971	12,612	11,857	15,729	17,402	19,321	20,095
1b Economic, social and territorial cohesion	50,984	52,753	55,108	47,502	60,403	50,831	54,087	55,532	42,390	48,504	56,473	54,006	51,125	41,888	30,073	46,527
2 Sustainable Growth: natural resources	58,659	59,850	60,102	59,191	63,877	62,470	58,569	59,239	55,794	58,016	58,036	55,959	55,979	54,972	54,121	56,041
3 Security and Citizenship	2,098	2,754	2,197	2,172	2,522	4,292	4,284	3,493	1,713	2,214	1,699	1,660	1,927	3,022	3,224	2,981
4 Global Europe	8,759	9,404	9,315	8,423	8,711	9,167	10,437	10,069	7,053	6,777	6,743	6,925	7,478	10,156	9,056	8,906
5 Administration	8,173	8,280	8,431	8,405	8,660	8,951	9,395	9,666	8,172	8,278	8,429	8,406	8,659	8,951	9,395	9,666
TOTAL	**142,194**	**148,428**	**152,048**	**142,690**	**162,273**	**155,277**	**159,831**	**160,696**	**126,727**	**135,758**	**144,451**	**139,034**	**141,280**	**136,642**	**126,771**	**144,768**

Notes:

1. 2011-17 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.

Source:

Figures for 2010 to 2017 are taken from the European Commission's Reports on budgetary and financial management.

Figures for 2018 are taken from Amending Budget 6 for the 2018 Budget.

European Commission Budget website: http://eur-lex.europa.eu/Budget/www/index-en.htm

Table C.2: Expenditure on the EU Budget Commitments and Payments by Heading in years 2011-2018 (£ million)

Appropriations	Commitments								Payments							
	2011	2012	2013	2014	2015	2016	2017	2018	2011	2012	2013	2014	2015	2016	2017	2018
1 Smart and Inclusive Growth	55,970	55,256	60,063	51,561	56,595	57,233	64,555	68,789	46,850	48,886	58,686	53,074	48,536	48,588	43,278	59,145
1a Competitiveness for Growth and Jobs	11,732	12,479	13,279	13,283	12,743	15,578	18,247	19,519	10,069	9,707	10,707	9,555	11,419	14,261	16,929	17,829
1b Economic, social and territorial cohesion	44,238	42,777	46,785	38,278	43,852	41,655	46,308	49,270	36,781	39,331	47,943	43,519	37,117	34,326	26,350	41,280
2 Sustainable Growth: natural resources	50,897	48,532	51,024	47,697	46,375	51,193	50,146	52,558	48,412	47,045	49,270	45,093	40,641	45,048	47,420	49,721
3 Security and Citizenship	1,820	2,233	1,865	1,750	1,831	3,517	3,668	3,099	1,486	1,795	1,442	1,338	1,399	2,476	2,825	2,645
4 Global Europe	7,600	7,626	7,908	6,787	6,324	7,512	8,936	8,933	6,120	5,495	5,725	5,580	5,429	8,323	8,323	7,902
5 Administration	7,092	6,714	7,158	6,773	6,287	7,335	8,043	8,576	7,091	6,713	7,156	6,774	6,286	7,335	7,335	8,576
TOTAL	123,379	120,359	129,083	114,982	117,810	127,246	136,844	142,575	109,959	110,085	122,633	112,036	102,569	111,975	111,076	128,442

Notes:

1) 1. 2011-17 includes all agreed Amending Budgets.

2) 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 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	2018	2011	2012	2013	2014	2015	2016	2017	2018
GROSS CONTRIBUTIONS																
Sugar levies	9	13	11	2	10	9	10	-3	8	10	9	2	7	7	9	-3
Customs Duties	2,554	2,703	2,557	2,775	3,192	2,997	3,610	2,943	2,216	2,192	2,171	2,236	2,318	2,456	3,163	2,611
VAT–based contributions	2,505	2,811	2,761	2,963	3,665	3,266	3,470	3,465	2,174	2,279	2,344	2,388	2,661	2,677	3,040	3,074
GNI-based contributions	12,588	14,012	15,899	15,539	19,288	14,468	13,872	16,080	10,922	11,362	13,497	12,521	14,003	11,856	12,154	14,267
VAT & GNI adjustments	42	-121	134	2,024	786	-	295	-2,824	36	-98	114	1,631	571	-	258	-2,505
United Kingdom rebate	-3,623	-3,835	-4,328	-5,481	-6,768	-4,732	-6,429	-4,787	-3,143	-3,110	-3,674	-4,416	-4,914	-3,878	-5,633	-4,247
Total Contributions	**14076**	**15,583**	**17,034**	**17,822**	**20,174**	**16,008**	**14,828**	**14,876**	**12214**	**12,636**	**14,461**	**14,362**	**14,646**	**13,118**	**12,993**	**13,198**
PUBLIC SECTOR RECEIPTS																
EAGF	3,073	3,395	3,236	3,395	3,251	2,766	3,103	3,085	2,667	2,753	2,747	2,736	2,361	2,267	2,719	2,737
EAFRD	483	359	729	529	637	488	722	567	419	291	619	426	462	400	633	503
European Regional Development	698	540	350	1,311	625	439	327	763	605	438	297	1,057	454	360	286	677
European Social Fund	448	721	290	331	780	376	162	333	389	585	246	266	566	308	142	295
Other Receipts	60	126	102	122	55	192	347	69	52	102	86	98	40	157	304	61
Total Receipts	**4,762**	**5,141**	**4,707**	**5,688**	**5,348**	**4,261**	**4,661**	**4,816**	**4,132**	**4,169**	**3,996**	**4,583**	**3,883**	**3,492**	**4,084**	**4,273**
Net Contributions	**9,314**	**10,442**	**12,327**	**12,135**	**14,825**	**11,747**	**10,168**	**10,060**	**8,082**	**8,467**	**10,465**	**9,779**	**10,763**	**9,626**	**8,909**	**8,925**

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.

2. Prior to 2010, the Sugar Levies row also includes figures for duties on agricultural products.

3. 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.

4. 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.

5. 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.

6. 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

7. 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 Budget Responsibility and HM Treasury

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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. 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 Paying Agencies and Managing Authorities. The Report draws on well-established data collection and assurance systems and processes.

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.

Boundary of the report

D.7 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.8 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 project.[1] 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.9 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.10 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.11 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.12 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.13 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.

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D.14 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.15 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.16 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.17 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 (FReM). By contrast, the public sector receipts in Table C.3 are reported on a cash basis.

D.18 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.19 The final settlement of claims by the EU may give rise to adjustments following the closure process or disallowance (see paragraphs D.31-D.32 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.31 below).

Management of EU funded schemes

Expenditure on EU funded schemes

D.20 This section of the document covers the expenditure on EU funded schemes between 2010 -11 and 2017-18.

D.21 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.22 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.23 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.24 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.25 The Expenditure Statement (Table D.1) shows gross expenditure on EU-supported schemes from 2010 -11 to 2017-18. After allowing for foreign exchange variations and adjustments to claims, the amount reimbursable by the EU (i.e. net expenditure) was £3.75 billion in 2016 -17 and £3.83 billion in 2017-18, 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.4. This table shows the increase in net expenditure between 16-17 and 17-18 is largely due to European Social Fund gross expenditure, which increased year on year as the new programme operated at full capacity in 17-18.

Accounting policies

Basis of preparation

D.26 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.

Foreign currency translation

D.27 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.28 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.29 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.

Expenditure Statement

Table D.1: Expenditure Statement for the years ended 31 March 2011 to 31 March 2018 (prior years restated)

£ thousand

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Gross expenditure on EU supported projects	4,397,505	4,773,977	4,216,794	4,345,271	4,254,226	3,361,171	3,774,481	3,812,404
Provisions created in year	(75,006)	(92,647)	(34,850)	(1,832)	(21,459)	(32,568)	(120)	0
Provisions released in year	19,856	22,817	10,495	60,452	11,770	335	1,198	8,692
Realised forex gain/(loss)	(35,739)	(23,617)	114,930	2,019	(30,005)	(12,012)	2,491	(2,271)
Unrealised forex gain/(loss)	2,779	51,182	(102,488)	(13,637)	51,733	(163,305)	(4,158)	16,470
Withdrawn from EU claim	(49,743)	(18,063)	(35,841)	(8,036)	1,171	2,858	(26,450)	(1,870)
Net expenditure reimbursable by the EU	**4,259,652**	**4,713,649**	**4,169,040**	**4,384,237**	**4,267,436**	**3,156,479**	**3,747,442**	**3,833,425**

* 2017-18 balances include the latest available information. Some Managing Authority returns may bebased on unaudited financial statements

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Table D.2: Statement of Assets and Liabilities as at 31 March 2011 to 31 March 2018 (prior years restated)

£ thousand

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Assets								
Advances to beneficiaries	219,642	25,594	17,340	26,143	24,788	26,640	42,262	148,886
EU funds receivable	1,931,886	1,763,336	1,763,235	2,314,084	1,622,625	2,146,918	1,219,556	1,492,592
Other assets	1,798	254,299	207,990	258,436	281,893	484,815	408,996	450,327
	2,153,326	**2,043,229**	**1,988,565**	**2,598,663**	**1,929,306**	**2,658,373**	**1,670,814**	**2,091,805**
Liabilities								
EU funds paid on account	(1,938,419)	(1,860,340)	(997,802)	(655,634)	(530,013)	438,265	(379,520)	(667,295)
Amounts payable to beneficiaries	(140,863)	(183,401)	(186,053)	(148,459)	(73,928)	(328,505)	(424,239)	(577,389)
Repayable to EU	(3,525)	(2,697)	(238,694)	(543,684)	(737,127)	(685,287)	(645,931)	(557,983)
Provision for disallowance	(177,886)	(212,390)	(214,681)	(100,154)	(5,585)	(34,180)	(245,558)	(184,080)
Other liabilities	(24,607)	(66,734)	285	517	517	(2,885)	(151)	(12,951)
	(2,285,300)	**(2,325,562)**	**(1,636,945)**	**(1,447,414)**	**(1,346,136)**	**(612,592)**	**(1,695,399)**	**(1,999,698)**
Net Assets / (Liabilities)	**(131,974)**	**(282,333)**	**351,620**	**1,151,249**	**583,170**	**2,045,781**	**(24,585)**	**92,107**

*2017-18 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements

Analysis of Net Expenditure by EU Scheme

Table D.3: 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	72,597	310,706	101,231	17,732	12,102	**2,565,924**	**1,208,557**
Total disallowance provided for	0	(120)	0	0	0	0	0	0	**0**	**(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	(12,366)	(3,485)	(10,599)	0	0	**(3,485)**	**(22,965)**
Net expenditure reimbursable by EU	**2,207,882**	**1,020,930**	**25,185**	**58,995**	**313,772**	**88,820**	**17,975**	**13,883**	**2,564,814**	**1,182,628**
Total Net expenditure reimbursable by EU	**3,228,812**		**84,180**		**402,592**		**31,858**		**3,747,442**	

Table D.4: Analysis of Net Expenditure by EU Scheme 2017-18*

£ 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	2,108,971	1,037,744	221,161	118,053	130,180	164,043	20,102	12,150	**2,480,414**	**1,331,990**
Total disallowance provided for	0	0	0	0	0	0	0	0	**0**	**0**
Total disallowance released	8,692	0	0	0	0	0	0	0	**8,692**	**0**
Total foreign exchange gains/(losses)	5,043	111	(5,935)	(270)	15,839	308	71	(968)	**15,018**	**(819)**
Total withdrawn from EU claim	0	0	0	(499)	(1,371)	0	0	0	**(1,371)**	**(499)**
Net expenditure reimbursable by EU	**2,122,706**	**1,037,855**	**215,226**	**117,284**	**144,648**	**164,351**	**20,173**	**11,182**	**2,502,753**	**1,330,672**
Total Net expenditure reimbursable by EU	**3,160,561**		**332,510**		**308,999**		**31,355**		**3,833,425**	

D.30 *2017-18 balances include the latest available information. Some Managing Authority returns may be based on unaudited financial statements.

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Provisions for future financial corrections (disallowance)

D.31 As previously stated in Chapter 5, disallowance are financial corrections 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.32 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.33 As set out in Chapter 5, table D.4 show that the majority of provisions in 2017-18 is related to agricultural funding this is largely due to the size of the fund and the complexity of the regulations. DEFRA believe that the final disallowance associated with the audit of 2016-17 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.

Annex E
Impact of EU Withdrawal

Overview

E.1 The Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, endorsed by the European Council on 25 November 2018[1], sets out the financial settlement that was reached on the UK's rights and obligations as a departing Member State.

E.2 The settlement is based on three agreed principles that ensure a fair deal for UK taxpayers:

- The UK will not finance any commitments that do not require funding from Member States, and will receive a share of any financial benefits that would have fallen to it had it remained a Member State.
- The Withdrawal Agreement establishes the UK's share of EU obligations in the settlement. For 2019-20, the share will be based on the current methodology for determining the UK's annual EU budget contributions. For payments after the end of the implementation period, it will be based on the UK's average share of contributions to the EU during the current Multiannual Financial Framework. In other words, the UK's share will be the average of its share of the EU budget (taking into account the rebate) over 2014-20.
- The UK will not be required to incur expenditure earlier than would have been the case had it remained a Member State, although the Withdrawal Agreement allows for exceptions to be made in a few specific cases where it might be in both sides' interests to settle costs early. This is particularly relevant for pensions, where costs will decline steadily over a long-term period.

E.3 This annex provides a summary of the financial settlement and its estimated cost, alongside costs outside the financial settlement that are set out in the Withdrawal Agreement.

Scope of the financial settlement

E.4 The financial settlement addresses mutual obligations that arose primarily as a consequence of the UK's participation in the EU budget, and commitments

[1] https://www.gov.uk/government/publications/withdrawal-agreement-and-political-declaration

related to the UK's broader membership of the EU. It does not cover the costs of facilitating withdrawal or new administrative arrangements that may result from the UK's exit. There is also no obligation in the financial settlement to pay for the relocation of EU bodies previously located in the UK.

E.5 The financial settlement does not cover costs that might be associated with the UK's future relationship with the EU. The Government has been clear throughout this period that there are some specific European programmes in which the UK may want to participate. If so, and this will be for the UK to decide, it is reasonable that an appropriate contribution should be made. These decisions are subject to negotiations on our future relationship with the EU, and future decisions of Parliament.

E.6 The financial settlement has three main components:

- First, the UK will continue to participate in EU annual budgets to 2020. This means that the UK will continue to make its contribution and get receipts from EU budget programmes under the normal rules.
- Second, the UK will then pay its share of the EU's outstanding commitments at the end of 2020 (the so-called RAL) and again will benefit from some of these commitments.
- Third, the UK will pay a share of the EU's liabilities as at the end of 2020, and any materialising contingent liabilities, and in return will benefit from a share of relevant EU assets.

Participation in the European Union annual budgets in 2019-20

E.7 Under the financial settlement, the UK will contribute to the EU's budget for the rest of 2019 and 2020, which covers the implementation period following the UK's withdrawal. The UK will benefit from the implementation of the budget as if it had remained a Member State over this period. The UK will continue to draw advantages from the normal management of projects and programmes funded through the current Multiannual Financial Framework until their closure, whether they are managed by the UK Government (such as the European Regional Development Fund) or directly allocated to beneficiaries from EU institutions (such as Horizon 2020).

E.8 The Withdrawal Agreement guarantees that any amendments made to the Multiannual Financial Framework after withdrawal will not apply to the UK, and the UK will not be obliged to contribute to any additional funding beyond what is set out in the Withdrawal Agreement. The UK will also be unaffected by any changes to the core rules on budget revenue. This is to protect the UK from any such changes that are made after departure.

EU outstanding budget commitments

E.9 A normal consequence of the EU's multiannual approach to spending is that many payments are made some years after a commitment is made. This is because the EU budget finances projects that run over multiple years, and which are subject to financial controls and programme conditionality. As a result, at any given time there is a stock of outstanding commitments that are yet to be paid – referred to as reste à liquider or RAL. The Withdrawal Agreement sets out that the UK will pay its share of these commitments as at 31 December 2020 as these commitments fall due. The UK will also benefit from some of these commitments, since it will benefit from EU programmes committed under the Multiannual Financial Framework 2014-20 until the closure of those programmes.

Assets and Liabilities

E.10 The UK will pay its share of the EU's liabilities as at 31 December 2020, and will benefit from a share of EU assets in a number of ways. In some cases, for example property and buildings, the asset reduces or removes a liability that might otherwise have fallen to the UK. In others, for example investment assets, the UK will get a share of the profits and original investment as they mature.

E.11 The most significant residual liabilities are in relation to the pensions and other employee benefits of the members and staff of the European institutions. The UK will contribute towards those pensions rights accrued on or before 31 December 2020. The UK will pay its share of these pension rights as the costs fall due to the EU, unless the UK decides to settle this early.

E.12 The financial settlement also includes a number of contingent liabilities, most of which are currently reported to Parliament as remote contingent liabilities. These fall outside the scope of international accounting standards (IAS 37 on Provisions, Contingent Liabilities and Contingent Assets) because the possibility of an outflow of resources is remote.

E.13 In most cases these contingent liabilities will be limited to those that the EU has taken on up to the date of withdrawal. The exception will be costs associated with legal cases related to the budget and linked policies and programmes, which will be limited to cases where the facts relate to the period of the UK's participation in the EU budget (before the end of 2020).

E.14 Most contingent liabilities relate to guarantees on EU and European Investment Bank (EIB) financial operations, and are currently reported to Parliament in the UK's Consolidated Fund accounts as having a remote probability of crystallising.

E.15 In addition, the UK's EIB paid-in capital of €3.5 billion will be returned over 12 years, starting in December 2019. This will be made in 11 yearly instalments of €300 million and the final reimbursement will cover the balance of €195,903,950. The UK will maintain a two-part contingent liability in respect of the stock of outstanding EIB operations at the point of the UK's withdrawal, which will decrease in line with the stock.

E.16 The Withdrawal Agreement also sets out that the UK will be reimbursed for its paid-in capital of €55 million in the European Central Bank. The date of this reimbursement and other practical details will be decided in accordance with Protocol (No. 4) on the Statute of the European System of Central

Banks and of the European Central Bank.

Cost of the financial settlement

E.17 Following the publication of the Joint Report from the Negotiators of the European Union and the United Kingdom Government in December 2017, the Government provided a reasonable central estimate of the size of the financial settlement settlement of €40-45bn, or £35-39bn based on the exchange rate at the time. Since March 2018, the OBR have produced an estimate of the size of the financial settlement at each Spring Statement/Autumn Budget. This estimate is reported in their Economic and Fiscal Outlook (EFO), which is laid before Parliament. The most recent estimate was published in the March 2019 EFO and stood at £37.8bn.

E.18 Since the OBR's March 2019 publication, the Government has agreed an extension of the Article 50 period with the EU. This extension will affect the size of the financial settlement because contributions to the EU that would have formed part of the settlement will be made while the UK remains a Member State, which reduces the size of the settlement. So the UK will make further contributions in 2019 as a Member State, but there will be an equal reduction in contributions in 2019 under the financial settlement. The net effect on EU contributions is zero.

E.19 The Government will provide an updated estimate of the value of the financial settlement once the UK has left the EU.

E.20 Table E.1 sets out the principal components of the settlement on a gross and net basis. Table E.2 provides a breakdown of the main asset and liability items referred to in table E.1. The largest item is the UK's share of the EU's pension liabilities. The European Fund of Strategic Investments and Guarantee Fund for External Action refer to guarantee funds held by the EU in respect of their contingent liabilities for lending undertaken by other parties. As set out in table E.3, the UK also stands behind a share of those contingent liabilities.

Table E.1: Forecast of the gross financial settlement by component

Component	Time period	£ billion
MFF contributions	2019-20	26.4
RAL	2021-28	29.8
Net A&L	2019-64	2.3
Total (gross)		**58.6**
UK receipts	2019-20	- 10.5
UK receipts (RAL)	2021-28	- 10.2
Total (net)		**37.8**

Source: OBR Economic and Fiscal Outlook March 2019 (based on HMT analysis). Due to rounding, totals may not exactly correspond to the sum of individual items

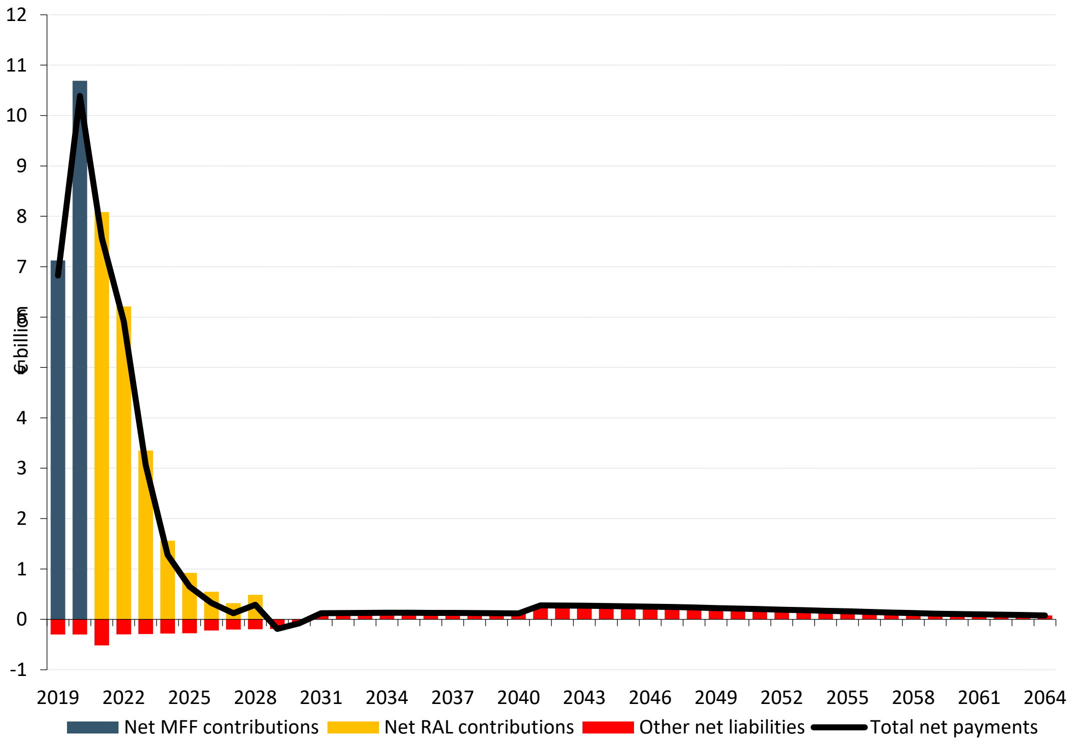
Table E.2: Profile of other net liabilities payments to the EU

Assets and liabilities	£ billion
Assets	
Fines	-1.0
Recoverables	-0.3
European Investment Bank	-3.2
European Fund of Strategic Investments	-1.0
Guarantee Fund for External Actions	-0.2
Financial Instruments	-0.7
European Central Bank	-0.1
2020 Surplus	-0.1
Liabilities	
Pension liabilities	9.0
Total	**2.3**

Source: OBR Economic and Fiscal Outlook March (2019, Fiscal Supplementary Tables (based on HMT analysis)

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

Chart E.1 Assumed annual path of EU financial settlement payments



Source: OBR; March 2019 EFO Fiscal Supplementary Tables

Contingent liabilities

Table E.3: Remote contingent liabilities, as at 31 March 2018

	At 31 March 2018 (£ millions)	(Restated) At 31 March 2017 (£ millions)
EIB: Callable capital subscription	31,288	30,528
European Financial Stabilisation Mechanism	6,740	6,959
Balance of Payments Facility	607	851
Third countries	2,466	2,472
European Fund for Strategic Investments	479	30
Other (macro-financial assistance, EIB lending, Euratom)	271	333
Total Loans Guaranteed by the EU Budget	**10,563**	**10,645**

Source: Consolidated Fund Account 2017-18[2]

E.21 Further details on these remote contingent liabilities are set out in the Consolidated Fund Accounts 2017-18.

Factors affecting the size of the settlement

E.22 In conducting sensitivity analysis on the financial settlement, the Treasury has considered the key individual variables within the settlement and the impact that a change in individual variables would have on the overall settlement value.

E.23 The final value of the settlement, by its nature, cannot be known definitively at present, since the settlement requires the UK and EU to pay only those amounts that fall due, rather than on the basis of a forecast. However,not accounting for the reductions arising form the extension to the Article 50 period as described above, the Treasury considers it unlikely that the final value, which will not be known for some years, will fall outside the estimated range.

E.24 The following are the main factors that could affect the value of the settlement. In future reports, if the Treasury considers the actual settlement is likely to fall outside its estimated range, it will set this out with an explanation of the factors that could lead to this.

Limits on EU expenditure and revenue

E.25 The ceilings of the Multiannual Financial Framework set the limits for how much the EU can commit over 2014-20, and therefore ultimately spend.

E.26 The settlement freezes the ceilings of the Multiannual Financial Framework 2014-20 for the UK, so that any changes agreed by Member States after the

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726585/CF_Annual_Accounts_2017-18_web.pdf

UK's withdrawal will not impact on the UK. This protects the UK not only during the transition period, but for the lifetime of the settlement. The EU's outstanding commitments at end-2020 cannot be larger than that agreed by the UK while it was a Member State.

E.27 The terms of the calculation of the UK's contribution, as set out in the Own Resources Decision, will also be frozen post-withdrawal. This protects the UK from any changes to rules for calculating revenue (including the UK's rebate) after withdrawal.

Profile of payments over 2019

E.28 EU Budget regulations permit the EU to request up to five twelfths worth of GNI/VAT contributions from Member States in the first quarter of any budgetary year. This 'draw-forward' of contributions is to allow the EU to handle budgetary expenditure pressures related to the European Agricultural Guarantee Fund. It does not give rise to any increase in revenue or expenditure during the year as a whole.

E.29 The estimated value of the financial settlement has always reflected that the Commission would follow this normal practice for 2019. Specifically, the OBR's latest forecast reflects the 4.7 twelfths of contributions requested by the EU for Q1 2019.

E.30 Ultimately, this factor does not affect the overall size of the UK's contributions to the EU budget. Instead, it only affects how much would be considered to be part of the UK's contribution while still a Member State, and how much would be considered part of the financial settlement after exit.

Decommitments

E.31 A key principle of the financial settlement is that the UK will only pay towards EU obligations that actually materialise. Both Treasury and OBR forecasts of the settlement therefore include an estimate of the EU spending that will be decommitted (planned, but ultimately never spent). The NAO reported in April 2018 on HMT's decommitments assumption, '*HM Treasury has estimated that 9.3% of all outstanding commitments after 2020 will be de-committed. The estimate is based on the de-commitment rate from outstanding commitments after 2013, the end of the last budget period. But this rate has fluctuated in previous budget periods. During the previous budget period (2007–2013) the de-commitment rate was 11.9%. If HM Treasury assumed the rate is going to be this high after 2020, its estimate would have decreased by €0.6 billion (£0.5 billion)*'[3]

UK Receipts

E.32 The forecast for UK receipts under the Financial Settlement is set out in Table E.1. This forecast assumes the UK's share of receipts from each heading will be the same percentage as that of previous years of this MFF. The UK's revenues from the EU may change in the context of withdrawal, although

[3] https://www.nao.org.uk/wp-content/uploads/2018/04/Exiting-the-EU-The-financial-settlement.pdf

this risk is mitigated because allocations for most EU expenditure in the UK have already been agreed.

E.33 Around three quarters of UK receipts are fixed automatically each year, through EU regulations or operational programmes. While subject to audit and potential correction, these amounts are generally less sensitive to year-by-year variation.

E.34 The remaining quarter of receipts are received through competitive grant programmes such as Horizon 2020, and by nature vary from year-to-year. Grants are assessed by neutral experts on the merits of the bid, and this remains the case for the UK under the terms of the Withdrawal Agreement.

Financing Share

E.35 The UK's financing share of the EU budget is calculated annually, and determines the amount of UK contributions to the EU Budget (taking into account the rebate) relative to all Member State contributions to the EU Budget.

E.36 Under the terms of the Withdrawal Agreement, the UK's financing share in 2019 and 2020 will be determined broadly as if the UK had remained a Member State. Beyond 2020, the UK's financing share will be equal to the ratio of UK own resources transferred to the EU over 2014-20 to total own resources transferred over 2014-20, taking into account the revenue adjustment exercises in 2021 and 2022.

E.37 Since nearly all the UK's own resources contribution to the EU between 2014 and 2018 has already been determined, there is unlikely to be any significant change to our current estimate of the overall 2014-20 financing share.

Exchange Rates

E.38 Under the terms of the financial settlement, the UK will continue to make its budget contribution in calendar years 2019-20 in sterling, before paying for any post-2020 obligations in euro. As a result, any movements in the euro-sterling exchange rate may affect the value of the settlement:

- Over 2019-20, changes in the value of sterling will affect the UK's financing share, as the UK's share of euro-denominated VAT and GNI bases will change. The sterling value of UK payments and receipts will also change.
- After 2020, changes in the value of sterling will still affect UK payments and receipts, but will no longer affect the UK's financing share, which is based on the average over 2014-20.

E.39 The Government does not have a target for the sterling exchange rate and does not comment on currency movements. In managing exchange rate risk with respect to public spending it applies the principles of *Managing Public Money*.

Balance sheet items

E.40 The main EU liability included in the financial settlement is in relation to EU pensions and other employment related benefits accrued by the end of 2020. These are predominantly unfunded defined benefit schemes where the final amounts paid to beneficiaries are affected by a number of factors, including the final salaries of the employees, their years of service and the length of time they live in retirement. The amount the UK pays will be affected by these factors. However, because the UK is only required to pay these amounts as they fall due many of the uncertainties in estimating pension liabilities (like the choice of discount rate used to convert the future flows into a lump sum amount) will not affect what the UK pays, unless the UK chooses to settle the obligation early, as provided for in the Withdrawal Agreement. The Treasury's estimate of the settlement used the EU's audited accounts for the pension liability, which is based on a low discount rate.

E.41 The UK will continue to stand behind contingent liabilities arising from EU financial operations approved before withdrawal. Several of these instruments have associated guarantee funds. These funds are held on the EU's balance sheet. The extent of returns to UK from these funds will depend on the financial performance of the funds and the underlying investments that are covered by the guarantees.

Treatment of EU receipts within the financial settlement

E.42 Under the financial settlement, the UK will continue to benefit from the implementation of the budget as if it had remained a Member State over the entirety of the current multiannual financial framework. This means that, subject to the normal audit and accountability requirements, all EU spending that is committed to the UK before the end of 2020 will be paid, even if those payments are due to be made in future years.

E.43 Payment of EU receipts is treated in national and Government accounts in different ways, depending on whether a Government body administers those receipts. Many 'public sector' receipts are in fact destined for the private sector (such as CAP, paid by managing authorities to the private sector). This distinction is therefore unhelpful in understanding the cost of the settlement. The OBR's March 2019 estimate of the financial settlement forecasts a total receipts figure and does not separate out those that will flow directly to the private sector.

Domestic replacements for EU spending

E.44 As receipts from the EU diminish, there will also be a direct cost to the public finances from any new domestic spending to replace financial support (to the public and private sectors) currently provided by receipts from the EU budget, or for the administration of services and functions currently provided by the EU.

E.45 The Government has pledged to commit the same cash total in funds for farm support until the end of the current parliament. This commitment will reflect the average annual funding provided for farm support under both Pillar 1 and Pillar 2 of the EU's 2014-20 Multiannual Financial Framework.

E.46 The Government is also committed to establishing a UK Shared Prosperity Fund to reduce inequalities between communities across the UK, and our four nations, after we have left the EU Structural Funds.

E.47 Any new domestic spending on replacements for EU programmes beyond 2020 will be decided at the next Spending Review.

Off-budget funds outside the financial settlement

E.48 There are a number of areas where funds, bodies and organisations have been established outside the EU Treaties through separate international agreements, but are managed by EU institutions or are in close alignment with EU policies. The Withdrawal Agreement makes provision for these to ensure there is certainty on how they will be treated. These mainly relate to development funding, where UK contributions are treated as Official Development Assistance (ODA) and count towards the UK's target for ODA spending of 0.7% of GNI. They are set out in the Department for International Development's DEL spending estimate and accounts.

E.49 The Government considers payments and receipts in relation to these to be outside the financial settlement. It does not expect to meet the cost of contributions to the European Development Fund (EDF) and bilateral contributions to the Facility for Refugees in Turkey or EU Trust Funds through authority granted by the Withdrawal Agreement Bill.

Table E.4: Outstanding off-budget development contributions, as at 31 March 2019

Outstanding off-budget contributions, as at 31 March 2019	At 31 March 2019	(€ millions)	(£ millions)[4]
European Development Fund[1]		3340.1	2866.8
Facility for Refugees in Turkey[2]		169.6	145.8
Emergency EU Trust Fund for Africa[3]		3.2	2.7

Sources:

[1]HM Treasury calculations using EDF internal agreements and EU Commission annual communications forecasting commitments, payments and contributions from Member States.

[2]Combined total of the UK's outstanding contribution to the first tranche of the Facility (which is sourced from DFID's Development Tracker: https://devtracker.dfid.gov.uk/projects/GB-GOV-1-300287/documents) and the UK's share of the second tranche, based on internal DFID/EU Commission figures.

[3]EU Commission website on EU Emergency Trust Fund for Africa: https://ec.europa.eu/trustfundforafrica/content/trust-fund-financials_en

[4] Assuming exchange rate as published in the Official Journal of the European Union, for 29 March 2019. €1 = 0.8583.

European Development Fund

E.50 Under the Withdrawal Agreement, the UK will honour its commitment to the current and previous European Development Funds. The EDF derives from the European Union's Cotonou Partnership Agreement. The eleventh and latest EDF covers the commitment period from 1 January 2014 to 31 December 2020, though payments relating to these commitments will continue to flow after 2020. It provides support to 79 African, Caribbean and Pacific (ACP) countries and Overseas Countries and Territories (OCTs) to eradicate poverty, support sustainable development and integrate ACP countries into the world economy. UK Overseas Territories will benefit from the current and previous EDFs until their closure.

E.51 Each year, the European Commission is legally obliged to provide statements of forecasted commitments, payments and the annual amount of the calls for contributions to be made in that year and the following two budget years to both the EDF and its Investment Facility, managed by the EIB. The Commission also provides forecasts for a further two years, which are non-binding estimations.

E.52 The most recent statements from the Commission details contributions in 2018 from Member States and forecasts of commitments, payments and contributions from Member States for 2018, 2019, 2020 and non-binding forecast for the years 2021-2022. The forecast UK contributions are summarised in Table E.4 . Although the Commission has not yet produced contribution forecasts for years after 2022, based on the most recent Commission statement the Government expects EDF contributions to continue to the mid-2020s.

E.53 Under the terms of the Withdrawal Agreement, the UK is entitled to its share of contributions to the EIB-managed Investment Facility, subject to any losses. The Investment Facility was set up in 2002 and financed by the 9th, 10th and 11th European Development Funds. As at end-2017, the UK had contributed €329mn[4] (£295mn) to the facility. By the end of 2020, the UK's share is estimated to be €502mn[5] (£449mn), less any loss.

E.54 Under the terms of the Withdrawal Agreement, the UK will also remain liable in respect of its guarantee to EIB own resources lending to ACP countries and the OCTs, as laid out in the EDF financing protocols under the Cotonou Agreement. Any calls on this guarantee would need to be met collectively by the UK and other EDF contributors in proportion to their respective shares in the agreements. Subsequently, the UK will be entitled to any share of amounts recovered in the event of a guarantee pay-out.

Table E.5: UK contributions and forecast contributions to EDF, as at 31 March 2019

Year	(€ millions)	(£ millions)[1]
2019	690	592
2020	720	618
2021	*631*	*542*
*2022**	*572*	*491*

Source: Commission Communication October 2018:
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0689&from=EN
[1] Assuming exchange rate as published in the Official Journal of the European Union, for 29 March 2019. €1 = 0.8583.
**Contributions for years after 2022 have not yet been forecast.*

EU Trust Funds and the Facility for Refugees in Turkey

E.55 The UK will also honour commitments it made to the Facility for Refugees in Turkey and the EU Trust Funds. As with EDF, these contributions count as ODA, with bilateral contributions currently paid using powers provided in the International Development Act 2002. The Government expects this practice to continue for these remaining commitments.

Future reporting on the financial settlement

E.56 The Government has set out proposals for reporting to Parliament on the financial settlement in its *White Paper: Legislating for the Withdrawal Agreement between the United Kingdom and the European Union.* The White Paper confirms that the Government will maintain its commitment to report regularly on the financial settlement.

Short-term public expenditure costs of EU exit

E.57 There have been short-term public expenditure costs associated with preparing for EU exit. In total over £4.2bn has been allocated by the Government to prepare for EU exit since 2016. This includes allocations of £400m at Autumn Budget 2016 and over £250m from the Reserve in 2017-18. Moreover, Autumn Budget 2017 committed an additional £3bn over

[4] https://www.eib.org/attachments/country/if_financial_statements_2017_en.pdf)

[5] This figure is based on the UK's share of total Investment Facility for the 9th, 10th and 11th EDF's, as detailed in their respective Internal Agreements.

2018-19 and 2019-20 to help departments and the devolved administrations to prepare for the UK's exit from the EU. In addition, at Budget 2018, the Chancellor made available an additional £500m for 2019-20. The most recent set of allocations – for 2019-20 – were set out in the Chief Secretary to the Treasury's Written Ministerial Statement of 18 December 2018. This funding is part of the Government's continued work to ensure the UK is ready to take full advantage of the opportunities created following our departure from the EU.

E.58 Table E.6 sets out departmental spending allocations regarding EU exit spending for financial years 2016-17 to 2019-20

Table E.6: Departmental allocations: EU Exit funding allocations 2016-17 to 2019-20

Department (£m)	16/17	17/18	18/19	19/20	Total
Cabinet Office		6.6	49.4	58.8	**114.8**
Competition and Markets Authority		1.0	23.6	20.0	**44.6**
Department for Business, Energy and Industrial Strategy		35.1	185.1	190.0	**410.2**
Department for Culture, Media and Sport		3.0	26.2	30.0	**59.2**
Department for Environment, Food and Rural Affairs		67.5	310.0	410.0	**787.5**
Department for Exiting the European Union	327.1				**327.1**
Department for International Trade	79.4	29.8	74.0	128.0	**311.2**
Department for Transport		19.6	75.8	25.0	**120.4**
Department of Health and Social Care			21.1	50.0	**71.1**
Department for Work and Pensions				15.0	**15.0**
Food Standards Agency		0.9	14.0	16.0	**30.9**
Foreign and Commonwealth Office	5.2	6.8	29.6	45.0	**86.6**
HM Revenue & Customs		41.7	260.0	375.0	**676.7**
HM Treasury		14.1	24.8	35.0	**73.9**
Home Office		60.0	395.0	480.0	**935.0**
Law Officers' Departments				2.7	**2.7**
Ministry of Defence			12.7	12.0	**24.7**
Ministry of Housing, Communities and Local Government				35.0	**35.0**
Ministry of Justice			17.3	30.0	**47.3**
Northern Ireland Office		0.3	0.4	1.1	**1.8**
Office for National Statistics			2.0	2.4	**4.4**
Police Service of Northern Ireland				16.0	**16.0**
Scotland Office		0.3	0.3	0.3	**0.9**
Single Intelligence Account				2.7	**2.7**
The National Archives			1.2	2.1	**3.3**
The Supreme Court				0.5	**0.5**
Wales Office		0.3	0.3	0.3	**0.9**
Total	**411.7**	**287.09**	**1522.8**	**1982.9**	**4204.5**
Barnett Consequentials (not necessarily ringfenced for EU exit)					
Northern Ireland Executive		2.4	15.2	20.9	**38.5**
Scottish Government		6.6	37.3	54.7	**98.6**
Welsh Government		3.7	21.4	31.1	**56.2**
Total		**12.7**	**73.9**	**106.7**	**193.3**

Sources: 16/17: Autumn Statement 2016; Supplementary Estimates 17/18; Supplementary Estimates 18/19; Main Estimates 19/20
NB. This table excludes i) exit expenditure funded by departmental reprioritisation and ii) ad hoc claims on the Reserve in 19/20.

Future relationship with the EU

E.59 The terms of any financial contribution to the EU consistent with the Political Declaration will be a matter for future negotiations, though the Political Declaration Setting Out the Framework for the Future Relationship between the European Union and the United Kingdom, published on 25 November 2018, includes the following, which sets out where future expenditure may be incurred:

> **Box E.1: The Political Declaration Setting Out the Framework for the Future Relationship between the European Union and the United Kingdom**
>
> 'Noting the intended breadth and depth of the future relationship and the close bond between their citizens, the Parties will establish general principles, terms and conditions for the United Kingdom's participation in Union programmes, subject to the conditions set out in the corresponding Union instruments, in areas such as science and innovation, youth, culture and education, overseas development and external action, defence capabilities, civil protection and space. These should include a fair and appropriate financial contribution, provisions allowing for sound financial management by both Parties, fair treatment of participants, and management and consultation appropriate to the nature of the cooperation between the Parties.'

E.60 Neither the Government nor the OBR has made forecasts of the net cost of additional financial contributions that the UK might be required to make to the EU over and above the estimate of spending on EU programmes described above. It would not be possible to model or forecast any of these potential payments without a detailed blueprint of the UK's future relationship with the EU – including specifying those agencies and programmes (if any) in which the UK would choose to continue to participate. Furthermore, any such payments would have to be negotiated with the EU, as part of the overall future agreement. It is not possible to predict the outcome of that negotiation.

E.61 Where the UK no longer participates in EU programmes, the Government will need to consider the merits of providing similar services or functions domestically. It is not possible to say now what those costs will be.

E.62 The OBR take a fiscally neutral approach to their post-Brexit spending forecast assuming that, when the UK leaves the EU, any reductions in the UK's net expenditure transfers to the EU will be fully recycled into extra spending. This includes the Government's already stated commitments on farm support and the UK Shared Prosperity Fund, outlined earlier.

Wider fiscal impact of withdrawal

E.63 There are further direct and indirect fiscal consequences associated with leaving the EU. In November 2018, the Government published EU Exit: Long-term economic analysis.[6] This analysed the potential costs and benefits of withdrawing from the European Union, looking at alternative future economic relationships with the EU, and including sensitivity analysis. It described both direct and indirect fiscal impacts.

E.64 Indirect fiscal impacts are those related to changes to the size and structure of the economy after the UK leaves the EU, which have implications for tax receipts and welfare spending. The direct fiscal impacts captured the additional fiscal costs and savings that are not primarily driven by changes in the size of the economy, including the UK's future financial relationship with the EU, potential customs revenue, and spending incurred by the UK Government to replace and administer EU programmes and services currently provided by the EU. In all modelled scenarios, net indirect fiscal impacts add to public sector net borrowing, while net direct fiscal impacts reduce it. In the modelled White Paper scenario, assuming no change to migration, the direct and indirect fiscal impacts are relatively modest, and of a similar size. In all other modelled scenarios, the indirect fiscal impact is several times greater than the direct impact. These results are summarised in Tables E.7 and E.8.[7]

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/760484/28_November_EU_Exit_-_Long-term_economic_analysis__1_.pdf

[7] The full fiscal analysis and a description of the results can be found in Section 4.8 of the *EU Exit: Long-term economic analysis* publication

Table E.7: Summary of impact on public sector net borrowing compared to today's arrangements, for the illustrative no change to migration scenario

Compared to today's arrangements as a percentage of GDP in 2035-36	Modelled no deal scenario	Modelled average FTA scenario	Modelled EEA-type scenario	Modelled White Paper scenario
Net direct impacts	-0.6 (-£22.0bn)	-0.2 (-£7.0bn)	0.0 (-£0.9bn)	-0.2 (-£7.0bn)
Net indirect impacts	+2.7 (+£104.2bn)	+1.7 (+£67.4bn)	+0.5 (+£19.6bn)	+0.2 (+£8.9bn)
Debt interest	+0.3 (+£12.8bn)	+0.3 (+£11.6bn)	+0.1 (+£3.8bn)	0.0 (-£0.5bn)
Additional borrowing associated with EU exit	+2.4 (+£95.1bn)	+1.8 (+£72.0bn)	+0.5 (+£22.5bn)	0.0 (+£1.3bn)

Source: EU Exit: Long-term economic analysis, November 2018

Table E.8: Summary of impact on public sector net borrowing compared to today's arrangements, for the illustrative zero net inflows of EEA workers scenario.

Compared to today's arrangements as a percentage of GDP in 2035-36	Modelled no deal scenario	Modelled average FTA scenario	Modelled EEA-type scenario	Modelled White Paper scenario
Net direct impacts	-0.6 (-£21.2bn)	-0.2 (-£6.9bn)	N/A	-0.2 (-£7.0bn)
Net indirect impacts	+3.2 (+£123.4bn)	+2.2 (+£87.2bn)	N/A	+0.7 (+£29.7bn)
Debt interest	+0.4 (+£16.9bn)	+0.4 (+£15.7bn)	N/A	+0.1 (+£3.8bn)
Additional borrowing associated with EU exit	+3.1 (+£119.1bn)	+2.4 (+£95.9bn)	N/A	+0.6 (+£26.6bn)

Source: EU Exit: Long-term economic analysis, November 2018, updated with HMT calculations (central estimates only)

Direct impacts include departmental spending on administration, the UK-EU financial settlement, future EU financial contributions, spending on EU related programmes, customs revenues and EU Budget savings.

Indirect impacts include migration, NTBs, tariffs, regulatory flexibilities and rest of world trade.

E.65 The Government also published a *Technical Reference Paper* to explain the methodology[8]. For EU programmes, it is assumed that in the long run the UK either continues to participate in EU programmes and pays the cost of receipts, or replaces the activity domestically at equivalent cost. For departmental spending to administer services and functions which are currently provided by the EU, the assumption for spending in future years is based on funding allocated for EU exit preparations in 2019- 20. These are, of necessity, simplifying assumptions. Without further detail on the future UK-EU relationship, including how these services and functions are to be provided, it is not possible to provide more robust estimates. However, given the relative sizes of the effects, plausible changes to the assumptions on these direct costs would make little difference to the overall conclusions of the analysis.

8 https://www.gov.uk/government/publications/exiting-the-european-union-publications

HM Treasury contacts

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If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk