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A year ago, at the conference in Dublin, I talked to you about error rates, the Declaration of Assurance, and the discharge procedure. My messages were triggered by an unsatisfactory development of error rates and the need for you to step up your efforts to counter the trend and improve the legality and regularity of your CAP management. Today, one year later, we have more or less the same food on our plates. This means that the work must go on. [Slide 1: "the war on error"] We have, however, made a good step forward in our methods to find out who and what causes the most serious problems. In addition, the new Horizontal Regulation has completed our toolbox to take the necessary measures. And, let us not forget, the political pressure to make progress has also increased as it clearly transpires from the European Parliament's discharge resolution for 2012.

Last year, I explained to you that we had applied a new methodology in our 2012 AAR in order to calculate the residual error rate for decoupled direct aids.

For the 2013 AAR we were required to extend our methodology to the whole CAP. The result was as follows:

[Slide 2 "error rates and reservations 2013"]

DG AGRI further adjusted the methodology applied for the 2012 AAR to bring it into line with that used in other areas of shared management. Essentially this means that we carried out a two-level assessment for each paying agency of the error rates which resulted from your control statistics and made adjustments based on "all relevant available information". This information included:

- The opinion of the certification bodies on your accounts and statements of assurance
- The systems assessments of the ECA in its annual reports of 2010, 2011 and 2012.
- DG AGRI own assessments based on audits carried out from 2011 to 2013.

We used this information to assess whether the error rates you had reported were reliable and complete. Where this was not considered to be the case, we applied a top-up to the error rate.

The reason this work was done at paying agency level is simple: to find out where the problems are and have to be tackled, even if the amount at error at ABB level or Member State level is below 2%, the situation must be examined for each paying agency with an error rate above 2%

For market measures, the situation was a bit more complex than for other types of CAP expenditure. It was necessary to examine the individual aid schemes and the situation for each Member State where the error rate was above 2%.

We then classified all paying agencies into risk categories as demonstrated by the table in the next slide:

[Slide 3: "risk categories"]

Where the RER is above 5%, we are obliged to make a reservation for the paying agency/Member State concerned. This was the case for 11 sub-reservations for Market Measures (i.e. individual aid schemes for individual Member States), 2 paying agencies for ABB03 and 13 paying agencies for ABB04.

Where the RER is between 2 and 5% whether or not a reservation is required depends on whether mitigating factors exist with regard to both

- the past (via an on-going conformity procedure) and
- the future (remedial action taken by the PA concerned).

A further 18 paying agencies each for ABB03 and ABB04 were subject to reservations due to insufficient mitigation factors.

[Slide 4: "Homer"]

In all, the new methodology resulted in 11 sub-reservations for ABB02 (market measures), 20 for ABB03 (direct payments) and 31 for ABB04 (rural development). That's 62 reservations for EAGF and EAFRD - plus we have one for IPARD.

Each reservation will require an action plan to address problems and in due time, , the Member States concerned will be contacted by the responsible unit within DG AGRI as to discuss what will be required of them.

The AAR process this year was also driven by the difficult discharge procedure for the 2012 budget which has resulted in some very strong comments and recommendations from the EP. To give you a flavour:

[Slides 5 & 6: EP calls on MS to reinforce controls]

[Slide 7: EP calls for suspension of payments where action plans don't remedy deficiencies]

As you know, in the new Horizontal Regulation there is a provision at Article 41 that payments can be suspended or reduced where the Commission concludes that the Member State is not in a position to implement in the immediate future the necessary remedial measures in accordance with an action plan. I will come back to this in a minute.

Also, the European Parliament wanted much more transparency as to where the error lies so that the necessary actions can be targeted. This was a major factor in DG AGRI having to examine the situation and decide on reservations at the level of each paying agency.

But all the criticism of the EP is not just for the MS. They also want improvements from the Commission.

[Slide 8: "We are all in the same boat"]

DG AGRI is currently working towards a multi-annual audit strategy and, as those of you who have been following the discussions on the Horizontal Regulation implementing acts in the Agricultural Funds Committee are aware, we have proposed a number of elements to shorten the life-cycle of the conformity clearance procedure, in particular strict procedural deadlines for each phase of the conformity procedure.

Challenges for the coming years [slide 9 with bullets (1)]

1. Legality and Regularity

One of the factors on which we in the Commission are relying strongly is the new assurance model. Faced with growing – and often justified - criticism over the past years about the reliability and the completeness of Member States' control statistics the solution we have offered is the legality and regularity work to be performed by the certification bodies. It is of enormous importance that the new role of certification bodies results eventually in a real improvement in the situation, that they detect the errors which you the paying agencies have overlooked and give a fully informed opinion on the reliability and completeness of the control statistics and the quality of the underlying controls. The outcome of the work of the certification bodies should be an important management indicator for the paying agencies. It can have a preventative role by informing the paying agencies of the CBs' findings in order that any necessary improvements can be made to management and control systems.

I know that this new work is costing Member States a lot of money. It will also mean a lot more work for us in the Commission. It is therefore of the utmost importance that we avoid wasting time and financial resources on this. The certification body opinion should not just be a rubberstamping of what the paying agencies are doing. They have to look critically at what you are doing and identify where you are going wrong. There must be a real value added to this work. We will therefore make an investment in accompanying the introduction of the new assurance model and take a close look at the quality of the Certification Bodies' work.

[Slide 10 : Team work]

[Slide 11: bullets (2)]

2. Follow up of reservations and action plans

Following this year's AAR exercise, we have 62 reservations (plus 1 for IPARD). Each reservation requires an action plan from the paying agency concerned. This will mean a challenge for the paying agencies concerned, as well as for us in DG AGRI who will have to ensure the follow up of each of these action plans.

[Slide 12: bullets (3)]

3. Suspension and reduction of payments

As I said above, if remedial action is not taken, then suspending or reducing payments will be a realistic option. It is clear that we will be under close scrutiny from the European Court of Auditors and the European Parliament to effectively apply suspension or reduction of payments if Member States and paying agencies do not promptly remedy the deficiencies.

In 2013 a couple of you have experienced interruption of rural development payments which can as of 2014 be applied for 6 and in certain cases for up to 9 months. Suspension and reduction of payments can go up to 24 months. Before they can be lifted, we will require clear evidence on your part that the deficiencies have really been remedied. Against this background it goes without saying that implementing action plans will be by far the better option. I can understand that the notion of action plan does not sound sweet to you: it means more work, reporting and scrutiny from the Commission's side. However, that's the road to go.

[Slide 13 : no pain no grain]

[Slide 14: Bullets (4)]

4. New legal framework

It is expected that all necessary elements of the legal framework will be in place by the summer break.

[Slide 15: Bullets (5)]

5. How can and will DG AGRI help?

In the first place, I note that while there are 62 reservations at paying agency level; their management by DG AGRI will be grouped at Member State level.

DG AGRI has recently established a new unit D.3 under Christina Borchmann. She will introduce herself and her new duties after I have finished with my presentation. She has a long experience in the Commission, including in DG AGRI and very well understands the challenges which face both you the paying agencies and us in the Commission. Christina and her excellent team will accompany you in your implementation of the new regime for Direct Payments as it has been agreed in the CAP reform. This unit will also have a responsibility for following up the implementation of action plans where they relate to the quality or completeness of the LPIS or to incorrect interpretation and application of the legislation.

For Rural Development the geographic units will continue to follow-up your action plans - and in particular for those of you with reservations this year will see where action plans need to be adjusted or supplemented to ensure that you are addressing weaknesses that have been identified.

For Market Measures, DG AGRI will address the very specific issue with you which have resulted in the 11 sub-reservations.

Directorate J will continue to play its role in protecting the EU budget.

[Slide 16: Bullets (5)]

5. Protecting the EU budget and bringing down the error rate

While we in the Commission have to continue to point out your management and control weaknesses, we know that many of you, in recent years, have made major efforts to improve and we appreciate your good co-operation and count on it for the future.

[Slide 17: "The devils"]

We cannot continue with such high error rates as we see them in the area of market measures and rural development. Member States and DG AGRI have to work together to really address this issue. We in the Commission have already looked carefully at the root causes of error and identified many elements for each of the three ABB activities.

For the market measures, the high error rate reported in this year's AAR arises from a limited number of cases in specific Member States where the rules have been wrongly applied resulting in a very high proportion of expenditure which is ineligible.

For the direct payments, much of the error comes from incomplete and out-of- date LPIS. The LPIS is definitely a good tool but it needs to be fed and applied correctly. Certain of you go to the trouble and expense of updating your LPIS and then you seem to not bother with it for a couple of years until the problems start to arise again. We therefore repeat the message that there is no alternative to keeping your LPIS in good shape – it is a continuous process (a bit like housework, not so pleasant - but necessary if you want your home to be clean and cosy …).

For the second pillar, we all know that rural development measures are generally characterised by a greater complexity which makes them more prone to errors. This is particularly the case for some of the very complex and demanding eligibility conditions which beneficiaries find difficult to fulfil and which you the Paying Agencies, find difficult to control. Let me stress here again that you should pay particular attention to this aspect when you are consulted on the new rural development programmes in your MS and regions. **Make it clear to your managing authorities that there is no more room for the luxury of gold-plating, inventing uncontrollable requirements or vague and misleading eligibility conditions!**

One interesting development in the new methodology for calculating the level of residual error and amounts at risk in the context of this year's AAR, is that in order to put these rates into perspective we had to carefully look at the data on the financial corrections which we have made.

I therefore go back to the table I showed you at the beginning but now with columns added for financial corrections and recoveries and showing them as a percentage of the expenditure.

[Slide 18: "corrective capacity"]

While it would not be appropriate to use these amounts to reduce the error rates or amounts at risk we used them for comparative purposes. Or in other words: to show the impact of financial corrections and recoveries on the degree of protection of the EU budget.

If you do the math you can see that **for ABB02 (market measures)**, the residual error rate is 7.44% but, if we take into account the net financial corrections which amount to 5.34% of expenditure, the actual effect on the budget would be a much more acceptable 2.1%.

<u>For ABB 03 (direct payments)</u>, the error rate net of financial corrections would be well below 2% and for the EAGF as a whole if recoveries are also taken into account, the budget effect of the error rate would be around 1.4%.

I would just note here that we don't currently have data on the recoveries at ABB level. This does place a limitation on the extent to which we can use them. In the implementing act to the HZR however, the new provisions for irregularities require more data on the budget areas concerned which would enable us to make the necessary split for the future.

<u>For ABB 04 (rural development)</u>, the picture however is less "rosy".

The error rate we found is 5.19% while the financial corrections only amount to 0.84% of expenditure. If we also take account of recoveries we would still arrive at a risk to the EU budget which would, at 3.6%, clearly be above materiality

There will therefore be pressure on DG AGRI to ensure that it can protect the budget to a greater extent as regards the second pillar expenditure. How we shall do this will have to be examined but it is at least likely that it will mean greater scrutiny by us on you as we increase the scope of our rural development audits.

So, ladies and gentlemen, the situation remains difficult. We have both fewer resources to do ever more work. This is one reason why we looked in the AAR at the issue of cost of control. Christoph Klockenbring will give you more information about this a bit later. A couple of interesting figures which we gleaned from that exercise was that you the MS spend almost 4 billion EUR on the management and control of the CAP funds. However, the cost-benefit ratio of this (cost compared to the benefit via aid reductions and recoveries) is only 8:1.

Rather therefore, than say that you need to do **more** controls, we would say that you need to concentrate on doing **better** controls. According to the assessment of the ECA this seems to be well possible if already now you could have detected half or more of the errors found. Invest the necessary time and money in getting your LPIS right and you should see the results in the aid reductions that you make. Look at the ECA's findings from the DAS and system audits as well as your CB's findings and DG AGRI's audit finding and ensure that your management systems are adjusted as necessary and that your controls are sufficiently comprehensive to check and detect elements which have resulted in previous deficiencies being detected.

There is a US management guru called Walter C. Wright and while he comes out with a lot of management mantras, there is one which particularly stuck with me: [Slide 19]

"If people are not making mistakes, they are not trying new things. If they are making the same mistake twice, they are not learning new things!"

I'm sure there will be some mistakes to make with a new CAP to implement. Let us try, with the help of the new structures within DG AGRI, to at least not make the same old mistakes we have made in the past.