

Public Accounts Committee

Oral evidence: Financial management of the European Union budget in 2014, HC 730

Thursday 25 February 2016

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Members present: Meg Hillier (Chair), Mr Richard Bacon, Deidre Brock, Chris Evans, Caroline Flint, Kevin Foster, Mr Stewart Jackson, Nigel Mills, David Mowat, Stephen Phillips, Mrs Anne-Marie Trevelyan

Peter Gray, Director, Adrian Jenner, Director of Parliamentary Relations, John Thorpe, Executive Leader, National Audit Office, and Richard Brown, Treasury Officer of Accounts, were in attendance.

Witnesses: Nick Joicey, Director General, Strategy, International, Food and Farming, Department for Environment Food and Rural Affairs, Jacinda Humphry, Finance Director, Department for Communities and Local Government, and Jonathan Black, Director, Europe, HM Treasury, gave evidence.

Chair: Welcome to the Public Accounts Committee on Thursday 25 February 2016. We are here to examine the financial management of the European Union's budget—arguably a hot topic at the moment. The purpose of the session is not for us all to parade our views—we all have views, obviously, around the Committee table—but to shed some light on how the EU budget is managed, both within the UK and more widely. So that is what the purpose of our first panel is.

We want to get into how the institutions are managing the overall budget, and how the UK is managing the individual budgets, which is why we have got three Departments in front of us. We want to have a reasoned hearing where we can contribute factually to the intense public interest and debate on how British money and other money is spent by Europe.

We have as our first panel three representatives from Government Departments. I am delighted to welcome Jacinda Humphry from the Department for Communities and Local Government, Jonathan Black from the Treasury and Nick Joicey from the Department for Environment, Food and Rural Affairs. Anne-Marie Trevelyan and Caroline Flint will be doing the bulk of the questioning, but obviously other Members will be chipping in as well. We are expecting this part of the session to last about 45 minutes. If you answer too long-windedly I may cut you short, so

I warn you in advance. We have a Twitter hashtag today—#eufinance, for anyone who is a Twitter fan.

Q1 Mrs Trevelyan: I am a new member of the PAC. This has been an interesting Report for me to get my head round the complexities and realities, as opposed to some of the myths that exist out there on this big black hole that is the financial management of EU funds. To all of you in turn: what challenges do you face within your areas in administering EU funds?

Nick Joicey: Thank you, Chair, for your welcome. The primary challenge that we face in DEFRA is how we ensure that we use those EU funds to deliver against our strategic objectives. We published, last week, our strategic departmental plan that sets out our key priorities. Clearly, the payments to farmers and to environmental schemes using the EU moneys are an important part of that.

The particular challenges in that area that I would highlight are ones around, first, the simplification of the common agricultural policy. We are working very closely with Commissioner Hogan on how we achieve that simplification. Also, in terms of our delivery of those funds, we are considering how we tackle the disallowance problems that we have faced. That is a key priority for us as a Department—across the whole DEFRA group—and as such it features heavily in our priorities for the next five years.

Chair: We had a hearing on the CAP rural payments not that long ago.

Jacinda Humphry: With the ERDF, I think that historically one of the issues for us has been the complexity—the distributed way in which the ERDF has been managed through regional organisations. As we move into the 14-20 programme, one of the key simplifications that we have undertaken to address that is to bring the programme together under a single departmental leadership, which is DCLG.

That should make a really big difference to the simplification agenda for us, and allow much more central control and support around procurement, which has been the historical weakness of the programme and the procurement processes—

Q2 Mrs Trevelyan: Is it effectively centralised? So the regional management has gone effectively?

Jacinda Humphry: Effectively, with the single exception of London. At the moment, we have London as an intermediary body, because London has the capacity and scale to manage the programme in that way. Generally, however, the programme is centrally managed; there is a single authority, the ERDF.

Q3 Mrs Trevelyan: Were we doing it regionally out of choice before? It wasn't an EU framework that fed the ERDF programmes down to the—that was our choice, as a UK Government, to do it at a regional level?

Jacinda Humphry: Yes.

Q4 Mrs Trevelyan: So we are free now to simplify?

Jacinda Humphry: We are free. I mean, we negotiate it, we discuss it with the Commission, but this is the new approach for the 14-20 programme. We are very confident that we'll address one of the issues for us, which has been the rate of error in the system.

Q5 Chair: Can I just be clear? What you are really saying is that a lot of the complications were because of the way the UK chose to implement the—

Jacinda Humphry: Some of the complications, and some of the errors and complexities, were because of the way it was organised, but to some extent the ERDF will always be a distributed system, because it is delivered through local areas and through local enterprise partnerships. What we're not saying is that this will be completely centralised and controlled. The LEPs have had a really active role in defining what the priorities are for local areas and working with local areas.

Q6 Chair: My point was that it was in the hands of the Department, or the Government in the UK to simplify it from where it was, to some extent.

Jacinda Humphry: Yes, in collaboration with the Commission.

Q7 Mrs Trevelyan: On that, do you think that it is going to give you—I might come back to Mr Joicey, as well—a better handle of answering the question, “Is there EU added value to that investment coming from the EU into the UK?”?

Jacinda Humphry: What it has helped us to do at the outset of the 14-20 programme is to work with the LEPs and the European Commission to be really clear about the ways in which we will assess value from the programme, and have a shared view of that. So the answer to that question is yes.

Q8 Mrs Trevelyan: And there is an individual—an accountable officer within DCLG—who has responsibility for monitoring that and coming up with the conclusion in 2020 on whether it has improved the added value?

Jacinda Humphry: I don't know the answer to that question. Can I come back to you?

Q9 Mrs Trevelyan: Yes, that would be great. Thank you. I will just ask the same question to Mr Joicey. In terms of monitoring—I know that simplification hasn't hit DEFRA yet, but we're hopeful and we look forward to it when it does—is there someone within the Department who has that oversight and who will report back on whether progress is made, on simplification and therefore on the added value that simplification might bring?

Nick Joicey: In terms of our approach to CAP in the round, and given your own earlier report and other messages around that, this is really one of the top priorities for the Department. The

executive committee chaired by our permanent secretary, Clare Moriarty, has this as one of the main priorities. Clare Moriarty, as accounting officer, will take responsibility for it.

As for the simplification of the CAP and the improvements in the delivery of payments, within the Department, across the DEFRA group, Mark Grimshaw at the Rural Payments Agency is now the senior reporting officer for the CAP delivery programme, so he has responsibility for that element of it. As the DG for food and farming, I have responsibility for the delivery of the food and farming element of our strategy.

Q10 Mrs Trevelyan: Thank you. Mr Black, from the Treasury's perspective, what are the challenges in administering this fund?

Jonathan Black: First, thank you for doing this inquiry; it was timed well with the NAO's Report.

The Treasury's role is obviously a bit different from that of other Government Departments, in the sense that other Government Departments, or the Administrations in Scotland, Wales and Northern Ireland, are responsible for the expenditure of their programmes. The Treasury's role is cross-cutting.

I would highlight two roles that we play in the priorities or challenges. The first is being responsible for the overall budget at the European level. Particularly as we are a net contributor to the budget, one of the most important aspects in terms of value for money for the British taxpayer is maintaining control of the overall cost of the budget. Within that we have a series of priorities that are shared across Government—Nick and Jacinda talked about them—for example, on the performance side, a stronger focus on the objectives and outcomes of the expenditure, and on the administration side, the simplification and the focus of the budget. We use our role at the European level, in negotiating both the overall seven-year budget and the annual budget and all the processes that go with that, to try to focus that at a European level.

The second bit is working with other Government Departments on areas of a common agenda that we all share. To give you an idea of how the Treasury does that, I am personally responsible for our European policy—I do the facing with Europe. As you will be aware, we have teams in each part of the Treasury that work with different Departments and we embed our interest in European spending as part of that so that we can consider how European and national expenditure align together.

Q11 Mrs Trevelyan: That is helpful. So, you have this team feeding into the EU framework in terms of simplification; do you think you are being listened to? Are we seeing progress? There is talk about the simplification agenda, but is it actually happening? Do you feel that progress is being made?

Jonathan Black: Nick and Jacinda may want to comment on the specific programmes, but I think we are moving down the road and making some progress, but it is a continuing road and there is still more to do.

Let me give you a couple of examples. As part of the new seven-year budget deal that was agreed in 2013, we have agreed a so-called common provision regulation for all the different

structural funds as a single regulation. That is a good thing, but it is fair to say that there is still more we can do to simplify that further. Secondly, as part of the new financial regulation for the seven-year period, we have agreed a stronger role for national audit agencies—the NAO and the Government Internal Audit Agency—in auditing expenditure. Those are two examples of what we have done on the seven-year period.

We are now about to head into the mid-term review of the budget, which is focused on the expenditure side. A very big priority for us will be the administration and simplification and how well the money is spent. Some Committee members may have been to Brussels and may have met Vice-President of the Commission Georgieva. This is a genuine priority for her “Budget Focused on Results” agenda. It is something we support very strongly and have been feeding into. For example, the UK is a world leader on the use of digital data to bring extra transparency, so we have been working with her on that.

Those are some examples of what we have been doing. We have taken some steps, but there is more to do and we need to use things such as the annual budget and the mid-term budget review as levers to continue that work.

Q12 Mrs Trevelyan: Can you say to me now three things that we are pushing into the EU that we want to see for simplification and more transparency? When we hit 2020 and reach the end of this MFF, are there three things on which you’ll all say, “Brilliant. The next one’s going to look a whole lot better because those three things have come through”?

Jonathan Black: I would highlight a stronger focus on objectives and outcomes up front. I think that is important. It is related to both the simplicity of the budget and its effectiveness. It is certainly something that we see as a priority, and I think the ECA has highlighted it in its report. Certainly, further simplification of some of the regulations, and linked to—

Q13 Mrs Trevelyan: Specifically, because there are lots of regulations, you are not going to get everything, so are you going to pick one and fight for it?

Jonathan Black: As I said, there is the new common provision regulation, which covers the whole structural fund. So you have the five different elements of structural funds, four of which apply—

Q14 Mrs Trevelyan: But you are saying that is in place now?

Jonathan Black: That is in place, but—

Q15 Mrs Trevelyan: So, looking forward—

Jonathan Black: My point is that that is in place, but I think more can be done to simplify that further, both in terms of regulation and how it then works in practice, in terms of administration.

Q16Mrs Trevelyan: Okay, so ensuring it does do what it says on the tin.

Jonathan Black: Indeed. Then the third thing—this becomes a bit more granular—is about focusing on areas in terms of practical questions around where error is. That has been one of the biggest challenges, and there is a lot of work ongoing on that. I just wanted to say a bit about it, because a lot is being done on it, for example, around procurement, which has been a persistent thing. When you ask if there are three things, my message is that those are the three umbrellas, if you like, but actually, this is about a substantial ongoing piece of work. It is really about focusing on the detail.

Q17 Chair: Before Anne-Marie comes back in, on this issue about practical questions about error, are you talking about error in spending within the UK that the Treasury is wanting to improve on, or are you talking about error more widely?

Jonathan Black: I think both. From a Treasury perspective, we obviously have an interest in how the overall EU budget is spent across the Union as well. Some of the issues are common. For example, on procurement, those are common challenges that are faced across all member states.

Chair: I am sure we will come back to that.

Q18Mrs Trevelyan: This is a key question that I would be negligent in not asking. Departmentally, at this point, there is presumably work ongoing strategically about whether there is a leave result on 23 June. How do you manage that at this point and strategically going forward if that is the outcome? If the result is remain, then we presumably continue as we are, but if it is leave, it will be interesting to hear how your strategic planning is looking at that.

Jonathan Black: The Government's position is to remain a member of a reformed European Union, and that is what we are looking towards.

Mrs Trevelyan: That was not really my question. Surely, if I asked the Foreign Office, they would not tell me they do not plan what to do in case Putin invaded. I can only assume that any sensible—

Mr Bacon: Actually, knowing the Foreign Office, it's quite likely that they don't.

Q19Mrs Trevelyan: Okay, sorry—naive choice. In terms of strategic planning, you must do work. I come from a farming constituency, and the questions there are practical ones. Is there strategic work going on to think through how you would do things differently in that position?

Jonathan Black: As I said, the Government's position is to remain in a reformed European Union. The focus of what we have been talking about here is how we will seek to continue to improve the value for money and simplicity of the budget as a member of the EU, which is what we are now.

Q20 Stephen Phillips: Mr Black, you can say it: there is no strategic planning going on in the event of a vote by the British people to leave the European Union. That's right, isn't it?

Jonathan Black: The Government's position is to remain a member of a reformed European Union.

Q21 Stephen Phillips: Right. There is no planning going on within the civil service as to what happens if Britain votes to leave the European Union, is there?

Jonathan Black: The work that we are doing is focused on ensuring that the EU budget, which we are part of as a member of the European Union, is structured and spent as wisely as it can be.

Q22 Chair: Mr Black is an official; I think we need to remember that. Mr Joicey, Anne-Marie Trevelyan has raised an important issue about farmers and the amount of money they get from the common agricultural policy through rural payments. Do you have any idea what they stand to lose or gain if Britain were to vote to leave the European Union on 23 June?

Nick Joicey: I would reiterate the point that Mr Black made. As a civil servant, I serve the Government of the day by implementing their priorities. In that respect, we are very focused in DEFRA on the delivery of payments to farmers at the moment, from the performance and delivery perspective, and on the simplification agenda and working with Commissioner Hogan on that.

In terms of your point about food and farming, I would pick up on the comments that our Secretary of State made at the NFU conference earlier this week, underscoring the importance of the European Union as a market for UK food and farming.

Q23 Mrs Trevelyan: I completely understand your position. Going forward, the CAP is the biggest chunk of money that comes back to us to redistribute. Do you feel you are getting support from the EU to help make progress in simplifying and reducing as a result the disallowances within that framework? As we all know, it has been a very challenging year, but it does not feel like you are getting the support as a Department from the EU to help you make progress.

Nick Joicey: The first thing I would say is that we think there is significant scope to reduce the burdens on farmers and on national authorities through the way in which the common agricultural policy works. That partly flows from the current CAP and the last set of CAP reforms; a complicated CAP was introduced through those. We have been working closely with Commissioner Hogan and his team in DG AGRI on the simplification agenda. It is encouraging that Commissioner Hogan has put forward simplification of the CAP as one of his priorities for this Council. We have seen some progress in some areas, but as I said, we think there is still a lot of scope to reduce those burdens.

Chair: I think you put that very mildly. I think farmers up and down the country are saying there is more than a lot of scope.

Q24 Caroline Flint: Good morning. We are discussing the financial management of the European Union budget in 2014. It is useful, for the record, to say that the European Court of Auditors has given a true and fair opinion on the accounts of the EU since 2007. Some members of the public might not even believe there are such accounting procedures in the EU, given some of the publicity given to activities when it comes to finance and our membership of the European Union.

It is quite helpful having you here today, because there seems to be in the Report a number of concerns from the ECA about the legality and regularity of EU payments. For 21 years, the ECA has given an adverse opinion on that. From what I understand, 80% of funds from the EU to member states, including the UK, are co-managed, which basically means that yourselves and others across Whitehall are responsible, working with others here in the UK, for passing funds on and making sure that is done in a proper manner.

I think that 20% of EU funds are managed directly by the Commission. On page 40 of the NAO Report, in paragraph 3.15, it says: "In 2014, 80% of UK public-sector receipts from the EU budget related to two funds: EAGF and ERDF." If we look at figure 22, we see that when it comes to disallowances—for the public viewing this, that means fines in one way or another—the UK is the sixth worst in the European Union. That pretty much comes down to your Department, Mr Joicey. Why are we doing so badly on this compared with France, Italy, the Netherlands, Slovenia, Denmark, Sweden, Poland, Spain, Luxembourg, Lithuania, Hungary, Malta, Finland, Belgium—I could go on?

Nick Joicey: Tackling disallowance and bringing down disallowance is a central priority for me and for the DEFRA group. The figures that I quoted here are for between 2005 and 2015. We did face a very high disallowance bill in 2005 and 2006 as a result of the problems that we faced then. In the period since then, we did take action to address those problems. That included investment that the Rural Payments Agency made in updating its mapping system, in giving new tools to its inspectors and in putting in place a director of compliance who is solely responsible for bringing down disallowance. That has meant that we have been able to reduce the disallowance bill from the 5% that we faced in 2005 to around 2% now—clearly it varies on a year-by-year basis. I think we absolutely recognise that we still have a lot to do in tackling disallowance.

Q25 Caroline Flint: I think that is laying out that you understand the problem and you have made efforts, but I am still not really hearing what practical changes have happened as a result of that. According to the NAO Report into the CAP delivery programme from December 2015, since 2005 DEFRA has incurred £642 million worth of disallowance penalties. We all want to see simplification but given that figure 22 shows that we are the sixth worst when it comes to these two big funding streams, what have you learnt from other countries that seem to be doing better than the UK in administering EU funds?

Nick Joicey: In terms of looking at that table, absolutely we recognise that we can learn from other countries and that is one of the things that we are looking to do.

Chair: You are looking to do it—

Mr Bacon: Is it a spectator sport?

Nick Joicey: We have learnt lessons from other countries in terms of some of the reforms that we have put in place.

Q26 Caroline Flint: What is the biggest lesson that you have learnt?

Nick Joicey: The biggest lesson that we have learnt is around the critical importance of the data and information that we hold on land and our land management system. We did take steps earlier at the Rural Payments Agency to update the data that we were using to make payments. However, we need to make further investment in our land management capability and the technology that we have to manage that.

Q27 Caroline Flint: I am hearing from that that basically the responsibility for the problems with administering some of these funds—not in totality, but a large proportion of it—was based on our systems here in the UK not being up to the job.

Nick Joicey: I think the problems that we faced, going back to 2005 and 2006—as I said, the disallowance bill was particularly high in those years—did reflect decisions that we had taken about how to implement—

Q28 Caroline Flint: It is a simple thing. You said it is about our data systems in land management and this is a big issue because the payments are based on area. It is a simple question. A large proportion of the problems that incurred these disallowance penalties were to do with our systems in the UK rather than something to do with the EU.

Nick Joicey: As I say, dating back from 2005 and 2006. We now have a disallowance strategy for the next five-year period. As I say, we set out in our strategic environmental plan—

Q29 Caroline Flint: At the moment, according to figure 22—this is based on the 2014 Report—if I am correct we are being fined £2.70 for every £100 spent. That compares with Germany at 0.1—sorry, 10p in every £100 spent. Germany is being fined 10p for every £100 and we are being fined £2.70 for every £100. Where do you think that figure of £2.70 will go as a result of these changes to how you approach reducing disallowances?

Nick Joicey: On the changes in approach, we have put in place a disallowance strategy, which was a focus of our spending review discussions with the Treasury last year. For the first time, we focused on disallowance, which was a major part of those spending review discussions, and we have put in place a disallowance strategy.

Q30 Mr Bacon: Can you say that again? It was the first time that it was a part of the spending review discussions?

Nick Joicey: No, sorry, it was not the first time that it was a part of the spending review discussions. For the first time we have a joint strategy for the reduction of disallowance that we have agreed with the Treasury, and we are going to involve the Treasury in the governance of that disallowance structure.

Q31 Mr Bacon: So 10 years after all those problems—10 years after the original problems with administering the single payment scheme—10 years later you have for the first time developed a strategy jointly with the Treasury. Is that what you are saying?

Nick Joicey: I am saying that we are putting in place—

Q32 Mr Bacon: So it's present continuous: "We are putting in place; we are looking at."

Chair: Can we let Mr Joicey finish? Then we need to bring Jonathan Black in.

Nick Joicey: We have a joint disallowance strategy. Under that strategy, we are investing in technology to reduce the disallowance risk. That includes a £45 million investment in the land management information system, which is designed to deliver improvements in disallowance.

Chair: I am anxious that we do not discuss the whole CAP report, which we will be publishing next week.

Q33 Caroline Flint: I do not want to leave DCLG out of this. Obviously, DEFRA is a major recipient of EU funding, but DCLG does not do too badly, either. About £2.8 billion out of the MFF is going to DCLG from 2014-2020. The NAO Report notes that, in 2014-15, DCLG closed three cases relating to ineligible payments at a cost to DCLG of £8.1 million. Whose fault was that, Ms Humphry?

Jacinda Humphry: Historically—I have talked about the simplification of the system for the new programmes and the lessons that we have learnt from the previous error rates in the past—that £8.1 million relates to the closure of programmes from 00-06. So quite historic programmes and write-offs did arise from the procurement errors that I have also talked about. We have really worked hard to learn the lessons of those previous programmes in thinking about how we drive those errors out of the 14-20 programme going forward, and we have redesigned our processes to make sure that we are supporting compliance upfront in the design of the programme, as opposed to finding it after the event.

So we have invested lots more activity in checking at the outset and improving the processes for making sure our procurements are sound. That has been a real investment and a real programme of activity together with the EC, so we have agreed with them how we can best build compliance in from the outset. We have introduced in-house compliance teams to check on this. We are RAG rating, so we are basically stratifying the risk in each of our projects at the outset so that we can really focus activity on driving and monitoring compliance.

Q34 Caroline Flint: That is interesting. How much sharing of what works and what doesn't work is there across Whitehall? Have you ever been in a meeting where you have sat down with your oppo in DEFRA, for example, and had a discussion about how you could share good practice, or learn from mistakes? Have you ever sat down with your opposite number responsible for this area in DEFRA?

Jacinda Humphry: Me personally, no, but that is largely because I am the finance director in DCLG. I am not the official responsible for managing the ERDF programme. She does work with her colleagues across Government to share lessons.

Q35 Caroline Flint: Do you have a sense that there is enough of that?

Jacinda Humphry: There is quite a lot of it where the programmes are absolutely aligned. For ERDF, it is most aligned with DWP's ESF programme. There we do have a joint managing committee quite deliberately and we are developing joint IT systems precisely for the reason—

Q36 Chair: That is slightly different because that's their aligned programmes. I think Ms Flint is trying to get an answer on, where there are completely different programmes but there are still the same problems, is there a place for shared learning?

Jacinda Humphry: Again, I do not have the expertise to answer that question.

Q37 David Mowat: You said something really interesting then. You said that you were the finance director and not responsible for the ERDF programme. Given that all this money has been lost, most finance directors would have shown a passing interest in why that was and what could be done to prevent it, both in your Department and across Whitehall.

Jacinda Humphry: Perhaps I misspoke. I was not saying that I was not interested in the finances of the ERDF. I certainly am and interested in the control mechanisms and the compliance of the ERDF. What I was saying was that I could not personally say that I had sat down with my counterpart responsible for managing the agricultural fund, for example, because I am not personally managing the fund.

Q38 David Mowat: Okay. I suppose what surprises me about the answers that Ms Flint has got from you, is that we have this emerging strategy but it does not appear to be top of anybody's priorities. Maybe that is unfair, but the Treasury can answer for that. Have we got a stretch target to perhaps get to the same level as Lithuania in terms of our performance?

That is just an example because, at the moment, this is real money going out of our country. We have an emerging strategy apparently, yet I do not get a sense of who in the civil service is accountable for getting us to the same level as Lithuania over the next three years, say. Is there anybody?

Chair: Is that for Mr Black for the Treasury?

Jonathan Black: I am happy to say something for the Treasury and others might want to add. The accounting officer responsibility lies with the Departments. There are two things to say about the Treasury. You asked about the extent to which expertise is shared. We do have a series of networks and groups within Government at official level to share information.

One thing we are particularly focusing on at the minute is preparation for the mid-term review, for example, which is due at the end of this year. A big priority for that will be the simplification and the extent to which there are common issues that stretch across the different structures—

Q39 David Mowat: All right, but let me ask my question again because it was a much simpler question than your answer. We have this chart in front of us that you have told us is a problem of 10 years ago, which was presumably before any of you could be blamed for it. It shows us that we were sixth worst over that 10-year period. We have heard about a strategy to fix that. Actually it is not a strategic question; it is tactics we need, not strategy but we'll leave that to one side.

Let's say that this Committee thinks that this country should be as good as Lithuania next time this chart is produced. Who in the civil service is accountable for that happening? Who will come and tell us if you have not quite got to the level of Lithuania or whatever it is? Who will say, "My hand's gone up; it is my fault."? Is it any of you three or somebody else altogether?

Nick Joicey: In terms of responsibility for driving down disallowance to the lowest level that we can, DEFRA has the lead responsibility. We do work jointly with the Treasury on that. The Treasury is closely involved and will hold us to account for our progress in driving that down.

Coming back to the actions that we have taken, we did take actions under the previous spending review period to improve the controls and performance of the Rural Payments Agency in driving down disallowance. That did enable us to get disallowance down from 5% in the mid-2000s to 2% now. On your question about tactics and strategy—

Q40 David Mowat: My question was a different one and you have not really answered it. I will finish and let colleagues have a go because I am clearly getting nowhere. My question is, if our stretch target is to get to the level of Lithuania—and this Committee thinks that is appropriate—who in the civil service is accountable for that? I am not getting an answer to that. I am getting the impression that you don't think it is you, other than that you are doing certain things.

Nick Joicey: DEFRA is responsible for driving down disallowance. The permanent secretary, as the accounting officer for DEFRA, is accountable for that. I, as the DG for food and farming, am accountable for the delivery of the disallowance strategy. I work closely within DEFRA alongside Mark Grimshaw, the chief executive of the Rural Payments Agency.

Q41 Chair: What is, to borrow Mr Mowat's phrase, your stretch target? What is your aim on disallowances, and what happens to you if you don't meet it?

Nick Joicey: DEFRA's aim has been to reduce disallowance to 2%—to below a level where it is material. We would like to drive it down as far as possible. The Treasury has encouraged us and will hold us to account on that. In terms of what we are able to do, the complexity of the new CAP, which has come into force this year—

Q42 Chair: I don't want to go too much into that, because we have got a Report coming out on it very soon.

Nick Joicey: That will increase the disallowance risk that we face. It is also the case that in 2014 the Commission changed the rules on disallowance, which will mean that the risks faced by all member states will increase, in terms of the likelihood of disallowance penalties.

Chair: But if there is a risk, surely it is the job of the Government and Departments to make sure they mitigate it—I see Mr Black nodding. I hope you are doing that. I am really trying not to go down the whole CAP agenda. I am going to bring in Caroline Flint, and then we have a few minutes left if anyone else wants to chip in.

Q43 Caroline Flint: If I could come back to you, Mr Black, do you agree that the Treasury is responsible for good financial governance across Whitehall?

Jonathan Black: Yes, the Treasury has overall responsibility for the value for money of what we spend on taxpayers' behalf.

Q44 Caroline Flint: Okay, so what is your role in making sure Government Departments get it right in terms of spending and accounting for EU money? Do you collect information from Departments about what went well and what did not? How do you help to ensure that good practice is shared across Whitehall?

Jonathan Black: There are various things to that. We talked a bit at the beginning about the extent to which the rules enable the most effective practice. There is a key role for us there, in terms of how they are set both at the beginning of the period and as they are amended during it.

Q45 Caroline Flint: Can I just get back to my specific question? Do you collect data from Departments about what went well and what did not, and do you analyse that?

Jonathan Black: Yes, in two respects. One, which goes back to your earlier question, is that there is a process for talking about shared issues across Departments. The Treasury performs that role with the Cabinet Office and ensures that there is an information flow.

Q46 Caroline Flint: And what is the outcome of that? Can you give me an example of an outcome of that process?

Jonathan Black: An example of an outcome—forgive me if this is not the question you were driving at—is this. If there are things that can improve the way the budget is managed and structured—if they are not about the individual programmes, such as those that Nick's Department works on with the agricultural directorate, but are about the budget as a whole—we use that to inform either how we approach the annual budget or the mid-term review of the budget, in terms of how the regulations are changed. We are going through that process now, because that mid-term review is at the end of the year.

Q47 Caroline Flint: Are you aware that, in preparing its 2014 annual report, the European Court of Auditors—sorry to come back to DEFRA again—tested 40 transactions in the UK relating to EAGF and ERDF transactions. They found that out of 40, which was just a sample, 23 were affected by errors, including examples of ineligible and unsubstantiated costs, unjustified direct awards, serious failures to comply with public procurement rules, payments for overstated eligible land—we heard a bit about that earlier—and non-compliance with agri-environment commitments. Has the

Treasury looked at those transitions in detail to see whether there is any wider learning for why that is happening across Whitehall?

Jonathan Black: We have discussed it with the Department.

Q48 Caroline Flint: Which Department have you discussed it with?

Jonathan Black: The specific examples on agriculture are relevant to DEFRA. An important thing that has come out of that is about the quality and the availability of data that the authorities can use. That is why we had a particular focus on this during the spending review, and it was decided that there was value in terms of investing additional resource and strengthening systems. That is the £45 million—

Q49 Caroline Flint: My question was actually about whether you have taken those examples from the ECA annual report for 2014 and have had discussions with Departments across Whitehall about what learning there is for good practice in the future. Have the relevant people from across Whitehall been brought together to discuss some of this?

Jonathan Black: In terms of the specific examples about agriculture, for example—

Q50 Caroline Flint: No, my question is really about what other learning there is. Clearly and obviously, DEFRA gets a huge amount of funding from the European Union to support our farming communities, which is fine, but has there been any effort to look at what learning there is about how we manage EU funds in this country, not only in DEFRA but in other Departments as well, and to share that across Whitehall?

Jonathan Black: Yes, but I make a distinction between issues that are specific to the specific programme, from which there may not be wider lessons, and issues that are potentially more generic, which therefore affect spending on agriculture and spending on structural funds and, indeed, on other things as well. That is where you can look across some—

Q51 Caroline Flint: I would have thought from my experience of funding situations, whether in local government or—*[Interruption.]* As a Minister, but I also used to work in local government many years ago and have worked in the voluntary sector. I have been the chair of a charity. In my experience, one of the concerns about any funding arrangement is ensuring clear lines around the data you get on what the problem is and who is eligible for support. You obviously then have to ensure that it goes to the right people in the right form at the right time. Now, it could be agriculture or something else, but those are pretty basic rules about lines of accountability.

You did say that the Treasury has a role to look at financial governance across Whitehall, and I am trying to get a sense of how you are pulling learning together to share it across Whitehall and to improve what is not a great end-of-term report for the UK.

Jonathan Black: Let me try and give an example. I was trying to be helpful by explaining that some things are specific to an individual programme and so may not provide wider lessons, but

there may be other areas. For example, one of the things that we think is common, which we included in the new regulations for this structural funds period, is a greater role for national auditors in terms of compliance on all EU spending. In terms of the legality and regularity report, that applies to all parts of EU spending, both in agriculture and in structural funds, and that work is now starting. The NAO and, as it happens, the Government Internal Audit Agency on structural funds are doing that. That will be just the sort of area where there may well be lessons for us to consider across the piece as that work is done. It was an important thing that we wanted to include in how the overall budget regulations were designed at the start, because they were, as you say, cross-cutting to the budget as a whole, as opposed to—

Q52 Caroline Flint: As you mentioned the NAO, my understanding is that when the NAO looked at Government spending—which is nothing to do with the EU, but rather the budget that the Government sets for different Departments—they found that there are 12 Departments or arm’s length bodies for whom they have had to give a qualified view of their accounts because of error. This is nothing to do with the EU; it’s just about how we spend taxpayers’ money through Government, into Departments and out again. Are you aware of that?

Jonathan Black: As you said, the NAO conducts, unlike the ECA which does—

Chair: Yes or no?

Caroline Flint: Are you aware of that?

Jonathan Black: I am aware of those things that the NAO does—

Q53 Caroline Flint: So there is already a problem within our own system here in the UK in terms of Government Departments’ capability to manage UK spending—nothing to do with the EU—and how it is done, the value for money and the errors within that. Would you accept that?

Jonathan Black: The role of the NAO is to identify—

Q54 Caroline Flint: Would you accept that there is a UK problem about how we ensure that money is spent correctly?

Jonathan Black: I do not think, as a Treasury civil servant, or any servant—you always want to spend money as best you can, and you can never be satisfied in that respect, and you keep on doing it.

Q55 Chair: The NAO is not satisfied; that is the point, Mr Black.

Jonathan Black: The job of the NAO is to highlight to us both individually and collectively that there are—

Q56 Caroline Flint: So you accept the NAO view that there are 12 Departments or arm's length bodies for whom they have had to give them a sign-off on their accounts as qualified due to error.

Chair: It is a fact, Mr Black. It is difficult to disagree with.

Jonathan Black: Indeed, and the point of those Reports is to provide us with the evidence and the information from which to learn and to—

Chair: Absolutely. We know what the point of the NAO is—

Mr Bacon: Mr Black, could you stop telling us things we already know, and start answering the question? It is getting very boring and irritating.

Q57 Mrs Trevelyan: I just want to come back to something that Mr Joicey mentioned just now, in terms of the Commission changing the rules on disallowance, which is increasing the risk of disallowance. Could you just explain how? Then perhaps, Mr Black, you could say where we were in the discussions in the EU going on—because is that really what we would be wanting to encourage the EU to do, as far as the UK is concerned?

Nick Joicey: One of the changes that the Commission has made is the way in which the flat rate penalty is applied when it identifies weaknesses. Under the previous system, if there was a weakness in a key control, the Commission could apply a flat rate penalty of 5%. Under the new arrangements, if it was to identify a number of key control weaknesses, it can now apply a multiple of that 5%. So in theory, if it was to find three key weaknesses, it could apply a penalty of 10%. That is the nature of the change.

There are some other changes that are also contributing to the increase in the disallowance risk, around the complexity of CAP, including the complexity of the greening requirements, but also the control regime that is in place to monitor that. I think one of the things that we are very keen to work through, and one of the things we are working through and discussing with the European Commission and the European Court of Auditors, is how we can ensure we have got a control mechanism that addresses the underlying risks to the European funds from these errors and how we can ensure we have got the most proportionate and best targeted control regime there.

If I could just come back on the question about the NAO, in terms of the NAO's findings, as they outline in their Report, as well as their role with regard to Exchequer funds, they also have their role with regard to the EU funds.

Chair: Yes, we know that.

Nick Joicey: One thing I did want to highlight there is that this year, for the first time, the NAO have been required in that role to look at the legality and regularity of the CAP funds, in addition to the other things that they looked at. That NAO Report has only just gone to the Commission. DG AGRI have to look at that, but the initial findings from that Report are that the error rates from the NAO's findings are below 2% and ought to result in a clearance of the Rural Payments Agency's accounts as the paying agency. As I say, that Report has only just gone to the Commission, so that still needs to work through.

Chair: Thank you for putting that on the record, because it is helpful, and we will consider how we take that.

Q58 Mrs Trevelyan: I would like just a final answer from Mr Black on the changes in the disallowance rules with this much more aggressive ratchet system as part of the Treasury's work in the EU on strategy. Is that something that the UK was actively supporting, or were we aware that the risks to UK funds were great, and we were not supporting them?

Jonathan Black: We did support the overall changes in terms of how the incentives are placed, and you are right that they placed a stronger incentive on the national managing authorities to manage their budgets. That then has helped inform the strategy that we have done together, as part of the spending round and the investment—

Q59 Mrs Trevelyan: So hopefully the €45 million will be well used, so that you will not have that coming back in extra fines.

Jonathan Black: The aim of the €45 million and the reason why it is part of what we are doing in terms of being a joint programme is to try and ensure that that is focused on the areas which will enable us to get the error rate down.

Q60 Mr Bacon: I would just like to ask Mr Joicey briefly about the strategy that you are developing, or have developed—you have said both—for the first time, with the Treasury, to reduce disallowances. I was surprised. I have just been looking up when the National Audit Office Report on the single farm payment fiasco first took place, and it was October 2006, so it was almost 10 years ago. Can you tell us when you will get the disallowances down to a level that is below the threshold for materiality?

Chair: You have given an indication, Mr Joicey. Perhaps you could expand on your previous comments.

Nick Joicey: As I said, our aim is to get it down to 2%, and below the level for materiality. In terms of the timescale for that, we face a very real risk next year that the disallowance rate for us, and for other member states, could increase as a result of the complexity of the new common agricultural policy and the changes in the disallowance fines.

Q61 Mr Bacon: Just to be clear, it was made more complex, not simpler?

Nick Joicey: The common agricultural policy introduced in 2013 is complex.

Q62 Mr Bacon: I understand that it is complex. You have said that. I am asking a simple question: is it more complex than it was before?

Nick Joicey: The greening requirements in the basic payment scheme—in pillar one—add to the complexity and have made that pillar one aspect more complex than it was before.

Q63 Mr Bacon: This is why you said earlier that there is an increased disallowance risk?

Nick Joicey: Yes.

Q64 Mr Bacon: Back to my question: when are you going to get the level of disallowances down below the threshold where it is material?

Nick Joicey: We want to reduce it, and the plan is to reduce it over this spending review period to the 2% level, and to below that level if we can.

Q65 Chair: By 2020?

Nick Joicey: By 2020.

Q66 Mr Bacon: I do not understand why you expect us to believe you. This was 10 years ago. The reason it all happened was because you chose to introduce an extraordinarily complex system—in fact, the most complex one available—on the shortest possible timetable while sacking all your most experienced staff and replacing them with temporary agency workers, who were forced to work antisocial hours on the minimum wage, and while using a digital mapping system that was flawed, although you refused to accept that it was flawed. Ten years later, you are talking about improving things, and you have for the first time—those are your words—got a strategy evolving with the Treasury for doing this in an environment where things are going to get more complex. Why on earth should we believe you?

Nick Joicey: Since 2005-06, we invested in better control systems, including the appointment of a compliance director at the Rural Payments Agency, and improvements to the information that the Rural Payments Agency was using for its mapping system, which helped us to get disallowance down from 5% to 2%. You are absolutely right that we faced a legacy from the approach that was taken in 2005-06. That was a damaging legacy, and it is one that we are still facing today.

In terms of implementing the new CAP, the lessons from that period have been at the heart of our approach. In terms of taking policy decisions about how we implement the CAP, we have tried, against the backdrop of the complex regulations, to simplify that as far as possible, such as in the landscape features that we allow farmers to use in the ecological focus areas. In the way in which we are implementing the new basic payments system, Mark Grimshaw is making those payments as quickly and as accurately as possible.

Q67 Mr Bacon: With lots of help from Mr Maxwell. Yes, we know.

Chair: We don't want to revisit that.

Nick Joicey: But the relevant point from the lesson from 2005-06 is that we have put emphasis on making the payments as quickly as possible and also accurately, and ensuring we have the control frameworks in place. With regard to the CAP IT system, we have used the core rules-

based engine, which was procured because of its track record in disallowance. We have brought together pillar one and pillar two—

Chair: We are in danger of going into a previous inquiry. We are going to have to move on to David Mowat. I have to say that not all farmers up and down the country got it. In fact, the reduction in the figures for those who got it on 1 December was incredible.

Q68 David Mowat: I just wanted to ask one final question on all this. Even your 2% target would leave the UK significantly worse than the European average. The changes that are coming in for the CAP and that are going to make it more complex apply to everybody else. There is no reason why the UK should be worse than the European average. We are talking about hundreds of millions of pounds. You have used the word “strategy”. If I was sitting in your position, I would have used the word “taskforce”. A taskforce is a different thing from a strategy. A taskforce is people who do something and make it happen. I want to ask this question again in a different way. Do you think it would be a good thing if somebody in the UK civil service—maybe you, maybe not—was accountable for getting our level of disallowance down to, say, the same level as Lithuania’s? That would be worth many millions of pounds. It would be in somebody’s job description to do that. There would be absolute, clear accountability, and he or she would be given the resources necessary. Would that be a good thing?

Nick Joicey: We—DEFRA—should be held accountable for making progress in getting disallowance down. In terms of the table that you referred to and the relative position of member states, Germany did take a decision to invest significantly in its mapping capability 10 years ago. I think we need to learn the lessons that we can from other member states. The table that is there is just a snapshot at a point in time.

Q69 David Mowat: It is not a snapshot; it is over a long period of time. You are saying it’s better now, but the fact is your target is still very high on this table. What is the number? Just to finish all this, what number will the disallowance be next fiscal year in your department? What is your estimate, as you’re in charge of this?

Nick Joicey: In terms of the disallowance—

Q70 David Mowat: What number is it? What number are we going for? How many millions do you think it will be?

Nick Joicey: There is a likelihood that the disallowance figure could be higher than the—

Q71 David Mowat: All right, this year. What number is it this year? What number is it? What’s the quantum, not the percentage? What number is it this year?

Nick Joicey: The disallowance estimate for the 2014 year that the ECA refers to—

Q72 David Mowat: The one we’re in—the one that’s about to finish. What number is it?

Nick Joicey: The disallowance figure depends on the Commission audit. The Commission audit was, for 2014—the disallowance following that is estimated to be €69 million. That is for pillar one and pillar two.

Q73 David Mowat: And what do you think it will be for this year? You must have a guess as to what it will be for this year. I know the Commission has to sign off, but what is it going to be approximately?

Nick Joicey: Prior to the Commission audit, it is very hard to assess what the disallowance will be. I am concerned that the disallowance—

Q74 David Mowat: Is it really?

Nick Joicey: I am concerned that the disallowance may be higher because of the complexity of the new system and because of the change in the rules.

Chair: One last point on this.

Q75 Mr Bacon: Mr Joicey, on this question of disallowance, are you aware that the disallowance for mapping has not changed for nearly 10 years? The disallowance for mapping in 2014 was €41.3 million. The year before that it was €41.2 million. The year before that it was €41.1 million. It has been static for many years, so that's not the main problem, is it? You are aware of that.

Nick Joicey: In terms of the disallowance, the fines that we have faced as a proportion of the EU funds that we received have come down, as I said, from 5% in 2005 to the 2% we are facing now. We need to make significant improvements in our mapping capability, and that is why we are investing the extra money in the mapping system.

Q76 Chair: We have that point on the record, and we have done a whole separate report on the common agricultural policy and rural payments. All I have time for is one final question to Jonathan Black. According to the NAO Report, we have a good success rate in the UK on bidding for research funds and so on. Is that something that you take a role in in the Treasury?

Jonathan Black: So—

Q77 Chair: Yes or no—I don't know whether the Treasury helps to make that a success or if it is just because we have got great businesses bidding for money from Europe.

Jonathan Black: The main role in that is done by the Department for Business, Innovation and Skills, who have responsibility for the relationship with universities and science. They are the primary Department that looks after that as opposed to the Treasury, but you are right: this is an area of the budget that the UK does particularly well in and has a very strong track record in, in terms of getting projects that are quite significant in number, but that are also ones that we think

are significant in terms of value for money. It was a big priority for the last MFF round that we increase the share of the budget.

Q78 Chair: So there is a Government policy to give support and make sure that we are maintaining a good level.

Jonathan Black: Yes.

Q79 Chair: Okay, I do not have time to go into that, but quickly on letters, we had a conversation about the joint approach to disallowances that was introduced in the last spending review. We have obviously gone round that a bit, but I wonder if we could get a letter, maybe jointly from the Treasury and DEFRA, about what exactly that means and what a joint approach now means compared with what has happened in the past. If you could explain that more fully, that would be helpful. We talked particularly to Ms Humphry about shared learning, so could you, between you, collaborate to find some examples of where there is learning?

My final point is probably to Mr Black, but maybe others could chip in very quickly. Have you actually gone and spoken to other member states that are doing well on some of these areas around disallowances to find out what they are doing? Germany has quite a lot of farms, as has Poland, and that does better than us. Do you—not necessarily you, Mr Joicey—talk to other member states about how to do a better job?

Jonathan Black: I have not personally talked to other member states about the question of disallowances. We have regularly talked to other member states about the overall value and reform of the budget. We have something called the budget disciplinarian group, which comprises Germany, which you mentioned, Sweden and the Netherlands.

Q80 Chair: Are you learning lessons? You have touched on this before, but I want to nail down whether we have learnt lessons from other countries.

Jonathan Black: Yes. We both share experiences and then consider how we can make joint proposals on reform together, so that we can, if you like, build an alliance in terms of changing the—

Q81 Chair: But it sounds to me as though you do not necessarily need joint proposals on reform if some are doing so much better than us, when, as we say, we are looking at disallowances on agricultural funding. Is there ever an example of us saying, “You are doing really well, Austria, with 10p in £100,” or, “You are doing really well, Spain, with £1.30 instead of £2.70 disallowances—what are you doing differently?” Do you have those discussions, Mr Joicey?

Nick Joicey: Yes, we do go and talk to other member states and work with them to learn lessons from them. Our investment in the mapping capability is based on those conversations. In addition to learning lessons from how other member states are implementing the CAP, we are also working with other member states on getting simplification at that European level—

Chair: Which we have heard before. Sorry, I don't mean to cut you off, but we have run over time for our first panel. It has been an interesting conversation. Thank you very much. You have an indication of the information we would like, so could you send us that in the next week? Our transcript will be up on the website, uncorrected, probably on Monday, because this is a Thursday meeting. You will be sent it as well, but please get any comments to us as quickly as possible. We are not sure exactly when our report will be out, but maybe after the Easter recess, given the timings. Thank you very much for your time—you are welcome to stay for the next bit if you are able to. We will now move on to our next panel.

Examination of Witnesses

Witnesses: Phil Wynn Owen, UK Member, European Court of Auditors and Dr Manfred Kraff, Deputy Director-General of DG for Budget and Accounting Officer of the European Commission, gave evidence.

Q82 Chair: Good morning and welcome to our hearing on budget management in the European Union. I think you were sitting in before, so I do not need to repeat my preamble, but I warmly welcome you, because we have the power to summon certain people, but I don't think you fall into that category. We welcome Phil Wynn Owen, who—I think—formerly worked at the Treasury and other Departments. Is my memory of your CV right?

Phil Wynn Owen: That is correct. I have worked at the Treasury, the Cabinet Office, the DWP and DECC in the UK.

Chair: So welcome back to London and to Britain. Mr Wynn Owen is the British member of the Court of Auditors in Europe. We give a warm welcome to Dr Manfred Kraff, who is the Deputy Director-General of the European Commission. You work with Kristalina Georgieva, who we had the pleasure of meeting. Richard Bacon and I were on that delegation about a year ago, and we were very impressed with some of her plans. We are here today to challenge and question you about budget management at Commission level, what you think is happening in member states and what the plans are with the mid-term review and the seven-year financial framework. I will ask Anne-Marie Trevelyan to kick off, and then I will go to Caroline Flint.

Q83 Mrs Trevelyan: As the UK's voice in the Court of Auditors, Mr Wynn Owen, do you feel that we have a strong voice and that you are able to be a very clear UK voice, or do you feel that you are separate from the UK and part of an audit framework that looks down across the whole of the EU process? Are there colleagues of yours who you feel bring more to the party in skills? You have an enormous background in public service and the civil service compared with some of your colleagues.

Phil Wynn Owen: First, I thank the Committee for holding this hearing and for inviting me, as I offer to come every year to talk about our annual report. It is very good that you are holding a hearing on it. Thank you for the question, which gives me an opportunity to explain my role, which I should make clear at the outset. I am the UK member of the European Court of Auditors, which is an independent body with responsibility for auditing the EU budget. The Court on which I sit is a collegiate body with collective decision making by its 28 members—one from each member state.

Each of us resigned all previous appointments when we joined. I resigned from the UK civil service when I joined the ECA. I am not of the UK Government, like an ambassador would be; I am an independent party now sitting on a collegiate body. Each of us on the Court took an oath to carry out our duties in a fully independent manner—that is absolutely crucial, as you know from working with the NAO in the context of audit—and in the general interests of the European Union. That is the context in which I appear here.

The Court is a collegiate body. I have made many good friends and colleagues. There is a lot of professionalism, both from audit backgrounds and financial backgrounds like my own. The UK has a history of sending people with a substantial degree of Treasury and financial experience: I was in and around the Treasury for more than 20 years.

Chair: I do not want to interrupt you, Mr Wynn Owen, but you have given us a flavour and we have a clear idea of what your role is.

Q84 Mrs Trevelyan: The key message from the report, as I have gone through it, is that everything is still very complex and the level of error is really very high, particularly on the UK side, as you heard earlier when we were discussing that with some of our civil servants. After 21 years of continued failure to control areas below that materiality threshold of 2%, it strikes me as a system that is not really doing what it is setting out to do. First, what do you feel are the reasons for that continuing failure? Are some countries worse than others? Is the system really not working and clearly not making progress to improve?

Phil Wynn Owen: The treaty charges us with two fundamental roles. The first is to look at the financial accounts, and I am grateful to Caroline Flint, who pointed out that we gave a clean opinion on the reliability of the 2014 accounts of the EU. We have done that since 2007. We said that they present a true and fair view. It is important to get that on the record, because honestly as a Brit I do not think that that is often understood here. We are also charged to look at the legality and regularity of the underlying transactions. On the revenue side, we said it was legal and regular, but on the payments side, you are correct that we gave an adverse opinion on the legality and regularity. The estimated level of error was 4.4%, which is well above the 2% materiality threshold.

What are the drivers? Let me go straight to the point, because we did more to analyse the drivers in this year's report, because we think it is important—to, for instance, the previous witnesses times 28 member states and the Commission—to really understand the problems and to try to address them. There is a short version of this annual report, and there is a tome in which there is a lot of good stuff if you have the time to glance through it, with some charts that are easily intelligible. We identify in the report the three biggest types of error across the European Union: first, ineligible costs included in reimbursement claims—that was around 1.8% of the 4.4% error; secondly, public procurement errors; and thirdly, incorrect declarations of area by farmers. If my addition is correct, and, as an auditor, I hope it is, those three—1.8%, 1.2% and 0.9%—add up to 3.9% of the 4.4%. In other words, those three are the three big drivers of error. I could go on. We give more drivers in the report, and the fourth and fifth are important too, but that tells a lot of the story.

Q85 Mrs Trevelyan: Looking at those by country, are there clear system failures in certain countries, or is every country bad at those things across the board at that sort of level? If it's the latter, that would imply to me a systemic failure in what is coming out of the EU.

Phil Wynn Owen: We audit the EU budget and not individual member states. Each member state has its own audit institution—you have an excellent one in the NAO, so we wouldn't presume to do their job. Also, statistically our sample would have to be much bigger if we were going to draw error rates out for each member state. We simply cannot do that. We audit around 1,200 transactions on a random sample basis across the EU to get a statistically relevant sample at EU level.

We do what we can, though. Particularly in recent years we have sought to do what we can to cast some light on what is going on. For the previous annual report, in autumn 2013 we published a little document called "Agriculture and cohesion: overview of EU spending", which included some tables in which the UK featured, like all other member states. We broke down the total number of errors over a five-year period, which gave a bit more insight than just one year, and we split it between agriculture and cohesion so that people could see at a glance some of the areas, at least on the basis of our samples, where there had been problems in their member state.

For some member states we couldn't draw much of a conclusion at all, because a very small member state might not have any transactions looked at in any particular year, but the conclusion we drew was that all member states for which a conclusion could be drawn—obviously the UK is big enough for that in our samples—are affected by a material level of errors with a degree of fluctuation around the average. The Court finds errors of the type I mentioned—those three big drivers—throughout the EU member states.

We also do sampling of control systems—if you like, the management systems in member states. We have predominantly concluded that they are partially effective, but there is some way to go. In our 2012 annual report, we identified the agricultural systems—the paying agencies—in England and Northern Ireland as not effective, and we drew that to the attention of this Committee and the relevant managing authorities and Departments in the UK at the time. As was previously discussed, we have all known for some time that there were serious problems in how the UK managing authorities—particularly in England and Northern Ireland in that case—were conducting their business.

Q86 Mrs Trevelyan: Dr Kraff, the auditors have produced this report. I am an auditor by background, so drilling down until you get to the root of the cause is important to me, but clearly both country and system failures are going on. As the accounting officer for the Commission responsible for moving this forwards, how do you see your role? What can the Commission do to really drive down the error rate?

Dr Kraff: First, let me thank you for inviting me to this hearing. We know, of course, that EU financial management is an issue which is discussed, and it attracts a lot of political interest, especially in your country. I am happy to answer your questions.

First of all, we agree with all the findings of the European Court of Auditors. We stated this very clearly in the annual report; we share the diagnosis of the Court of Auditors. In the annual activity reports of the Directors-General for the different policy areas—regional policies, social fund, agriculture—you find a lot of information on what is going wrong and what is going well in the different member states. You can find statistics on the error rates and on the residual level of error. The residual level of error is the level of error after all the corrections have been implemented. In the discussion with the previous witnesses, you focused a lot on the protection of the EU budget.

We impose financial corrections whenever we find evidence that there is expenditure incurred in breach of law.

We agree entirely with the court's error rate of 4.4%, but one should take into consideration that it would have been even higher without our corrective capacity. The Court of Auditors told us correctly that without the corrective mechanisms applied by the Commission and the member states, the error rate would have been 5.5%. The corrections that we impose create the 1.1% reduction in the error rate before payments were made.

So the court provides you with a correct snapshot of what is happening in the EU, but that is not the end of the story. Then come the financial corrections imposed after payments were made. You discussed especially the clearance of accounts procedure in agriculture; we have a similar procedure in the area of cohesion. When you analyse carefully how much money is involved, you can see that it is roughly 2% of the EU budget, depending on how you calculate it. So taking that into consideration, we think that the risk to the budget is adequately managed.

Of course, you cannot deduct this amount from the Court's error rate. Why? Because those financial corrections refer to previous years. The errors in the year that we are discussing now, 2014, will be addressed by upcoming financial discussions. You had a discussion with a DEFRA colleague on the risk that exists.

Q87 Mrs Trevelyan: So as the accounting officer for the Commission, you obviously want to manage the 28 member states' money which is put into the kitty for you to redistribute as well as possible. What are you trying to do to make sure that that corrected 4.4% decreases? That is a lot of wasted money, a lot of effort and a lot of member states failing to achieve what is referred to as EU added value—we give you a chunk of cash, and you give it back to us with a set of rules on how to spend it. If we are not doing it right, no one is getting any added value at all. It would be easier if I just wrote a cheque to my farmer. What are you doing as the Commission to improve that added value and reduce the error rate?

Dr Kraff: I agree entirely with your analysis. We have to bring down the error rate; there is no doubt about that. We should not focus on ex post financial corrections. It is important that we get it right from the beginning. Therefore, Commissioners Hogan and Crețu started immediately after they came into office a simplification initiative to make it easier for those who get EU money to get things right, and for the administrations to ensure that expenditure is legal and regular.

Furthermore, the Court of Auditors asked us, as well as the Council and the European Parliament, to carry out a profound analysis of why error rates are persistently high in certain areas. We will present a document in connection with a midterm review, which will take especially into consideration the excellent analysis by the European Court of Auditors that tells us that if you organise your schemes around entitlements, the risk is much lower than if you ask for invoices showing the eligibility of expenditure that has to be co-financed. So we will take this into consideration.

A second element that is extremely important is that it is as well to analyse with member states why things go wrong. In other words, how can we improve the management and control systems in member states? There, it is important to know that in many areas under shared

management, member states had sufficient information to prevent or correct errors before payments were made. For example, in the first pillar of agriculture, if all this information had been used correctly, it would be below 2%. The same is the case with the social fund. In ERDF, the regional development fund, we are slightly above the materiality threshold and a little bit higher in rural development. So this is another area which we will take into consideration to try to bring the error rate down.

Please let me add a further element. You mentioned Kristalina Georgieva, Vice- President of the Commission. The Director-General of DG Budget is Nadia Calviño. With them, I took the decision to create a taskforce to discuss together with member states why in certain areas action plans to improve the situation had a positive impact, but in others that does not yet work. We sent a letter signed by Nadia Calviño to all member states inviting them to take part in a working group to make progress in this area.

Q88 Mrs Trevelyan: That is very encouraging. With the change that Mr Joicey mentioned in the disallowance system so that the risk of disallowance has gone up, which is like me telling my kids to be good because they will then get a sweet, it is a good idea in theory, but if the systems in some countries really are not strong enough, you will just be billing people for a great deal more disallowance. Will the Commission be doing things to support those countries that hopefully, as you say, are coming together, but are in need of more help to make progress quickly to avoid that? The system is self-defeating. I get hitting them on the head to try to make them improve, but if there are countries that have not been improving, it will simply be an aggressive fining system rather than a constructive process to help them improve so that by the time we get to 2020 we can look back over this MFF and see that there has been a coherent improvement and therefore a reduction in wasted money.

Dr Kraff: Of course, we do not have an objective to impose financial corrections. We use financial corrections to protect the EU budget. Our objective is to bring the error rate down. We do everything to make sure that in the end we will be close to the materiality threshold or even below. Simplification is the principal instrument that we have at our disposal.

At the previous hearing, you asked whether the rules are more complicated. The diagnosis at the level of the Commission is that we made progress in some areas, but a lot still has to be done. For example, in January Commissioner Hogan went to the European Parliament Agriculture Committee and identified precise actions that he will implement to deliver this issue. The same is happening in regional development and the social fund. You may ask me what can be done concretely and implemented in the very short term: for example, simplified cost options. The Court of Auditors tells us that, especially with the social fund, whenever you, together with member states, apply simplified cost options, the level of error is virtually zero.

Now you will probably ask me why do member states not take this opportunity to move in this direction. Some of them are afraid that they do not correctly interpret the rules or that they see a risk that they probably go too far. So we are proactive and provide guidance, organise training and take further initiatives to make progress in this area.

Q89 Chair: If I could just chip in on your earlier point, Dr Kraff, you said that you were going to have this group that will work with member states. We might call it a bit of a Star Chamber, but I don't know whether that is over-egging it. Will you be working with our Department for

Environment, Food and Rural Affairs? There are clearly really big issues, but I am unclear whether it is the Commission's role to go in and micro-manage what is happening in member states. I don't think that that is quite your intention. Could you perhaps expand on that a little more?

Dr Kraff: To explain a little bit, how we work means that, for example, DEFRA would co-operate with the DG AGRI. I told you that the Director-Generals of the European Commission have to present annual activity reports. In those reports, you have declarations. In the declarations, the Director-Generals have to sign off whether, for example, the expenditure has been legal and regular. If there are problems, they have to identify them by reservation. Whenever there is a reservation, the Commission's Director-Generals make contact with the member states and with the regions concerned in order to establish action plans. So there is co-operation on that bilateral basis. The same is happening with the social fund, the fisheries fund, and the regional fund.

Q90 Chair: That's great. I want to interrupt you there, because, as you heard very clearly, the problem—we have a bit of an obsession on this Committee about how badly this has been going—is that it is not going very well in the UK. What difference is the Commission's support or intervention making?

Dr Kraff: I think you mentioned the key thing already: learning from others. In DG BUDG, because we have a horizontal co-ordination role like the Treasury, our idea was to have cross-cutting analysis not only vertically, meaning in the different policy areas, but between the policy areas to see what lessons can be learned in order to improve things. I am very confident that we will be successful in this area. Why? Because there are very concrete examples of where member states that faced large financial corrections approved action plans and then brought down the error rate and did not suffer any more from the negative decisions of the European Commission.

Q91 Chair: Can you give an example of a country that has done that well?

Dr Kraff: I think you can find elements everywhere, even in the United Kingdom. In the United Kingdom, you had reservations that were lifted after action plans were implemented. Certain questions were resolved together with the Administrations, so the risk of a financial correction turned out to be zero in the end. Why? Because certain issues were solved in a proactive way.

In addition, it is excellent that the National Audit Office is leading the consortium of certifying bodies in agriculture. Why? Because the European Commission, with the help of the legislator, requires the certifying bodies to publish error rates. As we know, error rates are an indicator of whether things go right or wrong. We will have the possibility of taking action together with these audit authorities and certifying bodies, and we are working in the direction of implementing single audit. Why do I mention single audit? Because the president of the council body dealing with the discharge procedure, Mr Dijsselbloem, was proud to say in the Committee on Budgetary Control of the European Parliament on Tuesday that single audit has been identified for the first time as an important subject in the discharge recommendation of the European Council. Therefore, there is political pressure on us, together with member states, to ensure that we, as a Commission, can rely on the work of the audit authorities and certifying bodies in member states. We will have a common diagnosis, which will then allow us to improve financial management in different areas.

Q92 Mrs Trevelyan: Paragraph 1.1.2 of the NAO Report talks about EU added value, which is an interesting statement. Could you expand a little on how you see that in tangible terms? How do you monitor it? Mr Wynn Owen, in terms of the auditor, is that something that can be quantified and should be looked at in a financial way?

Phil Wynn Owen: Thank you for the question. In presenting our annual report, our Court's president, Vítor Caldeira, called for a wholly new approach to EU budgeting. What does that mean? First, a focus on performance and results. That includes identifying EU added value and how to use the money to best effect, so you fulfil the policy objectives and secure value for money for the taxpayer. We very much want to see that, and it is something we have been making the case for in our annual reports and special reports year on year.

Secondly, it means seeking greater flexibility in the use of existing funds. We all know there are constraints on the EU budget, but we believe the money could be used flexibly and better, and we want that continuous improvement. Thirdly, we highlighted in our annual report that it means tackling problems with unused funds, which you might want to come to.

Q93 Mrs Trevelyan: I think my colleagues are going to discuss that. So how are you going to monitor and quantify whether that is actually working, from an audit perspective?

Dr Kraff: I referred to your Committee's visit to Brussels, where Kristalina Georgieva explained the budget focused on results initiative, in which we are focusing on the following questions. In which areas do we spend? An analysis is being done of European public goods with higher added value of funds. Then we analyse how we spend. That means more leverage from EU funds and more simplification efforts. Also, how are we assessed? There it is extremely important to have the performance framework, which is now incorporated into the legal requirements for the multi-annual financial framework 2014 to 2020. We have indicators which define exactly what we have to achieve by spending European money. We have milestones indicating when certain objectives have to be met, and so on.

We are now implementing this. For example, if you have a look at our programme statements, these are documents accompanying the draft budgets, so the European Parliament and the Council get this information in order to be able to take it into consideration when they take political decisions. Then we will have to improve our reporting. In the annual activity reports, we have a specific chapter which analyses what has been achieved with EU money—input, output, results—and an overall or horizontal report which evaluates the results of European policies.

This report, by the way, is used together with the annual activity report in the discharge procedure by the European Parliament and the Council, and the objective of the discharge rapporteur for the budget 2014, Mrs Dlabajová, said very clearly that she wants a two-pillar approach. As well as compliance—bringing down the error rate is very important—she wants to focus on performance and added value in what has been achieved.

Q94 Mrs Trevelyan: So 40% of the EU budget is spent on agriculture in its broadest forms.

Dr Kraff: Yes.

Q95 Mrs Trevelyan: So what will be the EU's added value? To me, that is not only financial. Will it improve how we use our land across the European land mass that we are looking after? Will it improve productivity in food production? Will it increase or reduce tariffs? What is the EU's added value into that 40% of the budget that is spent on agriculture? What will it look like in real terms?

Dr Kraff: That is an excellent question. The objectives of the agriculture policy are defined in the treaty. You mentioned some of them. Then we have other objectives: for example, the greening of agriculture. All these aspects will have to be taken into consideration. Detailed reports will provide information on whether the results have been achieved.

Of course, it must be taken into consideration that the first pillar of agriculture is 100% financed by the EU budget. It is not together with the member states. The second pillar is different. There is rural development. The EU budget finances a share, and the national budgets finance a share, so it is important that we get an overall picture to see what has been achieved with the EU budget.

If you allow me to give an overall assessment to evaluate the performance in the area of the EU budget, one has to take into consideration the fact that our budget represents roughly 1% of GNI and 2% of public expenditure, so it would not be fair to say that we are responsible for 100% of the failure or the success. That means that, in the area of evaluation, we have to take into consideration not only the EU budget, but the national budgets. The social partners are a very important exogenous factor. It is a challenging task, but it is very high on our agenda, and we consider it an absolute priority to deliver on it.

Chair: We remember that from our visit last year. I will go to Caroline Flint and then back to Anne-Marie.

Q96 Caroline Flint: Welcome to our Committee. Mr Wynn Owen, how does the 20% directly administered by the European Commission compare to the 80% administered by member states, in terms of error rates?

Phil Wynn Owen: This year, we found very similar error rates across the two, which scotched the perception that the fault is largely in the member states. We find faults across the two. We found a more interesting distinction in areas such as whether reimbursement is being done on actuals or on flat rates. For instance, we suggested that reimbursement on actuals was leading to a lot of errors. We included analysis of where the differences lay, and I mentioned three of the big drivers of the errors in our reports. There are two types of managed expenditure: directly, which is managed by the Commission, such as in some of the competitions for research; and so-called indirectly, where they do it through a third party, such as the EBRD or whatever. I am doing an audit of nuclear decommissioning, where the EBRD is the indirect manager. We found similar error rates across the piece.

Q97 Caroline Flint: Do you have any thoughts about whether the error rates for the Commission—given that you said that it is not all necessarily directly, and that there is sometimes a third party—should be less than what you might expect, all things being equal, for member states, because it is once more removed?

Phil Wynn Owen: In theory, the fewer players you have, as long as you have the core functions of audit and administration, the fewer opportunities there are for error. One important lesson I am learning from this hearing is that there is scope for ever more education and discussion between all the parties who bear a responsibility—the member states; the Commission; the auditors themselves, who must explain what they are doing; and parliamentarians, who must ask the challenging questions. It is great that you are holding this hearing.

I should mention in that context that I have undertaken an initiative with the help of your own National Audit Office in the past two years. I write to Committee Chairs to present our annual report and offer to come and give evidence. I also had meetings hosted by the National Audit Office in about late November. I brought a team over from the ECA to present and explain our annual report to officials not only from across Whitehall but from across the whole of the UK. Particularly this year, we had break-out groups on agricultural errors and cohesion errors, and we tried to get a bit of a learning experience going—albeit from a very small sample—on what we have seen going wrong and what the difficulties are. That is fruitful, and I think we should do more of it.

Q98 Caroline Flint: Mr Wynn Owen, you have considerable experience here in the UK. I think you were in the Treasury from 1981 to 2004, and you have been a DG in DWP and DECC up to 2013. I hope you would acknowledge that you have a fairly good insight into how UK Departments manage EU funding. Can you offer something from that experience about what could be done differently?

Phil Wynn Owen: If you mean I have probably been involved in a lot of mistakes in Government—

Caroline Flint: Poacher turned gamekeeper—

Phil Wynn Owen: —I hope I have learnt from them. I have, of course, been in front of some of you before as an accounting officer on challenging issues. Thank you for the question, and if I may take it as an opportunity for a few personal reflections, for me one of my biggest learning experiences was being director of the regulatory impact unit in the early 2000s. I think the principles of better regulation are very important. I was actually one of the initiators and sat on the so-called Mandelkern group in early 2000s that published an independent report from member states that forced/encouraged the Commission to adopt impact assessment and better regulation in Europe.

This is a journey towards better regulation. It is not a destination you get to, but the means of operating according to the simple principles of wanting balanced systems of governance with checks and balances that mean you target the right things and your outcomes are realistic. You do not target everything. It is very easy, for instance, in building a performance regime to build a Heath Robinson or Byzantine structure with far too much being measured and with its own bureaucracy, so we are working with the Commission, as they begin to embrace performance management, to make sure that what they do is proportionate—that is another key word—so you make sure that you pursue performance but that you get the systems right.

You also get the incentives right. We touched earlier on sticks and carrots, and you need both. We as the Court of Auditors encourage our auditee—particularly if the Commission—to use the instruments it has got. I have published an in-depth deep dive into the second biggest error I mentioned: public procurement. This came out in the autumn, and this is on public procurement errors in cohesion. In one of the most contentious recommendations, I said to the Commission that if certain member states have not fulfilled the so-called ex ante conditionalities—that is a slightly

elaborate European term for criteria—to get the money, you have got the power at the end of this year to suspend payments and you should use it. That is a stick.

There is also a carrot. There is something called a performance reserve in the new MFF period such that several percent will be held back for 2019 and if member states are not able to demonstrate within reporting on their performance that they have achieved the targets set, they will not be able to draw down the last several percent of their allocation. There is a lot of debate about whether that performance reserve was well designed—personally I think it could have been better designed, but that was the work of the legislators—but that is potentially a carrot to encourage better behaviour by member states to draw down the final capital available.

Q99 Caroline Flint: Dr Kraff, I was looking at your CV as well. You have massive experience in terms of work at the ECA—I think you joined them in 1983 and you were there until 2008—so you clearly have many years of experience in the auditing process and now, while I would not say you are on the other side, you have to receive these reports from Phil and others and try to make sure that the Commission and the EU, as much as possible, spends the money wisely. What do you have to add on the question I asked about the 20% and the 80% and the fact that, as Mr Wynn Owen said, the error rate is comparable between the two? Do you feel frustrated that, when it comes to directly administered funds, the Commission could be leading the way for member states on this?

Dr Kraff: Yes. Thank you for reading my CV. Maybe that explains why we agree with virtually everything that the Court of Auditors says. We—not only me, but also my colleagues out there—take all of their recommendations in order to improve the situation.

Caroline Flint: You know where all the bodies are buried, don't you?

Dr Kraff: No, no. Phil mentioned suspensions and we do not shy away from using suspensions. For example, in the communication on the protection of the EU budget, you can see that €7 billion of suspensions was imposed in 2014 in order to put pressure on the administrations that manage the funds. As regards the performance reserve, I would not be as pessimistic as Phil. I still think that it is an incentive for management to make sure that they really deliver on the objectives.

As regards my frustration, yes, I was very frustrated to get a message from the Court of Auditors that we are not in reality better than the member states, because as Phil has stated very clearly, it is not linked so much to the management mode, it is linked to the type of expenditure that we have to manage.

Of course, we analysed very carefully why it went wrong in the 20% that are managed directly or indirectly by us. The Court of Auditors told us—and we agree—that roughly half of the error rate could have been identified by our certified auditors or our own auditors.

Again, that is the same phenomenon that we find in the member states, but I see a light at the end of the tunnel. Some of the errors cannot occur any more under the new legal framework. Why? Because there we have simplified. For example, there was a huge—I think it was 100%—error, so completely ineligible, linked to in-house consultants, based on whether they are or are not eligible. All that has been simplified so it is not possible any more to commit this error. I hope that at least will not pop up in the new sample of the European Court of Auditors in the coming years.

Q100 Caroline Flint: Can I move on to a slightly different area? We have spent a lot of time talking about errors, which is quite right, but I was interested to read in the NAO Report of the unspent commitments.

My understanding is that at the end of 2013, there were €222 billion-worth of unspent commitments. I understand those are projects of all sorts such as infrastructure for which it has legally been said, “Yes, we accept the bid” but they have to find match funding in order to get the EU part of the funding to come through. That is correct as well. If we look at figure 12 on page 27, a lot of these commitments are not being realised. That says to me that there is a huge amount of the EU budget lying in wait for something to happen.

That was the figure for the end of 2013. I understand that it has gone down for 2014 and is likely to go up in 2015. Why is that? Is there something the Commission, with special reports from the ECA as well, should be looking at to see whether or not these commitments should be allowed to continue? I know you can de-commit. Does it hamper, for example, the flexibility of the European Union to tackle other necessary areas that might require budgets? For example, on page 9, figure 1 has a breakdown of how the 2014-20 multiannual financial framework has been divided up. Security represents 2% as a proportion of the total commitment appropriations.

Given the circumstances we are facing at the moment, with a massive challenge across the European Union of migration, people seeking refuge and everything else that is going on, I would like to know that, instead of holding money in a vacuum against something that may or may not happen, there was flexibility to reassess those commitments and take action to reassign some money to more immediate concerns for the EU.

Dr Kraff: You tackle the very interesting and challenging question. The figure on page 27 in the NAO Report is very interesting. There you see the member states that have problems regarding the absorption. Why do they have those problems? Sometimes it is administrative capacity, sometimes the lack of co-financing, sometimes it is legal procedures that block, for example, the implementation of programmes and so on.

The Commission took action by creating a taskforce for better implementation. So the figures that you see went down but there are still enormous challenges, one can say. Now you correctly said that the outstanding commitments went down but they will go up again.

To put it in a picture, I would say it is like a swimming pool. You have legal pledges regarding future activities, which fill the pool, and whenever you incur expenditure by implementing projects, the swimming pool is emptied. We now have new legal pledges for the period from 2014 to 2020, which is why the water is rising again.

On whether that hampers sound financial management and whether it might be wiser to use the unused commitments, which will not lead to payments, and finance something else, yes, that would of course make sense, but we have to be absolutely certain that the money will not be used. As you know, the legislator has extended the n+2 rule to the n+3 rule, meaning that it now takes three years before unused legal commitments can be cancelled when previously it was two years after they were agreed. In other words, we have to wait a longer time in order to have a legal basis to de-commit. However, whenever we have the possibility to move money from one area to another, we do that, which explains why we were able to make more money available for the fight against the problems of the migration crisis, for example.

Q101 Caroline Flint: I understand the logic of that. Looking at figure 12, these countries are at the top because they are obviously newer entrants to the EU. My region of South Yorkshire benefited a lot from objective 1 money some years ago when I was first elected. It is understandable and good that such countries are coming forward with many projects to level up their economies, because that will help with some of the migration pressure. I understand the de-committing and what you said about the year extension and decisions being put off is interesting, but I wonder whether there could be some more front-ended work to look at the capacity of these countries to realise big projects. I am not saying that this is just a Romanian or Bulgarian problem—we have looked at major projects and delivery in the UK on this Committee—but does the front-ended side of things need more attention? You don't want to set these countries up to fail.

Dr Kraff: As I mentioned, we have created a taskforce to deal with exactly that in order to have discussions with those that have to implement the commitments or programmes and to find possibilities in order to ensure that they are able to use the money that has already been earmarked for the projects going on. If it is not possible to ensure that the money will be used, it should be de-committed and used for other expenditure in other policy areas.

Q102 Mrs Trevelyan: So are you saying that not only will the taskforce look at existing unspent commitments and work out what to do with them, but there will be a new framework? Would it need to be legislative so that there can be an assessment before any money is committed? Would that require legislative change? The taskforce or A. N. Other body could look at it and say, "Romania wants a new road. That's a £50 billion investment. They have to match fund it. They cannot match fund it for the next five years, so we are not going to commit that money." Can we not get to that point so that there is money—we have 15% of the budget sitting in an unused pot, which is not value for money for all those member states who have put it into the kitty to help, as Ms Flint says, increase economic benefit across the whole EU.

Dr Kraff: The starting point, as you know, is the national envelopes. These are political decisions taken by Heads of State and Heads of Government, earmarking and accepting the amounts available for different member states. Then, in the process of adopting the operational programmes, the commitments are made and then comes the process of implementing the projects and using the money. But it must also take into consideration that unlike in other policy areas, in the area of cohesion, these national envelopes are objectives. They should be reached.

This was a decision at the highest political level of the EU, so it is then very difficult to change to a different regime. We have been proactive. We tried to help. We want to make sure that the money is really used as an instrument of last resort. Then we de-commit and use it for other purposes.

Q103 Mrs Trevelyan: How much has been de-committed?

Dr Kraff: I cannot tell you off by heart, but I will provide you with the answer in writing.

Phil Wynn Owen: We are making it clear in our annual report that we would like to see better long-term forecasting by the Commission, drawing on data from member states. We would like to see the opportunity taken in the mid-term review, for which they are due to produce their

ideas by the end of this year. If budget based on results is to mean something, it must mean a focus on performance and greater flexibility.

There are problems with unused funds, especially around commitments. We have just announced in our work programme for 2016 a study of the absorption problems in cohesion. A nice thing about special reports is that we do not just focus on errors; we can also promote best practice where we see it, so hopefully there can be some shared learning there.

I should mention that there is also another issue about unused funds, which is both a problem and a potential opportunity for Manfred and his team as they seek greater flexibility. There are funds building up in financial instruments—those are the involvement of private sector funds used by the Commission—and in so-called financial engineering instruments, or FEIs, which are largely administered by member states. We gave a figure at the end of 2014 of €1.3 billion sitting in financial instruments. We were not sure of the figure for financial engineering instruments, but we think there may be significant funds building up in those too. Those are pots of money that, notwithstanding all the problems of flexibility and who the decision makers are that Manfred identified, could be used flexibly to tackle some of the very real challenges that the Union faces at the current time.

Q104 Chair: Dr Kraff, you mentioned in response to both my colleagues that you want to ensure that the money allocated goes to meet EU priorities about levelling up—we do not need to rehearse what those are—and that you work hard to help them make sure it is spent. Can you perhaps take an example in Romania or Bulgaria? What practical support are you giving to make sure that this large amount of money that is sitting there waiting to be spent is spent? Do you get stuck in? Do you get them to work with other member states that have the capacity to deliver?

Dr Kraff: The taskforce went on the spot to discuss with those responsible in order to see, first of all, what the problems are and to find solutions. This was then implemented. The feedback that we got is that the situation is much better than it was. For example, you can see here the situation in 2014. As regards financial engineering instruments, which Phil mentioned, yes, there is indeed a problem. There was a figure of €14 billion in money sitting in financial engineering instruments. The Court of Auditors told me to focus—I will do so—on the three biggest countries, which make up a huge percentage of the whole amount, in order to see whether the money will be used and what amount is available. That was for the past.

For the new financial framework, the legislator limited the possibility of advance payments, so much smaller amounts are now put aside and made available for the financial instruments. It is now clearly forbidden for member states to have excessive balances. They have to identify those, inform us and take the necessary action. Also, the reporting requirements are much better than in the past. In the past, for the Commission, it was sometimes difficult to get the information, because member states were not obliged to provide precise information on the amounts concerned.

Q105 Caroline Flint: Finally, I want to ask something about fraud, which is obviously different from what we have been talking about today, and we have a European Anti-Fraud Office, known as OLAF. I noticed that page 16 of the NAO Report says: “Between January 2007 and December 2014, OLAF made 16 recommendations to UK competent authorities to recover EU monies. Eleven of these recommendations were dismissed. The remaining 5 recommendations led to an indictment (representing an indictment rate of 31%, compared with the EU member state

average of 53%).” Do you want to comment on that or say something more generally about how fraud is dealt with?

Phil Wynn Owen: If I go first, Manfred may have something to add. Combating fraud is not an easy business. You will know that in the UK that has had a somewhat chequered history: the history of the Serious Fraud Office and so on. It is not our core function; you are right that it is OLAF’s, which is a part of the Commission, but an independent part of it. We have been doing more in the ECA, because error is not fraud. As you know, there is a multiplicity of types of error, but where our auditors come across suspected fraud, they have a duty discreetly to gather what information they can and then we report it to OLAF to investigate.

That work has had a slightly rising profile. In the 2013 annual report period, we reported 14 cases and 22 in 2014. We have been doing more training for our auditors in fraud awareness, which may account for some of that increase. We also published an opinion on the Commission’s first report on anti-corruption measures in April 2014. There was a special paper from us. We applauded the fact that there was such a report from the Commission, although we said it needed more data and more analysis, which is perhaps a familiar refrain of this morning’s session.

We did a special report on this public procurement in cohesion, where there are elements of fraud suspected in some cases, as you can imagine on very large construction projects. We pointed to the potential for new technology to really make a difference in this respect. I should applaud the Commission; it has a tool called ARACHNE, which is a computerised database that can identify irregular patterns in public procurement, to which they have been encouraging as many of the member states as possible to sign up.

Q106 Caroline Flint: Has the UK signed up to use that tool for identifying irregular payments?

Dr Kraff: I think they did, but I am not—

Phil Wynn Owen: When we published our report several months ago, the Commission had not yet visited and had the discussion fully with the UK, so it was an open question several months ago. We don’t always track all follow-up activity to our reports because we move on to others. One source of concern was that the Germans had decided not to use ARACHNE, but a lot of other member states had signed up and I believe the number is growing. Of course, this is a classic single market initiative whereby the more who play, the better a result you get, because you can do cross-comparisons, for instance, of cross-shareholdings between companies.

Chair: We can check with the British Government.

Dr Kraff: I will provide you with a written answer on where we are with the United Kingdom. I only want to add one element to what Phil said. If you read the report of OLAF on the protection of the financial interest of the EU, you can see that the fraud as regards the EU budget represents 0.2% of the overall financial volume. So what you can read in the press is not at all reflected on the basis of the official statistics that are available.

Q107 Mr Bacon: I have a question for Mr Wynn Owen about special reports; in appendix six of our Report, there is a list of them. Last year the Court of Auditors did 22 reports; in 2014 it was 24. What is the cost to the European Court of Auditors of producing special reports?

Phil Wynn Owen: I haven't got the exact breakdown, but the cost of the ECA in 2015 was about €130 million, which is less than one tenth of 1% of the EU budget.

Q108 Mr Bacon: Remind me, what is that in sterling?

Phil Wynn Owen: It depends which exchange rate you take.

Q109 Mr Bacon: I only want a rough idea.

Phil Wynn Owen: As of close two days ago, it was about 78p to the pound, but I may be a p or two out, and it is probably changing as I speak. Take roughly three quarters of that, so around about—

Q110 Mr Bacon: £90 million to £100 million.

Phil Wynn Owen: We have just under 900 staff, excluding our 28 members.

Q111 Mr Bacon: So in terms of size, you are quite comparable to the National Audit Office, which has just over 800 staff and a budget of about £70 million—obviously a bit larger.

Phil Wynn Owen: Yes.

Q112 Mr Bacon: Of that budget, how much is spent on special reports?

Phil Wynn Owen: Depending on how you count it, something like a half to two thirds of our budget is responsible for the work that goes into our annual report and our statement of compliance exercise, which would imply—allowing for overhead costs—that a large part of the other half is going towards special reporting.

Q113 Mr Bacon: Really? So most of €65 million is going into these special reports? I find that extraordinary.

Phil Wynn Owen: No, I said our annual report—the thing that produces the error rate.

Mr Bacon: Yes, yes. You keep on answering a question that I have not asked. I am asking about the special reports.

Chair: I think Mr Wynn Owen was just doing the maths out loud.

Q114 Mr Bacon: Yes, I understood that. By a process of elimination, the remaining half—subject to overheads—was the rest.

Phil Wynn Owen: I haven't got the exact figure for you. My estimate would be that somewhere between a quarter and a half of our total costs go on special reporting. We are seeking to increase that proportion, which stakeholders have welcomed. We recently published our special report, Work Programme 2016, which shows that we are likely to publish somewhere between 20 to 40 special reports this year. The number is uncertain because we obviously have very high quality standards ourselves.

Q115 Mr Bacon: So does the National Audit Office. I am just slightly surprised that it is as high as that. A quarter would suggest €31.5 million. A half would suggest €65 million. So it is somewhere between €30 million and €60 million to produce 22 reports. That suggests that they are about €3 million each. That does not sound right, to be honest. I mean, the National Audit Office Reports cost £200,000 to £300,000 each, which is about €0.5 million, so for each special report of the list of 22 reports—the landscape of these is on page 59—to cost €3 million or even €1.5 million sounds extraordinarily top heavy.

Phil Wynn Owen: There are two things. One is that we have been seeking to learn from the excellence of the National Audit Office in the way they support this Committee in producing special Reports. There is a lot we have learnt from them and there is a lot more that we could learn from them. Secondly, without being an apologist, I point out that we are dealing with slightly different landscapes. We are dealing with a very large land mass of 500 million people in 28 different countries and Administrations.

We do some sampling audit visits to individual member states—perhaps four or five in each case. On public procurement, we actually had an audit team that came to the UK to look at good practice and development needs here. It also went to Italy, Spain and the Czech Republic. That and costs such as translation, which I do not think that the National Audit Office bears massively—other than my own dear native Welsh—is a major factor in our cost base, so there are differences between our cost bases.

Mr Bacon: Various things push up the cost.

Phil Wynn Owen: I have no doubt that we could become more efficient in the production of our special reports. We actually had a peer review by German, French and Swedish national audit offices in early 2014, from which we have learnt a lot. It said that we could do our special reports quicker and more efficiently on some of the more salient topics of the Union. We have been doing everything we can to drive that forward. The point behind your question—that we ought to be looking at the unit cost of each and every special report—is a good one and one that I am happy to take away.

Q116 Mr Bacon: Actually, that was only my preliminary question. I sit on the Public Accounts Commission and we provide the budget for the NAO. My question—I think you have sort of answered this—was that 22 sounds not really enough for the scale and range of activity of the EU. If

you were right-sized for the number of special reports you ought to do for the range of activity, what would the sweet spot be? What would the optimum number each year be on an ongoing basis?

Phil Wynn Owen: We have further to go but we are getting better all the time. I am happy to send the Committee Chair and members a copy of our Work Programme 2016—

Chair: Please do.

Phil Wynn Owen: —which has 40 potential reports for this year. I am not saying that we will produce them all this year, but we will certainly start or complete them this year. We are now focusing on all the really big challenges of the Union. You will see a stream of interesting reports coming out of the European Court of Auditors. I recently completed one on the problems in the internal energy market and energy security.

Q117 Mr Bacon: I wasn't actually after the detail. If you were right-sized, how many reports do you think, in a normal year and in a steady state, ought you to be producing?

Phil Wynn Owen: I don't think that we are necessarily wrong-sized. Look at our 2016 Work Programme, which I think has a comprehensive programme of special reports. Clearly, special reports are always on a sample of the major problems that the body you are auditing faces, but if you look at the 2016 Work Programme, which I will send to you, you will see that we are hitting many of the big European issues of the day.

Q118 Chair: So 40 is not bad.

Phil Wynn Owen: I think if we hit that, that will be a good result. Obviously, you are then dependent on the quality of each and every report.

Chair: I thank you both for your time and for coming from Brussels to speak to us. It is a very important issue anyway, but it is particularly important in the UK right now as we have a big decision to make as a nation in the next few months. Our transcript will be available on the website in a couple of days, but we will of course send you a copy. If you have any corrections, please let us know. We will also send you a copy of our final report. I cannot tell you exactly when it will be out, but it may well be after the Easter recess. We look forward to hearing your comments on it. Thank you very much.