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Annual Management and Performance Report for the EU Budget - Financial Year 2021

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Volume I

#EUBUDGET

FINANCIAL YEAR

2021

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The *Annual Management and Performance Report for the EU Budget – Financial year 2021*, together with its annexes, is the Commission's main contribution to the annual discharge procedure (1) by which the European Parliament and the Council of the European Union scrutinise the implementation of the EU budget. It fulfils the Commission's obligations under the Treaty on the Functioning of the European Union (2) and the financial regulation (3). Implementing the EU budget is a shared responsibility. The Commission works hand in hand with the Member States and with other partners and organisations.

The report is composed of three volumes, as described below.

- Volume I provides the key facts and achievements in relation to budgetary management for 2021.
- Volume II presents a more comprehensive picture of the implementation of the EU budget. Annex 1 provides an overview of the performance of the EU budget in 2021. Annex 2 provides a high-level overview of internal control and financial management. Annex 3 covers the performance and compliance aspects of the Recovery and Resilience Facility.
- Volume III contains technical annexes supporting the report. It includes Annex 4, with detailed programme-by-programme performance information in the 'Programme performance overview'.

This report is part of the broader integrated financial and accountability reporting package (4), which also includes the consolidated annual accounts (5), a long-term forecast of future inflows and outflows covering the next 5 years (6), the report on internal audits (7) and the report on the follow-up to the discharge (8).

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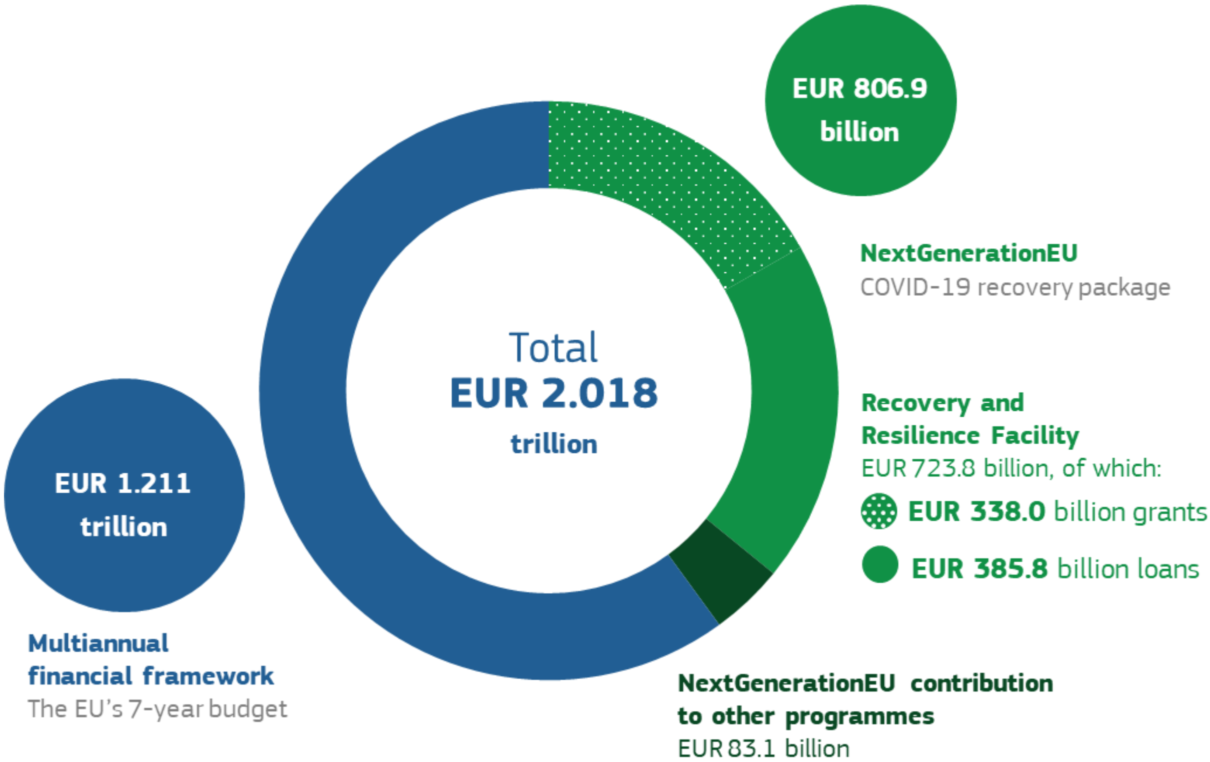
(1) The annual discharge procedure is the procedure through which the European Parliament and the Council give their final approval on the budget implementation for a specific year and hold the Commission politically accountable for the implementation of the EU budget (https://ec.europa.eu/info/about-european-commission/eu-budget/how-it-works/annual-lifecycle/assessment/parliaments-approval_en).
(2) Article 318 of the Treaty on the Functioning of the European Union.
(3) Articles 247(1)(b) and 247(1)(e) of the financial regulation.
(4) Article 247 of the financial regulation.
(5) Article 246 of the financial regulation.
(6) Article 247(1)(c) of the financial regulation.
(7) Article 118(8) of the financial regulation.
(8) Article 261(3) of the financial regulation.

Rising to the challenge: the EU invests in a greener, more digital and resilient future

In 2021, the EU sent a signal of solidarity and strength, countering the unprecedented crisis. Solidarity was key to containing the COVID-19 pandemic and to mitigating its economic and social impact. We saw the largest and quickest vaccination roll-out in the history of the EU, following the common procurement of vaccines through the innovative use of the EU budget via the Emergency Support Instrument. The EU budget also funded the infrastructure for issuing and verifying the digital COVID-19 certificates, which has set a standard well beyond EU borders. The EU supported citizens and business to overcome the fallout from the crisis. At the same time, it reacted to global challenges.

The EU managed not only to overcome the crisis but also to seize the opportunities that arose from it. The EU budget makes Europe fit for the future by anticipating its response to the crucial challenges of climate action and digitalisation. It invests in a more sustainable and resilient future for the EU and its Member States. Together with the 2021-2027 multiannual financial framework, the dedicated recovery instrument NextGenerationEU is at the heart of the EU's collective action. With a record stimulus package of more than EUR 2 trillion, the EU economy started rebounding in 2021 – faster than expected.



The EU's 2021-2027 multiannual financial framework and NextGenerationEU. All amounts are in billion EUR, in current prices.
Source: European Commission.

NextGenerationEU works thanks to a tailor-made, performance-orientated approach. With an unprecedented size of up to EUR 807 billion ([9]), NextGenerationEU has drastically increased the firepower of

([9]) EUR 807 billion in current prices, EUR 750 billion in 2018 prices.

the EU budget. Its key programme, the Recovery and Resilience Facility, is a unique and innovative tool to finance investments and reforms. Member States submit their recovery and resilience plans, comprising reforms and investments that reply to the six broad policy areas within the scope of the facility, the country-specific recommendations adopted by the Council in the context of the European Semester, and the green and digital targets. Financing provided under the facility depends on the successful implementation of the investments and reforms contained in the plans, in line with the performance focus of the new long-term budget (see box below). Twenty-two national recovery and resilience plans had been adopted by the end of the year.

The long-term budget and NextGenerationEU: the EU budget focuses on achieving objectives

Performance and results are at the heart of the new long-term budget and NextGenerationEU. The new programmes have been designed to deliver tangible results on the ground. In the case of the Recovery and Resilience Facility, payments are explicitly linked to the achievement of milestones and targets by the Member States. Moreover, every EU programme contains clear and ambitious objectives and related indicators to help ensure that these objectives are achieved. The Commission published a communication in June 2021 describing the new performance framework ([10]).

The new long-term budget has also provided the opportunity to review the efficiency of EU budget implementation. Programmes need to ensure a more integrated approach to policy challenges, for example the Neighbourhood, Development and International Cooperation Instrument – Global Europe, which brings together most of the former EU external action programmes within the EU budget. Another example is the redesign of executive agencies, where the Commission has established new agencies to fully align their portfolios with the Commission's strategic priorities and exploit the synergies between programmes and policies (such as the new European Health and Digital Executive Agency).

The EU provided liquidity to Member States by using all available budgetary resources. Under the Recovery and Resilience Facility, Member States received EUR 64 billion in 2021 – mostly in the form of prefinancing for the national recovery and resilience plans for those Member States with approved plans ([11]). Cohesion policy implementation accelerated in 2021 and a record amount of EUR 69 billion was paid to Member States. This was also thanks to the swift reaction to the COVID-19 crisis. The Coronavirus Response Investment Initiatives, established in 2020, allowed the fully flexible mobilisation of all the remaining funds in the 2014-2020 cohesion policy programmes. EUR 23 billion was reallocated to the health sector and measures to address the effects of the crisis. Finally, through additional financing from NextGenerationEU via REACT-EU, an additional EUR 7 billion was paid out, leading to Member States receiving a total of EUR 140 billion in liquidity in 2021.

Beyond liquidity, the EU budget is a vehicle for European solidarity. Next to the COVID-19 pandemic, natural disasters such as drought-driven forest fires and severe floods have taken a large toll on many Member States. Through the EU Civil Protection Mechanism, the EU has provided EUR 332 million in immediate disaster relief to affected Member States. In 2021, the mechanism was activated 114 times. In 2022, the war in Ukraine has already triggered the largest emergency operation since the creation of the mechanism.

The recovery effort is targeted towards building a greener and more digital future. The EU has increased its ambition for climate-related financing to 30% of the overall EU budget including NextGenerationEU, also reflecting EU global commitments, including the Paris Agreement and the sustainable development goals. Under the Recovery and Resilience Facility, at least 37% of financing will go towards

([10]) https://ec.europa.eu/info/publications/communication-eu-budget-performance-framework-2021-2027_en
([11]) For details, see Annex 3.

investments and reforms tackling climate change and at least 20% towards furthering the digital transition. Many of the national recovery and resilience plans adopted by the end of 2021 exceed these minimum requirements, showing the shared commitment to the twin climate and digital transitions across the EU. Overall, Member States have committed about 40% of financing to tackling climate change and about 26% to furthering the digital transition. Replacing fossil energy and the digital transition are key – not only to emerge stronger from the pandemic but also to strengthen our open strategic autonomy and withstand the impact of Russia's war against Ukraine. Key priorities are highlighted in the box below.

The twin transitions under the Recovery and Resilience Facility: key priorities for climate and digital

- In relation to mitigating and addressing climate change, roughly three quarters of financing is focused on the energy transition and building sustainable transport. To reach carbon neutrality by 2050, the focus is on both increasing energy supply from clean sources and decreasing demand for energy overall. Areas of investment include building up renewable energy generation and many projects focusing on energy efficiency, for example by improving building and insulation quality.
- To contribute to the digital transition and address its challenges, reforms and investments in this area go towards building digital public services (37%), increasing the level of digitalisation of businesses, in particular small and medium-sized enterprises (20%), and providing people with the necessary digital skills to participate in these changes (17%) ([12]). In line with the digital decade communication ([13]), which identifies the importance of digital public services, measures include e-government solutions to modernise and improve public administration processes, for example through integrating e-identification solutions in government processes and ensuring interoperability across various digital public platforms.

For the first time, key overarching EU policy goals – such as the fight against climate change – are fully integrated into the EU's budget programmes. As part of the *Annual Management and Performance Report for the EU Budget* package, the Commission is presenting the methodologies used to track the contribution of the EU budget to three such policy goals.

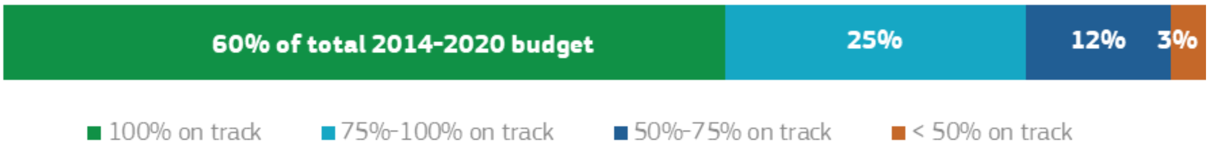
- The fight against climate change, where the updated tracking methodology relies on an effect-based classification of interventions. It has been enshrined in a consistent manner across all key basic acts.
- Halting and reversing biodiversity loss, where the tracking methodology has been largely updated in a similar fashion.
- Furthering gender equality, where a pilot methodology is being applied, which reflects the fact that most of the EU budget has the potential to contribute positively to furthering gender equality.

The EU has responded to diverse global challenges by using the EU budget effectively and flexibly. To respond to the structural investment gap globally, the EU launched the Global Gateway initiative. The initiative will mobilise EUR 300 billion between EU institutions and Member States, in a Team Europe approach, supporting investments in digital, energy and transport infrastructure and strengthening health, education and research systems. Addressing more immediate needs, the provision of COVID-19 vaccines to non-EU countries and supporting solutions for the refugee crisis triggered through developments in Afghanistan and Syria have taken centre stage. The budgetary agreement accompanying the Syrian refugee package in autumn 2021 was a major milestone. At the same time, tension had already started to build up on the EU's eastern borders in 2021, where migratory movements were instrumentalised to put

([12]) Numbers correspond to calculations based on the methodologies set out in Annex VI and VII to the Recovery and Resilience Facility regulation.

([13]) https://eur-lex.europa.eu/legal-content/nl/TXT/?uri=CELEX%3A52021DC0118 political pressure on the EU. In budgetary terms, these various challenges have required proactive reprioritisation and the extensive use of existing flexibility. The external dimension has accounted for EUR 0.9 billion, the largest part of the EUR 2 billion in budgetary reinforcements used in 2021.

At the point of transition between long-term budgets, EU programmes under the 2014-2020 budget continue to be implemented and to deliver results to EU citizens. The EU budget is primarily an investment budget, focused on delivering long-term value to the EU. Many programmes have continued to make progress towards their respective performance targets. The graph below shows that for programmes accounting for 85% of the EU budget, the vast majority of performance indicators are on track. Annexes 1 and 4 to the present report provide more detail on the individual programmes and their performance.



Breakdown of the 2014-2020 budget by progress of the underlying programmes. The graph displays progress as measured by the share of the indicators selected for the programme performance overview that have met or are well on track to meet their respective targets. For example, it shows that for programmes accounting for 60% of the 2014-2020 budget, all indicators have met or are well on track to meet their respective targets.

Source: European Commission.

A state-of-the-art borrowing capacity allows NextGenerationEU to deliver

To fund NextGenerationEU, the Commission set up an efficient bond issuance programme in record time. Formally starting work only at the beginning of 2021, the Commission issued the first bond on 15 June 2021 to great acclaim and record demand. By the end of 2021, the Commission had raised almost EUR 93.5 billion in long-term funding, complemented by short-term EU-Bills, to fund the first planned disbursements to Member States under NextGenerationEU. These novel EU bonds have been very well received by the markets, partly by assuming the role of a euro-denominated safe asset, something the market has been requesting for some time. The borrowing cost in 2021 for 10-year borrowing was mostly negative, and well below the average of the borrowing costs of individual Member States.

NextGenerationEU also reflects our political goals in terms of funding strategy, as we are issuing up to **EUR 250 billion as green bonds.** The Commission published the blueprint for its green bond programme, the NextGenerationEU Green Bond Framework ([14]), in September 2021. This framework outlines the arrangements for and conditions of its green bonds in line with best market practices. It has been certified by external experts, providing assurance to prospective investors that the proceeds from the EU green bond issuances will be used to finance legitimate green investments and reforms.

The first NextGenerationEU green bond issuance was a success in many respects. With EUR 12 billion raised in October 2021, the EU's first issuance was the largest green bond issuance worldwide to date**.** The fact that it was oversubscribed 11 times showed the high market demand for such an asset.

([14]) https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/nextgenerationeu_green_bond_framework.pdf

These green bonds also contribute to accelerating a virtuous circle of providing finance for sustainable investments. Following the first issuance, the Commission raised another EUR 2.5 billion of green bonds under the EU green bond programme in 2021, and EUR 6 billion by the end of May 2022. Over the next few years, this programme is expected to turn the EU into the world's largest issuer of green bonds, providing a boost to green finance more generally and enhancing the appeal of the euro for global investors, and thus its international role.

Despite the demanding market conditions in 2022, EU bond issuances have continued to be in demand. Due to Russia's unprovoked and unjustified invasion of Ukraine and the wider economic climate, bond markets have come under significant pressure recently. In spite of these challenging conditions, the Commission has had no difficulty placing further bonds on the market, even though borrowing costs have gone up in line with the more challenging market conditions generally. The flexibility provided by the Commission's diversified funding strategy will enable the Commission to continue its funding programme in a cost-effective manner. NextGenerationEU green bonds have continued to receive outstanding demand and positive feedback, due in part to the publication of the Green Bond Dashboard ([15]).

After a challenging 2021, pressures on the EU budget will increase further in 2022

The late adoption of the 2021-2027 multiannual financial framework gave rise to serious challenges in 2021. The legal acts establishing the new generation of programmes were only adopted by the co-legislators in the course of 2021. However, thanks to intensive preparatory work, the Commission was able to launch many of the programmes without further delay, in particular those directly managed by the institution itself. In shared management, the late adoption of the common provisions regulation, setting out the regulatory framework for programmes under management shared with Member States (such as the cohesion policy funds), meant that the implementation of the new programmes could not begin in 2021, even though preparations on the ground have started. While the 2021 budget was carried over to future years, the Commission is working intensively with the Member States to adopt partnership agreements and programmes as soon as possible.

Focusing cohesion policy on the fight against COVID-19 has allowed the EU to react swiftly. The additional flexibility introduced in cohesion funding has allowed the EU to provide liquidity to Member States very quickly by accelerating payments significantly. While indispensable in supporting Member States addressing immediate crisis needs in the health sector, employment and business, in particular the small and medium-sized enterprises, redirecting cohesion funding meant temporarily diverting support away from some long-term investment priorities. REACT-EU, preparing the green and digital transition, has provided an opportunity to compensate for such short-term reprioritisation of cohesion funding, allowing the resumption of projects previously halted in favour of emergency needs.

([15]) https://ec.europa.eu/info/strategy/eu-budget/eu-borrower-investor-relations/nextgenerationeu-green-bonds/dashboard_en

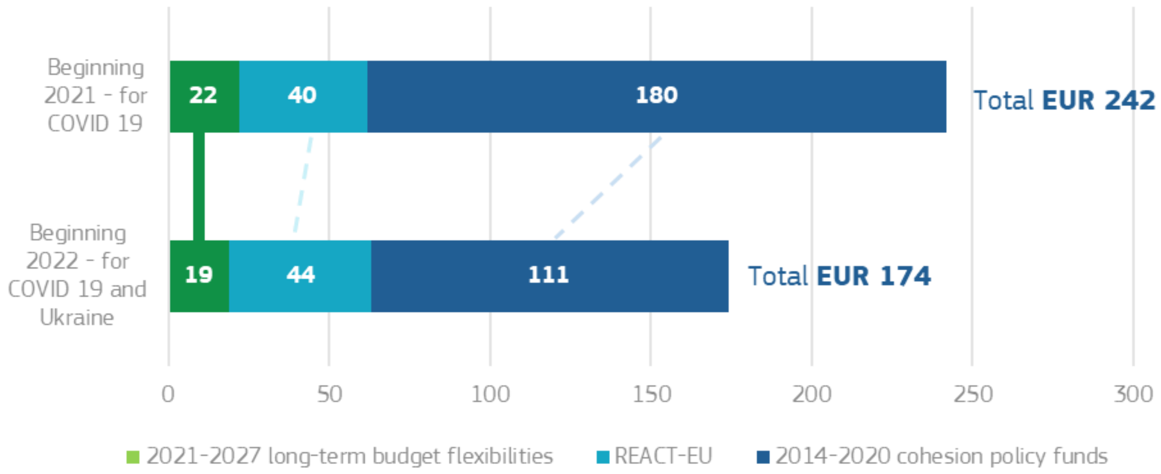
2022 will be another year of uncertainty and challenges, including for the EU budget. Russia's invasion of Ukraine in 2022 has unleashed new major dynamics that have profound implications for Ukraine as well as for the EU and its economy and society. At the same time, we are facing several other challenges: the pandemic is not over, new variants may emerge, and continued vigilance is essential. Inflation has reached levels not seen in decades, reducing the effective financial capacity of the EU budget, which is updated by a fixed deflator of 2% – well below the actual level of inflation. Supply-chain tensions are contributing to high inflationary pressures and are affecting the EU's open strategic autonomy in areas such as microchips. The number of natural disasters seems to be increasing.

This will put further pressure on the EU budget and on its management and implementation, underlining the imperative of an agenda focused on building resilience. Given the high level of uncertainty regarding the evolution of the war in Ukraine, it is currently impossible to estimate the funding amounts required in Ukraine and the EU. However, these needs will be significant. In early 2022, the Commission has focused on providing immediate relief to Ukraine and to the people fleeing the country. By the end of May 2022, the Commission had already disbursed the entire budget of EUR 1.2 billion ([16]) from the new emergency macro-financial assistance programme for Ukraine. An emergency package of over EUR 550 million from the EU budget provided further support, combining various measures such as emergency and humanitarian assistance and a state- and resilience-building contract. Furthermore, the EU budget is now mobilising EUR 800 million as pledged on 9 April and 5 May. On 18 May 2022, the Commission proposed granting Ukraine new exceptional macro-financial assistance in 2022 in the form of loans of up to EUR 9 billion.

To assist Member States, on a proposal by the Commission, the co-legislators agreed to extend the flexibilities of the remaining 2014-2020 cohesion policy funds, including REACT-EU, and home affairs funds. While crucially necessary to provide liquidity and support, this too relied on redirecting interventions financed from the 2014-2020 cohesion and home affairs programmes, entailing the aforementioned operational challenges.

While a substantial part of the funding made available through flexible budget management has been used, the remaining amounts need to address two major crises. The below graph shows that at the beginning of 2021, not counting the Recovery and Resilience Facility, a maximum of EUR 242 billion was available to address the various challenges, namely the EU internal effects of COVID-19. At the beginning of 2022, a maximum of EUR 174 billion was available to respond both to the ongoing effects of COVID-19 and to address the consequences of the Russian war of aggression in Ukraine. These amounts being upper limits, the amounts that are actually available are lower. Under cohesion policy, including REACT-EU, the currently available amounts that do not necessitate reallocations from other priorities and can be used to address the economic fallout of COVID-19 or expenditures to accommodate refuges from Ukraine under CARE – Cohesion Action for Refugees in Europe amount to EUR 17 billion, so any contribution beyond those EUR 17 billion would require redirection from other policy priorities. Moreover, the long-term budget flexibility covers 7-year amounts, which are therefore not available for a single year.

([16]) https://ec.europa.eu/commission/presscorner/detail/en/ip_22_3183



Resources available from dedicated flexibility mechanisms and flexible use of cohesion funding. All amounts are in billion EUR.
Source: European Commission.

The annual margins and flexibility in the EU long-term budget are small compared to the annual budget. Taken together, the margins and flexibility instruments under the new long-term budget over the full 7-year term amount to a maximum of EUR 22 billion, or roughly EUR 3 billion annually. Comparing that number to an annual budget of roughly EUR 170-180 billion provides a flexibility of less than 2%. The Commission was able to mobilise significant amounts of liquidity in 2021 primarily thanks to making existing 2014-2020 cohesion policy funds more flexible and to the presence of NextGenerationEU. Once used, these options are no longer available, thereby significantly reducing the margin of manoeuvre in the EU budget. Relying on at-scale redeployments of funds from existing programmes would require political choices, as this would impact the long-term capacity of the EU budget to achieve the political priorities stated in the objectives of individual programmes.

In addition, the Russian aggression against Ukraine is causing challenges for which no long-term budgetary solutions exist yet. All of the support provided so far has focused on addressing the immediate needs generated by the arrival of a large number of refugees from Ukraine in the EU and providing humanitarian and other support to Ukraine and neighbouring countries. However, the war against Ukraine will have significant impacts well beyond the immediate humanitarian and security situation. Ukraine will need to rely on international support during the war and to rebuild the country later, requiring a very significant effort leading to large financial needs in both the short and the long term. New challenges such as high inflation, energy security, food security and other knock-on effects also require budgetary solutions at the EU level. These unforeseen needs created by a war in Europe are well beyond the means available in the current multiannual financial framework and NextGenerationEU. Therefore, new financing sources will have to be identified.

On 18 May 2022, the Commission proposed REPowerEU – a plan to rapidly reduce dependence on Russian fossil fuels. REPowerEU ([17]) puts forward an additional set of actions to save energy, produce clean energy and diversify our energy supplies, with the final aim to achieve a more resilient energy system and a true energy union. The Commission has proposed that REPowerEU be implemented through the Recovery and Resilience Facility, and has proposed a number of financing sources to strengthen the funding for the facility

([17]) https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_en for this purpose, including redeploying funds from existing programmes and creating new, additional resources.

Effective tools are in place to ensure sound financial management

In order to make the best possible use of taxpayers' money, it is essential to ensure that funding reaches the intended beneficiaries in compliance with the applicable rules. To achieve this objective, the Commission relies on a number of tools, which have proved to be fit for purpose over the years.

The Commission's governance system and chain of accountability are tailored to its unique structure and role. The College of Commissioners is politically responsible for the management of the EU budget. It delegates the day-to-day operational management to the 51 authorising officers by delegation ([18]), who manage and steer their departments and are accountable for the share of the EU budget implemented in their department. Their annual activity reports contain a declaration of assurance on the use of the resources assigned to them, which they may qualify with reservations in case of weaknesses.

The Commission's internal control framework is an essential safeguard for the Commission's operations. This is all the more the case in the context of the pandemic and the ensuing response measures. In 2021, the Commission continued to closely monitor the risks arising from the pandemic and their effective mitigation. The Commission's anti-fraud strategy has continued to play a significant role in preventing the possible misuse of EU funds.

In 2021, the relevant departments put a particular focus on the adaptation of their internal control systems to the needs of NextGenerationEU, be it through setting up a high-level risk and compliance policy for borrowing and lending activities or by designing specific audit and control strategies for spending under the Recovery and Resilience Facility.

Within its internal control framework, the Commission relies on multiannual and risk-differentiated control strategies to prevent, detect and correct errors and weaknesses in the control systems. EU spending programmes are multiannual by design, and so are the related control strategies. This implies that detection and correction of errors may happen at any time, up to the point of closure at the end of a programme's life cycle. Moreover, the control strategies are adjusted to the different management modes, the actors involved, the policy areas and/or the funding methods and associated risks. This differentiation of the control strategies is necessary to ensure their cost-effectiveness, i.e. that they strike the right balance between a low level of error (effectiveness), fast payments (efficiency) and reasonable costs (economy).

([18]) The term 'authorising officers by delegation' covers directors-general of Commission departments, heads of executive agencies, offices, services, task forces, etc. Article 74(1) of the financial regulation states that: 'The authorising officer shall be responsible in the Union institution concerned for implementing revenue and expenditure in accordance with the principle of sound financial management, including through ensuring reporting on performance, and for ensuring compliance with the requirements of legality and regularity and equal treatment of recipients.'

The Commission and the Member States perform hundreds of thousands of checks every year. The Commission builds its assurance from the bottom up and at a detailed level, i.e. by programme or other relevant segment of expenditure. This allows the Commission to detect weaknesses and errors, to identify the root causes of systemic errors, to take targeted corrective actions and to ensure that any lessons learned are factored into the design of future financial programmes.

In agriculture:	In cohesion:
More than **900 000** checks were carried out by the Member States and **97** audits by the Commission.	The Commission reviewed the annual reports and opinions for **416** programmes and carried out **61** audits.

The Commission's control results confirm that the EU budget is well managed

The Commission and the Member States take action to prevent and correct weaknesses and errors. The Commission's key preventive mechanisms consist of *ex ante* controls and audits (see Annex 5 in Volume III), including system audits to detect weaknesses in the implementing partners' management and control systems. Under shared management, Member States' authorities also perform verifications and audits. Where preventive mechanisms have not been effective, errors affecting EU expenditure are detected and corrected after the Commission's payments by Member States and the Commission.

The Commission's controls and audits are effective.

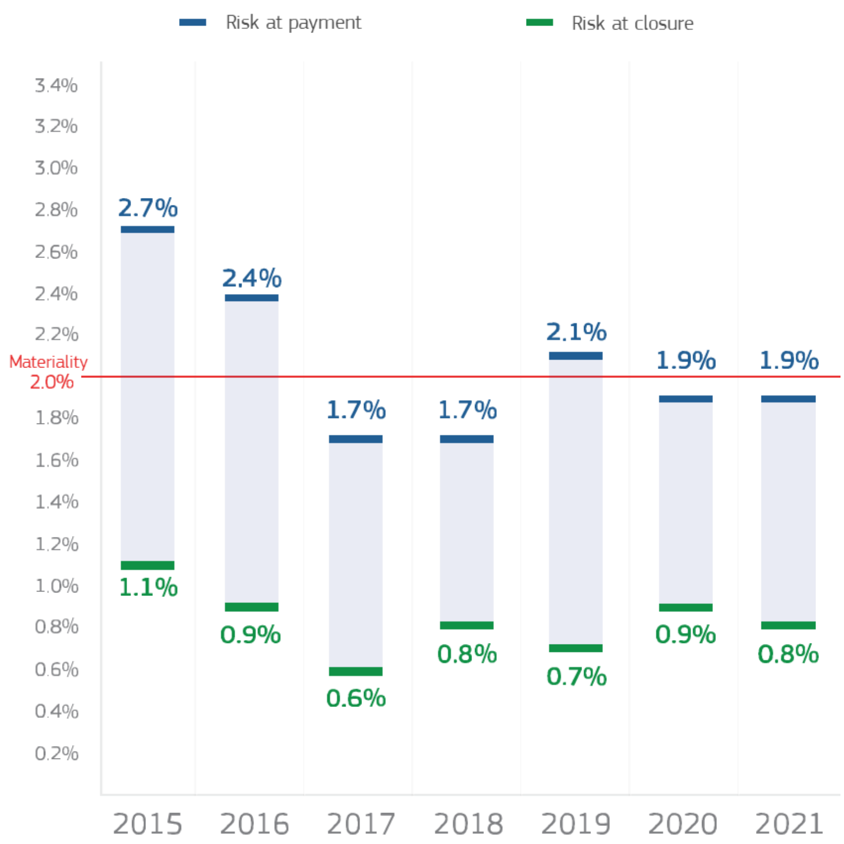
As a result of its controls and audits, in 2021 the Commission implemented preventive and corrective measures for an amount of EUR 1 063 million, EUR 298 million of which represented preventive measures, while the corrective measures implemented added up to EUR 765 million. This brings the cumulative amount of preventive and corrective measures implemented for the years 2017 to 2021 to EUR 26 billion. In addition, the Member States themselves implemented preventive and corrective measures for a total amount of EUR 4 557 million in 2021, partly based on Commission audits.

Overall, the risk at payment is below the materiality threshold of 2%. The Commission estimates that, after its preventive controls, the remaining level of error – i.e. the risk at payment – is 1.9% ([19]). This result is similar to that of 2020. Given the multiannual character of the funding programmes, the Commission deploys substantial efforts to perform controls after the payments and to make corrections until the closure of the programmes. These efforts are reflected in the estimated risk at closure ([20]), which corresponds to the risk at payment minus the Commission's future corrections forecast.

([19]) This result does not include the expenditure under the Recovery and Resilience Facility, for which the control results are disclosed separately on the basis of a qualitative assessment.

([20]) In the case of the common agricultural policy, the term 'estimated final amount at risk' is used instead to better reflect the fact that there is no set closure point for the European Agricultural Guarantee Fund measures.

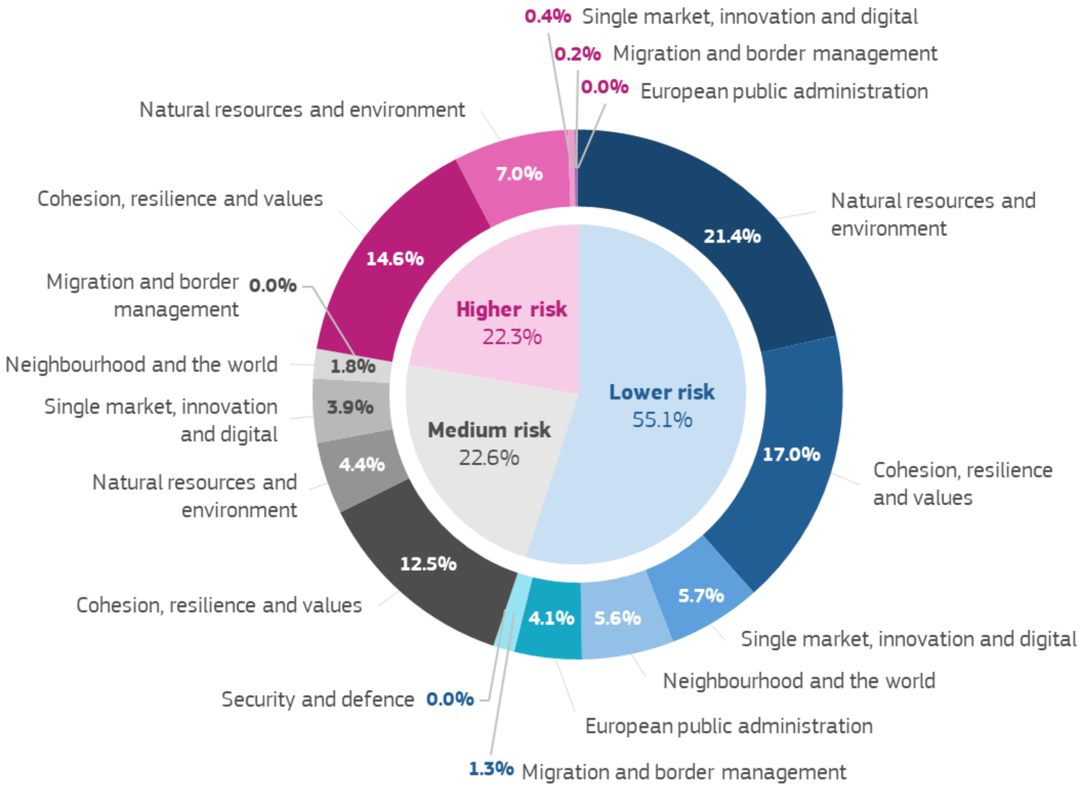
For 2021, the risk at closure is estimated at 0.8%. As this is well below the threshold of 2% – also used by the European Court of Auditors – the Commission considers that the budget as a whole is effectively protected. This is confirmed by the internal auditor's opinion ([21]).



Risk at payment and closure for the European Commission for the 2015-2021 period.
Source: the European Commission, the 2015-2021 annual management and performance reports for the EU budget.

Notwithstanding this overall good result, the Commission identifies which programmes have a higher level of risk, allowing it to focus its action where it matters most. Thanks to its detailed analysis, the Commission has robust evidence of the differentiated risk level for the EU's expenditure. Based on the risk at payment, expenditure is divided into lower- (below 1.9%), medium- (between 1.9% and 2.5%) and higher-risk (above 2.5%) segments. For natural resources and cohesion, this analysis is carried out at the level of individual paying agencies and programmes in the Member States, which allows to show that the situation is differentiated by programmes. This also allows the Commission to address specific weaknesses even for policies that, taken globally, are low risk, such as the common agricultural policy.

([21]) See Annex 2, Section 3.2 'Work of the Internal Audit Service and overall opinion'.



The European Commission categorisation of expenditure into higher-; medium- and lower-risk segments, as percentages of the total of relevant expenditure for 2021.
Source: European Commission.

In particular, the following involve higher-risk expenditure: some programmes for cohesion policy funds that show serious deficiencies and/or have maximum error rates above 2.5%; the programmes in the cohesion policy funds and the paying agencies for agriculture-related direct payments, market measures and rural development that have risk at payments above 2.5%; and expenditure related to complex grants in other funding programmes. Where the level of risk remains high, this is reported transparently through the issuance of reservations. For 2021, there are 16 reservations with a total financial impact of EUR 987 million, which is less than 1% of the total expenditure. These reservations are a keystone in the accountability chain. They outline the challenges and weaknesses encountered, along with the measures envisaged to address them.

In addition to financial corrections and recoveries, the Commission is taking action to address weaknesses leading to medium and higher risks. These include communication targeted at the most error-prone beneficiaries, more extensive use of simplified forms of grants, better controls and building the capacity of national authorities with deficiencies in their management and control systems.

The Recovery and Resilience Facility has entered the implementation phase

Established at the beginning of 2021, the Recovery and Resilience Facility is a new performance-based instrument, of an exceptional and temporary nature, at the service of EU recovery. With a total envelope of EUR 723.8 billion (in current prices) – EUR 338 billion in grants and EUR 385.8 billion in loans – its purpose is to mitigate the social and economic impact of the COVID-19 pandemic and promote a long-lasting recovery that embraces the green and digital transitions. Member States are the beneficiaries of the funds, which are disbursed against the achievement of predefined milestones and targets.

Twenty-two recovery and resilience plans were positively assessed by the Commission and adopted by the Council in 2021. These plans account for a total allocation of EUR 291 billion in non-repayable financing and EUR 154 billion in loans. These 22 recovery and resilience plans include a total of over 3 700 measures (around one third of which are reforms and two thirds investments), along with over 5 100 milestones and targets to be fulfilled by 2026.

Funding is disbursed in several instalments upon the achievement of milestones and targets to which Member States have committed themselves. In 2021, the Commission disbursed EUR 54 billion in pre-financing payments to 20 Member States ([22]), which helped kick-start the implementation of the investment and reform measures outlined in Member States' recovery and resilience plans. The Commission disbursed a first payment for milestones and targets of EUR 10 billion to Spain before the end of 2021, after receiving the payment request in November 2021.

Since the facility is a performance-based instrument, the legality and regularity of the payments made by the Commission depend on the actual achievement of the milestones and targets. Member States are primarily responsible for the protection of the financial interests of the EU, including checking compliance with applicable EU and national law. For that purpose, they put in place appropriate control frameworks at the national level, in particular with a view to preventing, detecting and correcting fraud, corruption and conflicts of interests and avoiding double-funding.

As a result, the focus of the Commission's controls is on the satisfactory achievement of the agreed milestones and targets. To ensure sound financial management, the Commission relies on the Member States' controls, and complements them as necessary at the following three stages.

- During the assessment of the recovery and resilience plans, the Commission assesses the Member States' control systems and invites the Member States to include additional milestones in the plans to address identified weaknesses before the first payment.
- During the implementation of the facility, the Commission assesses whether the milestones and targets have been satisfactorily fulfilled and all other conditions for disbursement have been met. If this is not the case, payments are suspended or proportionally reduced. The Commission also audits the functioning of the Member States' management and control systems to protect the EU's financial interests, and more particularly the measures to prevent, detect and correct cases of fraud, corruption, conflicts of interest and double funding.

([22]) Ireland did not ask for pre-financing and Finland was paid in January 2022 only.

- After disbursements, the Commission may perform *ex post* controls and audits [23] to check the achievement of milestones and targets. The Commission may also carry out ad hoc audits in case of suspicion of serious irregularities. If necessary, the Commission will recover proportionate amounts or require early repayment of the loans.

To gauge the level of risk associated with operations, the Commission makes a qualitative assessment of results from audits and controls both at the level of Member States and the Commission. In a context where payments are based on a qualitative assessment of the fulfilment of milestones and targets and where these milestones and targets are very diverse, control results cannot be extrapolated. Therefore, unlike other funding programmes, a meaningful error rate based on statistical methods cannot be determined.

Based on the positive assessment of evidence for the fulfilment of the milestones of the payment request, **the authorising officer by delegation confirmed that he had reasonable assurance** of the legality and regularity of the single payment made in 2021 under the Recovery and Resilience Facility.

Management conclusion

The Commission ensures that the EU budget serves citizens. Thanks to the effective tools in place and to the proactive management of the EU budget, the Commission has been able to deliver on its policy objectives and respond to multiple challenges. The Commission has provided its beneficiaries, implementing partners and the Member States with the necessary degree of flexibility, while ensuring sound financial management and maintaining an appropriate level of assurance on the management of the EU budget.

All authorising officers by delegation have provided reasonable assurance, although qualified with reservations where appropriate. The annual activity reports demonstrate that all Commission departments have put in place solid internal controls and provide evidence of the efforts undertaken to improve cost-effectiveness, further simplify the rules and adequately protect the budget from fraud, errors and irregularities.

On the basis of the assurances and reservations in the annual activity reports, taking into account the opinion of the internal auditor, the College of Commissioners adopts this *Annual Management and Performance Report for the EU Budget – Financial year 2021* and takes overall political responsibility for the management of the EU budget.

(23) In accordance with the Financing Agreement, *ex post* audits can be carried out for up to 5 years starting from the date after the last payment has been submitted.

Future developments: outlook for 2022 and beyond

Against a backdrop of continued immense challenges, close cooperation with other EU institutions and the Member States remains essential. As has been true for the pandemic, the dramatic unfolding of events in Ukraine makes a robust and coordinated EU-level response both necessary and justified as an indispensable complement to the work of the Member States.

The constraints of the 2021-2027 multiannual financial framework will pose challenges for the EU to respond in full to the situation following the Russian invasion of Ukraine. The Commission is committed to ensuring that every euro in the EU budget is used to maximum effect, including by reallocating and reprioritising when unanticipated challenges arise. However, there are limits to what can be achieved within the constraints of the current multiannual financial framework. Much of the flexibility in the budget has already been used to react to multiple crises, with the result that there will be less room to respond to future crises. An urgent reflection is therefore warranted on how to ensure that the EU budget is equipped to respond to the many demands and expectations placed on it in these exceptionally turbulent times.

The Commission has proposed a targeted revision of the financial regulation ([24]). Given that the changes brought about by the 2018 revision need time to produce their full effect, this proposal focuses on alignment with the new long-term budget, certain improvements on crisis management following lessons learned during the COVID-19 crisis and enhanced protection of the EU's financial interests.

The Commission is following up on its commitment to continue providing a single data-mining and risk-scoring tool (Arachne) to Member States. It supports the programme authorities in identifying risks for the expenditure by adapting the tool put at the disposal of Member States under the previous financial framework. The Commission will continue to offer support to Member States to allow for its effective use. In the ongoing revision of the financial regulation the Commission proposed to strengthen the use of this data-mining and risk-scoring tool.

On 16 February 2022, the Court of Justice upheld the validity of Regulation (EU, Euratom) 2020/2092 on a **general regime of conditionality for the protection of the EU budget**, which two Member States, Hungary and Poland, had contested. In March 2022, the Commission adopted guidelines on the application of the regulation. Following the work carried out throughout 2021, the Commission sent a first notification to Hungary in April 2022 as a subsequent step under the general regime of conditionality, triggering the procedure that may lead to the imposition of measures against a Member State for breaches of the principles of the rule of law. The Commission constantly monitors the situation across Member States and will start the procedure under the conditionality regulation if the conditions are fulfilled.

([24]) Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (recast), COM(2022)223.

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