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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Report on the functioning of the Interinstitutional Agreement on budgetary discipline and sound financial management

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1. INTRODUCTION

The Interinstitutional Agreement on budgetary discipline and sound financial management (IIA) is a political agreement between the European Parliament, the Council and the Commission. It contains many provisions and principles which have proven to be helpful and even necessary to ensure budgetary discipline and smooth budgetary procedures. The IIA affects numerous aspects of the planning, preparation, execution and control of the budget. Most prominently, it incorporates the Multiannual Financial Framework (MFF), an instrument which sets maximum annual amounts (ceilings) for broad categories of expenditure (headings).

The current IIA was adopted on 17 May 2006[1] on the basis of the MFF agreement reached at the Brussels European Council on 15-16 December 2005 and subsequent changes later agreed with the European Parliament. It represents the most recent milestone in a long history - more than 50 years - of budgetary debates between the European institutions. Since 1988, four successive IIAs have been concluded: the *Delors I* (1988-1992) and *Delors II* (1993-1999) packages, the *Agenda 2000* (2000-2006) and the current 2007-2013 package. Together, they have ensured that the EU budget has been adopted smoothly and on time over the last 20 years.

This report presents a thorough examination of the functioning of the current IIA and possibilities to refine the existing arrangements in line with Declaration 1 to the IIA, which foresees that "in relation to Point 7 of the Interinstitutional Agreement, the Commission will prepare a report on the functioning of the Interinstitutional Agreement by the end of 2009 accompanied, if necessary, by relevant proposals".

The analysis below follows broadly the structure of the IIA and focuses in particular on the procedures implementing the MFF (adjustments and revisions) and flexibility (functioning of the current instruments including the procedures for their mobilisation). Finally, the examination of issues related to the sound financial management of EU funds covers the Statements of Assurance, financial programming and the new financial instruments.

This report does not pretend to be exhaustive. A number of important issues related to the Interinstitutional collaboration are not examined here. And many important aspects of the budget reform are left to the "review of the financial framework" pursuant Declaration 3 to the IIA[2].

2. ANALYSIS OF IMPLEMENTATION PROCEDURES RELATED TO THE MFF

The MFF, together with the other provisions in the IIA, has ensured

[1] Interinstitutional Agreement (IIA) of 17 May 2006 between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management, OJ C 139, 14.06.2006.

[2] Insert reference to Budget Review document here.

- budgetary discipline: the annual budgetary procedure must respect the MFF ceilings;
- a smooth budgetary procedure and effective cooperation between institutions thanks to the various rules of procedure agreed upon in the IIA. It is important to recall that since 1988 all budgets have been adopted on time;
- more predictability on the evolution of EU expenditure.

Acknowledgement of the usefulness of the MFF is reflected in the insertion of an article in the Lisbon Treaty stating that "the annual budget of the Union shall comply with the multiannual financial framework".

2.1. Procedures to adjust the Multiannual Financial Framework

2.1.1. Yearly technical adjustment

Point 16 of the IIA foresees a yearly technical adjustment ahead of the budgetary procedure for year n+1. This involves in particular a revaluation, at year n+1 prices, of the ceilings and of the overall figures for appropriations for commitments and appropriations for payments.

For this purpose, a fixed deflator of 2% a year is used and not the price deflator of GDP as was the case for previous MFFs. This offers a clear advantage in terms of transparency as the ceilings are known in real as well as in nominal terms for the entire duration of the financial framework. This in turn facilitates long term financial planning and gives more certainty to all stakeholders involved in the budgetary procedure.

This clear advantage would appear to outweigh the inevitable difference between ceilings and overall figures for appropriations obtained using the fixed deflator and figures that would be obtained using the observed price deflator of GDP. At this stage, this difference appears rather limited. In 2008, the deflator index using the fixed deflator was at 108,2 (base year 2004 = 100) while the deflator index using the observed price deflator of GDP was at 108,0.

	2007	2008
Fixed deflator used for technical adjustments	2,0%	2,0%
Cumulated index using the 2% deflator (2004=100)	106,1	108,2
Price deflator of GDP (ECFIN Spring 2009 forecast)	2,8%	0,3%
Cumulated index using effective deflator (2004=100)	107,7	108,0

2.1.2. Adjustment related to allocation of cohesion policy envelopes

Point 17 of the IIA foresees a technical adjustment for the year 2011 if it is established that any Member State's cumulated GDP for the years 2007-2009 has diverged by more than +/- 5% from the cumulated GDP estimated when drawing up the IIA. In that case, the Commission will adjust the amounts allocated from funds supporting cohesion to the Member States concerned for that period.

This provision was introduced due to uncertainties related to GDP estimates, which – only in the case of Member States being subject to capping – had a direct bearing on the calculation of the allocated amounts. It should therefore only apply to Member States whose cohesion policy envelopes were capped and duly take into account the relevant additional provision in the Regulation laying down provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund[3]. The adjustment of the eligible Member State's 2007-2009 envelope should be linear, proportional to the positive or negative divergence in cumulated GDP and equally spread over the years 2011-2013.

Point 17 further defines a maximum amount for the adjustments. The total net effect, whether positive or negative, of those adjustments may not exceed EUR 3 billion. If the net effect is positive, total additional resources shall be limited to the level of underspending against the ceilings for heading 1B for the years 2007-2010.

The underspending for the years 2007-2010 includes (a) the sum of the differences between the ceilings for heading 1B for each of the years 2007 to 2010 and the commitment appropriations actually budgeted for the period, (b) the cancelled (or lapsed) commitment appropriations under heading 1B, excluding the 2007 amounts transferred to subsequent years under point 48 of the IIA and (c) total de-commitments of the years 2007-2010 related to cohesion.

Based on preliminary estimates, the resulting adjustment is likely to lead to upwards adjustments for a limited number of countries, but these will remain significantly below the EUR 3 billion ceiling. The assessment of the GDP divergence and, if necessary, the corresponding adjustment will be made by the Commission as part of the technical adjustment for the year 2011.

2.1.3. Adjustment of the global payment ceiling

Pursuant to point 18 of the IIA, the Commission checks every year the global ceiling for appropriations for payments, which was established when the financial framework was drawn up, in the light of implementation, to ensure an orderly progression in relation to the appropriations for commitments.

The actual level of payment appropriations has so far been significantly lower than the ceilings which could possibly lead to a catch-up phenomenon with higher than foreseen payment levels in years to come. Nevertheless, the current assessment regarding levels of payment appropriations until 2013 does not at this stage show a need to adjust the existing ceiling of payments.

The Commission will continue to monitor carefully the evolution of the situation and keep fine-tuning its estimates of payments for structural operations and for all other headings.

Regarding payments appropriations after 2013, the Commission confirms its intention to update the forecasts in 2010, in accordance with the terms of point 19 of the IIA. In this context, a particular attention may be paid to the evolution of the level of outstanding unpaid commitments (RAL).

2.1.4. Adjustment for implementation of structural funds, cohesion funds, rural development and the European Fund for Fisheries (EFF)

Under point 48 of the IIA, in the event of adoption after 1 January 2007 of new rules or programmes governing the Structural Funds, the Cohesion Fund, Rural Development and

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[3] Cf. in particular Point 14 of Annex II to Council Regulation N°1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation N°1260/1999.

the European Fund for Fisheries (EFF), the two arms of the budgetary authority undertake to authorise, on a proposal from the Commission, the transfer to subsequent years, in excess of the corresponding ceilings on expenditure, of allocations not used in 2007.

Appropriations for commitments totalling EUR 2 034 million lapsed in 2007, i.e. they were not implemented in 2007 and were not carried forward to 2008. This corresponds to the 2007 envelopes related to 45 Operational Programmes that could not be adopted in 2007, mainly due to delays in the submission to the Commission. The reprogramming for heading 1b and heading 2 was implemented as follows by Decision 2008/371 of the European Parliament and of the Council of 29 April 2008:

(in current prices, in EUR million)

	2008	2009	2010	2011	2012	2013
Heading 1b	378	0	0	24	24	0
Heading 2	394	387	387	147	147	147

This amount was much lower than the EUR 6 152.3 million reprogrammed in 2001[4].

Key messages on the procedures to adjust the MFF

The procedures to adjust the MFF appear to function well and there is no need to propose any immediate changes. The advantages of using a fixed deflator (point 16) clearly outweigh the limited cumulated difference with the observed price deflator of GDP. The adjustment of the cohesion envelopes (point 17) is clarified in this report and will be made by the Commission before 1 May 2010 as part of the technical adjustment for 2011. An adjustment of the global payment ceiling (point 18) has so far not been necessary, but a continued careful monitoring is appropriate. Finally, the adjustment for implementation (point 48) went smoothly and the amounts concerned were far lower than in 2001.

2.2. Flexibility in the Multiannual Financial Framework

2.2.1. Analysis of margins

Heading 1A covers priorities of immediate relevance for the renewed Lisbon agenda for growth and jobs, an area in which the EU budget should be able to react promptly to new challenges and upheavals.

This heading gathers the greatest number of different EU policies and is regularly under great pressure due to a quickly evolving international context. The recent past has shown that there are important needs in this area. These have increased further as a consequence of the economic crisis and climate change. In this context, the EU has for instance already indicated the need to double global energy-related RD&D by 2012 and increasing it to four times its current level by 2020.

Taking into account the recent proposals for GMES (EUR 85 million for 2011-2013), the European Supervisory Authorities (EUR 51 million for 2011-2013) and the decommissioning of the Kozloduy nuclear power plant beyond 2009 (EUR 300 million

4 See Decision 2001/692 of the European Parliament and of the Council of 3 May 2001 pursuant to paragraph 17 of the IIA of 6 May 1999.

for the period 2010-2013), remaining margins and possibilities for redeployment offer only limited scope to respond to future eventualities.

The issue of margins is not as relevant for **heading 1B** as, under point 13 of the IIA, the institutions are not obliged to maintain any margin under this heading, i.e. this ceiling is a target of expenditure.

The situation of **heading 2** is quite different. At the European Council in Brussels in October 2002 strict budgetary ceilings were laid down by EU leaders to cover CAP spending in the 2007 to 2013 period. The subsequent 2003 CAP reform introduced a financial discipline mechanism to ensure that the amounts for the financing of the CAP are not exceeded in any year. In practice this situation has not arisen, and the margins under the ceiling of heading 2 have so far been substantial. These margins have been a source of flexibility: decreases in heading 2 have offset increases in other headings, allowing the overall MFF to remain unchanged. However, it is expected that these margins will have a tendency to diminish over upcoming years in view of the continued phasing-in of direct aids in new Member States as well as the use of unpaid direct aids for 'Health check' related new challenges.

Recurring international crises and emergencies regularly confront **heading 4** with insufficient margins and flexibility issues. Problems in this area are particularly acute because of the volatile nature of external events, for example sudden conflicts and natural disasters. Even though it has so far been possible to accommodate the additional needs through recourse to various flexibility instruments in the course of the annual budget procedure, the protracted negotiations on the food facility, for instance, have clearly shown the limits of the IIA's flexibility mechanisms. Furthermore, the current strict separation of internal and external expenditure, which was highlighted when the budgetary authority rejected the Commission proposal to make available part of the financing for the food facility within the margin available under heading 2, appears to limit the Union's capacity to react to global challenges. In the remaining years of the present MFF the margins programmed for heading 4 are limited, and could come under pressure from unforeseen events. In addition, in the area of climate change, the EU budget could contribute to the adequate, predictable and timely EU financial support for implementation of an international agreement in the context of the UN Framework Convention on Climate Change.

Regarding **headings 3 and 5**, the margins have been manageable and no substantial problems are foreseen. Unlike heading 2, however, they don't offer much in the way of a useful surplus. However, although it has proved manageable with no problems from 2007 to 2009, the margin under heading 3b will be very tight during the rest of the period.

2.2.2. Instruments of flexibility

The IIA contains provisions regarding a number of instruments of flexibility: the Emergency Aid Reserve (EAR), the European Union Solidarity Fund (EUSF), the European Globalisation Adjustment Fund (EGF) and the Flexibility Instrument. The amounts for the EU Solidarity Fund are only entered into the budget when the Fund is mobilised while the amounts corresponding to Emergency Aid Reserve and the European Globalisation Fund are already entered into the budget from the beginning of the year, albeit in a reserve. The Flexibility Instrument is of a different nature: it is never entered into the budget as such but it allows budgeting expenditure above the ceiling of the corresponding heading of the multi-annual financial framework.

There are also slight differences in the procedures for the mobilisation of these instruments:

- The mobilisation of the **Emergency Aid Reserve** requires a transfer and a trilogue procedure, "if necessary in simplified form". The commitment appropriations mobilised recently are EUR 49 million in 2007, EUR 479 million in 2008[5] and EUR 188 million so far in 2009, including the latest proposal from the Commission.
- Mobilising the **EU Solidarity Fund** requires a proposal to deploy the instrument, the use of the "appropriate budgetary instrument", which de facto is an amending budget, and the initiation of a trilogue procedure, "if necessary in simplified form". Although the EUSF may be mobilised for up to EUR 1 billion in a given year, the highest mobilisation was in the first year, 2002, and was for EUR 728 million. In all other years the annual mobilisation levels have been between EUR 22 million and EUR 615 million. Similarly, there has never been a problem in respecting the rule that 25% of the total amount should remain unused by 1 October.
- The **European Globalisation Adjustment Fund** is mobilised through a proposal to deploy the instrument, a transfer, and a trilogue procedure, "if necessary in simplified form". The total amounts mobilised were EUR 18.6 million in 2007, EUR 49 million in 2008 and EUR 53 million in 2009, subject to the approval of the latest proposals from the Commission. Use of a transfer for the EGF should mean a speedier process. However, the necessity to accompany this with a mobilisation decision slows the procedure down. It is only when the mobilisation decision is finally adopted that the transfer can physically be made in the accounting system, although it has already been endorsed by the budgetary authority. If the whole procedure could be limited to a transfer proposal, this would increase the speed of the process[6].
- The mobilisation of the **Flexibility Instrument** is accompanied by a proposal for a decision of the European Parliament and Council. In practice this may accompany the Commission's Preliminary Draft Budget or a Commission proposal for a Preliminary Draft Amending Budget or an Amending Letter. The proposal may also be prepared following a political agreement at conciliation to mobilise the Instrument. In accordance with the provisions of the IIA, amounts mobilised are first taken from the oldest open tranche. The key difference between the present text, and that included in the IIA of 6 May 1999, is the deletion of the following text "The flexibility instrument should not, as a rule, be used to cover the same needs two years running". This stipulation no longer applies, which is a valuable development as experience has shown (e.g. in Kosovo or Palestine) that some crises require repeated interventions of the flexibility instrument. At the same time, there is an inherent contradiction – and inevitable trade-offs – when a financial instrument which has been conceived to respond to short term crises also has to play a role to solve lasting or recurring crises.

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5 Taking into account the one-off increase of EUR 240 million decided in the framework of the agreement reached during the conciliation on 21 November 2008 for the financing of the Food Facility.

6 It should be noted that, as part of the European Economic Recovery Plan published on 26 November 2008, the Commission announced its intention to make the EGF part of Europe's response to the crisis. Proposed changes in the functioning of the EGF do not bear on the procedure examined here. See COM(2008)867 of 16 December 2008.

The common strand for the first three instruments is the trilogue procedure "if necessary in simplified form". What this "simplified form" entails has never been clarified. The pragmatic solution, frequently followed, is that no trilogue takes place, unless a regular budgetary trilogue is on the horizon.

The main reason for mobilising the Flexibility Instrument over the period 2000-2009 has been to meet the needs of heading 4, where the margins have proved too tight to deal with unforeseen events. Once the political decision to mobilise is taken, the procedure has advanced quite smoothly. The main issue here is therefore not one of procedures, but one of available means compared to a vast array of needs responding to important European priorities.

2.2.3. Possibility to diverge by 5% from legal basis

Point 37 of the IIA defines the circumstances under which the amounts set out in the preliminary draft budget can depart by more than 5 % from the reference amounts, while it leaves to the Commission and to the Budgetary Authority a certain degree of discretion for deviations within the 5 % limit.

This has resulted in the elaboration of a set of common rules to be applied to budgeting and programming by the Commission: as a general rule, modifications are systematically offset in following years of the programming period in order to continue respecting the financial envelopes of the corresponding legal basis.

Exceptions to this general rule can be considered if the Commission finds substantial arguments to exceed the financial envelope, which will be explained in the financial programming documents transmitted to the Budgetary Authority. Whereas the general rule of compensation is applied to Commission proposals, it is not applied in the case of Council or European Parliament amending the PDB proposal with additional appropriations.

Key messages on flexibility in the MFF

Margins under all ceilings of the MFF are becoming very tight. The margins under heading 2 are expected to shrink significantly in coming years. At the same time remaining margins and possibilities for redeployment for headings 1A and 4 offer only limited scope to respond to future eventualities. Overall, the remaining margin for manoeuvre within *the MFF for years to come is severely limited. The various instruments (points 25 to 28) which provide flexibility* outside *the MFF have been used with varying degrees of intensity. The procedure for their implementation should be re-examined to facilitate and accelerate budgetary actions. Furthermore, regarding the Flexibility Instrument, the main issue is not one of procedures, but one of available means compared to a vast array of needs responding to important European priorities. Besides, the rules framing the possibility for amounts in the preliminary draft budget to depart from reference amounts (point 37) are clear and function well.*

2.3. Revisions of the Multiannual Financial Framework

2.3.1. Analysis of the recent revisions of the MFF and amendments to the IIA

Except for the first financial perspectives (1988-1992), only little use was made before 2007 of the possibility to revise the multiannual financial framework (MFF). The 1993-1999 framework was revised only once and the 2000-2006 framework not at all, apart from the adjustments related to enlargements. By contrast, exceptional developments have already triggered two revisions of the 2007-2013 financial framework, as well as one amendment of the IIA:

- In the first half of 2007, the negotiations with the private partners on the financing of the European Global Navigation Satellite System (GNSS) programmes EGNOS and **GALILEO** failed. In order to secure the implementation of this strategically important project, the budgetary authority decided on 18 December 2007 to revise the financial framework. The increase in ceilings of heading 1A for the years 2008 to 2013 by a total amount of EUR 1.6 billion in current prices was offset by an equivalent reduction of the ceiling for heading 2 for the year 2007[7]. Additionally, EUR 600 million were made available by re-allocating funds from other programmes and budget lines within heading 1A, and EUR 200 million by mobilising the Flexibility Instrument. In total, an amount of EUR 2.4 billion of EU financing was added to the amount foreseen in May 2006 when the financial framework was agreed.
- In order to provide a rapid response to soaring food prices in developing countries a EUR 1 billion **food facility** was set up in late 2008. The solution agreed by the three institutions for financing this facility required an amendment of the IIA in order to exceptionally increase the Emergency Aid Reserve (EAR) foreseen in Point 25 of the IIA by an amount of EUR 240 million in 2008[8]. This allowed the EAR to make EUR 340 million available to the food facility. The remaining amount was provided by the Flexibility Instrument (EUR 420 million for 2009) and through redeployment from other programmes within heading 4 (EUR 240 million in 2009 and 2010).
- On 2 April 2009 agreement was reached on the financing of a EUR 5 billion package for energy and broadband infrastructure proposed by the Commission in the framework of its **European Economic Recovery Plan** (EERP) of 26 November 2009. The agreement involved an immediate revision of the financial framework[9], by which the 2009 ceiling of heading 1A was increased by an amount of EUR 2.0 billion, fully offset by a decrease of the 2009 ceiling of heading 2. Additionally, EUR 600 million were made available within the margin of heading 2 in 2009 for broadband infrastructure and investments related to the "new challenges" identified under the Common Agricultural Policy's "Health Check". According to the agreement, which took the form of a Declaration of the three institutions to be attached to the IIA, the financing of the remaining amount (EUR 2.4 billion) is to be secured through a compensation mechanism at the conciliation of the 2010 budgetary procedure in November 2009 to be completed, if needed, at the latest at the conciliation of the 2011 budgetary procedure.

The above-mentioned revisions of the 2007-2013 MFF aimed at increasing the ceilings for commitment and payment appropriations under heading 1A. The time needed for an agreement (starting from the initial Commission proposal) tended to increase: three months were needed for the first revision (Galileo and EIT) of the 2007-2013 MFF. Five months were needed for the agreement on the EERP package, excluding the time needed for effectively implementing the budgetary "compensation mechanism" it provides for.

The Council only accepted the principle of a revision to the extent that the raising of the ceilings under heading 1A could be fully offset by the lowering of the ceilings of another

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7 OJ L 6, 10.1.2008, p. 7.
8 OJ C 326, 20.12.2008, p. 3.
9 OJ L 132, 29.5.2009, p. 8.

heading so as to leave the "overall ceiling" (i.e. the total amounts expressed in current prices for commitment appropriations as well as for payment appropriations for all headings and years) of the 2007-2013 MFF unchanged. In the case of the financing of the EUR 5 billion EERP package, a compensation mechanism potentially stretching over two or even three budgetary procedures was preferred to a one-off revision of the MFF as proposed by the Commission. The insistence on keeping the "overall ceiling" unchanged was motivated by political reasons, the effects of both approaches being identical in terms of additional own resources payments required from the Member States. In practice, however, this limited the flexibility allowed for by the IIA.

The full offsetting of the increase of the ceilings under heading 1A by the lowering of the ceilings of heading 2 was only possible because of exceptionally important margins left under that particular heading in the years 2007 to 2009. This was due to the combined effect of favourable market conditions in the agricultural sector, high levels of assigned revenue and the gradual phasing in of direct aids in the new Member States.

Overall, experience shows that agreement for a revision takes time and that recent revisions have been greatly facilitated by existing margins. However, such a favourable environment for revisions is unlikely to be found in the foreseeable future, thus calling into question the capacity of the Union to react swiftly and effectively to future changes.

2.3.2. Procedures applicable to revisions

Point 22 of the IIA, which lays down the voting rules for the revision of the MFF, sets the threshold for switching from a qualified majority vote in Council to a unanimous decision at 0.03 % of the EU GNI. This is to be interpreted as relating to each of the years concerned by the revision, e.g. for 2009 the threshold is set at 0.03 % of the EU GNI of 2009 which equals EUR 3.6 billion[10]. Even though consensual decision making has generally been sought, the possibility to have a qualified majority vote in Council was crucial in terms of obtaining a timely agreement on the revision.

Point 22 of the IIA further foresees that, "as a general rule", any revision of the MFF must be presented and adopted before the start of the budgetary procedure for the year or the first of the years concerned. The words "as a general rule" were interpreted as allowing for some flexibility in terms of the timing of the relevant Commission proposal within the budgetary year concerned.

There was, however, no agreement between the institutions on whether the increase of a ceiling for the present or future years can be "offset" (within the meaning of Point 23, second paragraph, of the IIA) by lowering a ceiling for a year for which the budgetary exercise is closed. As a result, this option was foreclosed.

Key messages on revisions of the MFF

Less than three years into the 2007-2013 MFF, the financial framework and the IIA have already been amended on three different occasions to accommodate new initiatives with substantial financing needs: the financing of Galileo and the EIT, the increase of the Emergency Aid Reserve to finance part of the Food Facility, and the European Economic Recovery Plan. The related adjustments to the current Financial Framework and the IIA totalled €8.4 billion. While the institutions agreed on the procedures and instruments to

[10] The GNI to be used for setting the threshold is the one used for the latest technical adjustment of the financial framework and it is the GNI used for the purposes of the Own Resources Decision.

deal with the financial impact of these unforeseen situations (points 21 to 23), in each instance their use led to prolonged and very difficult political negotiations. Success was ultimately possible because the increases in the ceiling of heading 1A were offset by decreases of the other ceilings, in particular of heading 2 where large margins were available. Recourse to this option will be more difficult in the second half of the Financial Framework at a time when further adjustments may be necessary.

3. THE INTERINSTITUTIONAL COLLABORATION

Points 31, 32 and 33 of the IIA, as well as its Annex II, set out the provisions related to improvement of interinstitutional collaboration during the budgetary procedure. These provisions have proved extremely useful as a framework for the annual budget procedure.

3.1. The Interinstitutional collaboration and the budget procedure

Point 32 makes specific reference to Activity Statements, which is valuable in raising the profile of this important tool of Activity Based Budgeting (ABB).

In Point 33, the budgetary authority undertakes "to bear in mind the assessment of the possibilities for implementing the budget made by the Commission in its preliminary drafts and in connection with implementation of the current budget". Point 33 also foresees the so-called "letter of implementability", in which the Commission comments on the European Parliament's first reading amendments. The IIA specifies that "the two arms of the budgetary authority will take those comments into account in the context of the conciliation procedure." It would be useful to see greater use made of these provisions, and this would certainly help to improve budgetary implementation.

Annex II of the IIA sets out the practical details for "interinstitutional collaboration in the budgetary sector", notably the timing of trilogues; the possibility for the Commission to revise its proposals through letters of amendment, including the ad hoc amending letter on agricultural expenditure and the fisheries agreement; and the goals of conciliation. There can be no doubt that having such practicalities set out clearly in the IIA is a valuable resource, and has contributed to smoother negotiation procedures.

Under the provisions of Part D of Annex II, both arms of the budgetary authority will inform the Commission by mid-June of their intentions in regard to pilot projects/preparatory actions, with a view to holding a first discussion at the conciliation meeting of the Council's first reading. During the 2009 procedure, important progress was made in this regard, when the European Parliament presented its initial proposals in July. All parties agreed that this had greatly improved the process, and hopefully such an approach can be built-on in the future.

3.2. Classification of expenditure

Since the Council has the final say on compulsory expenditure, and the European Parliament has the final say on non-compulsory expenditure, the potential for disputes was significant.

However, with the introduction of interinstitutional agreements, and an agreed breakdown between the two categories, this problem has largely been solved. The Lisbon Treaty takes this a stage further by abolishing the distinction altogether.

3.3. Maximum rate of increase

Article 272(9) of the Treaty, which is repealed by the Lisbon Treaty, provides that the Commission shall declare each year the 'maximum rate of increase' of non-compulsory expenditure in the budget of the following year and communicate this rate before 1 May to all the institutions of the Community. This maximum rate, which is based on the average growth of GDP, central government expenditure and cost of living in the Member States, was established at 4.6% for the 2010 budget[11], 5.0% for the 2009 budget and 4.7% for the 2008 budget.

Since the European Parliament, the Council and the Commission have agreed to respect the ceilings of the MFF, this maximum rate is *de facto* purely indicative.

3.4. Fisheries agreements and CFSP

The provisions relating to the fisheries agreements are set out in Point 41 and annex IV of the IIA. The Commission undertakes to keep the European Parliament regularly informed of developments, and each quarter the Commission presents detailed information about the implementation of agreements in force and financial forecasts for the remainder of the year.

This process seems to be working well in practice. It is not necessary to modify it.

The provisions relating to the Common Foreign and Security Policy (CFSP) are set out in points 42 and 43. The good practice of joint meetings between the Council and the European Parliament (committees AFET and COBU) held according to point 43 at least five times a year, proved to be a useful tool not only for the dialogue on political issues concerning the CFSP, but also for regular updates on the budgetary issues.

Key messages on the interinstitutional collaboration provisions

The IIA constitutes a useful tool to facilitate the interinstitutional collaboration. The principles and procedures for cooperation defined in annex II of the IIA (trilogues, conciliation) have been useful and have contributed to smoother negotiation procedures. Quarterly information by the Commission to the Parliament about the implementation of fisheries agreements in force and financial forecasts for the remainder of the year (Point 41) seems to be working well in practice. Similarly, regular joint meetings between the Council and the European Parliament on the CFSP (Point 43) have proved a useful tool. At the same time, greater use made of provisions regarding the letter of implementability and comments made by the Commission in the context of the conciliation procedure (Point 33) would certainly help improving budgetary implementation. Important progress was made during the 2009 procedure on information regarding pilot projects/preparatory actions (Annex II) and hopefully such an approach can be built-on in the future.

4. SOUND FINANCIAL MANAGEMENT OF EU FUNDS

4.1. Statements of Assurance

To implement Point 44 of the Inter-Institutional Agreement, the financial regulation and the implementing rules were completed with provisions to strengthen internal control in the area of shared management whereby the relevant audit authorities in Member States

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[11] SEC(2009)583 of 30 April 2009.

would produce an assessment of the compliance of management and control systems with Community regulations through an annual summary at the appropriate national level of the available audits and declarations[12].

The Commission issued guidance to Member States on the preparation of annual summaries on 2007, and revised these in the light of experience for the 2008 round to reinforce the value-added elements. While in Agriculture there is a legal requirement from sectoral legislation for the provision of annual statements of assurance, this is not the case in Cohesion policy. As a result the Commission recommended that Member States supplement their summaries in this field with a declaration of assurance: seven Member States provided such statements in their annual summaries due on 15 February 2009. For 2008 all Member States respected the obligation and submitted annual summaries which complied or mostly complied with the minimum requirements. For the first time annual summaries were also received in the area of justice, freedom and security.

The responsible services provide an assessment of the quality of annual summaries and of their contribution to assurance in their annual activity reports. The Commission will continue to work with Member States to maximise the added value of annual summaries and to obtain an increased assurance on their management and control systems.

In its annual report on the year 2008, the Court of Auditors concluded that a number of Member States submitted elements or analyses which added value to the annual summaries, by seeking to identify and comment on systemic deficiencies or cross-cutting issues.

Parallel to the work on annual summaries, the Commission supports the voluntary initiatives taken by some Member States to provide national declarations covering EU funds.

The question of both annual summaries and national declarations is contentious between the Parliament and Member States, and the former regularly requests the Commission in its discharge resolution to go further in this area.

4.2. Financial programming

In accordance with point 46 of the IIA, the Commission submits the financial programming to the budgetary authority twice a year – once in May/June with the documents accompanying the PDB, and once in December/January after the adoption of the budget.

In presenting the financial programming, the provisions of point 37 of the IIA are taken into consideration (see above).

The financial programming provides an orientation for future years, remains indicative in nature and, as such, does not prejudge any decision the Commission or the Budgetary Authority might take in future budgetary procedures.

In line with requests from the two arms of the Budgetary Authority, the format of the financial programming document has been revised to highlight more clearly the changes since the last financial programming.

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12 Articles 53b (3) of the Financial Regulation and 42a of the Implementing Rules.

Point 46 of the IIA also states that "on the basis of the data supplied by the Commission, stocktaking should be carried out at each trilogue". In practice this is not the case, unless one of the institutions specifically requests that the point is added to a trilogue agenda. This flexible approach is valuable.

4.3. Agencies and European Schools

In practice, Point 47 of the IIA regarding agencies has functioned through the *ad hoc* addition of an agenda point to budgetary trilogues whenever an agency dossier is sufficiently mature for the two arms of the budgetary authority to seek agreement on the financing of the agency.

However, during the trilogue held on 1 September 2009, the three institutions came to the conclusion that it would be appropriate to define a more systematic procedure for the implementation of article 47 to agencies and invited the Commission to draft a proposal. The Commission believes a procedure could include the three following elements:

- Each new proposal from the Commission would be systematically presented at the first budgetary trilogue
- The three institutions will come back later to this issue when they have assessed the Commission's proposal, also at the light of the development in the legislative sector.
- The agreement reached will be included in a joint declaration.

4.4. New financial instruments

In accordance with point 49, when presenting the PDB, the Commission is requested to report to the budgetary authority on the activities financed by the EIB, EIF and ERDB to support investment in research and development, TENs, and SMEs. There are no particular problems to address here, and no need for change.

Key messages on the sound financial management provisions

A positive overall assessment of provisions in the IIA regarding the sound financial management of EU funds can be made. The new format of the financial programming (point 46) appears to be a valuable tool for supporting political decisions. Reports by the Commission to the budgetary authority on the activities financed by the EIB, EIF and ERDB to support investment in research and development, TENs, and SMEs (Point 49) have been running smoothly. The issue of national declarations (Point 44) needs to be addressed but the current lack of a legal basis for an overall assurance to be given by Member States does not facilitate progress in the area of shared management. Lastly, the Commission agrees with the budgetary authority that it would be appropriate to define a more systematic procedure for the implementation of Point 47 regarding agencies.

5. CONCLUSIONS

The Interinstitutional Agreement has proved invaluable to facilitate budgetary discipline and ensure a smooth budgetary procedure. Overall, a rather positive appreciation of this instrument and, in particular, the Multiannual Financial Framework can be made.

At the same time, this report has highlighted that adjustments to the current Financial Framework and the IIA totalling €8.4 billion have already been required in the first half of this Financial Framework, and that the remaining margin for manoeuvre within the Financial Framework is now severely limited. This raises questions as to whether the

Union will be adequately equipped for new challenges and rapidly evolving circumstances in the second half of this Financial Framework. Concerns along these lines have already been expressed by the European Parliament in its Report on the Mid-Term Review of the 2007-2013 Financial Framework.

Further reflection is needed on how best to address these concerns and ensure that the Union is equipped with the right budgetary tools and sufficient flexibility, not least in view of the entry into force of the Lisbon Treaty, while preserving adequate budgetary discipline.

It cannot be excluded that further adjustments may be needed in the second half of the Financial Framework. There are a range of possibilities that could be explored in this context, including increasing the overall size of the annual ceiling currently foreseen for the Flexibility Instrument, reassessing the adequacy of the remaining margins in the headings of the Financial Framework under the greatest pressure, or exploring whether the margin of flexibility for multiannual programmes could be increased by allowing the financial envelop to depart further from the reference amount in the latest years of the MFF.

Furthermore, practical measures should be undertaken to facilitate and accelerate budgetary actions. In particular, the necessity to have a trilogue to mobilise the EAR, EUSF and EGF can be cumbersome and cause delays. If both arms of the Budgetary Authority are in favour of the proposals a pragmatic solution can be found, but it would be more correct to allow for such an approach within the text of the IIA.

While it would not be appropriate for the current Commission to present specific proposals at this point in time, the Commission will continue to deepen its analysis of these issues with a view to defining its position and, if necessary, tabling appropriate proposals, by May 2010 at the latest.