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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

on the follow-up to the discharge for the 2021 financial year

REPORT ON THE FOLLOW-UP TO THE REQUESTS MADE BY THE EUROPEAN PARLIAMENT IN ITS DISCHARGE RESOLUTIONS AND THE COUNCIL IN ITS DISCHARGE RECOMMENDATION FOR THE FINANCIAL YEAR 2021

1. Introduction

2021 was the year when restrictions linked to the COVID-19 pandemic were lifted and EU-wide economic recovery took place. From a budgetary perspective, it was the **first year in the implementation of the EU's temporary recovery instrument** (and its centerpiece the Recovery and Resilience Facility or RRF) and the **starting year of the new multiannual financial framework (MFF)**, with programmes coming into operation even while spending programmes from the **previous MFF** were still running and **continuing to respond to the EU's cross-policy priorities**.

On 10 May 2023, the European Parliament decided, taking account of a recommendation from the Council, to **grant discharge to the Commission** on its implementation of the EU budget in 2021. As part of the 2021 discharge procedure, the European Parliament in its discharge resolution, and the Council in its discharge recommendation, made several requests to the Commission. The Commission shares the main objectives underlying these requests:

- **protecting the EU budget from spending errors, fraud or any malicious interference:** the Commission takes all necessary measures to protect the EU budget (including, where appropriate, the suspension of payments and financial corrections);
- **putting performance at the heart of budget implementation:** money should be spent in line with the EU's priorities and should deliver the expected results on the ground, thus bringing about tangible results and positive changes for the general public and other beneficiaries;
- **striking the right overall balance:** it is important to get the right balance between different objectives (e.g. minimising errors; strong protection against misuse of funds; swift payments; a high level of transparency; keeping the costs and burden of controls for public authorities and beneficiaries to a reasonable level; and making sure that EU expenditure adds real value).

This report on the follow-up to the 2021 discharge procedure summarises, as part of the Integrated Financial and Accountability Reporting (IFAR), **the actions taken by the Commission** in response to the requests expressed in the section 'political priorities' of the discharge resolution. The Commission will provide more detailed and updated information in response to all specific requests when the 2022 discharge procedure begins later this year.

2. Improvements in the control system for EU funds

a. Digitalisation of controls and audits

The Commission's **proposal to revise the Financial Regulation**, which is currently being discussed by the European Parliament and the Council as co-legislators, is an opportunity to further increase the protection of the EU budget across management modes against irregularities, fraud, corruption and conflicts of interest. The proposed legislative changes are needed for the implementation of new measures.

Under the proposed rules, the Commission envisages to **make the use of an integrated IT system for data-mining and risk-scoring compulsory and more efficient in all Member States**. This IT system allows identifying measures, contracts and recipients that are vulnerable to irregularities, fraud, corruption, and conflicts of interest. The Commission has developed and supplied this IT tool, known as Arachne, to Member States implementing the EU budget under shared management and under the RRF. It is already widely used in the field of cohesion policy and to a certain extent for agricultural spending. The use of Arachne is currently voluntary, but making it compulsory would be an important step forward. The proposed changes also aim at further standardising the recording and storing of data on recipients of all EU funds and the interoperability of the system with other data sources.

The Commission has also proposed to **extend the scope and effectiveness of the Early Detection and Exclusion System (EDES)**. EDES provides a set of measures to protect the EU budget against fraudulent and unreliable economic operators. In particular, EDES enables authorising officers to detect, blacklist and possibly exclude from future awards of contracts financed by the EU budget for limited time-periods, all economic operators that are found to be unreliable because of their involvement in misconducts including irregularities and fraud and therefore pose a risk for the integrity of the EU budget. The Commission has proposed both to extend the application of EDES to funds under shared management and to better target funds under direct management, including where funds are disbursed as financial contributions to Member States (for instance under the RRF) so that the Commission would be able to act on the most serious grounds for exclusion. The objective is also to make it mandatory that exclusion decisions taken at the EU level are enforced at the national level in cases of shared management. The Commission has also proposed to make it possible to exclude affiliated entities and/or beneficial owners of a primary excluded entity from bidding for public contracts and ultimately from obtaining EU funds.

EDES and Arachne remain two different systems, but the Commission is exploring whether the exclusions contained in the EDES database can be inserted into Arachne so as to feed the data-mining tool and to provide a single entry point.

b. Rule of law and fundamental values

The Commission makes full use of all available instruments to ensure that breaches and risk of breaches of the rule of law principles affecting the sound financial management of the EU budget and the financial interests of the EU are addressed.

An important instrument is the **Conditionality Regulation**, which is applicable since 1 January 2021.

The first notification from the Commission under the Conditionality Regulation was made to **Hungary** on 27 April 2022. This initiated a process of assessment and exchange of information with Hungary that lasted until mid-September and led to the Commission submitting a proposal for a Council decision on 18 September 2022.

On 15 December 2022, the Council adopted an implementing decision under the Conditionality Regulation that suspended **55% of the commitments for three cohesion programmes** (the suspended commitments amount to approximately EUR 6.3 billion under the 2021-2027 MFF). The Council also prohibited any new legal commitments with any public interest trusts under any programme directly or indirectly managed by the Commission. These public interest trusts are organisations such as universities with public interest objectives, for which there remain conflict of interest issues.

Now that budgetary measures have been adopted by the Council, pursuant to the Conditionality Regulation, **Hungary can submit and take further remedial measures** to address the Commission's findings and demonstrate to the Commission that the conditions to apply budgetary measures are no longer fulfilled. The Conditionality Regulation states that, if the Commission considers that the issues have been partly or fully remedied, it must submit to the Council a proposal for an implementing decision to adapt or lift the adopted measures, by means of a written notification. At the time of preparation of this report (15 June 2023), Hungary has not submitted any such written notification.

Hungary committed itself to report to the Commission every 3 months until 31 December 2028 on the implementation, maintenance and application of all remedial measures. The second of these reports was due on 16 June 2023.

The Commission is monitoring the overall state of the rule of law in Hungary – and not only the issues covered by the remedial measures – just like it does for all other Member States.

In addition to the Conditionality Regulation, the **RRF Regulation** can also, within its scope, help address rule of law challenges identified in the country-specific recommendations.

In addition, in accordance with Article 22 of the RRF Regulation, Member States shall take all appropriate measures to protect the EU's financial interests during the implementation of the Facility. As required by the RRF Regulation, the Commission has assessed as part of the approval procedure of the national recovery and resilience plans (NRRPs) whether the Member State's control systems provided sufficient assurance to protect the RRF funds.

In some cases, in order to ensure compliance with Article 22 of the RRF Regulation, the Commission established measures agreed with the Member State and contributing to the protection of the EU's financial interests regarding the implementation of the Facility in the form of **milestones that should be satisfactorily fulfilled before any payment can be made**.

Following the Commission's proposals, the Council implementing decisions regarding the **NRRPs of Hungary and Poland** establish several such milestones, including measures aiming at addressing rule of law issues.

In 2021-2027, Member States also need to conform with certain **horizontal or thematic enabling conditions**. These are prerequisite conditions for the effective and efficient achievement of the specific objectives of shared management funds. One horizontal enabling condition relates to the effective application and implementation of the **Charter of Fundamental Rights of the European Union**. The Member States' programme submissions included an assessment of whether the enabling conditions linked to the selected specific objectives have been fulfilled. The Commission has reviewed these assessments and found that all the Member States except Hungary and Poland were fulfilling the horizontal enabling condition on the Charter¹. The Commission is currently working with Hungary and Poland to resolve the outstanding issues.

¹ In the case of Cyprus, the horizontal enabling condition for the Charter of Fundamental Rights is considered by the Commission not fulfilled for the Asylum, Migration and Integration Fund (AMIF) and the Instrument for Financial Support for Border Management and Visa Policy only (BMVI).

c. Strengthening integrity measures

The Commission has both a political commitment and a legal obligation to ensure that organisations and projects involved in criminal practices or practices that are incompatible with the EU's values do not receive EU financial support.

The swift suspension of funding in December 2022 to the non-governmental organisation (NGO) 'No Peace Without Justice', which was involved in the '**Qatargate scandal**', demonstrated the concrete action that the Commission can take under the EU's financial rules.

All entities applying for EU funding are subject to the same rules, irrespective of their status. The Financial Regulation provides the Commission with a range of measures that it can take when directly implementing the budget. These include **rigorous selection processes** based on objective criteria to ensure that funding is in line with EU values. During implementation, beneficiaries of EU funding are obliged to provide any information requested by the Commission without delay so that it can verify the eligibility of the costs or declared contributions; proper implementation of the action; and compliance with the other obligations under the grant agreement (these may include information on sources of funding from outside the EU budget if this is relevant to demonstrating compliance). As regards indirect management of the budget, the Financial Regulation requires persons and entities implementing the EU budget to **comply with applicable EU law and agreed international and EU standards** and, therefore, not to fund actions that contradict EU values.

The Commission also ensures through the **implementation of EDES** that EU funds do not benefit organisations that go against EU values. The grounds for excluding applicants from participating in award procedures or being selected to implement EU funds include grave professional misconduct, terrorist financing, fraud and corruption. The exclusion from participation in award procedures may take place not only when the organisation itself is in an exclusion situation, but also when any person who is a member of the administrative, management or supervisory body of the organisation (or any person having powers of representation, decision-making or control over the organisation) or its beneficial owners are in an exclusion situation established by a final court judgment or a final administrative decision.

As part of its ongoing **commitment to improve the system to protect the EU's financial interests**, the Commission has proposed adding 'incitement to discrimination, hatred or violence' as a new and explicit situation of exclusion and including a definition of NGOs in the Financial Regulation recast proposal together with a corresponding obligation for grant applicants to indicate whether or not they are NGOs.

Going beyond the specific objective of protecting the EU budget, the Commission also adopted an **anti-corruption package** on 3 May 2023. The package includes a directive on fighting corruption, which would – if adopted by the co-legislators – harmonise national provisions defining corruption and related offences and penalties, in order to ensure that highly effective, proportionate and dissuasive criminal-law tools are uniformly in place to fight the full range of corruption offences, better prevent corruption and improve enforcement. The package also includes a proposal to complement the Common Foreign and Security Policy (CFSP) toolbox of restrictive measures (sanctions) with a dedicated sanctions regime to fight serious acts of corruption worldwide.

The Commission has also adopted a proposal for the creation of an **interinstitutional Ethics Body** on 8 June 2023², covering members of EU institutions, as announced at the beginning of the mandate by President von der Leyen, and following informal consultations with the other institutions. With the establishment of the Ethics Body there will, for the first time, be common standards for ethical conduct of members of EU institutions and a formal mechanism for coordination and exchange of views on ethical requirements among institutions.

Besides the Commission, the **European Anti-Fraud Office (OLAF)** and the **European Public Prosecutor's Office (EPPO)**, in their respective capacities, carry out controls and investigations to ensure that the EU budget is spent according to the applicable rules.

The current MFF is based on stable staffing for all institutions, but the increase in OLAF's workload led the co-legislators, on the basis of the Commission's proposals, to **increase OLAF's staff with 13 full time equivalent (FTE)** in the last two years' budgets (7 FTE in the 2022 budget and 6 in the 2023 budget). The Commission has proposed to further increase OLAF's staff with 2 FTE for the draft 2024 budget. The increase is offset elsewhere in the Commission.

Similarly, the **EPPO's staff more than tripled between 2020 and 2022** while its EU funding increased fivefold over the same period, commensurate with its entry into operation in 2021 and subsequent increase in the number of its investigations and prosecutions. The EU budget provides significant funding to the EPPO in line with its key role in the fight against fraud. More precisely, the 2022 budget added 118 additional staff to the EPPO and the EU contribution increased by EUR 11.2 million to cover the additional salary cost. The EPPO's staff remains stable in 2023 compared with 2022 but, at the EPPO's request, the staff structure has changed with the conversion of 20 contract agent positions into establishment plan posts. The changed staff structure and corresponding increase in salary costs are included in the Commission's proposal for staffing and funding the EPPO in the draft 2024 budget.

d. The RRF control system

- Governance structures, internal processes and control strategies

The RRF provides financial support based on **performance**. RRF funds are disbursed when Member States have fulfilled key steps (known as milestones and targets) in implementing the reforms and investments included in the NRRPs. For each payment request, the Commission ensures that it has reasonable assurance that the underlying milestones and targets have been satisfactorily fulfilled.

In addition, Member States are required to put in place suitable **control systems to detect and prevent fraud, corruption, double-funding and conflicts of interest** and to **regularly check the implementation of the plan in accordance with all relevant national and EU legislation**. In the event of an individual case of serious irregularities, the Member State concerned is obliged to take corrective action and, if it fails to do so, it is for the Commission to recover the funds from the Member State. The Commission's assessment of the national plans includes an assessment of the audit and control frameworks of Member States described in those plans. A positive assessment is only possible if these frameworks were found to adequately protect the EU's financial interests.

² Communication from the Commission (C (2023) 311 final) - Proposal for an interinstitutional ethics body

During implementation and in line with its audit strategy, the Commission carries out **system audits** on the Member States' control systems in order to ensure that they adequately prevent and detect serious irregularities or serious breaches of obligations of the financing agreement. In the context of these system audits, the Commission also checks that the Member States' systems provide for and check compliance with EU and national rules, particularly as regards public procurement procedure. **The Commission had audited 23 national systems** by the end of April 2023 and intends to audit all the others by the end of 2023. Furthermore, and in response to recommendations from the European Court of Auditors (ECA), the Commission has been regularly checking since the start of 2023 that Member States verify **compliance with public procurement and State aid rules**. In the event of systematic failures in the system that amount to a serious breach of obligations, the Commission can suspend and recover between 5% and 100% of the funds allocated to the Member State in question.

The Commission also carries out **risk-based audits on milestones and targets** that have been included in payment requests. These audits verify the accuracy and reliability of the data in those payment requests.

The Commission's control arrangements are complemented by the audits and investigations carried out by the Commission's Internal Audit Service, the ECA, the EPPO and OLAF.

- *The Commission Communication outlining the framework for assessing the satisfactory fulfilment of milestones and targets and the methodology for the determination of payment suspension*

The Commission's **communication**³, published on 21 February 2023, provides further clarity and transparency on the procedures that the Commission has established for implementing the RRF.

The framework demonstrates that the Commission's assessment of milestones and targets is based on **objective and verifiable evidence** while also allowing reasonable flexibility. Minimal deviations linked to the amounts, formal requirements, timing or substance can be accepted in a limited number of circumstances and will be set out transparently to allow external scrutiny by the Economic and Financial Committee, as well as the ECA and the European Parliament.

The payment suspension methodology enables the Commission to determine the amount to be suspended if a milestone or target is not satisfactorily fulfilled. The Commission does so **in full respect for the principles of equal treatment and proportionality** and in line with the RRF's performance-based nature. The methodology was applied for the first time in May 2023 as regards a payment made to Lithuania.

3. Transparency of the EU budget & reporting

The Commission and the Member States already make available a wide range of information on recipients of EU funds (e.g. through the Financial Transparency System⁴ or through national transparency websites for the common agricultural policy). The proposal to revise the Financial Regulation would, if accepted by the co-legislators, further enhance the

³ Communication from the Commission COM(2023) 99 final, Recovery and Resilience Facility: Two years on - A unique instrument at the heart of the EU's green and digital transformation

⁴ The Financial Transparency System (FTS) provides details on the EU budget implemented directly by the European Commission or implemented indirectly by entrusted entities.

Commission's reporting in this area by ensuring that the **list of recipients of EU funds in all management modes will be published** as from the start of the new programming period.

Specifically, the proposal to revise the Financial Regulation would require both (i) Member States that implement the EU budget under shared management or that receive and implement EU funds under direct management; and (ii) persons and entities implementing the EU budget under indirect management, to at least once a year transmit for publication, to the Commission, information on the recipients and amounts of EU funding. The Commission would be responsible for consolidating, centralising and publishing the data on recipients of EU funding in a **single website and database covering all management modes**.

In addition to data linked to the recipients of funds, the Commission also provides information at project and programme level for various spending programmes under the 2021-2027 MFF (e.g. through its **cohesion open data platform** and its **Kohesio** website, which are both dedicated to the use of cohesion policy funds).

As regards funding under the RRF, the entry into force of the **REPowerEU** amendments to the RRF Regulation on 1 March 2023 has further strengthened transparency by requiring national authorities to publish information on the **100 final recipients receiving the highest amounts of RRF funding per Member State**. The first national portals were released in April 2023 and the first data, as reported by the Member States, was published on the recovery and resilience scoreboard on 23 May 2023.

Furthermore, the Commission recently released an **interactive EU map** to provide easy access to information on exemplary reforms and investments funded by the RRF. The map makes it possible to see investments by location and provides specific information on their state of implementation. The map does not contain an exhaustive list of all reforms and investments, but it is updated regularly (taking account of the increasing information provided by Member States in the context of the assessment of payment requests, and the information on the 100 final recipients receiving the highest amount of RRF funding per Member State).

The national portals and the interactive map complement the **recovery and resilience scoreboard**, which gives an overview of how the implementation of the NRRPs is progressing.

The Commission also ensures transparency as regards its contingent liabilities by publishing an annual report⁵ on the matter, including an overview of contingent liabilities relating to RRF loans.

4. Performance of the EU budget

The Commission attaches the greatest importance to **maximising the effectiveness of EU spending**.

For major spending programmes within the new MFF, **impact assessments or ex ante evaluations** were carried out to ensure efficiency by design, including by setting clear objectives and focusing on a number of high-quality performance indicators. As part of this process, the Commission also conducted a series of public consultations covering major

⁵ Report from the Commission to the European Parliament and the Council on financial instruments, budgetary guarantees, financial assistance and contingent liabilities: situation at 31 December 2021, COM(2022) 560 final.

spending areas to gather views from all interested parties. The **Regulatory Scrutiny Board** analyses all impact assessments reports, fitness checks and selected evaluations, and provides its quality assurance for the reports it scrutinises.

The Commission has integrated its **cross-policy priorities into the EU budget**. Its efforts in this area are fully in line with, and even exceed, the timeline and milestones agreed by the co-legislators in the **December 2020 interinstitutional agreement**, which envisages that different priorities are to be integrated into the EU budget to a varying extent in accordance with political and resource considerations.

As regards the **tracking of gender equality related expenditure**, the Commission has published (ahead of the schedule set out in the interinstitutional agreement) a methodology which has been applied on a pilot basis to the entire EU budget (rather than just a selection of centrally managed programmes, as foreseen in the interinstitutional agreement).

The Commission acknowledges that the **climate-tracking methodology for 2014-2020** had shortcomings and recalls that, in setting its climate-spending target and monitoring its achievement, it was bound by that methodology and its underlying assumptions and constraints. The Commission clearly and transparently communicated its methodology.

For the **new programming period 2021-2027**, the Commission has **strengthened several dimensions of its climate-tracking methodology**. The relevance for climate of an individual measure/intervention is now assessed on the basis of its expected **impact** rather than its **intended purpose** (i.e. whether the actions were designed specifically to contribute to climate actions). This helps ensure that similar actions in different spending programmes are assessed in the same way (i.e. they are assigned the same EU climate coefficient). In addition, all EU spending programmes take the **do-no-harm principle** into account when pursuing their objectives, albeit in different ways. At an aggregate level, a **climate-adjustment mechanism** is in place which empowers the Commission to propose changes to individual EU spending programmes if the aggregate minimum climate expenditure target for the whole EU budget is at risk of being missed.

The Commission not only calculates the share of expenditure on a given priority but is also conducting three methodological exercises on a pilot basis in the areas of climate, digital transition and jobs. These pilots measure **concrete results achieved at the level of the EU budget**. In particular, the Commission is developing a methodology to quantify the overall impact of the climate-related interventions funded under the RRF in terms of **greenhouse gas emissions that have been avoided**, taking into account data constraints and limitations. This methodology will underpin the first impact report on NextGenerationEU green bonds which the Commission plans to issue by the end of 2023. The Commission then intends to apply this methodology to the entire EU budget.

5. Outstanding budgetary commitments – ‘reste à liquider’ (RAL) and measures to speed up the implementation of EU funds

Outstanding commitments (commonly referred to as ‘the RAL’ – *reste à liquider*) are amounts that have been committed but not yet paid. They stood at EUR 452.2 billion at the end of 2022 (compared with EUR 341.6 billion at the end of 2021). The main driver of the increase in the RAL during 2022 was the implementation of the non-repayable part of NextGenerationEU – which increased total RAL by EUR 189.1 billion (42% of total RAL) at the end of 2022. As expected, the assigned revenue of NextGenerationEU’s programmes will

continue to increase the RAL in the coming years because the commitments will be made until the end of 2023 while payments will be made until 2026⁶.

As regard measures to **make it easier to absorb EU funds**:

- The Commission will continue during the annual budgetary procedures to propose **levels of payment appropriations that adequately meet payment needs**. This will take into account the implementing rules for specific programmes and funds that have been adopted by the co-legislators.
- Some **far-reaching simplifications** were adopted in the Common Provisions Regulation (CPR) and as part of the new legislative framework for the common agricultural policy (notably thanks to its new delivery model). These include a broader use of simplified cost options. Currently, taking into account the fact that the programming of the CPR funds has been completed, the Commission is focused (and working hand in hand with the Member States) on the timely, smooth and high-quality implementation of the programmes. Progress will be closely monitored and the Commission will, when necessary, propose mitigating actions to the Member States.
- The Commission highlights the fact that several measures are in place to coordinate the **simultaneous implementation of the RRF and of cohesion policy funds**; avoid the risk of double-funding; and address national administration capacity issues. Investment that is planned and implemented under the two instruments must be coordinated. Programming documents under both instruments must specify how they will complement each other. To ensure good coordination, the operational arrangements signed with Member States under the RRF also include an annual stakeholder event to be held in each Member State to discuss, amongst others, complementarity and synergies between the RRF and other EU programmes. The Commission also provides **continuous administrative support and guidance** to improve the administrative capacity of the Member States – by technical assistance in cohesion policy, the technical support instrument (TSI), peer-to-peer exchanges and practitioner networks. For instance, most Member States have received support from the TSI in preparing their REPowerEU chapters, and in identifying reforms and investments to reduce dependence on fossil fuel imports from Russia.

6. Looking ahead

The Commission is committed to delivering results on the priorities highlighted by the European Parliament and the Council as a result of the 2021 discharge procedure.

In 2021, the Commission was addressing the challenges that arose from the COVID-19 pandemic. Since then, the EU was faced by a new reality with **Russia's war of aggression against Ukraine**, with a surge in energy and food prices, a new macroeconomic environment

⁶ Further information on the level of the RAL is included in (i) the EU's 2022 annual accounts; (ii) Working Document V attached to the 2024 Draft Budget; and (iii) the annual report on the long-term forecast on the future inflows and outflows of the EU budget 2021-2027, which is part of the IFAR. In addition, the Commission provides relevant information to the European Parliament and the Council during dedicated interinstitutional meetings on payments that are held three times a year.

with a sharp rise in interest rates and inflation as well as a wide array of **humanitarian crises and environmental disasters**.

The crises and emergencies that the EU budget was called to address, combined with the continued need to deliver on the EU's political priorities, including the green and digital transition, put the **MFF under considerable pressure**. The budgetary flexibilities as agreed in 2020 for the current MFF were already very limited from the start. This made it challenging to mobilise funds to finance new priorities or address unexpected challenges.

Against this background and to ensure that the EU could deliver on its most urgent objectives, the Commission presented a **mid-term review of the 2021-2027 MFF** in June 2023, which takes stock of the implementation so far and proposes solutions to the challenges faced by the EU budget.

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