Czech Republic
Supreme Audit Office

EU REPORT 2017

REPORT ON THE EU FINANCIAL MANAGEMENT IN THE CZECH REPUBLIC

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Editor's note:

The editorial deadline for the *Report on the EU Financial Management in the Czech Republic in 2016* (Section I of *EU Report 2017*) was set at 31 March 2017.

Section II of *EU Report 2017* will be devoted to the completed 2007–2013 programming period and will be published separately at the end of 2017.

All the published data and information requested from or taken from Czech sources concern the 2016 budget year or, in some cases, the first quarter of 2017. Data on the management of EU budget funds taken from up-to-date reports published by the European Commission ("the Commission") and its bodies mainly apply to the financial year 2015, as data for the financial year 2016 were not available by the editorial deadline.

The results of audits conducted by the Supreme Audit Office (SAO) comprise findings from audit conclusions approved between April 2016 and March 2017 ("the period under scrutiny"). An overview of audits completed in this period is presented in Appendix 1.

Audit work by the Ministry of Finance (MoF), specifically its division 52 – Audit Body (AB), and by the European Court of Auditors (ECA) mainly covers 2015 and 2016.

Unless specified otherwise in *EU Report 2017,* the Czech crown/euro exchange rate published by the European Central Bank (ECB) as at 30 December 2016, i.e. 27.021 CZK/€, is used.

Opening message from the President of the Supreme Audit Office

Dear readers,

We are presenting you with the tenth SAO jubilee report on behalf of the financial management of the EU Funds in the Czech Republic. In this edition we also discuss your basic questions concerning the membership of the Czech Republic in the EU. These are how the Czech Republic managed to draw on the EU Funds, how it fulfilled individual EU policies, and how it transposed the EU legal rules in our legislation.

In 2016 we entered the 3rd year of the 2014-2020 programming period. By the time this report has been published we will have swung into the second half. The problems with the drawdown of the European funds remain. If the drawdown of the EU Funds occurred only gradually in the previous programming period, it hasn´t yet begun in this period.

The first application for payment of the projects was submitted as late as the second half of 2016 by the Czech Republic. Its delay was also affected by the effort to utilize the maximum possible funding from the previous programming period. What does this mean in figures? At the end of March this year the volume of money in applications for interim payments reached only less than 3 percent of the financial volume allocated for the Czech Republic in the EU structural and investment funds, i.e. only 16 billion crowns from more than 600 billion crowns.

Proof of lagging drawdowns can be found in our audits. It is sufficient enough to look at the two newest ones - in the course of audit 16/23 we found that, at the beginning of this programming period, over 140 million crowns were paid for the waste management within the OP *Environment for 2014–2020.* That is 1,5 % from the funds earmarked for the waste recycling projects in this programming period. We witnessed a similar scenario during the rural development audit (No. 16/14), where no EU Funds at all were drawn for the community-led local development in the first three years of the current programming period.

We still have 3 more years ahead of us, so this is the time to speed things up without losing the sense and quality of the supported projects. The objective is to avoid drawing on the EU Funds regardless of the cost, i.e. recklessly and in a hurry. The EU Funds should contribute to a better life for EU citizens and deliver meaningful results. Please bear this in mind for every project we endorse.

Miloslav Kala,
SAO prezident

List of abbreviations

AB	Audit Body
CAP	Common Agricultural Policy
CEF	*Connecting Europe Facility*
CF	*Cohesion Fund*
CMO	Common Market Organisation
CFP	Common Fisheries Policy
CNB	Czech National Bank
Cohesion policy	Economic, territorial and social Cohesion Policy
Commission	European Commission
Council	Council of the European Union
CR	Czech Republic
CR Report 2016	*Country Report Czech Republic 2016*
CR Report 2017	*Country Report Czech Republic 2017*
DAS	statement of assurance (Déclaration d´assurance)
EAFRD	*European Agricultural Fund for Rural Development*
EAGF	*European Agricultural Guarantee Fund*
ECA	European Court of Auditors
ECB	European Central Bank
EFSD	*European Fund for Sustainable Development*
EFSI	*European Fund for Strategic Investments*
EGNOS	European Geostationary Navigation Overlay Service
EMFF	*European Maritime and Fisheries Fund*
EP	European Parliament
ERDF	*European Regional Development Fund*
ESIF	European Structural and Investment Funds
ESF	*European Social Fund*
EU	European Union
FES	Fire Emergency Service
GDP	gross domestic product
GNI	gross national income
IB	*Intermediate Body*
INTERREG ČR–PR	*Interreg V-A – Czech Republic – Poland*
IPA	*Instrument for Pre-Accession Assistance*
IROP	*Integrated Regional Operational Programme for 2014–2020*
IS	Information system
ITI	*Integrated Territorial Investments*
IES	*Integrated Emergency System*
LEADER	community-led local development
LAG	Local Action Group
MA	OP Managing Authority
MCS	management and control system
MES	Medical Emergency Service
MFF7+	Multiannual Financial Framework 2007–2013
MFF14+	Multiannual Financial Framework 2014–2020
MoT	Ministry of Transport
MoF	Ministry of Finance
MfRD	Ministry for Regional Development
MoIT	Ministry of Industry and Trade
SME	small and medium-sized enterprise
MoA	Ministry of Agriculture
MoE	Ministry of Environment
NIS IES	*National Information System of the Integrated Emergency System*
SAO	Supreme Audit Office
SAI	supreme audit institution
SR	Slovak Republic
NCA	National Coordination Authority (MfRD)
OECD	Organisation for Economic Cooperation and Development
OFI	other financial instrument of the EU
OLAF	European Anti-fraud Office
OP	Operational programme
OP EC	OP *Education for Competitiveness*

OP EIC	OP *Enterprise and Innovation for Competitiveness 2014–2020*
OPEm	OP *Employment 2014–2020*
OPEn	OP *Environment 2014–2020*
OPF7+	OP *Fisheries 2007–2013*
OPF14+	OP *Fisheries 2014–2020*
OP HRE	OP *Human Resources and Employment*
OP RDE	OP *Research, Development and Education*
OPPA	OP *Prague–Adaptability*
OP PGP	OP *Prague – Growth Pole of the CR*
OPT	OP *Transport*
OPTA	OP *Technical Assistance 2014–2020*
PCA	Paying and Certifying Authority
R&D	research and development
RDP7+	*Rural Development Programme of the CR for 2007–2013*
RDP14+	*Rural Development Programme of the CR for 2014–2020*
ROP CB	*Regional Operational Programme NUTS II Central Bohemia*
ROP MS	*Regional Operational Programme NUTS II Moravia-Silesia*
ROP NW	*Regional Operational Programme NUTS II North-West*
ROP SE	*Regional Operational Programme NUTS II South-Eeast*
ROP SW	*Regional Operational Programme NUTS II South-West*
TFEU	*Treaty on the Functioning of the European Union*
Period under scrutiny	Period from 1 April 2016 to 31 March 2017
SAIF	State Agricultural Intervention Fund
SAPS	Single Area Payment Scheme
SCP	*Single Collection Point for State Budget Revenues*
SF	Structural Funds
TORs	traditional own resources
V4+2	Visegrad Group, Slovenia and Austria
VAT	value added tax
YEI	Youth Employment Initiative

EU Member States (EU-28) (abbreviations are used in chart legends)

AT	Austria
BE	Belgium
BG	Bulgaria
CY	Cyprus
CZ	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
FI	Finland
FR	France
HR	Croatia
HU	Hungary
IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

Section I

Report on the EU Financial Management in the Czech Republic in 2016

Summary of Section I

General information

- **The Commission opened the European Semester**[1] **2016** by publishing the ***Annual Growth Survey 2016***, in which it defined economic and social priorities in the fields of re-launching investment, pursuing structural reforms to modernise economies, and responsible fiscal policy.
- In May 2016, **the Czech Republic (CR)** submitted strategic documents containing the **National Reform Programme** for 2016 and **Convergence Programme of the Czech Republic** to the Commission for assessment and to the Council of the European Union ("the Council") for recommendations. **The Council's recommendations** focused on **fiscal sustainability of public finances, removing investment barriers, completing corruption reforms, the availability of e-Government services** and **governance in research and development, education** (inclusion), and **obstacles to labour-market participation**.
- **The Commission** performed an analysis of the Czech economy in the light of the Annual Growth Survey and assessed progress in structural reforms. It published the results in the ***Country Report Czech Republic 2017***, in which it stated robust economic growth, the lowest rate of unemployment in the EU, and a number of other significant improvements. **The Commission stated: *"Overall, the Czech Republic has made some progress in addressing the 2016 country-specific recommendations."***[2]
- **The Commission reviewed the functioning of the multiannual financial framework 2014–2020** (MFF14+) with regard to how long-term challenges were being addressed. It also reviewed allocations to Member States for Cohesion Policy, as a result of which **the allocation for the CR was reduced by €115 million** at current prices.
- According to official figures published by the Commission, the CR's net position for 2015 exceeded €5.5 billion. At the start of 2017 the MoF informed that the net position for 2016 exceeded €2.9 billion.
- According to the latest Commission figures published in the annual report for the financial year 2015, **EU Member States** reported **a total of 22,349 irregularities** of a fraudulent or non-fraudulent nature to the European Anti-Fraud Office (OLAF)s[3]. These irregularities involved EU budget revenues and expenditure with a total financial impact of **over €3.21 billion**, with the **CR** reporting **800 irregularities** with a financial impact of approx. **€255 million**.

1 EU political timetable according to which Member States negotiate on their budgetary and economic plans.

2 Country Report Czech Republic 2017, Commission Staff Working Document SWD (2017) 69 final on February 22, 2017

3 Office européen de lutte antifraude.

Sector matters

EU budget revenues

- **Based on the Council's recommendations** regarding the national reform programme and convergence programme which concerned **the fight against large-scale tax non-compliance, the Czech Republic launched the implementation of three interconnected measures: the reverse charge mechanism, control statements and electronic sales records.**
- **During 2016, several legislative amendments linked to the revenue side of the EU budget were adopted (e.g., extending the reverse charge obligation** to additional entities, **changes to VAT** and **the adoption of a new Customs Act).**
- **The SAO's audit work relating to EU budget revenues comprised two completed audits** in the period under scrutiny. The first audit targeted finances spent on measures linked to simplifying the collection and administration of taxes and insurance premiums, and most notably the *Single Collection Point for State Budget Revenues*. The second audit, which was conducted in cooperation with the SAI of Slovakia, focused on the effectiveness of excise duty administration.

EU budget expenditure

- As of 31 December 2016, **the Czech Republic satisfied the ex-ante conditionalities laid down in the Partnership Agreement for the programming period 2014–2020 ("Partnership Agreement"),**[4] with the understanding that one ex ante conditionality will not in the end be applied after the Operational Programme (OP) *Transport* programming document was modified.
- In line with the EU legislation, the designating body (Ministry for Regional Development – National Coordination Authority) designated a Paying and Certifying Authority (PCA) and programme Managing Authorities (MAs) for the 2014–2020 programming period.
- **In the period under scrutiny, the SAO completed nine audits** directly linked to EU budget expenditure. **Analysis of the identified shortcomings consisting in breaches of the law** revealed that the largest group of errors was **ineligible expenditure**, followed by **deficiencies in management and control systems** (MCSs) and in **public procurement**.
- **Economic, territorial and social Cohesion Policy (Cohesion Policy)**
    - For the most part, the Czech Republic did not meet the conditions for the submission of the first applications for interim payments under programmes until the second half of the programming period's third year, i.e., between June and November 2016.
    - Under the announced calls, legal documents had been issued for 18.1% of the main allocation for Cohesion Policy[5] for the 2014–2020 programming period (EU budget finances allocated to OPs) for OPs by the end of February 2017. 3.4% of the main allocation had been paid out to beneficiaries by the end of February 2017, and the amount of money billed in payment applications by the end of February 2017 equalled 2.4% of the main allocation. Payment applications for 1.0% of the main allocation had been sent to the Commission by the end of February 2017.
    - For the period from 1 July 2015 to 30 June 2016, the Audit Body only issued a statement "without reservations" for OP *Employment*; in other cases, it had to refuse to issue a statement as no expenditure had been certified.

4 Partnership Agreement is a strategic document defining the objectives and priorities for efficient use of the European Structural and Investment Funds (ESI Funds) in order to achieve the Europe 2020 Strategy on the basis of defined national priorities.

5 The main allocation for Cohesion Policy is based on the total allocation in the ESI funds minus the allocation for RDP14+, OPF14+, INTERREG CR–PR and the 6% performance reserves for other OPs.

- The Czech Republic is lagging behind in implementing OPs and utilising the allocation for 2014–2020, which is evident from a comparison with the previous programming period. There is a risk that certain milestones set for the end of 2018 will not be reached. That is linked to a possible loss of part of the performance reserve[6].
- In the period under scrutiny, the SAO completed seven audits targeting Cohesion Policy programmes and projects. Three of these audits scrutinised the working of MCSs as well as the standard audit of transactions. The remaining four audits checked the legality and regularity of operations and adherence to the principles of effectiveness, efficiency, and economy.
- A comparison of audit work done by the SAO, AB, and the ECA (there are differences in audit mandates, methods, and execution) targeting operations from the 2007–2013 programming period revealed that most errors were in general identified in expenditure eligibility, compliance with the public procurement regulations and programmes' management and control systems.

- **Common Agricultural Policy (CAP) and Common Fisheries Policy (CFP)**

- **In 2016, more than CZK 34.5 billion** was paid out under the **CAP in the CR**, with EU finances accounting for roughly CZK 30 billion of that. Direct payments, through which a total exceeding CZK 24 billion was paid out to farmers, accounted for the largest share of CAP subsidies. The amount is equivalent to that in previous years.
- **99.88% of the allocation of the *Rural Development Programme of the CR for 2007–2013* ("RDP7+") was utilised.** The Ministry of Agriculture (MoA) drew down almost €2.9 billion from the EU budget. Czech farmers, foresters and municipalities obtained almost CZK 100 billion thanks to national co-financing.
- Since the start of the implementation of the ***Rural Development Programme of the CR for 2014–2020*** (RDP14+), the Ministry of Agriculture has disbursed **over €410 million (more than CZK 11.2 billion)** to farmers and foresters, **which is almost 18%** of the allocation from the *European Agricultural Fund for Rural Development* (EAFRD). These are almost entirely claim-based payments, however.
- **More than 90%** of the financial framework for ***OP Fisheries 2007–2013*** **("OPF7+") was utilised**. Czech fisheries acquired more than CZK 900 million under this programme. **No subsidies** were disbursed to beneficiaries under the **CFP** in 2016.
- **The SAO performed two audits focusing on the rural development programmes in 2016.** One audit looked at support provided for education, advice services and promotion, scrutinising money provided to beneficiaries out of both the EU and state budgets. The second audit dealt with support for regional development under the LEADER initiative[7].

- **Other EU financial instruments[8] (OFIs) and other expenditure**

- **More than €16.3 billion** was channelled into EU Member States **under OFIs** in 2015.
- **The Czech Republic obtained** approx. **€124 million** of that amount, making it, as usual, one of the least successful EU-28 countries in terms of OFI drawdown per capita.

6 The total performance reserve is the equivalent of CZK 38.6 billion.

7 The LEADER approach (*Liaison entre actions de développment de l´économie rurale*) is defined in Council Regulation (EC) No 1698/2005 of 20 September 2005, on support for rural development by the European Agricultural Fund for Rural Development (EAFRD).

8 The group of funds and programmes whose finances the EU allocates directly (over and above the allocation for a Member State) or by public competition.

Other activities

Legal matters

- **In 2016, the SAO issued specific comments on 70 draft legislative amendments** and changes concerning materials linked to legal regulations**.** Among other things, the SAO commented on the draft amendment of the Act on Budgetary Rules, the Act on Public Procurement and the draft Act on Management and Audit of Public Finances. Most of the SAO's comments were accepted by the legislator.

Implementation and transposition of European Union law in the CR

- **From the end of 2015 to the end of 2016 the CR's transposition deficit**[9] **grew** from 0.5% to 1.5%, exceeding the EU-28 average. By contrast, **the average transposition delay was cut by two months** and was well below the EU-28 average.
- In terms of **the number of infringement cases** in the same period, the CR ranked among the one third of EU Member States with an above-average number of cases.

International activities

- In 2016, **the SAO performed a joint audit in the field of excise duty with the SAI of the Slovak Republic**, which culminated in the issuance of a joint final report.
- The SAO hosted **a meeting with representatives of the International Monetary Fund** dealing with **the utilisation of ESIF finances** in the Czech Republic.
- The SAO held talks **with Commission representatives on strategic planning in public procurement.**

9 Expresses the total percentage of directives which remain for Member States to transpose into national law and for which the transposition deadline has passed.

A. General information

A.1 Current developments in the management of EU budget finances

A.1.1 Coordinated measures of EU economic policy

For the year 2016 the European Commission announced a revised approach to the annual cycle for the coordination of economic policies at EU level, known as the **European semester**, doing so in the form of a communication to the European Parliament (EP), the Council and the ECB[10]. The fundamental rationalisation of the European semester consists in the fact that country reports written by Commission staff on Member States are to be issued in February of the current year. The earlier date for issuing reports creates more space for genuine dialogue between the Commission and Member States and makes it possible for national reform programmes to react to the analyses contained in the country reports and propose relevant measures for the future. Another modification of the European semester is the fact that, starting in 2016, the series of Commission recommendations targeting the euro area is to be issued at the same time as the Annual Growth Survey, i.e. at the start of the European semester and not at the end.

The European semester 2016 opened with the issuance of the ***Annual Growth Survey 2016***[11]**.** The Commission states in this document that the EU economy is experiencing a moderate recovery with falling unemployment, partly as a result of temporary factors such as low oil prices and the relatively weak euro. On the other hand, geopolitical tensions and pressure on public expenditure linked to the arrival of refugees and asylum seekers are causes for growing concern. Economic performance, social conditions and reform implementation remain uneven across the EU. To keep the economic recovery sustainable and ensure the process of Member States' economic convergence continues, the Commission regards it as essential that EU institutions and Member States act together. For that reason, **the Commission, in line with its recommendations from the previous year, proposed the following economic and social priorities for 2016:**

- **Re-launching investment** – the focus should be on mobilising private and public investments; selecting strategic projects under the Investment Plan for Europe (€315 billion in funding for a three-year period out of the *European Fund for Strategic Investments*[12]); improving the investment and regulatory environment; and extending investment priorities beyond traditional infrastructure to investment in human capital and related social investment.
- **Pursuing structural reforms to modernise economies** – coordination between Member States must be more effective to attain higher productivity and speed up convergence; there must be more emphasis on tackling youth unemployment and long-term unemployment; and markets must be more integrated to stimulate innovation and job creation.
- **Responsible fiscal policies** – support should be given to growth-friendly and equity-friendly fiscal consolidation; tax systems need to be improved with a view to making them more effective and fairer; social protection systems should be modernised so that they are fiscally sustainable and respond effectively to possible risks.

10 Communication from the Commission to the European Parliament, the Council and the European Central Bank on steps towards completing economic and currency union, COM (2015) 600, final wording of 21 October 2015.

11 Communication from the Commission to the European Parliament, the Council and the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank: *Annual Growth Survey 2016, Strengthening economic recovery and fostering convergence,* COM (2015) 690, final wording of 26 November 2015.

12 Established by Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015.

The ***Country Report Czech Republic 2016***[13] (2016 CR Report) was published as part of the **European semester 2016.** The 2016 CR Report assessed the progress made by the CR in implementing the Council's recommendations from July 2015 and in achieving the CR's national targets in the context of *Europe 2020*. This report was commented on detail in the *EU Report 2016*.

In line with the priorities set out in the *Annual Growth Survey 2016* the CR drew up strategic documents for 2016: the national reform programme and the convergence programme. ***The 2016 National Reform Programme of the Czech Republic***[14] was approved by the government at a meeting of the Committee for the European Union on 27 April 2016 and presented to the Commission for assessment on 11 May 2016. The government subsequently approved the ***2016 Convergence Programme of the Czech Republic***[15], which was submitted to the Commission on 12 May 2016. Based on the Commission's recommendation[16], **the Council issued a statement on both documents at once**[17] in the light of the interconnected nature of the two programmes.

The Council expects the CR to comply with the provisions of the *Stability and Growth Pact*[18] within the framework of the convergence programme. In the long-term outlook, however, there are medium-sized fiscal risks, mainly because of the ageing population and spending on healthcare and the pension system. The fiscal framework is relatively weak; a reform package aiming to transpose Council Directive 2011/85/EU[19] was approved by the Czech government to address the main shortcomings. One of the measures envisages the establishment of an independent fiscal council to monitor public finances and increase transparency. The Council also stated that investment in the CR remains below the EU average in per capita terms. The execution of transport and energy infrastructure projects has been delayed by lengthy procedures for issuing land-use permits. The Council is of the opinion that the development of the business enterprise in the CR is held back by the low rate of use of public online services and that the sophistication of e-Government services is among the lowest in the EU. The incidence of tax evasion in the Czech Republic is relatively high, and effective measures are not being adopted to cut the costs associated with tax collection. Public administration also displays weaknesses: for example, certain anti-corruption laws were not passed and, despite some efforts, the public procurement system still needs improving. The Council welcomed the increased investment in research and development (R&D), but went on to say that better coordination is needed for R&D funding. Educational outcomes are generally good, but the attractiveness of the teaching profession remains a problem because of its low pay. The labour market situation in the CR has improved, but public employment services could be intensified with a view to increasing the participation of vulnerable groups[20]. In the light of the progress assessment set out in the 2016 CR Report and after examining the convergence programme **the Council made the following recommendations to the Czech Republic for 2016–2017:**

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13 *Country Report Czech Republic 2016,* Commission staff working document SWD (2016) 73, final wording of 26 February 2016.

14 *2016 National Reform Programme of the Czech Republic*, drawn up by the Office of the Government of the CR, was approved at the 193rd session of the Committee for the European Union.

15 *2016 Convergence Programme of the Czech Republic 2016* was drawn up by the Ministry of Finance and approved by Czech government resolution no. 410 of 11 May 2016.

16 *Recommendation for a Council recommendation on the 2016 National Reform Programme of the Czech Republic and delivering a Council opinion on the 2016 Convergence Programme of the Czech Republic,* COM (2016) 324, final wording of 18 May 2016.

17 *Council recommendation of 12 July 2016 on the 2016 National Reform Programme of the Czech Republic and Council opinion on the 2016 Convergence Programme of the Czech Republic (Official Journal of the European Union,* 2016/C 299/06, 18 August 2016).

18 Agreement between euro area members on coordination of their budgetary policies, which also partly applies to EU Member States that have not adopted the euro.

19 Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (*Official Journal of the European Union,* L 306, 23 November 2011).

20 Women with small children, low-skilled workers and members of the Roma community.

1. Take measures to ensure the long-term sustainability of public finances, in light of future risks in the area of healthcare. Adopt legislation to strengthen the fiscal framework.
2. Reduce regulatory and administrative barriers to investment (in particular in transport and energy) and increase the availability of e-Government services. Adopt the outstanding anti-corruption reforms and improve public procurement practices.
3. Strengthen governance in R&D and facilitate the links between academia and enterprises. Raise the attractiveness of the teaching profession and take measures to increase the inclusion of disadvantaged children (including Roma) in mainstream schools and pre-schools. Remove the obstacles to greater labour market participation by under-represented groups (in particular women).

A.1.2 Implementation of the national reform programme and convergence programme of the CR

In February 2017 **the Commission published** a Commission staff working document entitled ***Country Report Czech Republic 2017***[21] ("2017 CR Report"), in which it **assessed the Czech economy in terms of the annual growth survey and assessed progress** on structural reforms and prevention and correction of macroeconomic imbalances. The assessments in the 2017 CR Report are structured according to the areas they deal with, as per the following subsections A.1.2.1 to A.1.2.3.

A.1.2.1 Economic situation and outlook

- **Economic growth** is judged to be robust – after a sharp 4.5% increase in gross domestic product (GDP) in 2015 the rate of growth is expected to have slowed to 2.4% in 2016[22], partly because of the decline in EU-financed investment activity. Real GDP growth is forecast to accelerate to 2.6% in 2017 and 2.7% in 2018. Economic growth has been stronger in the CR than in the EU as a whole in recent years, fostering continued economic convergence. GDP per capita on a purchasing power basis stood at around 87% of the EU level in 2015. However, the emergence of demographic constraints, most notably labour market shortages, is projected to weigh on potential growth in the years up to 2021.
- **Investment –** there was a significant reduction in the level of investment in 2016 compared to the previous years, mainly because of the low rate of drawdown from the *European Structural and Investment Funds* (ESIFs) in the new programming period. The decline in total investment was 1.6% in real terms, primarily due to a sharp fall in public investment in buildings and structures other than housing. The Commission expects investment to recover, with projected growth rates of 2.5% and 3.3% in 2017 and 2018 respectively.
- **Inflation** – the inflation rate reached 2% in 2016 as targeted by the Czech National Bank (CNB). After the discontinuation of the CNB's exchange rate policy designed to keep the Czech crown cheap compared to the euro, the crown can be expected to strengthen, which represents a downside risk to inflation.
- **Labour market** – labour market outcomes have improved considerably in recent years, to the extent that there is a risk of labour market shortages. The unemployment rate averaged 4% in 2016, the lowest in the EU. The youth unemployment rate (15–24) has also fallen significantly, reaching 10.5%. The lower labour market participation of women of childbearing age, caused by a shortage of child-care facilities, especially for under-threes, remains a problem. In addition, labour market outcomes continue to be significantly weaker for low-skilled workers (9.5% of the working age population). Despite the tight conditions on the labour market, wage growth has remained moderate, reaching 3.5% in nominal terms.

21 *Country Report Czech Republic 2017,* Commission staff working document SWD (2017) 69, final wording of 22 February 2017.

22 According to a MoF estimate from 30 January 2017, actual GDP growth in the Czech Republic was 2.5% in 2016.

- **External trade** – the Czech Republic has continued to maintain a sizeable positive trade balance in recent years, with the surplus driven mainly by trade in goods. This trend is expected to continue in 2017 and 2018. However, the positive trade balance has been counterbalanced by dividend and profit outflows by foreign-owned firms operating in the CR. The Czech Republic increased its export market share in 2014 and 2015, indicating competitiveness gains.
- **Financial sector** – the banking sector is well capitalised and very stable; the banking system remained profitable in the past 10 years. Mortgage lending to households has accelerated, reflecting higher confidence on the part of households to enter the housing market. Household indebtedness continued to rise in 2016 (to 30.4% of GDP), but remains far below the EU average (50.4% of GDP).
- **Public finances** – the CR's headline balance reached a surplus in 2016[23] and, according to the Commission's forecast, attained 0.3% of GDP, with the surplus driven by improved tax collection and weaker public investment at the start of the new programming period for EU funds. The public finances headline balance should remain positive in 2017 at 0.1% of GDP. Spending on public investments via infrastructure projects is expected to increase. The debt-to-GDP ratio is forecast to remain on a downward path, dropping to 35.6% of GDP in 2018.

A.1.2.2 The Czech Republic's progress with the Council´s recommendations

In the context of the implementation of recommendations addressed to the Czech Republic since the 2011 European semester the Commission assessed the implementation of the Council's recommendations in 2016 as follows:

1. **Public finances – *some progress***

   The Czech authorities achieved limited progress on addressing long-term sustainability of public finances (shortcomings in the management and cost-effectiveness of the healthcare system and pension system risks); substantial progress has been made on strengthening the fiscal framework.

2. **Administrative barriers, anti-corruption reform and public administration – *limited progress***

   Limited progress was made on eliminating administrative barriers (amended Construction Act, environmental impact assessment); there was limited progress towards increasing the availability of e-Government services; the Czech authorities made some progress on adopting certain anti-corruption reform measures; and limited progress was made on improving public procurement practices (a new act was passed).

3. **Research and development, education and the labour market – *some progress***

   Limited progress was made on strengthening governance in the R&D system; substantial progress was achieved in improving the attractiveness of the teaching profession (pay increase for teachers); some progress was made on increasing the inclusion of disadvantaged children (education system reform); and some progress was made on removing obstacles to greater labour market participation by some under-represented groups (women's participation was increased thanks to the growing number of "child groups").

The Commission stated: *"Overall, the Czech Republic has made some progress in addressing the 2016 country-specific recommendations."*

23 According to data published by the Ministry of Finance on 3 January 2017, the CR's headline balance was CZK 61.77 billion.

A.1.2.3 Reform priorities of the Czech Republic

In the 2017 CR Report the Commission stated the following regarding the CR's priorities defined in the *2016 National Reform Programme of the CR*:

Public finances and taxation

- **Taxation** – the Czech authorities plan to simplify the tax system (a new act on income tax is being drafted); to integrate tax and social security administration; to improve the digitalisation of tax administration; to prevent frequent amendments of the tax system and to simplify the tax system.
- **Fiscal framework** – To strengthen the Czech Republic's fiscal framework, an Act on Fiscal Responsibility[24] and an act amending certain acts in connection with the new Act on Fiscal Responsibility[25] were passed in January 2017.
- **Long-term sustainability of public finance** – According to the Commission, the steps taken by the Czech government consisting in capping the retirement age at 65 (to be reviewed every five years, the aim being to allow workers to spend around a quarter of their lives in retirement) and the option to increase pensions on an ad hoc basis (by a maximum of 2.7% annually if the pension indexation system foresees a lower increase) reduce the predictability of the system and may worsen the long-term sustainability of public finances.
- **Healthcare** – The ongoing reform efforts include a discussion of a new system for a more equitable distribution of funds among health insurance companies (e.g. the pharmacy cost-based groups model) and revamped financing of hospitals based on diagnosis-related groups. To counter possible shortages of medical staff, their salaries were increased from January 2017 and changes to the education system for healthcare professionals are planned (making it easier for medical school graduates to pursue further specialist training and shortening the required education of nurses). The Commission notes the absence of measures to shift inpatient care towards more cost-effective outpatient care services and criticises the low rate of central public procurement.

Labour market, education and social policies

- **Labour market** – The Commission has long rated labour market participation among women of childbearing age as low, with the exploitation of women's potential and skills rated even lower. The Czech government sought to support women on the labour market through proposed amendments to the Labour Code. These changes include more flexible labour arrangements and greater availability of home working arrangements. Under discussion are a new paternity leave allowance (the paternity leave legislation can be expected to apply from around July 2017, entering into effect at the start of 2018) and an amendment of the Act on Social Support providing for more flexible drawing of parental allowance. From 2017 on the state should guarantee places in kindergartens. To address the employment of low-skilled workers, regional mobility was supported in some regions to cover the costs of commuting to another region.
- **Social policy (poverty, social aspects of social security systems)** – The CR has the best results of all EU Member States in terms of the proportion of the population at risk of poverty or social exclusion; the national *Europe 2020* target value for this proportion was therefore upgraded, and this target was already achieved in 2015. To tackle homelessness and housing exclusion, Czech government adopted the *Social Housing Policy of the Czech Republic for 2015–2025*[26] and an Act on Social Housing is being drafted and is expected to apply from October 2017 (or, more realistically, from autumn 2018). An amendment of the Act on Social Services is also under discussion.

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24 Act No. 23/2017 Coll., on the rules of fiscal responsibility.

25 Act No. 24/2017 Coll., amending certain acts in connection with the adoption of fiscal responsibility legislation.

26 Social Housing Concept approved by Czech government resolution no. 810 of 12 October 2015.

- **Education and skills** – The Commission stated that Czech students' basic skill levels have deteriorated and the impact of students' socioeconomic background on their performance remains strong. Although the early school leaving rate remains among the lowest in the EU, the high proportion of Roma children who leave school early is a cause for concern. In response to the *Education Policy Strategy of the Czech Republic up to 2020*[27], in September 2016 the Czech authorities launched a reform[28] designed in part to increase the participation of special-needs children in mainstream education. The improvement in inclusivity also covers children from socially disadvantaged families. The attractiveness of the teaching profession has improved slightly, with teachers' salaries being increased by 8% in September 2016 and targeted to rise to 130% of the national average wage in the coming years. A new career system for teachers and pedagogical staff should be rolled out in September 2017. The Czech authorities are currently implementing tertiary education reform designed to raise the standards of accreditation and internal quality assurance and to give institutions more autonomy.

Investment

- **Investment in transport infrastructure** – The Commission rated the investment in transport infrastructure in recent years (in particular the road network) as inadequate. At the same time, it highlighted the delayed implementation of projects, where the complexity of the approvals system causes EIAs to be invalid or out-of-date. To simplify and accelerate procedures, in September 2016 the Czech government approved an amendment to the Construction Act and related legislation. The new draft simplifies procedures for granting construction permits and integrates EIA into the current permit procedure.
- **EU funds** – The Commission stated that investments co-financed from EU funds in 2016 registered a significant decrease due to the closure of the 2007–2013 programming period and the slow launch of the 2014–2020 programming period. It attributed the delay to the late adoption of operational programmes and, most notably, the lengthy preparation of selection criteria. Irregularities in the management of EU funds caused substantial financial corrections to be applied. Checks performed by Managing Authorities revealed that implementation error rates were above the acceptable 2% rate for several of the operational programmes.
- **Investment in housing** – While demand for housing has risen in recent years, supply has been lagging behind. The rising demand reflects low mortgage interest rates, growing household incomes and the increasing number of households.
- **Business environment** – The Commission stated that the business environment was characterised by a heavy regulatory burden and numerous administrative barriers to investment. A World Bank report on the business environment for 2017[29] identifies the construction permit procedure in the CR as an area contributing to inefficiencies in the business environment. The same applied to tax regulations. The Czech authorities have implemented a number of simplifying measures, e.g. the cost and the time required to register a company in commercial courts have been reduced (with an online system rolled out). The time needed to resolve insolvency has also fallen sharply, but the process remains very costly. The Insolvency Act has been amended[30] to make it possible for smaller businesses to use the legal option of corporate reorganisation and to

27 Strategy approved by Czech government resolution no. 538 of 9 July 2014.

28 *Long-term Plan for Education and Development of the Educational System of the Czech Republic for 2015–2020*, which was put before the Czech government, print no. 340/15.

29 *Doing Business 2017,* World Bank Group 2017, which put the CR in 27th place in the overall global ranking of business environments (75th place in 2014); for the second time the CR even came out in first place in terms of the conditions for foreign trade.

30 Act No. 64/2017 Coll., amending Act No. 182/2006 Coll., on insolvency and ways to resolve it (Insolvency Act), as amended, and certain other acts.

strengthen the protection of debtors. Major barriers to the majority of professions persist in the Czech Republic due to the stringent demands on mandatory qualifications, and the level of restrictiveness[31] remains higher than the EU average despite the conducted review of professional qualifications.

Sectoral policies

- **Research and development** – R&D intensity has increased significantly in recent years, with expenditure at par with the EU average of 2% of GDP. But the expenditure was largely financed by ESIFs, so the dynamism of non-governmental domestic sector expenditure needs to be increased. In line with the plan for a *European Research Area*[32], the Czech government set the following priorities for the R&D sector:

  - streamlining of governance;
  - implementation of a new evaluation framework;
  - development of a base for applied research;
  - improvement in the research and innovation capabilities of the business sector.

  The Czech authorities launched reforms of the R&D system with a view to strengthening governance and the structure of responsibilities related to the evaluation and allocation of research funding. In addition, a series of measures is being taken to improve cooperation between business and public research institutes[33].

- **Energy and resource efficiency** – The dominant role of industry in the Czech economy means that energy and carbon intensity (per unit of GDP and per capita) has remained above the EU average despite the continuing decrease in recent years. The targets set in the National Energy Efficiency Action Plan have not been achieved. On the other hand, the CR has already met its *Europe 2020* targets for renewable energy.

- **Environmental protection** – Landfilling remains the predominant option for treating municipal waste, even though the recycling rate has increased in recent years. To bring about changes, the Waste Act was revised[34] (among other things, it requires separate collection of biodegradable waste and bans the landfilling of recyclable waste); in addition, regional waste management plans were adopted to implement the national plan for waste management from 2015. The Czech Republic suffers from frequent problems linked to air pollution and the overstepping of the limits defined in both national standards and European legislation, in particular for nitrogen dioxide and particle pollution. Measures to cut greenhouse gas emissions are having a positive impact.

Public administration

- **e-Government services** – The extent and use of e-Government services increased in the CR in 2016[35] but continue to lag behind the EU average. In response to the *Strategic Framework for the Development of Public Administration of the CR for 2014–2020*[36], which includes the expansion and availability of e-Government services among the

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31 Composite indicator of restrictiveness of regulated occupations used by the Commission.

32 This plan was announced in Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: *Towards a European research area*, COM (2000) 6, final wording of 18 January 2000.

33 E.g. the EPSILON or TRIO programmes in industrial research.

34 Act No. 223/2015 Coll., amending Act No. 185/2001 Coll., on waste and amending certain acts, as amended, and Act No. 169/2013 Coll., amending Act No. 185/2001 Coll., on waste and amending certain acts, as amended, Act No. 25/2008 Coll., on the integrated environmental pollution register and integrated system for fulfilling reporting duties in the field of the environment and amending certain acts, as amended, and Act No. 56/2001 Coll., on the conditions for operating vehicles on roads, as amended.

35 CR came 50th in the global *e-Government Development Index*.

36 Strategic Framework for the Development of Public Administration of the CR for 2014–2020 was approved by Czech government resolution no. 680 of 27 August 2014.

principal goals, the Czech authorities adopted an updated action plan for the development of the digital market and launched the *202020 Initiative*[37], which aims to make the CR one of the top 20 countries in Europe for the use of e-Government services by 2020. The Government Council for Information Society coordinates the work of the three ministries responsible for the roll-out of e-Government services.

- **Public procurement** – The Commission's working staff stated that in 2016 Czech contracting authorities awarded an average of 16% of contracts without publishing a call for tender, the second highest proportion in the EU. The CR was also among the worst-ranked Member States for contracts awarded with only a single bidder. The low level of professionalism among procurement officers was identified as the main reason. Further to the new Public Procurement Act[38] and making use of the procedures described in the *Methodological Instruction for Public Procurement for the 2014–2020 Programming Period*, the Czech authorities launched specialised training programmes for responsible employees, largely focusing on the use of quality criteria instead of the lowest price criterion. Implementation of the *Strategy for the Digitalisation of Public Procurement for the 2016–2020 Period* went ahead, with use of the National Electronic Tool (NET) becoming compulsory in 2018. Considerable progress has also been made in joining up and centralising purchasing activities. However, centralised procurement in the CR only amounted to roughly half the EU average. The Contracts Register Act[39] should also boost the transparency of the public procurement process.
- **Anti-corruption measures** – The situation in the perception of corruption by Czech citizens and enterprises improved significantly between 2013 and 2016 but is still a problematic factor for doing business. Progress was achieved in 2016 in implementing the *Government Concept of the Fight against Corruption for 2015–2017*[40] and legislative tools for tackling corruption[41] were adopted. Solutions still need to be found for effective and impartial supervision over political party financing, for the adoption of a law on internal management and financial audit in public administration[42] and for broadening the powers of the SAO.

A.1.3 Annual reports of the European Court of Auditors for the financial year 2015

In legislative terms, the issue of the European Union's accounts and financial statements is covered by Title IX of the regulation[43] on the financial rules applicable to the general budget of the EU. The European Court of Auditors fulfils the role of the EU's external auditor. Its status and duties are laid down in Section 7 of the *Treaty on the Functioning of the European Union* (TFEU)[44]. The European Court of Auditors is independent from the bodies, institutions and entities it audits; Article 287 of the TFEU provides that it is obliged to provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions.

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37 The prime minister of the CR presented the *Initiative 202020* project at a press conference on 15 September 2016.

38 Act No. 134/2016 Coll., on public procurement.

39 Act No. 340/2015 Coll., on special conditions of the effect of certain contracts, the publishing of such contracts and on the register of contracts (Contracts Register Act).

40 Concept approved by Czech government resolution no. 1057 of 15 December 2014.

41 Act No. 302/2016 Coll., amending Act No. 424/1991 Coll., on the formation of political parties and political movements, as amended, and certain related acts; Act No. 321/2016 Coll., amending certain acts in connection with proving the provenance of property; government draft of a new act on the state prosecutor's office.

42 Draft Act on Management and Audit of Public Finances.

43 Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002.

44 rticle 285 et seq. of the consolidated wording of the *Treaty on the Functioning of the European Union, Official Journal of the European Union*, C 115, 9 May 2008.

In accordance with Article 287 (1) and (4) of the TFEU and Articles 148 (1) and 162 (1) of Regulation No 966/2012 of the European Parliament and of the Council and Articles 43, 48 and 60 of Council Regulation 215/2008[45], the ECA adopted annual reports[46] for the financial year 2015 at its 14 July 2016 meeting. Along with the replies of the relevant institutions to the ECA's observations, the annual reports were transmitted to the European Parliament and the Council for approval confirming that the Commission duly fulfilled its obligations in implementing the budget.

The core messages of the *Annual Report of the European Court of Auditors on the Implementation of the Budget* (2016/C 375/01)[47] for the financial year 2015 (2015 Annual Report) are the ECA's statement of assurance (DAS) concerning the reliability of the EU's annual financial statements and statements on the legality and regularity of the underlying transactions.

Based on the results of its audit work, the ECA issued the following pronouncements:

- *"In our opinion, the **consolidated accounts** of the European Union for the year ended 31 December 2015 **present fairly, in all material respects, the financial position of the Union** as at 31 December 2015, the results of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector."*
- *"In our opinion, **revenue** underlying the accounts for the year ended 31 December 2015 is **legal and regular in all material respects**."*
- *"In our opinion, because of the significance of the matters... the **payments** underlying the accounts for the year ended 31 December 2015 **are materially affected by error**."*

These pronouncements by the ECA are essentially the same as in previous years. However, the European Court of Auditors did register a further palpable reduction in the estimated error rate[48] in payments. The rate fell by 1 percentage point from 2012 to 3.8% in 2015, but it remains significantly higher than the defined materiality threshold[49].

The restructuring of budget chapters in MFF14+ done in 2014 has made it impossible to rigorously compare the long-term evolution of the estimated error rate for the individual EU budget chapters. For that reason, the following diagram only compares 2014 and 2015, when practically the same methodology, or the same data base, was used.

45 Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund, as amended by Regulation (EU) No 567/2014.

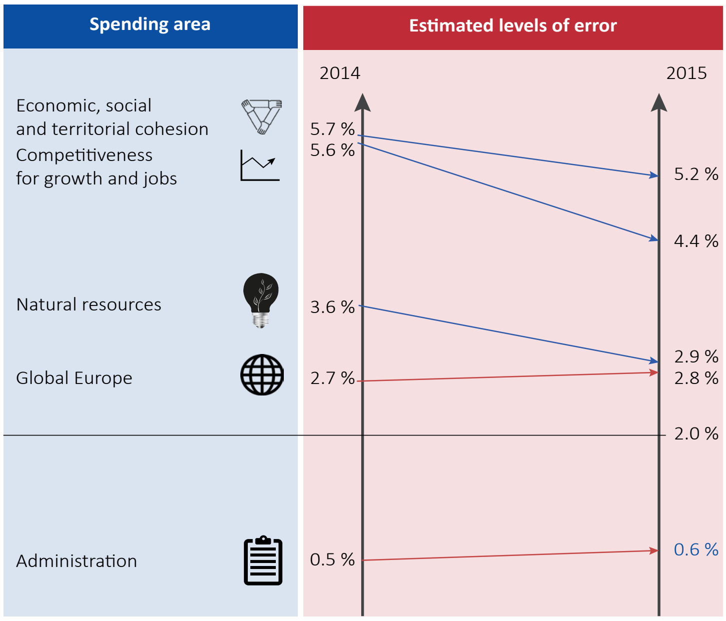
46 *Annual Report of the Court of Auditors on the Implementation of the Budget concerning the Financial Year 2015 and Annual Report of the Court of Auditors on the Activities Funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs) concerning the Financial Year 2015, Official Journal of the European Union of 13 October 2016*

47 *Official Journal of the European Union of 13 October 2016,* Part IV *Notices from European Union Institutions, Bodies, Offices and Agencies*, section C 375/01.

48 The estimated error rate is derived from quantifiable errors detected in a tested sample of operations. The European Court of Auditors compiles the sample and determines the error rate using standard statistical procedures.

49 The European Court of Auditors works with a materiality threshold of 2%.

Diagram 1: Comparison of the estimated error rate for EU spending areas in 2014 and 2015



Source: ECA annual reports on the implementation of the budget for the financial years 2014 and 2015, ECA 2015 and 2016.

This diagram clearly shows a relatively significant fall in the estimated error rate of operations in the spending areas *"economic, social and territorial cohesion"* (down 0.5 percentage points), *"competitiveness for growth and employment"* (down 1.2 percentage points) and *"natural resources"* (down 0.7 percentage points). However, the pronounced fall in the estimated error rate in *"natural resources"* in 2015 was mainly driven by the change in the legal basis of the CAP; as a result of this change the ECA no longer includes *Cross Compliance* operations[50] in its testing. In 2014 these irregularities accounted for 0.6 percentage points of the error rate in this spending area. It follows that the error rate in *"natural resources"* did not change significantly year-on-year.

The diagram also shows that an estimated error rate below the materiality threshold was only found in the spending area *"administration"*[51]. The ECA therefore stated that expenditure on *"administration"* (unlike the other spending areas) was free from material error.

The European Court of Auditors performed a more detailed analysis of the audit work done and found the following:

- Management mode has only a minor impact on error rates: the ECA estimated the error rate under shared management (spending managed by the Commission jointly with Member States) at 4.0% and the error rate under direct management (spending managed directly by the Commission) at 3.9%.
  In the case of entitlement expenditure, where payment depends on meeting certain conditions (e.g. student and research scholarships, salaries of EU staff, direct aid for farmers etc.), the estimated error rate in 2015 was 1.9% (2.7% in 2014)[52]. For reimbursement

50 The disbursement of direct payments and other support is conditional on the agricultural land being in *good agricultural and environment condition* and on compliance with Statutory Management Requirements laid down for two areas: *environment* and *public health, animal and plant health*.

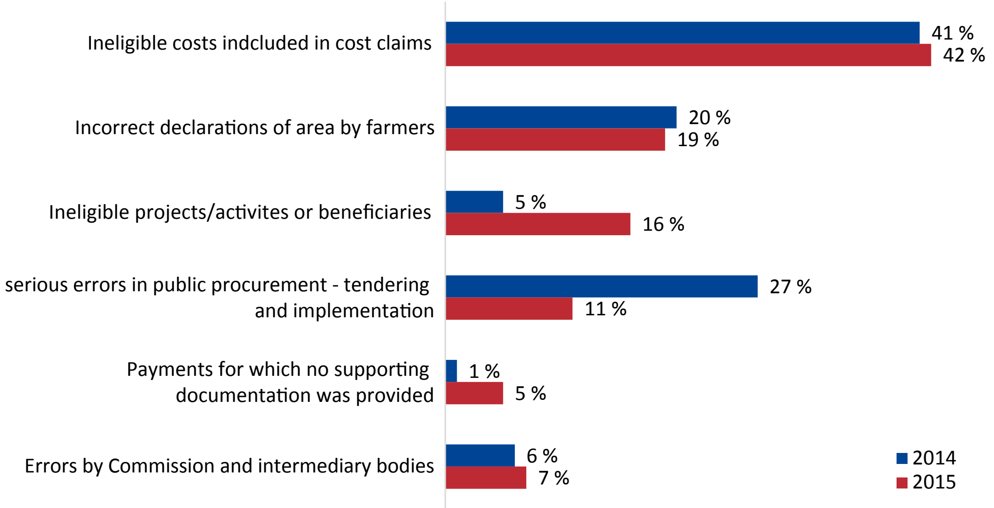
51 The results of audits done by the ECA at the various agencies of the Commission and at other decentralised EU bodies and European schools are covered by specific annual reports published separately.
The ECA's own expenditure is audited by an external company and the auditor's report is published in the *Official Journal of the European Union*.

52 Since 2015 the ECA has not included cross-compliance in operations testing, which has had a significant impact on these values (see above).

of costs, where the EU reimburses eligible costs for eligible activities, the estimated error rate was much higher at 5.2% (as much as 5.5% in 2014).

- The ECA also compared the frequency of different types of errors identified in 2014 and 2015 and found that while there was a significant fall in the error rate in the category of *"serious errors in public procurement – tendering and implementation"* (down from 20% to 11%), a significant increase in the number of errors was found in the categories *"ineligible projects/activities or beneficiaries"* and *"payments for which no supporting documentation was provided"* (from 5% and 1% respectively to 16% and 5%). True to tradition, the most common error was the inclusion of ineligible costs in cost statements submitted to the EU. All this information is presented in the following chart.

Chart 1: Breakdown of the total estimated error rate by type of error



Source: ECA annual reports on the implementation of the budget for the financial years 2014 and 2015, ECA 2015 and 2016.

NB: The European Court of Auditors modified its error categorisation in 2015. The value for 2014 for the category *"errors by Commission and intermediary bodies"* is approximately the sum of the values for *"administrative errors in natural resources"* and *"other error types"*. In addition, the category *"payments for which no supporting documentation was provided"* was used differently in 2015; its value for 2014 was recalculated subsequently.

Annual Report of the European Court of Auditors on the Implementation of the Budget for the Financial Year 2015 in the context of the CR

As part of its audit of the spending areas *"economic, social and territorial cohesion"* and *"natural resources"* the ECA tested a total of 575 operations, 37 of which (approx. 6.4%) directly concerned the CR.

In *"economic, social and territorial cohesion"* the ECA scrutinised 28 operations in the CR, six of which were affected by error; four of these errors were quantifiable.

Nine operations under *"natural resources"* in the CR were scrutinised. None of the four tested operations from the category *"market support and direct aid"* displayed errors. However, as many as four of the five tested operations falling under *"rural development, environment, climate and fisheries"* were affected by error, with all four errors quantifiable.

The ECA found that payments to Member States for the MFF7+ period had attained almost 90% of the total of €446.2 billion by the end of 2015. Approx. €45.4 billion of MFF7+ commitments remained unused. One interesting detail is that more than half of the still unused commitments of European funds (specifically €27.9 billion) pertained to five Member States: Spain, Italy, Poland, Romania and the CR.

The 2015 Annual Report also mentions the Czech Republic among five Member States (the others were Italy, Latvia, Poland and Great Britain) in which the ECA identified breaches of the EU rules on state aid in 2015.

The ECA found several cases of ineligible projects in the Czech Republic (and in Italy and Poland). These included a case where the call for tenders stipulated that only small and medium-sized enterprises (SMEs) were eligible candidates but the MA provided funding to an entity that was not confirmed as genuinely belonging in the SME category at the time of project selection.

The ECA also stated that 13 of the 15 Member States, including the CR, in which the setting of indicators for the outputs of projects approved for support out of ESIFs was scrutinised, were found to lack the kind of indicators that would make it possible to assess the degree to which the supported projects contributed to the achievement of the OP objectives. The ECA found that in these countries the necessary indicators had not been defined for more than half the audited completed projects.

A.1.4 Current developments in the protection of the EU's financial interests

In July 2016 the Commission published a report to the European Parliament and the Council concerning the protection of the EU's financial interests and the fight against fraud for 2015[53]. The Commission submits this report every year in accordance with Article 325 (5) of the *TFEU*. The report is drawn up in cooperation with Member States in view of their primary responsibility ensuing from the predominance of shared management of expenditure and revenue collection under traditional own resources. The report mainly informs about measures taken by the Commission and Member States[54] in the fight against fraud and other unlawful conduct harmful to the EU's financial interests and presents the results achieved in this field in 2015. It also presents conclusions and recommendations that follow from the data analyses performed for the past five years.

The Commission reported that in 2015 it completed all the actions it proposed in its anti-fraud strategy, as well as performing periodic activities such as training and raising awareness. It also launched an experience sharing programme to improve coordination and exchange best practice among the responsible authorities in the fight against corruption. OLAF also participated in several of these meetings on behalf of the Commission.

On the revenues side of the budget, the revised Regulation (EU) No 2015/1525[55] of the European Parliament and of the Council amending Council Regulation (EC) No 515/97 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters entered into force in 2015. As an anti-fraud measure on the expenditure side of the budget, following the adoption of Regulation No 2015/1929[56] amending the Financial Regulation[57] an improved system for early detection of risks and exclusion of economic operators posing a risk to the EU's financial interests

53 Report from the Commission to the European Parliament and the Council: *Protection of the European Union's financial interests – Fight against Fraud: 2015 Annual Report*, COM (2016) 472, final wording of 14 July 2016.

54 For example, national strategies for the fight against fraud were adopted by six Member States, including the CR, and a further five Member States are currently adopting national strategies.

55 Regulation (EU) 2015/1525 of the European Parliament and of the Council, *Official Journal of the European Union*, L 243, 18 September 2015.

56 Regulation (EU, Euratom) 2015/1929 of the European Parliament and of the Council of 28 October 2015 amending Regulation (EU, Euratom) No 966/2012 on the financial rules applicable to the general budget of the Union.

57 Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002.

(EDES[58]) was launched. The Commission also adopted a package of four delegated regulations[59] for reporting irregularities in the area of shared management for MFF14+ and four implementing regulations for these delegated regulations.

Discussions continued in the European Parliament and the Council on two proposed initiatives in the fight against fraud. First and foremost, this involves the draft directive on criminal-law measures against fraud. This directive will harmonise the definition of offences affecting the EU's financial interests, as well as the sanctions and time limitations for these cases. The second proposed initiative is a regulation on the establishment of a European Public Prosecutor's Office. Negotiations on the Office's structure and investigative powers have already been completed.

Member States, which manage approx. 80% of EU expenditure under shared management, are obliged to report irregularities – whether involving fraud or not – via the IMS[60]. Irregularities linked to direct expenditure under direct management by the Commission are reported via the Commission's ABAC[61] accounting system.

58 *Early Detection and Exclusion System*.

59 *Official Journal of the European Union*, L 293, 10, November 2015.

60 *Irregularities Management System*. A new version of this system was launched in 2016 in order to standardise and improve the reporting process in terms of report comparability.

61 *Accrual Based Accounting*.

Table 1: Numbers of cases of suspicion of fraud and non-fraudulent irregularities reported by EU Member States in 2015 and the amounts involved

Budget sector (expenditure/revenues)			Number of fraud suspicions	Volume of fraud suspicions (€ million)	Number of other irregularities	Volume of other irregularities (€ million)
Natural resources	**Agriculture** (market support and direct payments)	EU	180	38.30	1,244	131.20
	Rural development	EU	232	28.80	2,857	186.60
	Both	EU	13	3.80	86	5.20
	Fisheries	EU	19	3.20	183	19.50
	Total	EU	444	74.10	4,370	*342.40
		out of which CR	13	0.80	57	2.10
Cohesion Policy	**ESIF 2014–2020**	EU	1	0.20	1	0.00
	Cohesion 2007–2013	EU	360	429.20	9,730	1,681.60
	Structural and cohesion funds before 2007–2013	EU	10	48.10	591	88.10
	Total	EU	371	477.50	10,322	*1,769.80
		out of which CR	35	14.40	623	234.80
Pre accession assistance 2007–2013 and 2000–2006		EU	29	7.80	98	5.30
		out of which CR	0	0.00	0	0.00
Direct expenditures		EU	5	0.20	1,606	110.80
Total expenditure		EU	**849**	**559.60**	**16,396**	**2,228.20**
		out of which CR	**48**	**15.20**	**680**	**236.90**
Total revenues		EU	**612**	**78.00**	**4,492**	**349.00**
		out of which CR	**2**	**0.04**	**70**	**3.50**
Total		EU	**1,461**	**637.60**	**20,888**	**2,577.20**
		out of which CR	**50**	**15.24**	**750**	**240.40**

Source: Report from the Commission to the European Parliament and the Council: *Protection of the European Union's financial interests – Fight against Fraud: 2015 Annual Report*

* The value of the resulting total is calculated using non-rounded amounts.

The Commission informed that in 2015 Member States reported to OLAF a total of **22,349 irregularities**[62] **in relation to EU budget revenue and expenditure**[63] **involving a total amount exceeding €3.21 billion**. In comparison to 2014, the number of irregularities reported increased by 36% while the corresponding financial amounts fell by 1%. Of that total number, reported **fraudulent irregularities** accounted for **1,461 cases**, a fall of 11% from 2014, while the corresponding financial amounts grew by 18% to **€637.6 million**. The European Commission had not published data for 2016 by the EU Report 2017 editorial deadline.

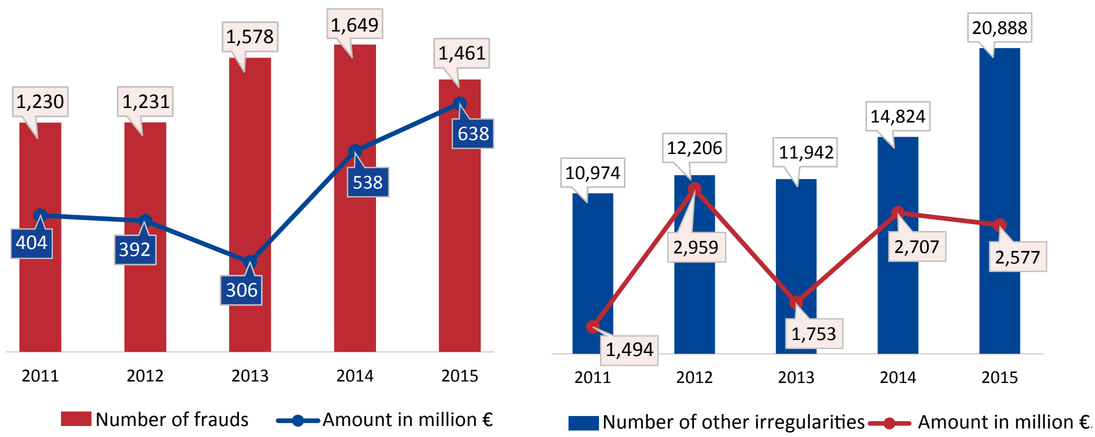
62 Member States are obliged to notify the Commission of every suspicion of fraud and all irregularities involving in excess of €10,000 of EU finances.

63 The detected irregularities for 2015 constituted 1.71% of traditional own resources collected on the revenue side and 1.98% of total payments on the expenditure side.

On the revenue side, fraudulent irregularities decreased in terms of both numbers and amounts compared to 2014. By contrast, on the expenditure side there was a decrease of 10% in the number of reported fraudulent irregularities but the amounts involved increased by 55%. **20,888** non-fraudulent irregularities were reported by Member States, **up 41% from 2014**.

The annual report also comments on the overall development trend in fraudulent irregularities from 2011 to 2015.

Chart 2: Numbers of cases of suspicion of fraud and non-fraudulent irregularities reported by EU Member States in 2011–2015 and the amounts involved



Source: EU Reports 2013–2016 and Report from the Commission to the European Parliament and the Council: *Protection of the European Union's financial interests – Fight against Fraud: 2015 Annual Report*

The charts show that while the numbers of reported cases of fraud did not fluctuate much from 2011 to 2015, the numbers of other irregularities registered constant growth in that period.

The chart also shows clearly that although the number of reported cases of fraud fell in 2015 from the peak reached in 2014, the corresponding reported financial impact continued its growth trend to end the five-year period at its highest value.

Although the number of all irregularities rose sharply (by approx. 83%) between 2011 and 2015, cases of fraudulent irregularities accounted for a very small proportion of this growth. In relative terms, the proportion of all reported irregularities involving fraud actually fell from 10% to 6.5%.

Annex 1 of the *2015 Annual Report on the Fight against Fraud* contains data on suspicions of fraud reported for 2015 via AFCOS[64] (Member States' anti-fraud coordinating structures). **For 2015, the Czech Republic reported 48 cases of suspicion of fraud on the expenditure side involving a total of €15,190,237 and two cases of suspicion of fraud on the revenue side involving €44,705.** Although the number of cases reported was up slightly on 2014 (by approx. 10%), the financial impact was only half the 2014 amount. Cohesion policy accounted for roughly 73% of the total number of cases reported and as much as almost 95% of the total financial impact.

Annex 2 of the *2015 Annual Report on the Fight against Fraud* contains data on non-fraudulent irregularities. The summary shows that **in 2015 the CR reported a total of 680 of non-fraudulent irregularities on the expenditure side with a total financial impact of €236,946,526**, with Cohesion Policy accounting for over 90% of the total number of cases and 99% of the total reported financial impact. Compared to 2014, the number of reported

64 *Anti-Fraud Coordinating Structure*.

non-fraudulent irregularities fell by approx. 40% and their financial impact by approx. 20%. **On the revenue side, the CR reported 70 non-fraudulent irregularities involving €3,459,097 in 2015.** Compared to the previous year, the number of reported cases decreased by over 15% and the total financial impact was just under one third of the previous year's figure.

In administrative and legal terms, the role of the central contact point of the AFCOS network in the CR is carried out by the MoF[65], specifically Department 69 – Analysis and Reporting of Irregularities, which comes under Section 04 – Financial Management and Audit. This department simultaneously serves as the contact point for the central database for excluding economic operators from the process of obtaining EU funding for a defined period in line with Commission Regulation (EC, Euroatom) No 1302/2008[66]. This regulation lays down a duty to transmit information to the Commission on persons officially convicted of crimes harming the EU's financial interests and, where applicable, on the erasure of convictions for such crimes. **Two cases** were reported to the Commission by the CR for 2015 on the basis of a definitive judgement issued by a court. The first case concerned the crime of attempting to harm the EU's financial interests, the crime of attempted forgery and tampering with a public document and the crime of attempted credit fraud. The second case involved the crime of harming the EU's financial interests and the crime of tax and customs duty evasion.

According to data published in the *Report on the Results of Financial Audit in Public Administration for 2015*[67] drawn up by the MoF, the cases of all **728** reported fraudulent and non-fraudulent irregularities on the expenditure side, involving a total of **€252.2 million**, were still open at the end of 2015. These cases had been passed on to the authorities responsible for the subsequent administrative or judicial procedures for resolution.

A.1.5 Review of the Multiannual Financial Framework 2014–2020

In mid-2016 the Commission performed a review of the functioning[68] of MFF14+. The purpose of this review was to ascertain how MFF14+, approved in 2013, is coping with serious long-term challenges such as the need to strengthen the European economy and social fabric, ensure security within the EU and at its external borders, manage migration and address the causes and consequences of climate change.

By assessing the outputs of the review, the Commission identified various **problem areas**: The main ones are:

- **Eliminating the payments backlog**

  An insufficient level of payment appropriations in the 2014 budget was identified. This was caused by a very significant backlog of outstanding payment claims at year-end (involving €24.7 billion). The backlog of payments is expected to be eliminated by the end of 2016.

  The elimination of the backlog was facilitated by the slower-than-expected launch of the new generation of programmes financed from the ESIFs, which resulted in large margins remaining available under the payment ceilings in 2015 and even more so in 2016. Even though this situation temporarily allows for new needs to be accommodated without requiring additional contributions from national budgets, it is likely to result in significant payment pressures towards the end of MFF14+.

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65 The Czech Republic currently has three central points for communication with OLAF: besides the MoF, these are the Supreme Public Prosecutor's Office, Serious Economic and Financial Crime Division, for criminal matters and the General Directorate of Customs for the revenue side of the EU budget.

66 Commission Regulation (EC, Euratom) No 1302/2008 of 17 December 2008 on the central exclusion database.

67 The *Report on the Results of Financial Audit in Public Administration for 2015* was noted by the Czech government by resolution no. 509 of 8 June 2016.

68 In line with Article 2 of Council Regulation (EU, Euratom) No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014–2020.

- **Implementation of the European Structural and Investment Funds**

  Simpler and more flexible rules were proposed to help speed up the implementation of ESIFs.

  Member States' Cohesion Policy allocations were reviewed in June 2016. The purpose of the review was to take account of the difficult situation of Member States who suffered most from the crisis. Allocations for 2017–2020 were adjusted on the basis of the most recent data available[69]. The review helped Spain and Italy most, with their allocations increased by €1,837.1 million and €1,417.8 million respectively. The additional allocations should mainly be channelled into measures helping tackle the migration crisis and youth unemployment. Conversely, the biggest **allocation reductions affect the CR and Slovakia** (€99.1 million[70] and €59.3 million respectively at 2011 prices). The reduction of the CR's Cohesion Policy allocation reflects partly the growth of the CR's economy in recent years, where the regions of the CR are advancing in relative terms in the EU, and partly the positive results of Cohesion Policy interventions done in the CR in previous programming periods.

- ***Youth Employment Initiative***

  Youth unemployment remains high in a number of EU regions; nevertheless, the YEI has achieved its first encouraging results. For the YEI to deliver even better results, it was proposed that the original allocation (€3.2 billion and a further €3.2 billion from the *European Social Fund* (ESF)) should be increased to almost €8 billion (including a further increased contribution from the ESF).

- **Competitiveness programmes**

  Based on the first experiences, it was proposed to supplement the original allocation to certain programmes over 2017–2020 to further enhance the EU's support for jobs and growth. Specifically, the allocation is to be increased for *Horizon 2020*, the *Connecting Europe Facility (CEF) – Transport* (each by €0.4 billion) and *Erasmus+* and COSME (each by €0.2 billion).

  The Commission adopted the *WiFi4EU* proposal, with a total budget of €120 million, including a reinforcement by €50 million. The aim of *Wifi4EU* is to promote the provision of free local wireless connectivity in the centres of local public life.

- **European Fund for Strategic Investments (EFSI)**

  At the same time as it presented its mid-term review of MFF14+, the Commission presented a legislative proposal to extend the duration of the EFSI to 2020. This proposal includes a transfer of €500 million from CEF financial instruments to the EFSI and a transfer of €1,146 million from CEF financial instruments to CEF grants, with these finances to be blended with EFSI financing or other instruments dedicated to energy efficiency. The Commission also proposed using €150 million from the "unallocated margin". According to the Commission, the implementation of these proposals should ensure a maximum impact of EU funds, eliminate overlaps and maximise the synergies between different grants and financial instruments as well as with private investors.

  The Commission also proposed increasing the finances earmarked for *CEF – Transport* grants by €1.4 billion. This sum will be used to finance cross-border transport infrastructure for priority networks in the EU.

69 Communication from the Commission to the Council and the European Parliament: *Technical adjustment of the financial framework for 2017 in line with movements in GNI and adjustment of cohesion policy envelopes (Article 6 and 7 of Council Regulation 1311/2013 laying down the multiannual financial framework for the years 2014–2020),* COM (2016) 311, final wording of 30 June 2016.

70 This sum represents a reduction of €115 million at current prices.

- **Migration, refugee crisis and security**

  It is a reasonable expectation that the long-term crisis affecting the EU in this area will continue to have serious budgetary implications. €2.55 billion is needed at EU level for 2018–2020: this money will be used to cover the increased needs of the European Border and Coast Guard and to reinforce EUROPOL and to cover activities proposed by the Commission, e.g. related to the EU Agency for Asylum. If these measures prove insufficient to address the migration and security challenges, additional resources would need to be made available. In such an event, financing under the proposed new European Union Crisis Reserve could be used. This reserve is funded by the re-use of de-committed appropriations.

  The Commission also proposes mobilising €750 million for the *Partnership* framework process and €250 million for the *European Fund for Sustainable Development*.

In addition to **increasing the funding contained in the draft budget for 2017**, especially in the area of migration, and **additional funding under technical adjustments of allocations** to Cohesion Policy[71], the proposed financial package[72] for 2017–2020 includes **additional EU funding of almost €12.80 billion** for the areas of employment, growth, migration and security.

In response to the review, the Commission presented the following **legislative proposals**:

- a proposal for amending Council Regulation No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014–2020, as amended by Council Regulation No 2015/623 of 21 April 2015 and corresponding adjustment of the Interinstitutional Agreement on budgetary discipline, on cooperation in budgetary matters and on sound financial management[73];
- a proposal for amending Decision No 2015/435 of the European Parliament and of the Council of 17 December 2014 on the mobilisation of the Contingency Margin[74];
- a proposal to simplify financial rules under the Financial Regulation and relevant basic acts[75];
- a proposal for amending the EFSI Regulation (2015/1017) with the purpose of extending the EFSI[76];

71 Communication from the Commission to the Council and the European Parliament: *Technical adjustment of the financial framework for 2017 in line with movements in GNI and adjustment of cohesion policy envelopes (Article 6 and 7 of Council Regulation 1311/2013 laying down the multiannual financial framework for the years 2014–2020),* COM (2016) 311, final wording of 30 June 2016.

72 Communication from the Commission to the European Parliament and the Council: *Mid-term review/revision of the multiannual financial framework 2014–2020 – An EU budget focused on results,* COM (2016) 603, final wording of 14 September 2016.

73 Council Regulation amending Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014–2020, COM (2016) 604, final wording of 14 September 2016; and proposal: *Amendment of the Interinstitutional Agreement of 2 December 2013 between the European Parliament, the Council and the Commission on budgetary discipline, cooperation in budgetary matters and on sound financial management,* COM(2016) 606, final wording of 14 September 2016.

74 Proposal for a decision of the European Parliament and of the Council amending Decision (EU) 2015/435 on the mobilisation of the Contingency Margin, COM (2016) 607, final wording of 14 September 2016.

75 Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union and amending Regulation (EC) No 2012/2002, Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1305/2013, (EU) No 1306/2013, (EU) No 1307/2013, (EU) No 1308/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014 and (EU) No 652/2014 of the European Parliament and of the Council and Decision No 541/2014/EU of the European Parliament and of the Council, COM(2016) 605, final wording of 14 September 2016.

76 Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 1316/2013 and (EU) 2015/1017 as regards the extension of the duration of the European Fund for Strategic Investments as well as the introduction of technical advancements for that Fund and the European Investment Advisory Hub, COM (2016) 597 of 14 September 2016.

- under the External Investment Plan:
    - a proposal for a Regulation of the European Parliament and of the Council on the *European Fund for Sustainable Development* (EFSD)[77] and establishing the EFSD Guarantee and the EFSD Guarantee Fund[78];
    - a proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC, Euratom) No 480/2009 establishing a *Guarantee Fund for External Actions*[79];
    - a proposal for a decision of the European Parliament and of the Council amending the decision granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union[80];
- under the Telecommunications package:
    - a proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 1316/2013 and (EU) No 283/2014 as regards the promotion of Internet connectivity in local communities and public spaces[81].

The Commission called on the Council and the Parliament to ensure a very swift adoption of these proposals and their financing.

The impacts of the MFF14+ review at the level of the CR were discussed by the National Convention on the EU at its 14 October 2016 session[82].

A.2 The EU budget and its relation to the Czech Republic

A.2.1 European Union budget revenues

The European Union's revenues come mainly from **own resources**[83], which made up more than 94% of all EU budget revenues in 2015. Own resources are divided into:

- **Traditional own resources** (TORs) are customs duties collected on products imported from non-EU states and also sugar levies. TORs are collected on behalf of the EU by Member States, who pay 75% of the funds thus acquired into the EU budget, keeping the rest to cover the costs associated with collecting the funds. In 2015 TORs (after deducting the amount covering their collection) brought more than **€18.73 billion** into the EU budget.
- The **VAT-based resource** derives from a uniform rate of 0.3% levied on the harmonised VAT base of each Member State.[84] The VAT base to be taxed is capped at 50% of gross national income (GNI) for each Member State. This resource brought in almost **€18.09 billion** in 2015.

77 *European Fund for Sustainable Development*.

78 Proposal for a Regulation of the European Parliament and of the Council on the European Fund for Sustainable Development (EFSD) and establishing the EFSD Guarantee and the EFSD Guarantee Fund, COM (2016) 586, final wording of 14 September 2016.

79 Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC, Euratom) No 480/2009 establishing a Guarantee Fund for External Actions, COM (2016) 582, final wording of 14 September 2016.

80 Proposal for a Decision of the European Parliament and of the Council amending Decision No 466/2014/EU granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union, COM (2016) 583, final wording of 14 September 2016.

81 Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 1316/2013 and (EU) No 283/2014 as regards the promotion of Internet connectivity in local communities, COM (2016) 589, final wording of 14 September 2016.

82 *Mid-term review of the Multiannual Financial Framework, EU financial planning after 2020 and the principle of European Added Value,* EUROPEUM, October 2016.

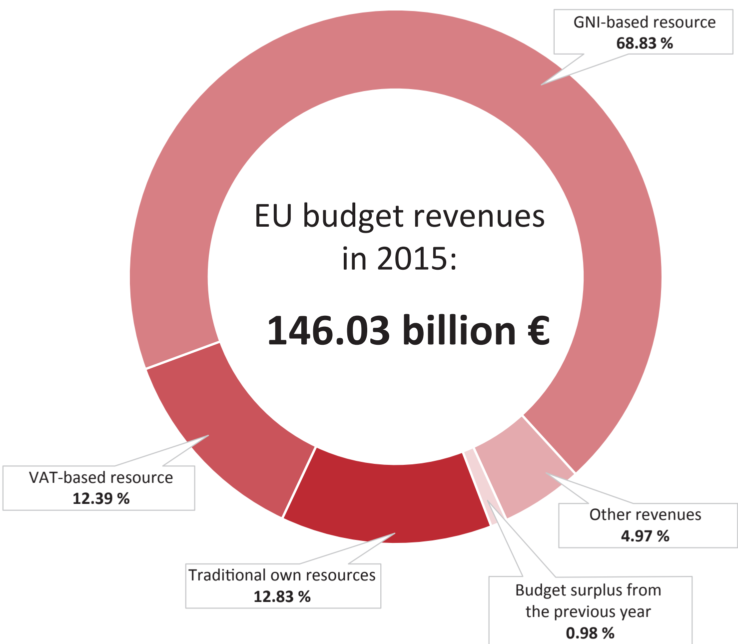
83 The total volume of own resources must not exceed 1.23% of the GNI of the European Union.

84 Application of this rule brought a reduction in contributions from this source in 2015 for Croatia, Cyprus, Luxembourg, Malta and Slovenia.

- The **GNI-based resource** is a variable resource. Since 1988 it has been used to settle the difference between EU budget revenues and expenditure so that the budget as a whole is balanced. The single percentage rate applied to all Member States was more than 0.66% in 2015. This source of budget revenue, the largest of them all, brought in almost **€100.52 billion** in 2015 (after allowing for all correction mechanisms – see below).
- The resources based on VAT and GNI are funded from Member States' national budgets. The amount of EU revenue originating from these resources is influenced by **correction mechanisms**, under which certain Member States pay in reduced amounts from these resources. The main reasons for the reduced payments are to compensate for a pronounced budgetary imbalance between payments into the EU budget and revenues from the EU budget[85] and certain Member States' non-participation in selected EU policies[86]. The costs of these measures are borne by other Member States according to their share of the GNI of the EU as a whole, with the burden of financing this mechanism reduced for certain Member States[87].
- The smallest EU budget revenue amount comes from the transfer **of a budget surplus** from the previous year; in 2015 this was **€1.35 billion**.

The remaining resources featuring on the revenue side of the EU budget are grouped together as **other revenues**; these include revenues from fines imposed for breaches of competition rules or other regulations, income taxes and other employee contributions from employees of EU institutions or contributions from non-member states to EU programmes. Other EU budget revenues totalled almost **€7.26 billion** for 2015.

Chart 3: Structure of the revenue side of the EU budget 2015



Source: *EU budget 2015 – Financial Report*, Commission 2016.

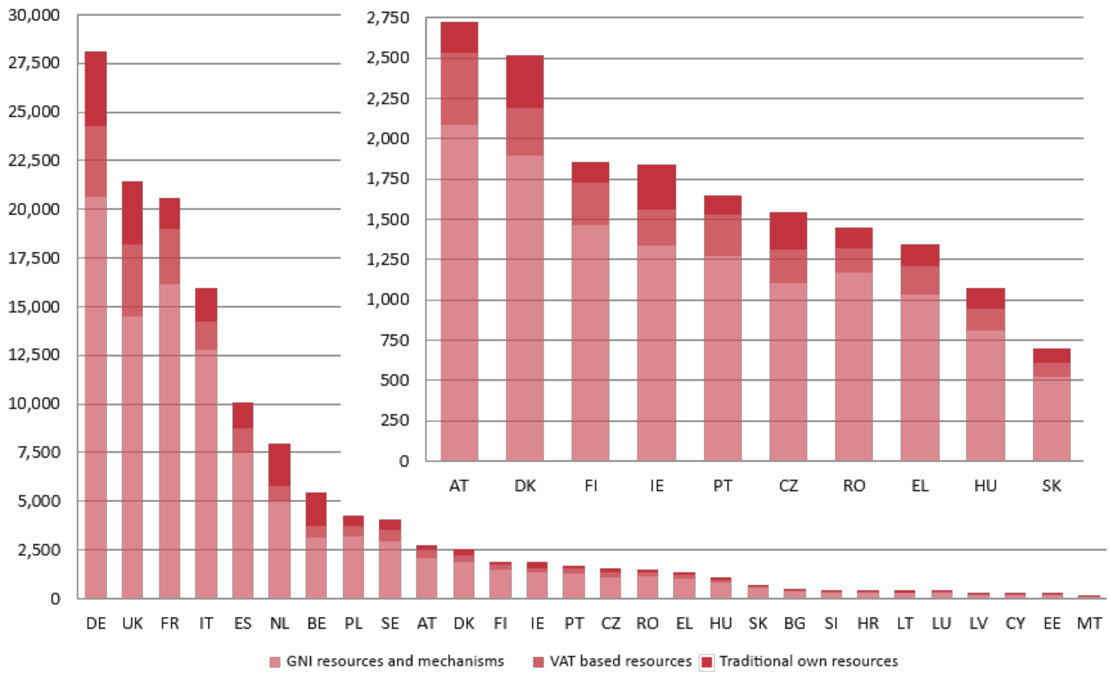
The following chart shows a breakdown of EU budget revenues by Member States, after factoring in correction mechanisms.

85 Only the UK rebate, which stood at almost **€6.08 billion**, was used in 2015.

86 Payments by Denmark, Ireland and the UK are reduced in line with their refusal to participate in certain areas of legal and security cooperation. This reduction totalled almost **€49.88 million** in 2015.

87 For Austria, Germany, the Netherlands and Sweden, the funding of the UK rebate was reduced to one quarter of their share. The remaining three quarters of their share was paid by other Member States in proportion to their GNI's share of the GNI of the European Union as a whole.

Chart 4: Payments to Member States from the EU budget in 2015 (with close-up section) (€ million)



Source: *EU budget 2015 – Financial Report*, Commission 2016.

A.2.2 European Union budget expenditure

European Union budget expenditure is used to cover the needs of the EU's policies and defray the costs associated with the working of European institutions.

The expenditure side of the EU is made up of six headings that cover the EU's various policies. The following structure is used for MFF14+:

- 1. *Smart and inclusive growth*
  - 1a *Competitiveness for growth and jobs*
  - 1b *Economic, social and territorial cohesion*
- 2 *Sustainable growth: natural resources*
- 3 *Security and citizenship*
- 4 *Global Europe*
- 5 *Administration*
- 6 *Compensations*

In general terms, the expenditure side of the EU budget has **two levels: commitments** (i.e. amounts to be defrayed in the current year or coming years) **and payments** (i.e. payments in the current year). Payments can only be executed if underpinned by a valid commitment. **Annual ceilings** (i.e. upper limits) for commitments and payments are laid down **in the multiannual financial framework** adopted unanimously by the Council with the consent of the European Parliament.

Total EU budget spending on payments (i.e. expenditure channelled into EU Member States and elsewhere) was almost €142.0 billion in 2015 (including the €390 million contribution to EFTA[88]). That figure does not include **assigned revenue**[89] of almost €3.4 billion, however.

The largest EU budget spending area by volume in 2015 was again heading **1. *Smart and inclusive growth***, which has two subheadings. The first, **1a *Competitiveness for growth and jobs***, comprises finances channelled mainly into research, innovation and technological development, lifelong learning, and support for SME or for the development of trans-European transport, energy and digital networks. **€15,950.7 million in payments** was disbursed out of this subheading in 2015. Subheading **1b *Economic, social and territorial cohesion*** comprises finances earmarked for building new infrastructure, educational programmes and cross-border cooperation and for investing with a view to strengthening economic, social and territorial cohesion and boosting growth and the development of regions that are lagging behind. Expenditure under this subheading amounted to **€50,961.4 million in payments**.

More than **€56,634.8 million in payments** was disbursed for agriculture, food production, rural development, fisheries and environmental protection under heading **2. *Sustainable growth: natural resources*** in 2015.

More than **€1,971.2 million in payments** out of budget heading **3. *Security and citizenship*** contributed to the fight against terrorism and crime, migration flows management and the creation of a common asylum system as well as to consumer protection in the EU or the promotion of European culture.

Heading **4. *Global Europe***, which funds the EU's external policy, i.e. spending on EU cross-border activities, EU enlargement, bilateral relations and humanitarian or development assistance, provided almost **€7,652.6 million in payments** in 2015.

Expenditure mainly funding the salaries of EU employees and the management of EU institutions' buildings, which comes out of heading **5. *Administration***, amounted to **€8,552.8 million in payments**.

Almost **€252.5 million** was disbursed under ***Special Instruments***[90].

Expenditure of the ***European Development Fund***[91] stands apart from the EU budget and MFF14+ structure.

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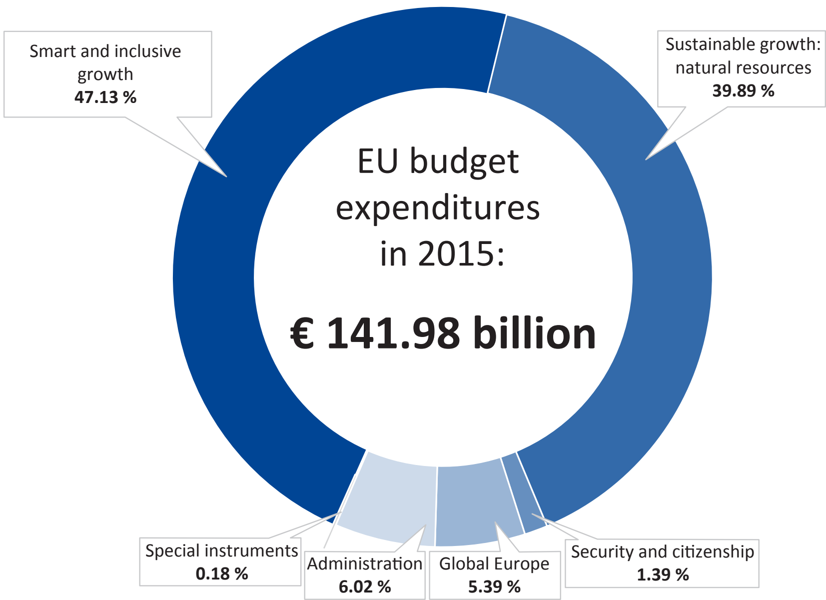
88 The members of EFTA, the European Free Trade Association, are Iceland, Lichtenstein, Norway and Switzerland.

89 Assigned revenues are revenues (pursuant to Article 43 of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013) arising out of financial corrections based on decisions on the financial statements and decisions on compliance approval, from irregularities and from milk levies. These finances are assigned to fund EAGF expenditure.

90 These instruments are the *Emergency Aid Reserve, European Globalisation Adjustment Fund, European Union Solidarity Fund and Flexibility Instruments*.

91 The fund's purpose is to finance the EU's development cooperation and aid to ACP (Africa, Caribbean, Pacific) countries.

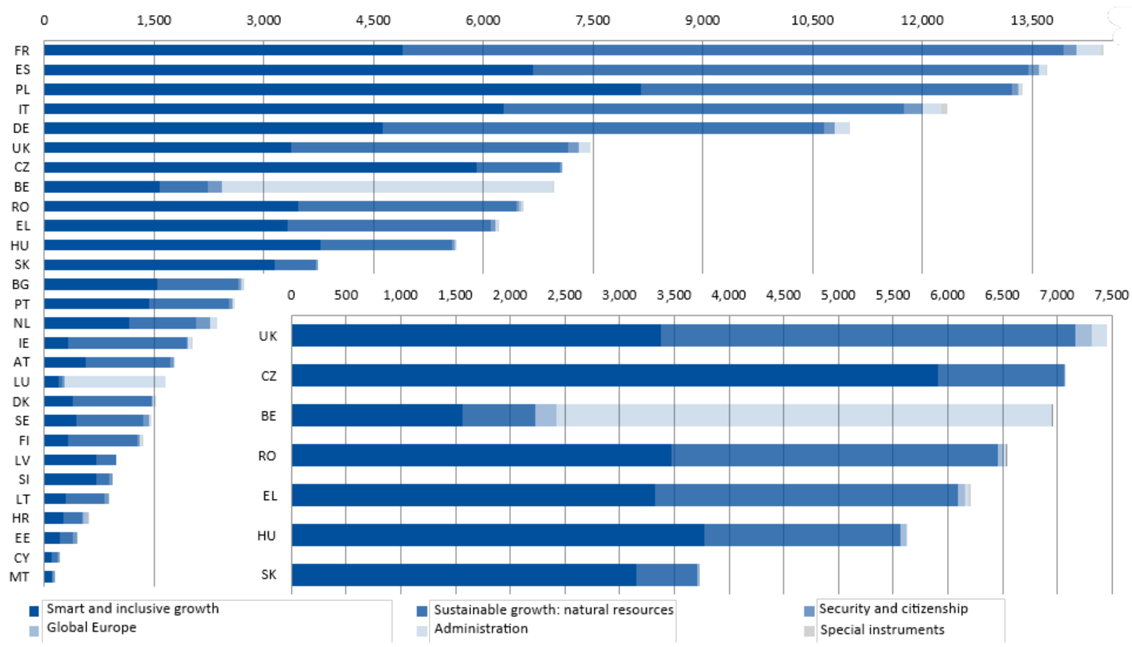
Chart 5: Structure of the expenditure side of the EU budget in 2015



Source: EU budget 2015 – Financial Report, Commission 2016

As the chart shows, the biggest headings in volume terms (*Smart and inclusive growth* and *Sustainable growth: natural resources*) jointly account for 87.02% of all EU budget expenditure, a value of €123.5 billion.

Chart 6: Member States' drawdown from the EU budget in 2015 (with close-up section) (€ million)



Source: *EU budget 2015 – Financial Report*, Commission 2016.

Whereas Member States who joined the EU in or after 2004 mainly utilise expenditure channelled into **Cohesion Policy**, which is financed from heading 1. *Smart and inclusive growth*, and in particular subheading 1b *Economic, social and territorial cohesion*, the older

Member States (EU-15) largely draw down finances under heading 2. *Sustainable growth: natural resources*, which mainly covers the **CAP**.

The payments budget for 2015 was the second biggest in history and represented the third consecutive year when the final volume of payments was greater than the amount defined in the original budget.

2015 cannot be regarded as a typical year in terms of drawdown from heading 1. *Smart and inclusive growth.* The distribution of drawdown in this heading between Member States was not influenced solely by the size of their allocation (which was defined mainly with regard to Member States' economic development and population size), but also by the course of drawdown of the allocation for the entire 2007–2013 programming period (more than three quarters of operational expenditure went on programmes that operated according to the rules of the previous multiannual financial framework). This issue and its relation to the CR is covered in greater detail in subsection A.2.3.2.

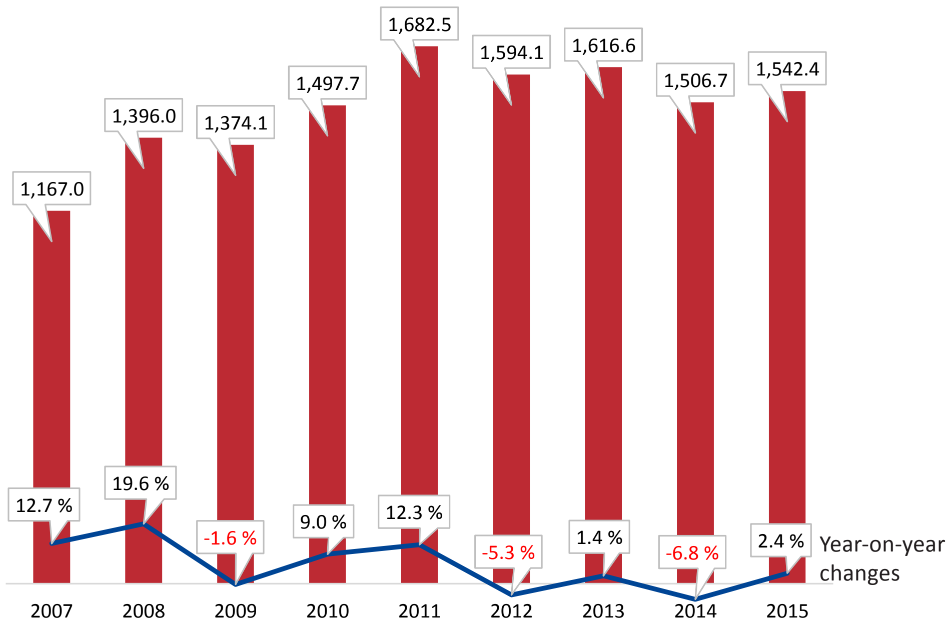
A. 2.3 The EU budget in relation to the CR

One of Member States' obligations is to contribute to the European Union budget. At the same time, these countries have the right to draw down finances from the EU budget. Since joining the EU in 2004, the Czech Republic has been a "net beneficiary", i.e. one of those countries that draw down more money from the EU budget than they pay in.

A.2.3.1 Contributions of the Czech Republic to the EU budget

From its accession to the European Union to the end of 2015 the Czech Republic contributed almost €16.0 billion to the EU budget, with the country's average annual contribution standing at approx. €1.5 billion in the 2007–2013 and 2014–2020 programming periods.

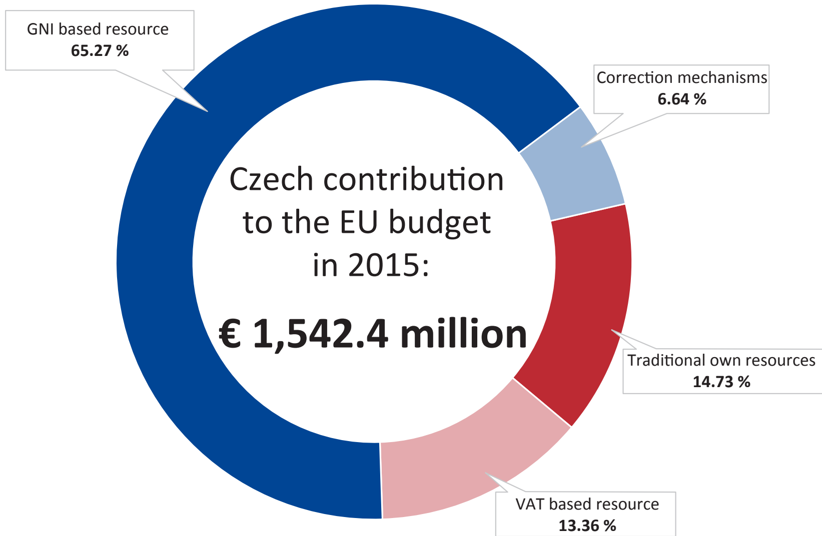
Chart 7: Overview of Czech contributions to the EU budget (€ million) and year-on-year changes (%) in 2007–2015



Source: *EU budget 2015 – Financial Report* and previous reports on the EU budget, Commission 2008–2016.

In 2015 the CR's contribution to the EU budget was almost €35.77 million greater than in 2014. That is a year-on-year increase of 2.37%. As expected, there was no repeat of the relatively sharp fall in contributions that occurred in 2014 (see Chart 7) and was caused by the weakening Czech crown, a result of the Czech National Bank's direct interventions in the foreign exchange market begun in November 2013. Another factor was the Czech Statistical Office's methodological adjustments to national accounts and calculation of GNI.

Chart 8: Structure of the CR's contributions to the EU budget in 2015

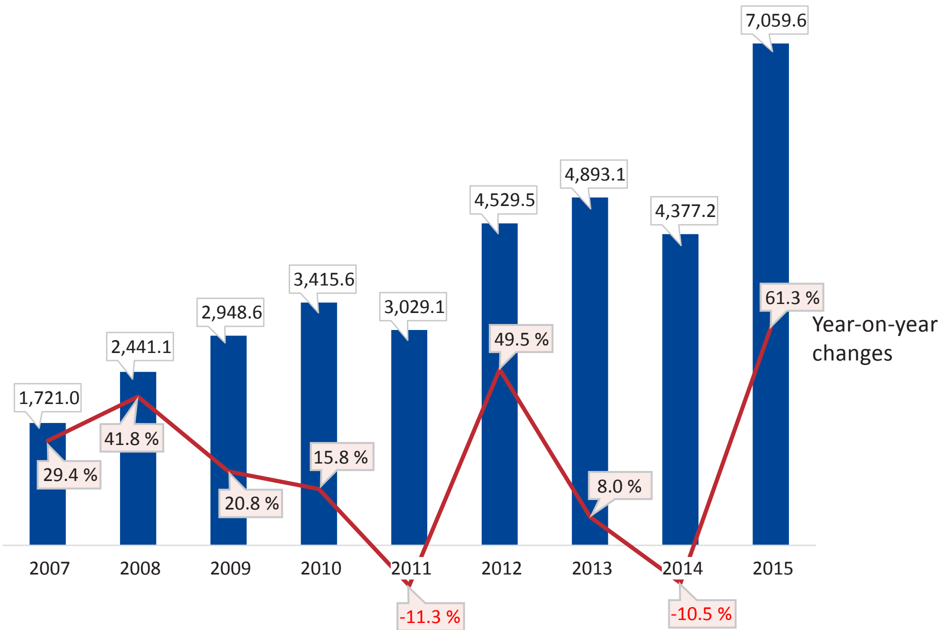


Source: *EU budget 2015 – Financial Report*, Commission 2016.

A.2.3.2 The CR's revenues from the EU budget

From 2004 to the end of 2015 the Czech Republic received over €37.6 billion in total from the EU budget, with 2015 a record year in this regard, as the following chart shows.

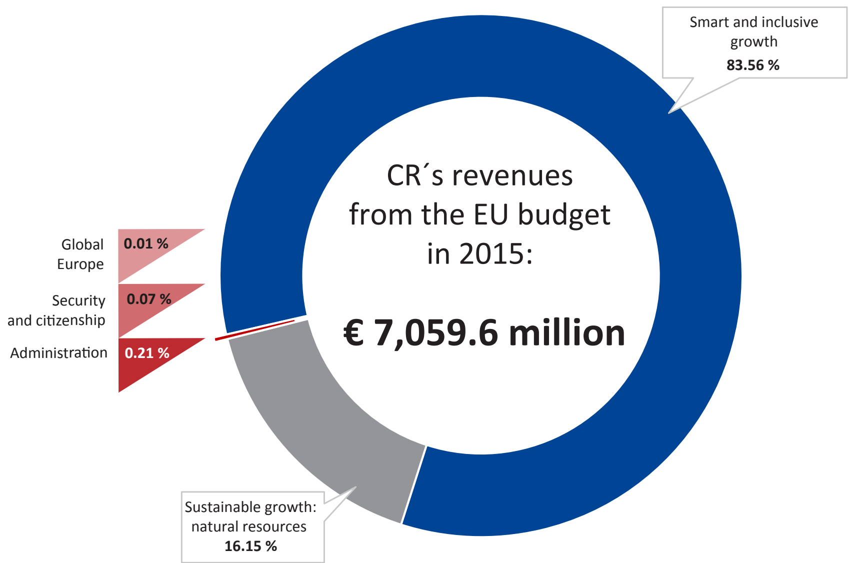
Chart 9: The CR's revenues from the EU budget (€ million) and year-on-year changes (%) in 2007–2015



Source: *EU budget 2015 – Financial Report* and previous reports on the EU budget, Commission 2008–2016.

The CR's revenues from the EU budget reached almost €7.1 billion in 2015, a year-on-year increase of more than 61%. This sharp rise was mainly caused by the rush to utilise the entire allocation to the CR for the 2007–2013 programming period (see subsection A.2.3.2 for more details). Another factor, however, was the fact that a payment exceeding €671.0 million executed on the basis of payment application no. 12 of 23 December 2014 was not remitted to the CR by the Commission until 2 March 2015.

Chart 10: Structure of the CR's revenues from the EU budget in 2015



Source: *EU budget 2015 – Financial Report*, Commission 2016.

Chart 10 makes it clear that the majority of the revenues streaming into the CR from the EU budget comes from the heading *Smart and inclusive growth*, which covers **Cohesion Policy** activities. In 2015 revenues from this budget heading amounted to almost €5.9 billion, a record amount for the CR. The second most significant policy in terms of the amount of finances received is the **CAP** (funded out of the heading *Sustainable growth: natural resources*), which accounted for almost €1.1 billion. Funding obtained under these two policies has traditionally formed over 99% of the CR's total drawdown of EU resources.

2015 was also exceptionally successful in terms of the quantity of finances obtained by the CR from the EU budget in comparison with other Member States. That is demonstrated by both Chart 9 and Table 2 below.

Table 2: Drawdown of finances allocated to EU Member States (€ million and € per capita) from heading 1. *Smart and inclusive growth* in 2015, after deducting expenditure provided for European territorial cooperation and "other financial instruments[92]

State	Drawdown (€ million)	Order	State	Drawdown (€ per capita)
ø EU-28	1,721.41	–	EU-28	94.49
PL	7,812.47	1	SK	562.75
CZ	5,767.14	2	CZ	546.45
ES	5,100.77	3	HU	356.45
IT	4,959.83	4	LV	328.10
HU	3,504.12	5	SI	287.94
RO	3,224.28	6	EL	261.19
SK	3,053.60	7	PL	205.77
EL	2,816.56	8	BG	193.86
DE	2,563.34	9	MT	176.68
FR	2,311.62	10	RO	163.17

Source: *EU budget 2015 – Financial Report*, Commission 2016.

On the other hand, the CR's second-place ranking in the EU in terms of utilisation of finances from the budget heading *Smart and inclusive growth* should not be seen as positive. This ranking is the direct consequence of long-term problems afflicting the CR when utilising allocations, especially in Cohesion Policy. These drawdown problems have been regularly covered in previous editions of the EU Report. In *EU Report 2017* this issue is mainly dealt with in Section II. It should be mentioned here that drawdown in the last year of the 2007–2013 programing period (adding two years under the n+2 rule) was more than 53% greater than it would have been if drawdown of the entire allocation was evenly spread (i.e. 1/7 of the total allocation per year). In this regard the CR was only outdone by Slovakia, which, as it too sought to utilise the full allocation, exceeded the rate of evenly distributed drawdown by over 88%. Third place in terms of this unflattering statistic was taken by Bulgaria, which had to speed up its drawdown by more than 45%.

A.2.3.3 Net position of the CR in the EU

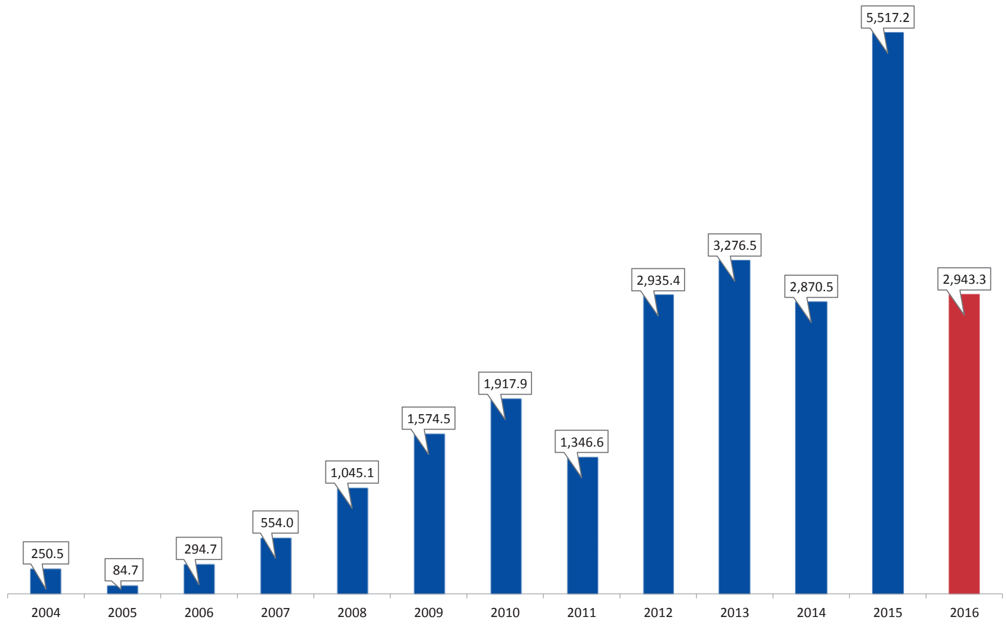
As mentioned above, the Czech Republic has continually been a **net beneficiary**. From the Czech Republic's accession to the EU to the end of 2015 **the cumulative value of the CR's net position reached almost €21.67 billion**, the equivalent of almost CZK 591.07 billion[93].

2015 brought the highest ever value of the CR's net position at almost €5.52 billion. The year-on-year increase, which exceeded 92.2%, was also a record. It is clear that the biggest factor driving these figures was the massive final drawdown of the rest of the Cohesion Policy allocation, the result of long-term shortcomings in the utilisation of the allocated funds. Another major factor was that part of the payments applied for in 2014 was not paid out by the Commission until 2015. Possible automatic de-committing by the Commission can have no impact on the net position for 2015, as it was not performed immediately after the end of 2015; the Commission will only perform it (in view of the closure of the 2007–2013 programming period) after 31 March 2017, the deadline by which Member States have to send in applications for payment of the final balance for each OP.

92 For more information on OFI see subsection B.2.6.
93 The ECB's average annual exchange rate for 2015 was used: 27.279 CZK/€.

The following chart shows the evolution of the CR's net position as reported in official Commission sources for the years 2004 to 2015 (but without excluding re-calculated expenditure in the *Administration* spending area). The final column in the chart shows the net position for 2016 as reported by the Ministry of Finance[94].

Chart 11: Net position of the CR in 2004–2015 (with MoF figure for 2016) (€ million)



Source: *EU budget 2015 – Financial Report* and previous reports on the EU budget, Commission 2005–2016; MoF figure for 2016 published in January 2017.

In January 2017 the MoF issued a press statement announcing that the CR's net position for 2016 was CZK 79,566.56 million[95]. The Commission had not published its data by the editorial deadline for *EU Report 2017*, but there is no reason to expect the EU's official figure to differ much from the MoF's.

As the press statement announces, the CR's total revenues from the EU budget in 2016 stood at CZK 123,756.98 million, with the CR's total contributions to the EU budget worth CZK 44,190.42 million. The press statement adds that the biggest factor influencing the high value of drawdown of EU finances was efforts by Czech entities to utilise the maximum possible funding allocated to the CR for the 2007–2013 programming period, particularly in the structural funds[96] (SFs) and cohesion fund (CF).

A.2.4 The EU budget in 2016 and 2017

A.2.4.1 The EU budget and draft amending budgets in 2016

The EU budget for 2016 was adopted by the European Parliament on 25 November 2015. The budget set total commitments at €155.00 billion and total payments at €143.89 billion, leaving a reserve of €2.3 billion.

Among other things, the approved budget responded to the migration and refugee crisis and allocated more than €4 billion to commitments to Member States and third countries.

94 The press statement *"The Czech Republic obtained CZK 79.6 billion more from the EU budget than it paid in"* was published on 24 January 2017 at http://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2017/cr-ziskala-v-roce-2016-o-79-mld-vice-27395.

95 The CNB's average annual exchange rate for 2016 was used: 27.033 CZK/€.

96 The SF consisted of the *European Regional Development Fund*, *European Social Fund* and *European Maritime and Fisheries Fund* in the 2007–2013 programming period.

At the same time, it significantly increased funding earmarked for the fight against crime and protection against acts of terrorism, allocating 64.0% more funding year-on-year to commitments under the *Internal Security Fund* and 46.7% more to payments.

Support for pro-growth measures, including research, also registered a sharp increase. Compared to 2015, 8.3% more funding was allocated to commitments in this area and 10.8% more to payments.

The EU budget also took into account the impact of the Russian embargo on imports of certain agricultural products and the difficult situation in the dairy and pork production sectors. The budget set aside €698.0 million through emergency measures for mitigating the negative impacts.

Table 3: Summary of the approved EU budget for 2016

Appropriations by heading[99]	Commitments	Payments
	(€ billion)	
1. Smart and inclusive growth:	69.84	66.26
1a Competitiveness for growth and jobs	19.01	17.42
1b Economic, social and territorial cohesion	50.83	48.84
2. Sustainable growth: natural resources	62.48	55.12
3. Security and citizenship	4.05	3.02
4. Global Europe	9.17	10.16
5. Administrative expenditures (for all EU institutions)	8.93	8.94
Special instruments	0.53	0.39
Total appropriations	**155.00**	**143.89**

Source: *Official Journal of the European Union,* L 48, 24, February 2016.

Adjustments on both the revenue and expenditure sides of the budget make it possible to revise the EU budget during the year in line with developments. These adjustments are called "amending budgets"; they are adopted by the Council of the EU and the European Parliament on a proposal by the Commission.

Six amending budgets were adopted during 2016:

- Draft amending budget no. 1, which was adopted by the European Parliament on 13 April 2016[97], made it possible to finance emergency support for Greece and other Member States overwhelmed by the refugee crisis. €100 million was made available in commitments and €80.2 million in payments for these purposes.
- The adoption of draft amending budget no. 2, which took place on 6 July 2016, incorporated the budget surplus of 2015[98], amounting to €1.35 billion, into the revenue side of the EU budget.
- On 25 October 2016 the EP approved draft amending budget no. 3, which increased the 2016 EU budget by €15.8 million. These funds were earmarked for certain EU institutions to reinforce their security measures following the terrorist attacks in Paris in November 2015 and in Brussels in March 2016.
- Draft amending budget no. 4[99], which the EP approved on 1 December 2016, reflected the most recent needs estimates, reducing Member States' contributions to the 2016 EU budget by €8.6 billion (by €41.5 million for the CR) and also the amount of funds in payments by €7.3 billion. It also provided for additional financial assistance to tackle

97 The adoption of this amending budget was preceded by the establishment of a Union emergency support mechanism on 15 March 2016.

98 The incorporation of the previous year's budget surplus in the EU budget accordingly reduces Member States' contributions to funding the EU budget in the current year.

99 See also subsection B.1.1.1.

the migration crisis and ensured a quicker mobilisation of €73.9 million in commitments for the EFSI.

- On 1 December 2016 the EP approved draft amending budget no. 5, which incorporated the retroactive application of the new own resources decision (as from 1 January 2014), which entered into force on 1 October 2016. This amending budget also changed Member States' individual shares in the financing of the EU budget.
- The final draft amending budget for 2016 (no. 6) was also approved by the EP on 1 December 2016. This amending budget provided financial assistance to the German region of Lower Bavaria in response to flooding caused by intense torrential rains in May and June 2016.

A.2.4.2 The EU budget for 2017

On 1 December 2016 the European Parliament adopted the EU budget for 2017. This budget set expenditure of €157.86 billion in commitments and €134.49 billion in payments, leaving a reserve[100] of €1.1 billion for unforeseen requirements. Funds for payments were reduced by 1.6% compared to 2016 in view of the lower actual requirements.

Compared to 2016, there was a further increase of approx. 11.3% in the EU budget for tackling migration pressure and ensuring greater security for European citizens. Almost €6 billion is available in commitments for activities linked to both legal and illegal migration in 2017.
Roughly 11% more than in 2016 was made available in funding for commitments for boosting economic growth and job creation. These funds in the EU budget feature in instruments such as *Erasmus+* (19% increase) and the *European Fund for Strategic Investments* (25% increase). The budget also supports other measures benefiting young people in particular (e.g. the *Youth Employment Initiative* can draw on €500 million in funding for 2017).
A further €500 million is earmarked for measures supporting milk-producing farmers and other farmers in animal production.

Table 4: Summary of the approved EU budget for 2017

Appropriations by heading	Commitments	Payments
	(€ billion)	
1. Smart and inclusive growth:	74.90	56.52
1a Competitiveness for growth and jobs	21.31	19.32
1b Economic, social and territorial cohesion	53.59	37.20
2. Sustainable growth: natural resources	58.58	54.91
3. Security and citizenship	4.28	3.79
4. Global Europe	10.16	9.48
5. Administrative expenditures (for all EU institutions)	9.40	9.40
Special instruments	0.53	0.39
Total appropriations	**157.86**	**134.49**

Source: *Official Journal of the European Union, L 51, 28, February 2017.*

100 Against the maximum possible annual budget defined by MFF14+ (known as the "margin").

B. Sector matters

This chapter provides information about current developments in the financial management of EU budget funds in the Czech Republic in the period under scrutiny, i.e. from the start of April 2016 to the end of May 2017, broken down into **revenues** and **expenditures**.

Expenditures are divided according to the underlying policies, i.e. **Cohesion Policy, the CAP and CFP**, and the area covering programmes with European added value, or some other special-purpose funds.

Attention is paid to information concerning the Czech Republic, including the perspective of external audit bodies, i.e. the AB and the ECA as well as the SAO.

B.1 European Union budget revenues from the CR

B.1.1 Current developments in budget revenues

B.1.1.1 Developments in the EU

Own resources make up the largest part of the EU budget's revenue side and the amount of own resources is always defined for each Member State in the EU budget for the given financial year. These are revenues contributed to the European Union pursuant to Article 311 of the TFEU[101] to finance the EU budget.

Total contributions of own resources by EU Member States were budgeted at €142,268.6 million for 2016, with the Czech Republic's contribution set at €1,588.8 million. During 2016 the Commission revised its forecast for TORs (i.e. customs duties and sugar levies) and the VAT and GNI bases, and included the relevant corrections (correction mechanism) for Great Britain, and accordingly revised the amounts making up the revenue side of the EU budget. This led to a change in the way Member States' contributions to the EU budget were broken down. During the year the Commission proposed two amendments to the general budget for 2016 with an impact on the revenue side of the budget. The draft amending budget[102] issued by the Commission in September 2016 reduced EU Member States' total contributions in own resources to €133,642.5 million, with the Czech Republic's own-resources contribution reduced to €1,547.3 million.

On 5 October 2016 the Commission issued a report[103] analysing the operation of the inspection arrangements for TORs in the years 2013 to 2015. For its oversight of the TORs collection system the Commission can perform several types of checks: checks on regulations, checks on documents and on-the-spot inspections. The system of TORs checks contributes to the protection of the EU's financial interests and improves compliance with EU rules. The financial impact is significant: in 2013–2015 Member States provided an additional sum of approx. €348 million to the EU budget.

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101 Consolidated wording of the *Treaty on the Functioning of the European Union, Official Journal of the European Union*, C 115, 9 May 2008.

102 *Draft amending budget no. 4 to the general budget for 2016 – Update of appropriations to reflect the latest developments on migration and security issues, reduction of payment and commitment appropriations as a result of the Global Transfer, extension of EFSI, modification of the staff establishment plan of Frontex and update of revenue appropriations (own resources)*, COM (2016) 623, final wording of 30 September 2016.

103 Report from the Commission to the European Parliament and the Council: *Eighth report from the Commission on the operation of the inspection arrangements for the own resources system (2013–2015) (Article 18 (5) of Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000),* COM (2016) 639, final wording of 5 October 2016.

In the 2013–2015 period the Commission carried out 86 inspections under Article 18 of Regulation No 1150/2000[104]. Of the 288 findings noted, 122 (i.e. 42.36%) had a direct financial impact and 63 (i.e. 21.88%) a regulatory impact. The inspections targeted customs duties and the accounting for finances on a separate account (known as Account B) in combination with corrections on the standard account (Account A).

Since 1 May 2016 new customs legislation[105] has been applicable and, after ratification by Member States, a new own resources legislative framework for the period 2014–2020 will be retroactively applied from 1 January 2014.

In May 2016 the Council issued a regulation[106] altering the way in which own resources (collected by Member States) are credited to an account in the Commission's name with the national treasuries or national central banks. The procedure for adjusting own resources from VAT and GNI is being streamlined in the interest of simplification and in order to reduce the fiscal strain on Member States and the Commission, especially towards the end of the year.

B.1.1.2 Developments in the CR

In its recommendations concerning the *2016 National Reform Programme of the Czech Republic* and in its opinion on the *2016 Convergence Programme of the Czech Republic* (see also subsection A.1.2), the Council states that the available evidence points to a relatively high incidence of tax evasion in the Czech Republic. In particular, the Council mentions the area of VAT. As the principle of carousel fraud is based on the sequential delivery of goods between EU Member States, it is clear that the high rate of VAT fraud applies to the EU as a whole and not just the CR. The differences between Member States are also significantly influenced by the differing degrees to which fraud is detected in these countries.

The Czech government based its measures in the fight against VAT evasion[107] on three interconnected pillars: the reverse charge mechanism[108], control statements and electronic sales records.

The reverse charge mechanism was applied to domestic transactions in the Czech Republic in recent years and its application has been extended to selected types of goods and services. The reverse charge mechanism has been used for real estate since January 2016 and for supplies of natural gas and electricity since February 2016. The Czech Republic would welcome it if the Commission were to make use of a legislative initiative to propose the award of a temporary exemption for the broad application of the reverse charge mechanism.

Applying the reverse charge mechanism across the board, i.e. to all taxable supplies, would be possible only if there is an overall conceptual change and reworking of the EU legislation (then this measure could be made mandatory for all Member States) or on the basis of an individual exemption awarded by an implementing decision of the Council. Along with three other countries, the Czech Republic requested from the Commission an exemption for the broader application of this mechanism, but the Commission rejected the request. For that reason the Czech Republic wants to test the possibility of broader application of the reverse charge mechanism via a pilot

104 Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources.

105 Regulation (EU) 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code; Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code; Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) 952/2013 of the European Parliament and of the Council laying down the Union Customs Code.

106 Council Regulation (EU, Euratom) 2016/804 of 17 May 2016 amending Regulation (EU, Euratom) No 609/2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements, *Official Journal of the European Union*, L 132, 21 May 2016.

107 *2016 National Reform Programme of the Czech Republic.*

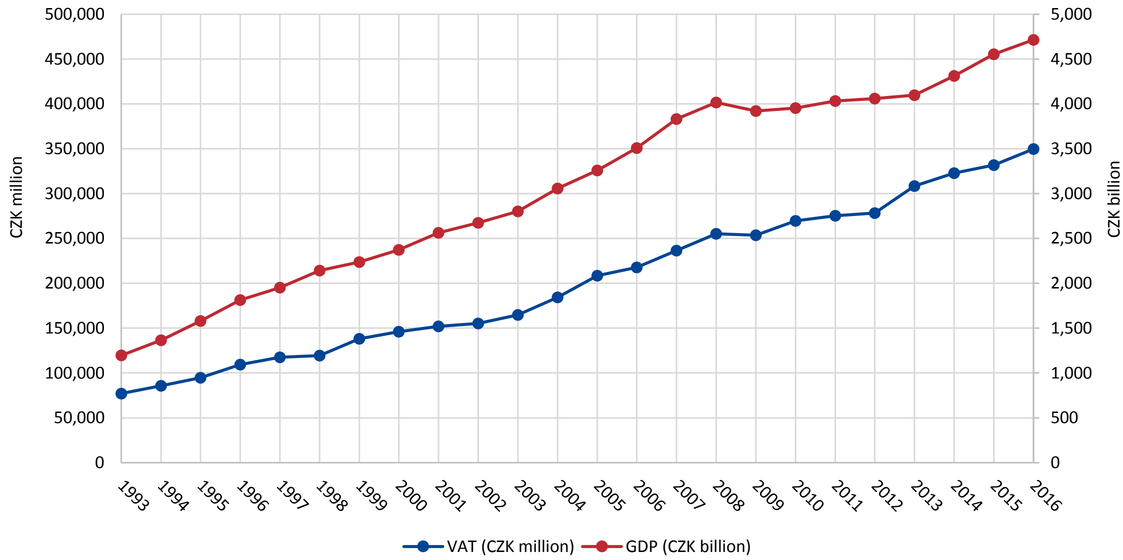
108 VAT is returned and paid by the payer for whom the taxable supply was performed.

project[109]. The Czech authorities *are seeking the introduction of the mechanism for supplies exceeding €10,000 in the form of a temporary exemption*.

Opinions on the use of the reverse charge mechanism as a final solution to VAT fraud differ in the EU. In its action plan on VAT[110] (VAT Action Plan), the Commission promotes a different system, where the supplier of goods collects VAT from its customer – the Commission intends to extend this system to cross-border transactions (for more details see subsection B.1.2.1).

One of the most important measures the Czech Republic introduced to implement the Council's VAT-related recommendations from previous years was control statements. According to MoF information[111], VAT collection amounted to CZK 349.7 billion in 2016, a year-on-year increase of CZK 17.9 billion.

Chart 12: Evolution of GDP and VAT collection in 1993–2016



Source: Data from the Financial Administration of the CR and Czech Statistical Office.

The chart shows that VAT collection has displayed continual growth as GDP has increased and in line with other influences, and the result for 2016 does not significantly exceed the year-on-year collection increases from previous years. The impact of the introduction of control statements on VAT collection is therefore not clear.

The Council's recommendations draw attention to the fact that the CR is not planning any measures to reduce the relatively high costs associated with paying tax or any measures to simplify the tax system. Form pre-filling services offered by the tax authorities are limited. Taxpayers also make limited use of systems to e-file tax returns, although some progress has been made on VAT in this regard. According to the most recent international reports, the costs of tax collection are moreover relatively high. High employer social contributions contribute to an overall high level of taxation on labour, and diversification into other areas, such as property taxes, is limited.

109 Babiš A.: *The Ministry of Finance is trying to promote the transferred tax obligation in several ways,* www.mfcr.cz, 19 November 2015.

110 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT: *Towards a single EU VAT area – Time to decide,* COM92016) 148, final wording of 7 April 2016.

111 Presentation of the Financial Administration of the CR of 6 March 2017: *Evaluation of the effects of control statements and broadening of the possibility of waiving fines.*

From 1 December 2016 the Czech Republic introduced electronic sales records. According to the substantiation of the need for this mechanism, the project should lead to both increased tax collection and a reduced administrative burden for tax administrators while improving the effectiveness of their work.

The Cobra[112] team also participates in the fight against tax evasion in the CR. The team's members counter against tax evasion and tax crime, mainly in the fields of value added tax and excise duties.

B.1.2 European Union regulations in the area of Member States' revenues

EU initiatives in the area of tax policy in 2016 mainly focused on the deepening of the general principles in the administration of corporation tax (tax on the income of legal persons, mainly for large enterprises) and the common system of value added tax. For these taxes the Commission is proposing fundamental systemic changes that will impact on both tax administrators and taxpayers in the years up to 2021. As regards excise duties, some material-law amendments to the regulations were adopted and Council Directive No 92/83/EEC on the harmonization of the structures of excise duties on alcohol and alcoholic beverages was assessed.
The measures mainly apply to large and very large enterprises and should contribute to tax fairness with regard to small taxpayers. The proposals should simplify the fulfilment of tax obligations for small taxpayers and provide a level playing field for enterprises.

The Commission moreover withdrew certain proposals from previous years[113].

B.1.2.1 Value added tax

The single VAT system is a key element of the European single market. In April 2016 the Commission issued a VAT Action Plan intended to simplify the current VAT system in the European Union, making it less open to abuse and simultaneously friendlier to enterprises. The VAT Action Plan sets out principles for the future single EU VAT area, short-term measures for combating VAT fraud, plans to review reduced VAT rates, proposals for simplifying VAT legislation, principles for e-commerce and the announcement of a package of VAT measures intended to bring relief to SMEs.
The current VAT system was originally meant to be a transitional system and is complicated and fragmented for businesses operating across borders. It is open to fraud, because domestic and cross-border transactions are treated differently and goods or services can be bought free of VAT within the single market. The gap between expected and actually collected revenues from VAT was estimated at around €170 billion[114] in 2015, with cross-border fraud alone amounting to approx. €50 billion of revenue loss each year.

The existing VAT system therefore needs modernising so that it is simpler, more effective and better able to combat the growing risk of fraud. For that reason, the Commission is preparing

112 "Tax Cobra" is a joint team of the National Centre against Organised Crime, the General Financial Directorate and the General Directorate of Customs.

113 Proposal for a Council Regulation laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, COM(2007) 746, final wording of 28 November 2007; Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services, COM(2007) 747, final wording of 28 November 2007; Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards a standard VAT return, COM(2013) 721, final wording of 23 October 2013; Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC, COM(2011) 594, final wording of 28 September 2011; Proposal for a Council Regulation on the methods and procedure for making available the own resource based on the financial transaction tax, COM(2011) 738, final wording of 9 November 2011. Source: *Official Journal of the European Union,* C 155 of 30 April 2016 (2016/C 155/04).

114 CASE*, Study to quantify and analyse the VAT Gap in the EU Member States*.

a legislative proposal to put in place a definitive VAT system that will rest on the principle of taxation in the country of destination of goods. This means that the taxation rules according to which the supplier of goods collects VAT from his customer will be extended to cross-border transactions. According to the Commission, this change should help reduce cross-border VAT fraud by €40 billion per year. The European Parliament and the Council have agreed on this definitive VAT system. After many years of unsuccessful attempts, the Commission abandoned the objective of implementing definitive VAT arrangements based on taxing all cross-border supplies of goods in the Member State of their origin, under the same conditions that apply to domestic trade, including VAT rates. The Commission continues to permit this system as an exception, stating that it will review it on the grounds of existing risks.

One related measure should be **strengthening the tools currently used in Member States** when exchanging information on VAT fraud and fraudulent procedures and sharing tried-and-tested procedures (*Eurofisc*). The existing tools of administrative cooperation are not being sufficiently exploited. Competent officials working in *Eurofisc* should have direct access to relevant information held in different Member States, enabling them to exchange, share and analyse key information and launch joint audits (the measure should be presented in 2017).

The reverse charge mechanism (VAT is reported and paid by the payer for whom the taxable supply was performed) has been introduced and expanded in recent years in the CR. The Commission continues to permit this system as an exception, stating that it will review it and identify its risks.

The VAT Action Plan also sets out two ways of enabling greater flexibility in the introduction of reduced tax rates by Member States. Under the current rules, Member States wanting to apply a zero or reduced VAT rate must adhere to a predetermined list of goods and services. The Commission wants to modernise the rules for setting rates and give Member States more room for decision-making in future. The first option is to maintain the minimum standard rate of 15% and regularly review the list of goods and services that can benefit from the application of a reduced rate (Member States would be able to submit to the Commission their views on the needs for adjustment). The second option is to abolish this list. That would make it necessary, however, to have safeguards preventing fraud on the single market and unfair tax competition. In addition, the cost of complying with the new rules could rise for enterprises. The currently used zero and reduced rates would be maintained under both options.
A standard rate of 15% will be applied with effect until 31 December 2017. In December 2016 a proposal was presented for a Council directive[115] allowing Member States to apply the same system for electronic publications as for printed books, i.e. reduced and super-reduced VAT rates. The reduced rate applicable to printed publications in the Czech Republic, for example, is 10%. The aim of this legislation is to respond to technological and economic developments.

The existing VAT system for e-commerce between multiple Member States is complex and costly for both Member States and businesses. EU businesses are at a competitive disadvantage; as non-EU suppliers can supply VAT-free goods to consumers in the EU. The complexity of the system also makes it difficult for Member States to ensure compliance. For these reasons the Commission presented a set of legislative proposals on 1 February 2016 designed to modernise VAT for cross-border B2C e-commerce. These are three proposals for Council regulations[116] changing the VAT system.

115 Proposal for a Council Directive amending Directive 2006/112/EC, as regards rates of value added tax applied to books, newspapers and periodicals, COM (2016) 758, final wording of 1 December 2016.

116 Proposal for a Council Regulation amending Council Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax, COM(2016) 755, final wording of 1 December 2016; Proposal for a Council Regulation amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sale of goods, COM(2016) 757 final wording of 1 December 2016; Proposal for a Council Implementing Regulation amending Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, COM(2016) 756, final wording of 1 December 2016.

The impacts[117] of the proposed modernisation of VAT for cross-border e-commerce were assessed by the Commission, which found that without a concerted approach at EU level VAT measures adopted at the national level alone will not resolve the issues, so the VAT Directive[118] will need to be amended.

A Council directive[119] of 27 June 2016 set additional rules for the time and place of supply of goods and services and the chargeability of VAT by means of vouchers. The directive introduces a definition of single-purpose and multi-purpose vouchers. Whereas in the case of single-purpose vouchers the transfer of the single-purpose voucher is regarded as a supply of goods or services, in the case of multi-purpose vouchers the actual provision of the service or the actual handing over of the goods is regarded as the supply of goods or services. The directive also sets rules on the chargeability of VAT for services related to the supply of goods or services by means of vouchers (e.g. distribution or promotion services). The directive will be effective from 1 January 2019 and will apply to vouchers issued after 31 December 2018.

B.1.2.2 Excise duties

During 2016, rules were repeatedly adopted on the compulsory data provided in EMCS[120], the system for monitoring the movement of goods between EU Member States.

In October 2016 the Commission presented a report[121] to the Council stating that the directive was only partially effective in achieving its objectives. Shortcomings were found in the following areas:

- the classification of certain products (in particular “other fermented beverages”) into a tax category;
- the interpretation of the regulations on the tax exemption for denatured alcohol, where EU Member States apply different rules;
- the lack of options for Member States to apply reduced rates to small producers.

A Commission implementing regulation[122] establishing a common denaturant within the EU will enter into force from 1 August 2017. According to publicly available sources, however, the MoF regards the common denaturant as insufficient and easy to remove. Cases were identified in the past in the Czech Republic where spirits contained denaturing agents in contravention of the legislation and also cases where they were removed.

B.1.2.3 Corporation tax

The issue of tax fraud and aggressive tax planning in the field of corporation tax is a worldwide problem. Attempts to tackle it are being made by countries of the G20[123], OECD[124] and the EU authorities. Attempts to resolve this problem at national level alone are generally ineffective.

117 Commission staff working document – *Executive summary of the Impact Assessment accompanying the document Proposals for a Council Directive, a Council Implementing Regulation and a Council Regulation on modernising VAT for cross-border B2C e-commerce,* SWD (2016) 382, final wording of 1 December 2016.

118 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

119 Council Directive (EU) 2016/1065 of 27 June 2016 amending Directive 2006/112/EC as regards the treatment of vouchers, *Official Journal of the European Union*, L 177, 1 July 2016.

120 The EMCS (*Excise Movement and Control System*) is a computerised system for monitoring the movement of products subject to excise duties.

121 Report from the Commission to the Council on the evaluation of Council Directive 92/83/EEC on the structures of excise duties on alcohol and alcoholic beverages, COM (2016) 676, final wording of 28 October 2016.

122 Commission Implementing Regulation (EU) 2016/1867 of 20 October 2016 amending the Annex to Regulation (EC) No 3199/93 on the mutual recognition of procedures for the complete denaturing of alcohol for the purposes of exemption from excise duty, *Official Journal of the European Union,* L 286, 21 October 2016.

123 The G20 is the group of the world’s biggest economies represented by finance ministers and central bank governors. The G20’s members are 19 countries and the European Union.

124 The OECD (*Organisation for Economic Co-operation and Development*) is an intergovernmental organisation of 35 highly developed countries.

Eliminating aggressive tax planning and practices designed to avoid tax is a key challenge. In January 2016 the Commission informed[125] the European Parliament and the Council of new initiatives following up the OECD action plan approved by the G20 to combat tax base erosion and profit shifting (BEPS[126]). In a communication from July 2016[127] the Commission recapitulated the progress made to date and set out priority areas for action in the coming period at both EU level and at international level to strengthen the fight against tax evasion, tax avoidance and illicit financial activity. The priorities listed by the Commission included a revision of the Directive on Administrative Cooperation in the field of taxation and amendments to the Fourth Anti Money Laundering Directive. The Commission's principal activities include preparing a proposal to re-launch the Common Consolidated Corporate Tax Base (CCCTB[128]) and drawing up its own list of "non-cooperative jurisdictions".

At the beginning of 2016 the Commission presented an anti-tax avoidance package that contained a framework communication[129], proposals for directives[130] and recommendations concerning tax treaties[131] and a study on aggressive tax planning. On 25 May 2016 the Council adopted an updated directive[132] on automatic exchange of information between national tax administrations, based on the Commission's proposal[133]. The updated directive establishes a requirement for Member States to oblige multinational enterprise groups to submit relevant information (country-by-country reports) and automatically to exchange this information with other concerned Member States.

Transparency is being further boosted by a proposal for a directive[134] of April 2016 designed to make it compulsory for multinational enterprise groups with a net consolidated turnover exceeding €750 million to publish data on their revenues, profits, taxes paid and number of employees in every country in which they operate. These data will be publicly available. The threshold value should cover 90% of the turnover of all multinationals.

In July 2016 the Commission proposed[135] a revision of the Fourth Anti Money Laundering Directive[136].

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125 Communication from the Commission to the European Parliament and the Council – *External Strategy for Effective Taxation*, COM (2016) 24, final wording of 28 January 2016.

126 *Base Erosion and Profit Shifting*.

127 Communication from the Commission to the European Parliament and the Council – *Communication on further measures to enhance transparency and the fight against tax evasion and avoidance,* COM (2016) 451, final wording of 5 July 2016.

128 *Common Consolidated Corporate Tax Base*.

129 Communication from the Commission to the European Parliament and the Council – *Anti-tax avoidance package: Next steps towards delivering effective taxation and greater tax transparency in the EU,* COM (2016) 23, final wording of 28 January 2016.

130 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the single market, COM (2016) 26, final wording of 28 January 2016; Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM (2016) 25, final wording of 28 January 2016.

131 Commission Recommendation (EU) 2016/136 of 28 January 2016, on the implementation of measures against tax treaty abuse, notified under document C (2016) 271, *Official Journal of the European Union*, L 25, 2 February 2016.

132 Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, *Official Journal of the European Union,* L 146, 3 June 2016.

133 Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM (2016) 25, final wording of 28 January 2016.

134 Proposal for a Directive of the EP and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches, COM (2016) 198, final wording of 12 April 2016.

135 Proposal for a Directive of the EP and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and Directive 2009/101/EC, COM (2016) 450, final wording of 5 July 2016.

136 Directive of the European Parliament and of the Council (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC and Commission Directive 2006/70/EC, *Official Journal of the European Union,* L 141, 5 May 2015.

The aim of the Commission's initiative in the proposed legislation[137] is to enable tax authorities to have constant access to the information necessary for the fight against money laundering so that they can carry out their duty to monitor the proper application of the Directive on Administrative Cooperation by financial institutions.

On 12 July 2016 the Council adopted a directive[138] plugging many of the loopholes exposed by the "LuxLeaks" scandal. This directive establishes measures against tax avoidance in the form of excessive borrowing costs and defines them (e.g. interest), tackles exit taxes (transfer of an enterprise's assets), establishes a general rule against abuse of a tax system (ruling out arrangements that are not genuine), and defines rules for controlled foreign companies.

In October 2016 the Commission presented a proposal for a directive[139] focusing on the "first step" of a staged approach to defining a common corporate tax base. It is limited to the elements of the common base, i.e. the rules for calculating the common corporate tax base, including certain provisions against tax avoidance and on the international dimension of the proposed tax system. The proposal covers two additional topics. These are the rules against debt bias and a super-deduction given for research and development. A company that applies the rules of this directive will cease to be subject to national corporate tax regulations in respect of matters regulated by this directive, unless otherwise stated (one of the conditions is that the group's total consolidated revenue exceeds €750 million for the financial year).

B.1.3 Current developments in the legislation on revenues in the CR

During 2016 there were legislative amendments[140] in the field of VAT that extended the reverse charge mechanism (RCM) with effect from 1 February 2016 for traders in gas and electricity and for transfers of allowances for greenhouse gas emissions. A change in the legislation also allowed the RCM to be applied, by contractual agreement, to selected goods regardless of the CZK 100,000 threshold and, with effect from 1 October 2016, to the provision of electronic communication services provided under contracts on connection or access pursuant to Section 78 et seq. of the Act on Electronic Communications[141]. This change means that the tax obligation is transferred in the case of access to voice services, data services, virtual networks services, connection to public communication networks and advance sale of electronic communication services.

In connection with the adoption of the Act on Electronic Sales Records[142], VAT changes[143] with dual effect were introduced.

137 Proposal for a Council Directive amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities, COM (2016) 452, final wording of 5 July 2016.

138 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, *Official Journal of the European Union,* L 193, 19 July 2016.

139 Proposal for a Council Directive on a Common Corporate Tax Base, COM (2016) 685, final wording of 25 October 2016.

140 Government resolution no. 11/2016 Coll., amending government resolution no. 361/2014 Coll., specifying the supply or goods or provision of services for the use of the reverse charge mechanism, as amended by government resolution no. 155/2015 Coll.; government resolution no. 296/2016 Coll. amending government resolution no. 361/2014 Coll., specifying the supply or goods or provision of services for the use of the reverse charge mechanism, as amended.

141 Act No. 127/2005 Coll., on electronic communications and amending certain related acts (Act on Electronic Communications).

142 Act No. 112/2016 Coll., on sales records.

143 Act No. 113/2016 Coll., amending certain acts in connection with the adoption of the Act on Sales Records.

The following VAT changes are effective from 1 May 2016:

- rules on the electronic form of submission in Section 101a, whose subsection 3 now specifies permissible forms of electronic submissions in respect of VAT, so the general rules laid down in Section 71 of the Tax Code[144] do not apply;
- a change in the legal qualification of mandatory electronic submissions in respect of VAT in Section 101a (4), which provides that the wrong format or structure of a data message makes the submission null and void and causes it to be treated as non-submitted.

On 1 February 2016 the reduction of VAT from the previous 21% to 15% entered into force for all restaurant and hospitality services bar the sale of alcoholic beverages and cigarettes. This rule does not apply to catering services provided in connection with education (Section 57), i.e. meals for pupils in school canteens, or catering services provided in connection with the provision of healthcare services (Section 58) and in connection with the provision of social services (Section 59), which the Act on VAT exempts from tax without any entitlement to a tax deduction.

In connection with the entry into force of the new Customs Act[145], adopted in response to the new Regulation (EU) No 952/2013[146] of the European Parliament and of the Council, certain other acts were amended. The changes were mainly technological in nature and seek to ensure that domestic law is consistent in its use of terminology and does not conflict with the EU Customs Code and new Customs Act. Going beyond the amendments made necessary by the new EU Customs Code, exemption from VAT when releasing goods into a duty free zone[147] was abolished because of tax fraud. Now, the supply of goods in a duty free zone and the provision of services linked to these goods is a taxable supply.

On 1 January 2017 a tax on gambling games became part of Czech law, replacing the previous contribution levied on lotteries and other similar games[148]. The tax on gambling games was adopted as part of the reform of the regulation of the operation of gambling games, which comprises the Act on Gambling Games[149] and the so-called "Amendment Act"[150] as well as the Act on Taxation of Gambling Games[151]. The new Act on gambling games also deals with the issue of the cross-border operation of gambling and the criticism of the CR concerning breach of fair competition.

As one of the measures against aggressive tax planning, the Act on Income Tax[152] incorporated a rule consisting in the non-application of the exemption of profit shares flowing into the CR if the related amounts are tax-deductible in the Member State of the payer. The Czech Republic reduced the high tax burden on labour by means of discounts provided to payers of natural persons' income tax, not by shifting taxation to other areas. In particular, this involves the establishment of staggered discounts on natural persons' income tax for a second and further child and the gradual increase of these discounts. Another measure was the establishment of a tax discount for putting a child in a pre-school childcare facility up to the level of the minimum wage.

144 Act o. 280/2009 Coll., the Tax Code.
145 Act No. 242/2016 Coll., the Customs Act.
146 Regulation (EU) 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast).
147 10 duty free zones are permitted in the Czech Republic, which, bar Croatia, where free zones are established for utterly specific reasons, is more than in any other Member State.
148 Act No. 202/1990 Coll., on lotteries and other similar games.
149 Act No. 186/2016 Coll., on gambling games.
150 Act No. 188/2016 Coll., amending certain acts in connection with the adoption of the Act on Gambling Games and the Act on Taxation of Gambling Games.
151 Act No. 187/2016 Coll., on taxation of gambling games.
152 Act No. 586/1992 Coll., on income tax.

B.1.4 Audit work in the field of revenues in the period under scrutiny

B.1.4.1 Audit work by the EU

In March 2016 the European Court of Auditors published Special Report[153] No. 24/2015 – *Tackling intra-Community VAT fraud: More action needed*. This audit focused on the system for combating intra-Community VAT fraud and found that the control system is not sufficiently effective and that some of the adopted measures need to be strengthened or applied more rigorously[154].

B.1.4.2 Audit work by the SAO

The Czech government has declared the intention to simplify tax collection in its strategic documents since 2010, but significant progress has not been made. In 2016 the Supreme Audit Office completed an audit[155] scrutinising spending since 2008 on measures linked to simplifying the collection and administration of taxes and insurance premiums, and in particular the project for a Single Collection Point for state budget revenues (SCP). The SAO stated that the target state of establishing the SCP had still not been achieved in 2015. That was despite more than CZK 3 billion being spent on the project. The Managing Authorities of the SCP project did not carry out their duties and flouted the principles of efficiency and economy when spending money. No timetable has existed for the project since 2013, which was one of the reasons that the project had still not been officially completed in 2016. Moreover, there was no legislation governing the SCP.

Up to 2013, the establishment of the SCP formed part of tax system reform in the National Reform Programme of the CR. The audit found that the kind of legislative, agenda and information technology changes making it possible to merge the collection functions of the financial administration, customs administration, social security administration and Universal Health Insurance Company had not been carried out at any of these organisations. Over the eight years of developing the SCP there has been no significant simplification of the tax system or related savings.

According to the audit results, there are ways to simplify the administration of taxes and insurance premiums and make savings on the side of both taxpayers and the state. That can be achieved mainly by ensuring that procedures in the administration of tax and insurance premiums are mutually compatible, the performance of tax and insurance premium administrators is optimised and the standard of information sharing among administrators is improved.

Since 2014, the Council of the European Union's recommendations regarding the National Reform Programme of the CR have repeatedly drawn attention to the need to shift the tax burden from labour to other areas, e.g. to regularly paid property taxes, which are relatively low in the CR. In 2016 the SAO completed an audit[156] focusing on the taxation of real estate and transfers of real estate and property acquired by inheritance and gifts. The SAO's audit findings tally with the Commission's conclusions set out in country reports on the Czech Republic for the given year and with the Council's recommendations.

153 Special reports are official written outputs by which the ECA informs about the results of selected performance and compliance audits targeting specific areas of the EU budget or topics linked to administration and governance. The ECA selects and designs these audit tasks in a way ensuring their impact is maximised, while taking into account performance and compliance risks, the volume of the relevant revenues or expenditure, expected developments, political interests and the public interest. The full wording of published special reports is available at www.eca.europa.eu.

154 For more details, see *EU Report 2016.*

155 Audit no. 15/17– *Funds spent on measures related to streamlining of tax and insurance collection and administration, mainly within the project "Setup of Single Collection Point for State Budget Revenues".*

156 Audit no. 15/15 - *Taxation on real estate, real estate transfers and property acquired by inheritance or gift.*

Based on the results of the audit, the SAO recommended examining the question of property taxation, as the effectiveness of the administration of property taxes is low compared to the effectiveness of the administration of other taxes and revenues acquired as gifts are almost impossible to control with regard to their inclusion in income tax.

At the end of 2016 the SAO completed an audit[157] targeting the effectiveness of the administration of excise duties, which it performed in cooperation with the SAI of the Slovak Republic (SAI SR). The effectiveness of the administration of excise duties and energy taxes is high compared to other tax revenues in the CR. That is caused by the rate of taxation and the extent of oversight, but even so there is room for annual cost savings running into the tens of millions of Czech crowns. That is despite the fact the excise duties administration system has not been simplified, administrative costs have not been reduced (on the contrary, they are rising slightly) and energy taxes' share of total tax revenues is not growing, which goes against the strategies of both the government and the EU.

Sufficiently precise information is not available for an international comparison of the effectiveness of the administration of excise duties. Compared to other EU Member States, excise duty rates in the CR are average or slightly below average, but they are high relative to purchasing power (that applies particularly to tobacco, alcohol and fuels). That provides motivation for obviating the legal regulations. The rates of energy taxes on gas, electricity and especially solid fuels are low in the CR.

The SAO also assessed the impacts of the launch of two projects. In the case of the *Modernisation of the Customs Administration of the CR* the SAO concluded that fundamental changes to processes, downsizing of the organisational structure, reduction of the workforce and increased effectiveness of processes were not delivered. The objectives that led to approx. CZK 51 million being spent on the project were achieved only partially and the equivalent could have been achieved while retaining the original governance structure. The key goals of the project entitled *Comprehensive Introduction of Process Management and Process Optimisation in the Customs Administration of the Czech Republic*, on which approx. CZK 17 million was spent, have not yet been achieved. Processes under the competence of the Customs Administration of the CR were not made more effective, strategic management registered no significant quality improvement and there was no reduction in paperwork as a result of the modification of processes. The SAO's audit conclusion declared that the General Directorate of Customs used the funding for the defined purpose and integrated process management into its governance of the organisation, but the implementation process had still not been fully completed and the benefits of introducing process management were not evident. Strategic management and process management are not oriented towards customers and economic indicators (effectiveness and economy).

Based on the results of its audit, the SAO recommended pushing ahead with the digitalisation of excise duty administration (in particular online data transfer and automatic data processing) and also recommended that the Customs Administration of the CR should be conceived as a control authority of state administration in which ordinary administrative tasks, including decision-making in administrative proceedings, should be minimised.

157 Audit 15/33 – *Administration of excise duties.*

B.1.5 Protection of the EU's financial interests and the fight against fraud in the area of revenues

In connection with the continuing fight against fraud on the revenue side of the budget, a revision of Council Regulation (EC) No 515/97, which established an EU database on goods entering, transiting and leaving the EU[158], entered into force in 2015. The fight against cigarette smuggling and other forms of the illicit trade in tobacco products remains a high priority for the EU and Member States. The *Hercule III* financing programme is helping strengthen the operations and administrative capacities of Member States' customs and police forces. The *AFIS Project* deals with mutual assistance in customs matters and management of irregularities. The Anti-Fraud Information System (AFIS[159]) is a set of anti-fraud applications operated by OLAF under a common technical infrastructure and intended to ensure timely and secure exchange of fraud-related information between the competent national and EU administrations and storage and analysis of relevant data.

In the fight against VAT fraud, Member States are working together with the Commission to explore new ways of enhancing the *Eurofisc* network to speed up the detection of various forms of VAT fraud. These fraudulent operations exploit weaknesses in the way chains of transactions are checked as a result of the inclusion of counterparts based in third countries. Negotiations were opened between the EU and Norway in 2015 regarding an agreement on administrative cooperation on VAT.

There were 50 agreements in force in 2015 containing provisions on mutual administrative assistance with 73 countries; a partnership and cooperation agreement was signed with Kazakhstan; and talks were ongoing with the USA and Japan.

In the field of excise duties, anti-fraud measures targeted the application of markers to gas oils and kerosene, which are taxed at a lower national rate of excise duty than that applied to motor fuels used as propellants. As fraudulent activities consisting in the illegal removal of the marker substance had been on the rise, in September 2015 the Commission published a call for expression of interest to find a new, better performing chemical substance that could replace the existing marker and help prevent illegal activities involving diesel. This project will probably last several years.

Important steps were taken in previous years to strengthen the protection of the EU's financial interests on the revenue side of the budget. For the coming period the Commission recommended that Member States should cooperate closely and exchange experiences on instances where the customs authorities were particularly successful in detecting fraud or irregularities at the time of clearance and should adapt their customs control strategies to take account of the growing number of cases of voluntary admission of irregularities.

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158 Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters, *Official Journal of the European Union,* L 82, 22 March 1997.

159 *Anti-Fraud Information System*.

B.2 European Union budget expenditure in the CR

B.2.1 State of fulfilment of ex ante conditionalities

The introduction of “ex ante conditionalities” was one of the major changes in the preparation of the 2014–2020 programming period, which the Commission transposed into the ESIF regulations[160]. Failure to fulfil them would mean the suspension or non-provision of payments into the areas where the commitments were not complied with. The Commission has to verify Member States’ fulfilment of the ex-ante conditionalities.

Most of the 40 ex ante conditionalities defined for the Czech Republic in the Partnership Agreement were requirements to put in place a strategy in the selected areas or adopt legislation regulating areas of importance for the utilisation of EU funds. According to a report[161] by the Ministry for Regional Development (MfRD) submitted for the information of members of the Czech government at its session on 29 March 2017, the Czech Republic had fulfilled all the applicable ex ante conditionalities at national level as of 16 December 2016 and the state of fulfilment was being verified by the Commission. The final ex ante conditionality was verified on 9 February 2017.

Ex-ante conditionality *7.3 Other modes of transport*, for which it was agreed with the Commission that the part applying to water transport would be omitted (specific objective 1.2 *Improving infrastructure for greater competitiveness and greater use of inland water transport in the TEN-T main network*) from OP *Transport*, is deemed irrelevant (inapplicable) to the CR.

B.2.2 Designation

Article 124 (1) and (2) of Regulation (EU) No 1303/2013 of the European Parliament and of the Council provides that before submitting the first application for an interim payment Member States must notify the Commission of the date and form of designation of the Managing Authority and, where appropriate, the certifying authority. This designation is based on a report and statement of an independent audit body that assesses the fulfilment by the authority of the criteria relating to the internal control environment, risk management, management and control activities and monitoring. Under Czech government resolution no. 612 of 21 July 2014, the tasks of the independent audit body fulfil for the ESIFs Ministry of Finance (MoF), division 52 – Audit Body. Government resolution no. 918 of 12 November 2014 tasked MfRD-NCA with fulfilling the roles of the body that performs the designation of bodies; the MfRD-NCA performed the designation of bodies on the basis of the independent audit body’s report and notified the Commission accordingly.

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160 Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the *European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund,* and laying down general provisions on the *European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund* and repealing Council Regulation (EC) No 1083/2006.

161 The *8th Quarterly Report on the State of Implementation of the Ex Ante Conditionalities* was put before the Czech government in March 2017.

Table 5: State of designations as at 9 March 2017

Audit subject	Audit completion	Audit opinion	State of designations	Date of designation	Scope restriction/note
Monitoring system MS2014+	17 June 2016	unmodified	designated	NR	without restriction
Paying and Certifying Agency /PCA/	30 May 2016	unmodified	designated	NR	without restriction
OP *Employment 2014–2020* /OP Em/	5 June 2016	unmodified	designated	8 July 2016	restricted in the area of financial instruments
OP *Transport* /OPT/	29 June 2016	unmodified	designated	18 July 2016	restricted in the areas of ITI and financial instruments
OP *Environment 2014–2020* /OP En/	29 June 2016	unmodified	designated	18 July 2016	restricted in the areas of ITI and financial instruments and simplified reporting
Integrated Regional Operational Programme 2014–2020 /IROP/	18 July 2016	unmodified	designated	22 August 2016	restricted in the areas of ITI and financial instruments
OP *Prague – Growth Pole CR* /OPP GP/	22 July 2016	unmodified	designated	3 June 2016	restricted in the areas of ITI and financial instruments and simplified reporting
OP *Enterprise and Innovation for Competitiveness 2014–2020* /OP EIC/	11 August 2016	unmodified	designated	24 August 2016	restricted in the areas of ITI and financial instruments
OP *Research, Development and Education* /OP RDE/	11 August 2016	unmodified	designated	24 August 2016	restricted in the areas of ITI
OP *Technical Assistance 2014–2020* /OPTA/	2 September 2016	unmodified	designated	27 September 2016	without restriction
Interreg V-A – Czech Republic – Poland /INTERREG CR–PR/	13 September 2016	unmodified	designated	1 November 2016	without restriction
OP *Fisheries 2014–2020* /OPF14+/	Audit completed and designation carried out after the editorial deadline.				

Source: MoF – division AB information, March 2017.

The table shows that the CR did not meet the conditions for the submission of the first applications for interim payments under individual programmes until the second half of the programming period's third year, i.e. between June and November 2016.

The designated Managing Authorities for OPT, OPEn, IROP, OP PGP and OP EIC are restricted in the areas of ITI[162] and financial instruments[163]. The designated Managing Authority for OP RDE is restricted in ITI and the designated MA for OPEm is restricted in the area of the financial instruments.

162 **Integrated Territorial Investments** (ITI) are an instrument of territorial development enabling effective and transparent implementation of territorial strategy. The ITI instrument is based on the *Europe 2020* strategy and other documents at European and national level. New "metropolitan areas" were defined for the territory of the CR.

163 **Financial instruments** support investments through loans, guarantees, capital and other mechanisms for managing risk, possibly combined with technical support, interest rate subsidies or guarantee fee subsidies within the same operation. The obvious advantage of financial instruments is the possibility of long-term recycling funds over the long term; in addition, they help mobilise further public or private co-investments in order to address market failures in line with *Europe 2020*.

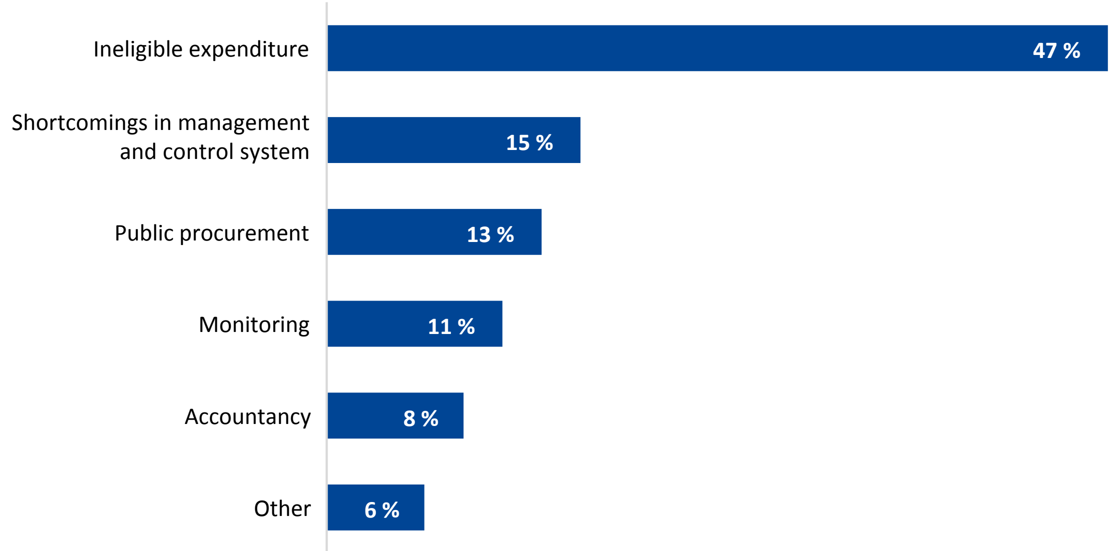
B.2.3 Analysis of the results of the SAO's audit work in the field of EU budget expenditure

In the period under scrutiny the SAO completed nine audits dealing with expenditure from the ESIFs to finance joint projects of the Czech Republic and EU. Seven of them focused on Cohesion Policy, with the other two covering CAP-related issues.

In its audits the SAO mainly examined the legality and regularity of operations and assessed whether spending was efficient and economical. In two cases the SAO also looked at the design and working of the system for implementing EU budget finances in the CR by auditing selected programmes.

The analysis reveals the incidence of breaches of the law, broken down by thematic area. The analysis does not feature findings where the 3E principles[164] were used as audit criteria.

Chart 13: Nature and incidence of breaches of the law identified by audits completed in the period under scrutiny, expressed as a percentage



Source: Audit Information System of the SAO, March 2017.

NB: The "Other" category mainly comprises breaches of the regulations on public administration, management of state property and regulations of the EP and of the Council.

Analysis of the SAO's audit findings during the period under scrutiny revealed that, unlike in the previous period[165], the incidence of the most numerous error item, i.e. ineligible expenditure, stagnated. There was a slight increase in the audit-identified error rate of management and control systems and in the area of the absence of appropriate monitoring indicators for assessing programmes (some indicators for assessing achieving of programmes' goals were non-specific or non-measurable). Conversely, there was a slight fall in the incidence of breaches of the Act on Public Procurement.

When the statistical results of the SAO's audit findings from audits targeting Cohesion Policy and the CAP for the period under scrutiny are compared with the results of the distribution of the estimated error rate reported by the ECA from audits in the same areas covering 2015[166], there is an obvious similarity despite the two institutions' different audit procedures

164 Economy, efficiency and effectiveness.

165 The 2016 calendar year commented on in the SAO annual report for 2016. The set of audits completed in the period under scrutiny matched the set analysed for the purposes of compiling the annual report to the degree of 33%.

166 *Annual Report of the Court of Auditors on the Implementation of the Budget concerning the Financial Year 2015*, Chapter 6, *Economic, Social and Territorial Cohesion* and Chapter 7, *Natural Resources* (agriculture, rural development, environment, climate action and fisheries).

and methods. **The most numerous type of shortcoming identified by both the SAO and ECA is the inclusion of ineligible expenditure in cost statements. The second most numerous group of the ECA's audit findings is ineligible projects/activities or beneficiaries. In the SAO's findings the second most numerous group is management and control system shortcomings, where the biggest factors are poor selection and assessment of projects (ineligible projects) and shortcomings in verifications done prior to commitment (assessing the eligibility of beneficiaries). For both the ECA and the SAO, the third group of identified shortcomings in terms of incidence was serious errors in public procurement.**

B.2.4 Economic, social and territorial Cohesion Policy

B.2.4.1 Current developments in economic, social and territorial Cohesion Policy

Allocation

According to the latest Commission information, €23.98 billion[167] has been earmarked for financing the ESIFs in the CR in the 2014–2020 programming period (including spending on RDP14+ and OPF14+) from the EU budget, with national funding to provide a further €8.31 billion. The current budget (main allocation) for implementing Cohesion Policy, i.e. after deducting the allocation to RDP14+ and OPF14+ (which are not part of Cohesion Policy, see subsection B.2.4) and the territorial cooperation INTERREG CR–PR programme (not included in the Partnership Agreement), is shown in the following table.

Table 6: Breakdown of the total allocation to Cohesion Policy in the CR by funds and their share of the total Cohesion Policy allocation

Fund	Allocation (€ millions)			Total share (%)
	Total	EU	CR	
CF	7,363.44	6,258.93	1,104.51	25.66 %
ERDF	17,107.42	11,940.69	5,166.73	59.60 %
ESF	4,217.31	3,430.00	787.31	14.69 %
YEI	14.80	13.60	1.20	0.05 %
Total	**28,702.97**	**21,643.22**	**7,059.75**	**100.00 %**

Source: Commission, https://cohesiondata.ec.europa.eu/countries/CZ, state as at 15 March 2017.

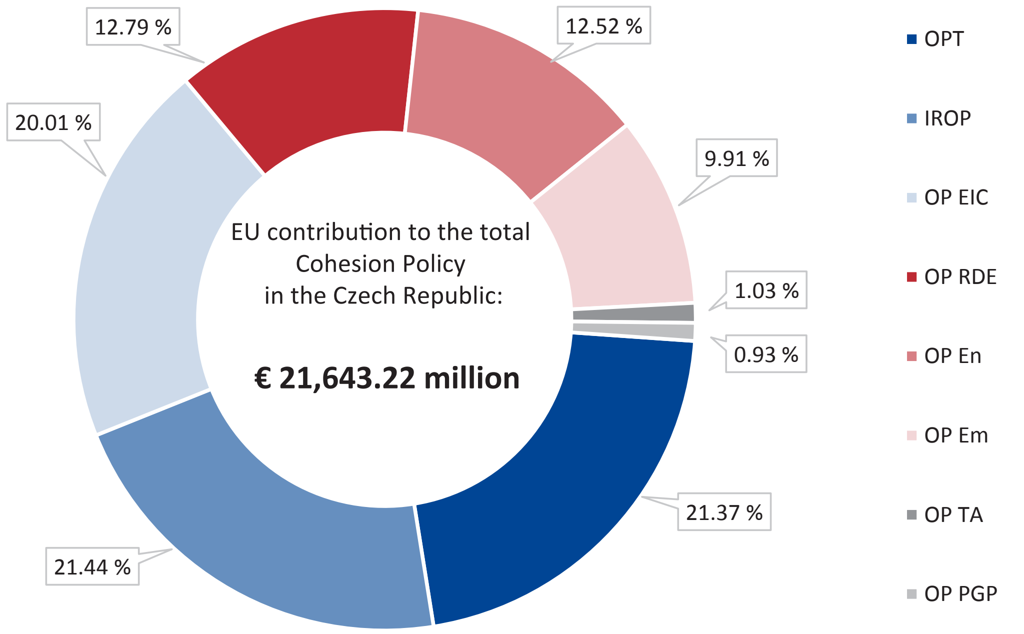
NB: The YEI source was reinforced 100% by ESF finances. . EU allocated for the CR in total €27,20 million for the YEI and €3,416.40 million for the ESF.

The largest amount of funding from the EU budget in the total allocation has gone to IROP (almost €4,641 million), followed by OPT (€4,622 million[168]) and OP EIC (€4,331 million).

167 This sum does not include the allocation of almost €0.23 billion to the cross-border cooperation programme INTERREG CR–PR.

168 The OPT allocation was reduced by €73.76 million and the OPEn allocation increased by the same amount.

Chart 14: OPs' percentage share of the total Cohesion Policy allocation



Source: *Partnership Agreement for the 2014–2020 Programming Period*; approved programme documents.

Calls announced in operational programmes for 2014–2020[169]

From the start of the 2014–2020 programming period to 28 February 2017, **a total of 389 calls have been announced for all operational programmes, with a total allocation of CZK 443.4 billion** (EU contribution), which represents almost **81% of the total allocation to Cohesion Policy** (not including the "performance reserve") **in this programming period.**

Table 7: Calls announced in individual OPs and their share of the main allocation of funds from the EU budget to Cohesion Policy

Operational programme	Number of calls	Volume of calls announced (billions CZK)	Share of announced calls in main (%)
OP EIC	93	72.6	66.0 %
OP RDE	33	46.8	66.6 %
OP Em	73	48.5	89.0 %
OPT	25	130.6	111.2 %
OP En	64	43.0	62.5 %
IROP	68	91.6	77.7 %
OP PGP	29	4.1	80.1 %
OPTA	4	6.2	109.1 %
Total	**389**	**443.4**	**80.7 %**

Source: MfRD – *Information on the state of drawdown of finances from EU funds in the 2014–2020 programming period*; March 2017; MS2014+, Managing Authorities, state as at 28 February 2017.

169 Not including RDP14+, OPF14+ and INTERREG CR–PR.

Drawdown of finances from Cohesion Policy funds

Table 8: State of drawdown of Cohesion Policy finances 2014–2020 as a % of the main allocation[170] as at 31 March 2017

Operational programme	Finances in legal acts to grant payments	Finances in reimbursed applications	Finances billed in payment applications	Finances in applications for interim payments
OP EIC	24.4	2.9	0.7	0.1
OP RDE	17.8	4.6	1.0	0.2
OP Em	58.6	14.9	10.0	6.7
OP T	23.0	7.1	6.1	1.0
OP En	10.0	4.1	2.1	0.1
IROP	18.1	0.2	0.3	0.0
OP PGP	7.3	0.7	0.3	0.0
OPTA	43.8	13.3	11.2	5.1
Total	**24.5**	**6.5**	**4.5**	**2.7**

Source: MfRD – *Monthly information on the implementation of the ESI funds in the Czech Republic in the 2014–2020 programming period*, March 2017.

As at 31 March 2017, applications for interim payments had been sent to the Commission under all programmes bar OP PGP.

As at the end of March 2017, i.e. in the fourth year of the seven-year programming period, the amount of finances involved in applications for interim payments reached just 2.7% of the main allocation to Cohesion Policy.

B.2.4.2 The SAO's audit work for the period under scrutiny

In volumes 4/2016 to 3/2017 of its bulletin the SAO published seven audits[171] that focused partly or wholly on finances from the expenditure side of the EU budget earmarked for Cohesion Policy. The SAO analysed the findings from the audits and divided them into two basic groups. The first group comprises systemic findings related to the design and working of management and control systems and the second group contains findings linked to project implementation.

Systemic findings at MCS level

The Financial Regulations of the EP and the Council for 2007–2013 and 2014–2020[172] set out the principles of sound financial management, i.e. the 3E principles. Specific, measurable, achievable, relevant and timed objectives must be set for all sectors of activity covered by the budget. Achievement of these objectives must be monitored by performance indicators for each activity.

Managing authorities very often fail to respect these principles and set objectives that are vague, impossible to verify and often only relate to the outputs and results of operations and only rarely their impacts. More detailed information is provided in points 1 to 3 below.

170 Not including RDP14+, OPF14+ and INTERREG CR–PR and the 6% performance reserves of other OPs.

171 Audit no. 15/26 – *EU and state budget funds spent within technical assistance for the activities related to publicity and promotion of operational programmes and projects implemented in the programming period 2007–2013;* audit no. 16/01 – *EU and state budget funds earmarked for financing interventions with the Operational Programme Enterprise and Innovation with the focus on the fulfilment of objectives;* audit no. 16/02 – *Funds earmarked for ICT and crisis management systems of units of the Integrated Emergency System;* audit no. 16/06 – *Funds earmarked for modernisation of the D1 motorway*; audit no. 16/10 – *Funds provided for the improvement of nature and landscape;* audit no. 16/11 – *State budget funds earmarked for creation of equal opportunities for persons with disabilities;* and audit no. 16/16 – *Funds earmarked for interoperability on the current railways.*

172 Council Regulation (EC, Euratom) No 1605/2002 and Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council.

At the systemic level, fewer errors were found in the setup of control systems and in programme publicity than in the past. More detailed information is provided in point 4 below.

1. **Design of the implementation framework, compilation and subsequent modification of programme documents, including the application of follow-up management steps**

   Audit no. 16/01

   For nine of the 19 scrutinised goals, it is hard to prove whether their qualitative characteristics as measured by the defined monitoring indicators were achieved. That even applies to the global objective, which is insufficiently specific and is non-measurable. These shortcomings were qualified as breaches of the EU regulations. Towards the end of the programming period the Ministry of Industry and Trade (MoIT) transferred the administrative control of payment applications and award procedures to the intermediate body, the CzechInvest agency, even though that contravened the Act on Financial Audit.

   Audit no. 16/10

   The Ministry of Environment (MoE) did not define quantifiable values to be achieved through the support, particularly with regard to the desired change to nature and the landscape.

2. **System for assessing and selecting operations according to programme documents**

   Audit no. 15/26

   Managing authorities did not assess the commensurateness of the budget when approving publicity and promotion; compliance with the principle of economy was therefore not assessed.

   Audit no. 16/01

   The MoI required beneficiaries to achieve binding indicators that were, bar exceptions, project outputs (area, number of machines, capacity). It only scrutinised results (e.g. increased productivity) through monitoring indicators that were non-binding. The MoIT made no attempt to check whether the values given were correct. The aforementioned setup of conditions can result in part of the provided support being ineffective. The SAO demonstrated that using the case of the project entitled *Slavičín Centre of Information Technologies and Applied Informatics.* When certain types of project were being assessed, the planned number of jobs to be created was taken into account. But even though this parameter had an impact on whether a subsidy was obtained or not, the MoIT did not bind the subsidy beneficiaries to create these jobs. The same applied to other parameters, e.g. reducing energy consumption, reducing waste generation etc. In the case of applicants with an unclear ownership structure the MoIT had to rely on the applicants' sworn statements regarding the size of the enterprise. This gave rise to a risk that applicants that were actually ineligible would receive support. The size of an enterprise could also change during project implementation. Although the MoIT laid down procedures in case of a change, it did not check systematically whether changes took place. In one case the SAO found that suspicions that an enterprise was of the incorrect size were not sufficiently checked, even though the MoIT had been warned of these suspicions. Shortcomings were also found in project selection: the MoIT approved a project that was completely ineligible for support; in the case of another project only some of the proposed activities were eligible. In one case the MoIT did not perform a full assessment of a project, but subsequently approved it anyway. The MoIT provided support to projects that were not eligible for it according to the programme document (the projects did not involve industrial entrepreneurs).

3. System of financial and substantive programme monitoring; impact on the assessment of the achievement of programmes' defined objectives

Audit no. 15/26

Some of the media campaigns aimed at the "general public" target group were not appropriately timed (e.g. TV and radio advertisements were aired at the very end of the 2007–2013 programming period). The Managing Authorities did not take into account the recommendations from interim evaluations of the communication plans to optimise the set of indicators for measuring the achievement of the objectives.

Audit no. 16/01

The SAO detected serious shortcomings in the aggregated data on jobs created, i.e. in the monitoring indicator of the result at the level of the entire OP, which is further aggregated into data at the level of the *National Strategic Reference Framework*. Duplicate reporting and the failure to respect the jobs methodology leads to huge differences. Monitoring the audited projects was the duty of the intermediate body (IB), the agency CzechInvest; the SAO found errors in the verification of binding indicators in approx. 8% of projects (5 out of 61). For example, the IB contented itself with data presented by the beneficiary in the monitoring report even though there were ways to verify the data. The MoIT set contradictory rules in the subsidy provision conditions for the possibility of reducing the target value of a binding indicator by over 10%. It stated that it was possible to request such a change. At the same time, however, it stated that a reduction of over 10% was not possible and would be rejected. In reality, however, it permitted such a change for certain beneficiaries. The SAO judged that to be a risk of unequal, discriminatory and non-transparent treatment. The SAO also assessed progress made towards objectives in individual support areas, priority axes and also the global objective according to the attained values of monitoring indicators. The result was: two priority axes fulfilled; three fulfilled partially; one not fulfilled; global objective of OPEI non-assessable.

Audit no. 16/10

The benefits of specific projects could not be assessed because the projects did not feature a specific quantified benefit for the desired state of nature and landscape. Assessing the efficiency of the money spent under OPEn was prevented by the fact that the MoE did not set specific and measurable targets to be achieved with the money. Despite the significant amounts spent, there was no major positive development in a number of indicators of the state of nature and the landscape; some even got worse in the period under scrutiny.

Audit no. 16/16

The Ministry of Transport (MoT) did not put in place a set of indicators making it possible to assess the effectiveness and efficiency of spending on ERTMS[173] projects under OPT and under the *Rail Transport Interoperability* programme. The MoT did not set a binding timetable for the introduction of the GSM-R and ETCS[174] systems. It did not respond to the delay in the roll-out of the ETCS compared to the original expectations. The project (construction) contractors for the infrastructure parts of GSM-R were not selected in a competitive environment.

173 *European Railway Traffic Management System*.

174 GSM-R is the communication platform for the European Train Control System (ETCS). It enables voice and data communication for the requirements of railway operation via on-board units located in railway vehicles. The GSM-R system can also be used for communication between railway operational staff (e.g. engine drivers, dispatchers, shunting team members and track labourers). It is the equivalent of a public mobile network but with special requirements for the quality and reliability of communication and with the option of functionalities specific to railway operation.

4. **Programme publicity**

   Audit no. 15/26

   The audit as a whole was designed as a cross-cutting audit of publicity in four selected OPs and focused on information and communication activities performed by the Managing Authorities. The MAs did not always perform information and promotion activities in a way ensuring their objective was achieved economically. Risks of uneconomical spending emerged as early as during the planning and preparation phase. The MAs did not assess the commensurateness of the budget when approving projects covering information and promotion activities. Consequently, the MAs did not assess compliance with the principle of economy in any of the audited projects. The principle of economy was also ignored when certain public contracts for publicity services were awarded. In many cases the MAs did not draw up analyses to calculate the expected value of the contracts or failed to document how and based on what materials the expected value was defined. Consequently, even the lowest candidate's bid might have been overvalued.

Findings at project level

A significant number of errors continues to be found in contractor selection, expenditure eligibility, the achievement of time-related, financial and substantive parameters of operations and the sustainability of operations. More detailed information is provided in points 1 to 4 below.

1. **Contractor selection and conclusion of contracts with contractors**

   Audit no. 15/26

   The economy principle was neglected when certain public contracts for publicity services were awarded; in many cases the Managing Authorities did not draw up analyses for calculating the expected value of contracts. Certain other errors were identified: e.g. breaches of the transparency principle or failure to perform ex ante verifications before concluding framework agreements.

   Audit no. 16/01

   Violations linked to contractor selection were found, i.e. obviation of the public procurement rules by splitting up the contract. The selection process did not lead to the firm with the most advantageous bid being selected. On the contrary, a contractor that should be have been excluded was selected. The wrong choice of assessment criteria, which impacted on economy of spending, and other violations of a formal nature were found.

   Audit no. 16/06

   Numerous award procedures lacked a sufficiently competitive environment, which could have had a negative impact on the prices of the public contracts. Based on the results of public procurement, the role of investor's technical supervisor was carried out by the authors of project documentation, which could have influenced the objectivity of the assessment of changes during construction owing to possible shortcomings in the construction documentation.

2. **Project/operation financing; expenditure eligibility, accounting for expenditure and financial audit; beneficiaries' claims for reimbursement of expenditure; final billing and financial closure of projects/operations.**

   Audit no. 15/26

   The purpose of distributing promotional items was not always clear; there was no clear link to the relevant target group: it was not clear who the items were provided to and for what purpose. Some of the reports from interim evaluations of communication plans in OP *Education for Competitiveness* and OP *Human Resources and Employment* drawn up during 2011 by various companies, received multiple funding out of public money.

Audit no. 16/01

Ineligible expenditure was found: e.g. failure to submit documents proving that work trips were related to the project; failure to submit elaborated project outputs (manuals) or to document the need for their elaboration; outsourcing of services the beneficiary could have taken care of itself.

Audit no. 16/02

Eligible expenditure was reduced during project implementation because no progress was being made towards of the main objectives of the project. Eligible expenditure was not reduced by the appropriate amount, however.

Audit no. 16/10

In the case of one project from priority axis 6 of OP *Environment 2007–2013*, the conditions set out in the subsidy provision decision were violated, as materials for the final assessment were not presented by the set deadline. The SAO judged this to constitute wrongful use of finances in respect of the provided sum of CZK 6.62 million and notified the appropriate tax administrator.

3. **Compatibility between operation goals and programme goals; attainment of the time-related, financial and substantive parameters of operations and sustainability.**

Audit no. 15/26

The goals relating to raising awareness of assistance provided from EU funds among the "general public" target group were not sufficiently measurable. The Managing Authorities did not choose suitable monitoring indicators as performance indicators, or failed to set initial and target values. The difficulty of measuring goals made it impossible to verify whether the goals were achieved; the MAs thus violated the principle of sound financial management.

Audit no. 16/02

Although the programme for an information system for the *Integrated Emergency System* (IES) significantly improved communication and coordination between IES units, the *National Information System of the Integrated Emergency System* (NIS IES) did not achieve at least five of the thirteen goals set by the General Directorate of the Fire Emergency Service (FES) in the project documentation. The Ministry of the Interior, for example, neglected project preparation, wrongly assuming that under the project it could manage and coordinate medical emergency services (MES) administered by the regions. That was ruled out for the ministry by the legislation, however, which the ministry failed to take account of in its plans. Under the NIS IES project, all components of the IES were meant to transfer mutual communication to an already developed integrated telecommunication network of the MoI. In the end, regional MES joined the said network in view of the support from European funds. There was one exception, however: the MES in Prague, which did not join the said network. Consequently, MES operators in Prague had to continue to pass on all information about call-outs to fire services and the police by telephone. The General Directorate of the FES also abandoned one aspect of the project, namely the establishment of a national system of emergency calls reception costing over CZK 150 million, which was meant to replace the various emergency call information systems the IES components used. Information about call-outs necessary for mutual coordination was also supposed to be transferred in electronic form. Although that was achieved, it was only achieved by modifying and interconnecting the existing information systems. One consequence of the fact that the national system for emergency calls was not created is the complication of the use of the *Geographical Information System* that was meant to enable all basic components of the IES to share visualised localisation of the site of an incident and the movement of units dispatched to it. Furthermore, not all IES vehicles were fitted with a navigation system, so the visualisation of operational situations is merely partial.

Audit no. 16/06

The findings from the scrutinised areas showed that the right conditions for economical and efficient use of finances were not put in place during the preparations for the modernisation of the D1 motorway. A more efficient alternative reconstruction of the D1 motorway was not clarified before the start of project preparation and the Roads and Motorways Directorate was still weighing up alternatives when four construction works were already underway. Shortcomings in preparatory work subsequently became the main reason for the delay of at least two years in the completion of the modernisation of the D1 motorway. Consequently, out of the financial, substantive and time parameters approved by the MoT, the time parameter will not be complied with. The concentration of more complicated and most expensive construction works in the final years of the modernisation project presents an increased risk that financial and time parameters will not be complied with. It is nevertheless fair to say that the purpose of the modernisation of the D1 motorway is being achieved and the first 34 km of modernised stretches are a benefit.

Audit no. 16/10

The benefits of the projects could not be assessed because the projects did not contain a specific quantified benefit for the desired change to nature and landscape. The benefit cannot be categorically quantified in respect of the programmes' objectives and the change to nature and landscape.

4. **Publicity**

Audit no. 15/26

The audit scrutinised selected publicity projects which the MAs, as the beneficiaries of technical assistance, performed to ensure that the information and communication activities defined in the OPs' communication plans were carried out. The audit of the contracting organisations' procedure found errors consisting in violations of the transparency principle and failure to perform ex ante verifications before concluding framework contracts.

B.2.4.3 Results of the work of the Audit Body

2007–2013 programming period

In 2016 the AB's activities focused on, among other things, audit of operations and audit of systems, during which the implementation of corrective measures from previous system audits and the closure process for all OPs for the 2007–2013 programming period were scrutinised. The Audit Body performed 558 audits in 2016, covering programmes under the ESF, *European Regional Development Fund* (ERDF) and Cohesion Fund. 539 were audits of operations and 19 system audits.

- For all the OPs the AB assessed whether management and control systems worked effectively and provided reasonable certainty that the statements of expenditure presented to the Commission were accurate and the related transactions were legal and regular. In its opinion it stated a reservation solely for OPEI and ROP NW.

Based on the results of its audit work in 2016 the Audit Body stated:

- the management and control systems of the various operational programmes had improved;
- the various operational programmes were ready for the closure process;
- application of appropriate corrective measures to remedy the shortcomings identified during previous audit work.

2014–2020 programming period

Article 123 of Regulation 1303/2013 of the EP and of the Council provides that each Member State designate a national, regional or local public authority or body functionally independent from the MA and certifying body as the audit authority. The Czech government issued resolution no. 448 of 12 June designating the Ministry of Finance as the audit body for the ESIFs in the 2014–2020 programming period; by a decision of the minister, the MoF's Department 52 – Audit Body was tasked with the function of audit body.

Article 127 (1) and (2) of Regulation 1303/2013 of the EP and of the Council provides that the AB ensures that audits are carried out of the proper functioning of operational programmes' management and control systems and audits of a representative sample of operations based on declared expenditure. Under subsection 5 (a) and (b) of the same article, the AB draws up an audit opinion in accordance with the second subparagraph of Article 59 (5) of the Financial Regulation and a control report setting out the main findings of the audits done in accordance with paragraph 1, including findings with regard to deficiencies found in the management and control systems, and the proposed and implemented corrective actions.

For the accounting period from 1 July 2015 to 30 June 2016 the AB was only able to issue an opinion "without reservations" for OPEm; in other cases, it had to refuse to issue an opinion.

In most cases its audit was constrained by some or all of the following factors:

- the state of implementation of the OP in consequence of the late time of approval and uncompleted designation;
- the certifying authority had not certified any expenditure;
- it was impossible to verify the functioning of management and control systems because, owing to the state of implementation of the OP, the Managing Authority had not presented any payment applications to the certifying authority;
- there was limited access to the MS2014+ information system for standard verification of all the entered processes and documentation and it was not yet possible to allocate appropriate access rights to AB auditors in this information system.

B.2.4.4 Audit work by the EU authorities in the field of Cohesion Policy in the period under scrutiny

In the period under scrutiny the European Court of Auditors issued six special reports[175] relating to expenditure from the Cohesion Fund and Structural Funds. The audit findings contained

175 Special Report No. 08/2016 – *Rail freight transport in the EU: still not on the right track*; Special Report No. 16/2016 – *EU education objectives: programmes aligned but shortcomings in performance measurement*; Special Report No. 19/2016 – *Implementing the EU budget through financial instruments – lessons to be learnt from the 2007–2013 programming period*; Special Report No. 24/2016 – *More efforts needed to raise awareness of and enforce compliance with State aid rules in cohesion policy*; Special Report No. 31/2016 – *Spending at least one euro in every five from the EU budget on climate action: ambitious work underway but at serious risk of falling short*; Special Report No. 36/2016 – *An assessment of the arrangements for closure of the 2007–2013 cohesion and rural development programmes.*

in these special reports are significant for Member States and may generally concern the Czech Republic as well. The following are the key findings:

1. Ineligible expenditure is often identified.
2. Objectives and monitoring indicators are not measurable or sufficiently focused on operations' impacts.
3. There is a risk that certain strategic objectives (e.g. the *Europe 2020* strategy) will not be achieved.
4. Member States committed many errors when designing and implementing public support systems in the 2007–2013 programming period. The greater responsibility of Member States in the 2014–2020 period brings the risk that the number of public support errors will rise.
5. A number of significant problems were found that undermined the effectiveness of financial instruments as a mechanism for implementing the EU budget in the 2007–2013 programming period.

Findings 1 to 3 are identical to the SAO's findings, despite the different methods and nature of the audit reports.

Only in one case[176] were entities from the CR included in an audit sample, namely in an audit targeting the effectiveness of investments in rail freight in the EU. In this audit the ECA scrutinised the impact of investments of approx. €28 billion from the EU budget in the 2007–2013 period on improving the performance of rail freight in the EU, as regards the modal share and the transported volume. The audit was conducted in five Member States: the CR, Germany, Spain, France and Poland[177]. The ECA found that the performance of rail freight remained generally unsatisfactory, while the position of road transport continued to strengthen and the share of rail freight in goods transport in the EU had actually fallen slightly from 2011. The modal share fell from the year 2000 to 2013 in four of the five audited states; in the Czech Republic, for example, it fell by more than 11.5 percentage points to just 20.3%.

The ECA stated that the single European railway area is far from fully built and the EU's rail network remains a system of separate networks with various national authorities and very different national rules governing path allocation, management and pricing. Traffic management procedures are not adapted to the needs of rail freight, even within rail freight corridors.

The Commission and Member States must help rolling stock and track operators improve rail freight's reliability, frequency, flexibility, customer focus and transport time and price. The auditors recommend that the Commission and Member States find greater consistency between the objectives of the policy on the one hand and the allocated funding and selection, planning and management of projects and network maintenance on the other.

Many of the negative findings applied to the Czech Republic. The special report states that in the CR and Poland in particular the performance of rail freight suffers from the bad condition of the rail network (one factor was that precedence is given to roads when finances from EU funds are being allocated, but insufficient maintenance and care over almost five decades

176 Special Report No. 8/2016.

177 The Czech Republic, Spain and Poland were the three biggest overall recipients of EU funds earmarked for the railways for the 2007–2013 period. Germany and France were the main beneficiaries of funding from TEN-T for railway projects during the same period.

have also had a negative impact), high access charges[178] and, in the case of the CR, the fact that the regulatory body is not sufficiently independent. Neither country had achieved the targets set in the *White Paper* from 2001[179]. Furthermore, the infrastructure manager in the CR applies priority rules under which international freight transport has the lowest priority.

B.2.5 Common Agricultural Policy and Common Fisheries Policy of the EU

B.2.5.1 Current developments in the Common Agricultural Policy

The Common Agricultural Policy has undergone a whole series of reforms since its inception. Its latest revision took place before 2014, when a new form of the CAP for the 2014–2020 period was created. The new CAP was meant to enter into force on 1 January 2014, but delays in the legislative process meant that the entire year 2014 was a transitional period in which the new measures only operated to a limited extent. Applicants in the CR were able to make use of the RDP7+ that was drawing to a close and obtain subsidies according to the original rules. The actual start of the new period was thus put back to 2015 and RDP14+ only started to function from September 2015.

The structure of the two pillars of the CAP and two agricultural funds remained unchanged. The main agricultural fund for support provided in the first pillar of the CAP is the *European Agricultural Guarantee Fund* (EAGF), from which farmers draw direct payments and related production and market support. The EAFRD is used to provide support in the second pillar of the CAP, which is rural development.

In 2016, according to data from the State Agricultural Intervention Fund[180] (SAIF), **€34.54 billion was paid out under the CAP** in the Czech Republic (including the *Horizontal Rural Development Plan of the CR for 2004–2006* and instalments on the loan from the Support and Guarantee Fund for Farmers and Forestry (SGFFF) to the rural development programme), with EU finances providing almost CZK 30.01 billion and the national share exceeding CZK 4.53 billion.

Direct payments

Direct payments form the biggest part of the CAP budget in financial terms (approx. 70%). In the new programming period, direct payments will focus on environmental protection and improving the climate, the quality of food products and support for young farmers or less favourable regions. Farmers may obtain support only if they comply with the active farmer condition and satisfy the defined environmental criteria and binding conditions for farming, which concern the environment, the health of humans, animals and plants and good living conditions for animals.

Almost €5.2 billion has been earmarked for direct payments in the CR for the 2015–2020 period, with the **annual envelope for direct payments** amounting to the equivalent of **roughly CZK 23 billion** at an exchange rate of 27.021 CZK/€.

As in the previous programming period, the biggest single item of direct payments was the **single area payment scheme** (SAPS), which makes up more than 50% of the CR's annual envelope and is paid entirely out of the EU budget. The level of this payment depends on

178 The Commission opened infringement proceedings against Poland and the CR in the matter of the incomplete/ /incorrect implementation of Directives 2001/14/EC and 91/440/EEC. The Court of Justice of the EU issued its judgments in May and July 2013 and both Member States subsequently took measures to ensure compliance with EU legislation, particularly as regards the calculation of infrastructure access charges. It is expected that these measures will lead to a reduction in the infrastructure access charges in the concerned Member States.

179 *White Paper: Roadmap to a Single European Transport Area – Towards a competitive and resource efficient transport system,* COM (2011) 144, final wording of 28 March 2011.

180 The source of the data is the Common Agricultural Policy and marketing budget for 2016 and its drawdown as of 31 December 2016, compiled by the State Agricultural Intervention Fund.

the area of farmed land. Besides SAPS, under direct payments farmers receive **greening payments**, which account for roughly 30% of direct payments, and **payments to young farmers**.

Since 2015, selected sensitive commodities/sectors of plant and animal production that face certain difficulties and are important for economic, environmental or social reasons are also supported out of direct payments. Equivalent payments, known as special support, were paid out to selected commodities/sectors in the previous programming period. Support for sensitive commodities via **voluntary support coupled to production** is growing every year. It is up to each Member State to decide what counts as a sensitive commodity, with the EU then assessing and approving the proposals. In the CR, for example, breeders of dairy cattle, meat calves, sheep and goats and growers of hops, potatoes, sugar beet and selected types of fruit and vegetables have received support.

In addition to the support paid out of the EU budget, the MoA pays farmers temporary national support out of its budget, which follows up the formerly paid national Top-Up Payment and is intended to raise the level of direct payments for selected commodities to the level in the original EU Member States.

In 2016 farmers received both direct payments on the basis of applications from previous years (including the now discontinued decoupled sugar payments for sugar and special support) and payments based on applications from 2016. In total, more than CZK 24 billion was paid out in direct payments in 2016, a much larger amount than in 2015 representing an increase of roughly 30%. The main reason is the delay in the payment of applications from 2015 and the deferral of payments to the start of 2016. Payment applications from previous years totalled CZK 12,065 billion, which is roughly half the total amount paid out in 2016 in direct payments.

Table 9: Overview of finances paid out on direct payments in 2016 (CZK thousand)

Direct payments	CR	EU	Total
SAPS	0	12,206,446	12,206,446
Greening	0	6,719,099	6,719,099
Payment coupled on production – sensitive commodities	0	4,297,422	4,297,422
Payment for young farmers	0	59,723	59,723
Transitional national aid	876,377	0	876,377
Further payments*	0	1,879	1,879
Total	**876,377**	**23,284,569**	**24,160,946**

Source: SAIF materials, March 2017.

* These are discontinued forms of support (decoupled sugar payment and special support paid out for selected sectors of animal and plant production).

Common Market Organisation

Common Market Organisation (CMO) applies to agricultural primary produce and products of first-stage processing and is intended mainly to stabilise agricultural produce markets and secure incomes for farmers. Various instruments are used to this end, such as financial support, subsidies, production quotas, intervention purchasing, aid for storage, support for the promotion of agricultural products etc.

Following the abolition of milk quotas and in consequence of the Russian embargo on imports of selected agricultural products from the EU, many farmers found themselves in financial difficulties in 2016. In response, the Czech government approved emergency measures designed to mitigate the harm caused to certain breeders and producers in the dairy cattle and pig breeding sectors and in the milk and meat sectors. There was substantial interest in the emergency measures, which compensated for the low prices of milk and pork. More than

CZK 860 million was paid out on these measures in 2016. The Ministry of Agriculture held talks with the Commission at which a further increase in the finances to be paid out along with state budget finances in 2017 was agreed. The continuing Russian embargo on imports of certain products from the EU also disrupted the market in the fruit and vegetables sector, so the Commission decided to announce emergency support for this sector. Part of the funds was paid out in 2016, with part to be provided in 2017. To mitigate the consequences of the Russian embargo, the Czech Republic also decided to support supplies of fruit and vegetables to schools, including supplies of school milk.

To increase sales, the Czech Republic, like other EU Member States, draws on support from the EU's joint funds to promote its own agricultural products.

Table 10: Overview of finances paid out on CMO measures in 2016 (CZK thousand)

CMO measures	CR	EU	Total
Financial support	569,665	689,834	1,259,499
Subsidies and levies	121,560	139,795	261,355
Export subvention	0	0	0
Intervention purchases	388,639	1,861	390,500
Support of agricultural products	27,965	46,607	74,572
Other related expenditure*	334	0	334
Total	**1,108,163**	**878,097**	**1,986,260**

Source: SAIF materials, March 2017.

* This is the transfer of the forfeited share from subsidy recoveries.

Compared to 2015, there was a pronounced increase in spending on the CMO, which was up by roughly CZK 1.2 billion. The emergency financial support paid out for milk and pork production, which totalled over CZK 860 million, was a major factor in the increase. Spending on intervention purchasing of dairy products (powdered milk) also increased. Roughly the same amount of money was paid out on other CMO measures as in 2015.

Rural Development Programme for 2007–2013

The pay-out of subsidies under RDP7+ drew to a close in 2016. The SAIF paid commitments from previous years to beneficiaries, with disbursements of claim-based support accounting for almost 91% of the programme's budget. These were mainly non-project measures paid under Axis II of RDP7+ (with agri-environmental measures implemented in the form of five-year commitments taking the largest share) and *Early Retirement from Farming* measures under Axis I of RDP7+, under which the SAIF pays farmers a subsidy for a period of as much as 15 years but only up to the age of 70.

Roughly CZK 129 million was paid out on RDP7+ project measures in 2016, with non-project, or flat-rate, measures receiving approx. CZK 1,309 million. In total, almost CZK 1,439 million was paid out under RDP7+.

Table 11: Overview of finances paid out under RDP7+ in 2016 (CZK thousand)

Axis RDP7+		CR	EU	Total
I	*Improving competitiveness of agriculture and forestry*	54,504	67,814	122,318
II	*Improving environment and landscape*	327,414	982,080	1,309,494
III	*Quality of life in rural areas and diversification of rural economy*	1,580	4,740	6,320
IV	LEADER	102	308	410
Total		**383,600**	**1,054,942**	**1,438,542**

Source: SAIF materials, March 2017.

During the implementation of RDP7+ there were 23 rounds of receipt of applications in total, with the last two being targeted at investment projects that could be executed as quickly as possible so that the maximum amount of the programme allocation could be utilised. The MoA's goal for 2016 was to use up the rest of the allocation and close the programme as a whole.

The RDP7+ has funded investment projects for farmers, food producers, foresters and also municipalities, as well as non-investment projects aimed at education and advice services in the agriculture sector; environmentally friendly farming and forestry techniques, farming in less favourable areas and green agriculture were supported. Almost €2.86 billion was available to the CR from the EU budget for the implementation of RDP7+, i.e. the equivalent of more than CZK 77 billion. As at 30 June 2016 the Czech Republic had utilised a sum exceeding €2.85 billion, i.e. 99.88% of the allocation. Czech farmers, foresters and municipalities could obtain almost CZK 100 billion thanks to national co-financing and this sum was almost utilised in its entirety.

Table 12: Overview of drawdown in the individual axes of RDP7+ from the EU allocation as at 30 June 2016

Axis PRV7+	Allocation RDP7+	Drawdown PRV7+	
	(€ thousand)	(€ thousand)	(%)
Axis I	654,691	654,339	99.95
Axis II	1,590,276	1,588,462	99.89
Axis III	442,365	442,015	99.92
Axis IV	159,673	158,806	99.46
Axis V	10,500	10,458	99.60
Celkem	**2,857,506**	**2,854,081**	**99.88**

Source: SAIF materials, March 2017.

Rural Development Programme for 2014–2020

The *Rural Development Programme for 2014–2020* was approved by the Commission in May 2015. In June 2016 the Commission approved the second amendment of the programme document, which contains a number of additional focus areas targeting farmers, foresters and food producers. At the same time, an increase from the originally planned 25% national co-financing of subsidies to 35% co-financing was successfully negotiated. Consequently, the RDP14+ budget grew from CZK 83.0 billion to CZK 95.8 billion, an increase of over 15%.

The total programme allocation, including the contribution from the state budget, thus stands at almost €3.55 billion. The European share is almost €2.31 billion (i.e. more than CZK 62 billion), with the state budget providing €1.24 billion (approx. CZK 34 billion). Most of the money is earmarked for flat-rate measures (roughly 65% of the total allocation).

RDP14+ emphasises improving the environment and landscape, protecting forests and agricultural land, efficient use of natural resources, modernisation and innovation in agricultural enterprises and diversifying activities in the countryside with a view to creating jobs and improving farming.

Even though the implementation of RDP14+ was delayed by roughly a year, more than €410 million had been drawn down from the EU budget by the end of January 2017, which is 17.8% of the total allocation of the European share[181]. Compared to other programmes co-financed out of the ESIFs, RDP14+ is the most successful programme in the CR in terms of finances disbursed. It should be noted, however, that the dominant share consists of claim-based payments disbursed to farmers based on a uniform application and at regular intervals.

181 Capping control report – capping including 2016/Q4 published by the Commission on 30 January 2017.

By the end of 2016 the MoA had opened three rounds of receipt of applications with a total financial volume of CZK 6.9 billion. Receipt of applications takes place at regular intervals twice a year (always in spring and autumn). All administration is handled electronically on the *Farmer Portal*.

Since the start of April 2017 the SAIF has been receiving applications for the 4th round of RDP14+, which seeks to support investments in agricultural and forestry enterprises and also innovation and cooperation projects, providing over CZK 1.7 billion. Subsidy applicants can apply under thirteen focus areas.

In 2016 the MoA, or SAIF, managed to disburse more than CZK 6 billion to beneficiaries, with non-project, flat-rate measures accounting for approx. 95% of that sum. The biggest subsidy amounts were paid out to agri-environmental and climate measures and measures for less favourable areas.

Table 13: Overview of finances paid out under RDP14+ in 2016 **(CZK thousand)**

Measures RDP14+	CR	EU	Total
M04 *M04 Investments in physical assets*	15,765	15,453	31,218
M08 *Investments in forest area development and improvement of the viability of forests*	769	1,697	2,466
M10 *Agri-environment-climate commitments*	571,323	1,713,967	2,285,290
M11 *Organic farming*	211,419	634,254	845,673
M12 *Natura 2000 and Water Framework Directive*	3,880	11,642	15,522
M13 *Payments for areas facing natural or other constraints*	628,037	1,884,112	2,512,149
M14 *Fair living conditions for animals*	218,751	214,416	433,167
Total	**1,649,944**	**4,475,541**	**6,125,485**

Source: SAIF materials, March 2017.

Compared to 2015, when the implementation of RDP14+ was still getting underway and only claim-based payments totalling CZK 1.13 billion were disbursed, 2016 brought a sharp increase in the amount paid out in RDP14+ subsidies.

B.2.5.2 Current developments in the Common Fisheries Policy

Along with the CAP, the Common Fisheries Policy is one of the oldest EU policies. Its long-term goals include ensuring sustainable fisheries in economic, environmental and social terms and renewal of fish stocks, improved aquaculture and strengthening the position of fishermen on the market.

2007–2013 programming period

In the 2007–2013 period a total of €36.14 million was made available to the CR for implementing the CFP, with the EU contribution amounting to €27.11 million and the state budget providing €9.03 million.

No finances were disbursed under OPF7+ in 2016, as the cut-off point for eligible expenditure was 31 December 2015 and expenditure on projects had to be reimbursed by that deadline. There were 20 rounds of receipt of applications for subsidies during the entire OPF7+ implementation period. 90% of the OPF7+ financial envelope had been utilised as at 30 March 2017, according to data of the PCA.

Table 14: Overview of drawdown of the OPF7+ allocation by axis as at 31 December 2016 (CZK thousand)

Axis OPR7+		Total allocation	Share of CR	Share of EU	Total drawdown	Drawdown in %
II	*Aquaculture, processing and marketing of fish products and aquaculture and their placing on the market*	564,005	136,439	409,316	545,755	97
III	*Common interest measures*	321,937	69,258	207,774	277,032	86
V	*Technical assistance*	48,068	8,147	24,440	32,587	68
Total		**934,010**	**213,844**	**641,530**	**855,374**	**92**

Source: MoA data – OP Fisheries Managing Authority Department, March 2017.

2014–2020 programming period

A new Common Fisheries Policy entered into force in 2014. In the CR, the CFP principles for the 2014+ programming period, based on the *Europe 2020* strategy, were incorporated into a strategic document entitled *Multiyear National Strategic Plan for Aquaculture*[182]. In June 2015 the Commission approved OPF14+, which is financed out of the *European Maritime and Fisheries Fund* ("EMFF"). The allocation for the entire 2014–2020 period is €41.2 million, with €31.1 million coming from the EMFF and €10.1 million from national sources.

The first and second calls for submission of applications were announced in August 2015, and the first applications for subsidies under OPF14+ were submitted in October of that year.

In 2016 the MoA announced four calls with a total allocation of CZK 525.5 million. At the start of April 2017 the MoA announced four more calls, under which more than CZK 166 million is to be distributed among fishermen. The subsidies will go towards business development, for example, starting a business in the fisheries sector, organising seminars, issuing publications and promotional activities. One new feature is the inclusion of a contribution to retail sales (shops, mobile shops, market stalls) in the context of business diversification. Applicants will now also be able to apply for a contribution towards establishing a producers' organisation and production plan, which will strengthen their position on the market.

No money was paid out to applicants under OPF14+ in 2016; applications were merely received (all electronically via the *Farmer Portal*) and processed. As at year-end 2016 the MoA had approved 99 OPF14+ projects and had issued decisions to provide subsidies exceeding CZK 124 million in total.

Table 15: Overview of approved projects and amount of subsidies covered by a legal document, broken down by OPF14+ measures, as at 31 December 2016

Measures	Number of approved projects	Total subsidy (CZK thousand)
2.1 *Innovations*	2	1,250
2.2 *Productive investment into aquaculture*	67	58,684
2.3 *Support for new breeders*	2	2,809
2.4 *Recirculating equipment and run-through systems of cleaning*	12	48,203
2.5 *Aquacultures providing environmental services*	4	4,001
5.3 *Investment into product processing*	3	753
Technical assistance	9	8,408
Total	**99**	**124,108**

Source: MoA data – OP Fisheries Managing Authority Department, March 2017.

182 Approved by Czech government resolution no. 876 of 27 October 2014.

B.2.5.3 The SAO´s audit work in the field of the CAP in the period under scrutiny

The SAO conducted two audits targeting agriculture and rural development in 2016.

Audit no. 15/09[183] targeted **the provision of support for education, advice services and promotion in the MoA department.** Both EU funding under RDP7+ and national subsidies were scrutinised. The total amount of spending on selected projects and subsidies in the 2007–2014 period audited by the SAO exceeded CZK 60 million.

The multi-source systems for subsidising education and advice services (RDP7+, national subsidies[184] and national subsidies to NGOs[185]) form discrete, closed units which are not mutually linked and between which there is no cooperation.

In the case of national subsidies for education and advice services, the MoA had neither a strategy nor a concept for their distribution. As a rule, the amount provided in subsidies was determined by the current capacity of the state budget.

The RDP7+ subsidy provision system was found to be functional: there were clear rules and procedures governing how the MoA and SAIF distributed and disbursed funding. What was problematic, however, was the **targeting of support**, which **did not reflect actual needs**. That made it possible to finance almost any educational or advisory activity.

The MoA did not have a functioning system for assessing whether the purpose of either RDP7+ or national subsidies was being fulfilled and did not monitor either the effects or impacts of the support provided. The insufficient evaluation of the impacts and benefits of this support meant that the MoA often did not know what it was getting for the money provided.

Based on the results of this audit, the SAO recommended drawing up a comprehensive strategy for **national subsidy programmes**, so that it is clear what the subsidies are supposed to be provided for. As regards RDP7+, the SAO recommended introducing assessments of educational activities and testing of participants. In addition, the SAO recommended **that high-quality assessment of the impacts and benefits of provided support should be introduced for all types of subsidies.**

In 2016 the SAO also conducted **audit no. 16/14**[186], which dealt with **support for community-led local development (LEADER) provided under RDP7+**. The aim of the audit was to scrutinise the LEADER management and control system in the 2007–2013 period both at MoA and SAIF level and at the level of local action groups (LAGs). The SAO’s auditors also focused on how community-led local development was set up in the new programming period 2014–2020.

Almost 10,000 projects received a total of approx. CZK 4 billion in support between 2007 and 2013.

The Ministry of Agriculture failed to put in place optimal conditions for utilisation of subsidies: in particular, it did not define eligible expenditure precisely and did not set limits for some expenditure. Furthermore, it did not set rules for mandatory criteria for the acceptability, selection and assessment of projects in a way ensuring that the necessary projects received subsidies in conformity to the principles of economy, efficiency and effectiveness of public spending. The MoA defined inappropriate indicators for monitoring projects’ outputs.

183 Audit 15/09 – *Funds spent on education support, consultation and promotion within the Ministry of Agriculture.*

184 These subsidies are provided according principles that lay down subsidy provision conditions on the basis of Sections 2 and 2d of Act No. 252/1997 Coll., on agriculture: The MoA lays down general conditions for the provision of subsidies and announces the individual subsidy programmes.

185 These subsidies are provided according to the government principles for the provision of subsidies from the state budget of the Czech Republic to NGOs by state authorities, which the Czech government approves every year.

186 Audit 16/14 – *EU and state budget funds earmarked for support of local development within the Leader initiative via the Rural Development Programme.*

The MoA failed to manage LEADER adequately under RDP7+; it did not monitor the execution of the local development strategies; and it did not sufficiently monitor and evaluate the benefits of projects and the effectiveness of the support provided in the participating regions.

The implemented LEADER measures did not deliver the planned target for the *"total number of jobs created"* monitoring indicator, which was set at 400. The MoA registered 267 new jobs in total for the entire programming period.

In addition, the MoA also held an extraordinary round of receipt of subsidy applications for the implementation of cooperation projects, but this round was not carried out in line with the 3E principles. The MoA lowered the requirements for project quality and outputs for this round. The SAO therefore stated that this round was merely expedient, as it was mainly used to provide operational subsidies to LAGs to resolve their current financial difficulties.

The process of administering and checking applications and projects was done by LAGs and in certain areas again by the SAIF. **The duplicate performance of certain aspects of administration resulted in the process being complicated and lengthy.** In the current programming period 2014–2020 the implementation and administration process has been even more complicated and delayed because of the multi-fund approach, i.e. the involvement of multiple entities in the implementation of the LEADER method and in connection with a new process: the standardisation of LAGs. The SAO found that the standardisation of LAGs is more of a formal process without any effect on improving the quality of LAGs' work.

LAGs committed errors in project administration, especially in the project assessment phase. When starting to implement LEADER measures, LAGs were not able to set realistic targets for their strategies; consequently, the targets were either not met or exceeded by, in some cases, hundreds of per cent. **LAGs often defined strategic goals as non-specific and non-measurable targets and the indicators for measuring them gave no information about the effectiveness of the support provided in the given territory.**

Now, almost halfway through the 2014–2020 programming period, the support for community-led local development is marred by serious problems. The implementation system has become more complicated and more time-consuming, requiring greater coordination between the implementing entities. No finances have been drawn down from European funds for community-led local development in the first three years of the current programming period.

B.2.5.4 Audit work by ECA bodies in the field of the CAP in the period under scrutiny

In the period under scrutiny, the European Court of Auditors issued eight special reports[187] dealing with agriculture, food production, rural development and environmental protection. The Czech Republic was not part of the audit sample in any of these audits. A questionnaire-based survey took place in the CR in the context of the audit of *Natura 2000*, however.

187 Special Report No. 1/2016 – *Is the Commission's system for performance measurement in relation to farmers' incomes well designed and based on sound data?*; Special Report No. 6/2016 – *Eradication, control and monitoring programmes to contain animal diseases*; Special Report No. 18/2016 – *The EU system for the certification of sustainable biofuels*; Special Report No. 25/2016 – *The Land Parcel Identification System: a useful tool to determine the eligibility of agricultural land – but its management could be further improved*; Special Report No. 26/2016 – *Making cross-compliance more effective and achieving simplification remains challenging*; Special Report No. 34/2016 – *Combating food waste: an opportunity for the EU to improve the resource-efficiency of the food supply chain*; Special Report No. 36/2016 – *An assessment of the arrangement for closure of the 2007–2013 cohesion and rural development programmes*; Special Report No. 1/2017 – *More efforts needed to implement the Natura 2000 network to its full potential*.

Special Report No. 1/2017 sought to examine whether the *Natura 2000* network is being properly implemented. The audit found that considerable efforts are required if the EU's ambitious goals to protect biodiversity are to be met. Member States were not managing the network well enough. EU funding was not well mobilised; there was no reliable estimate of EU funds used for *Natura 2000* and there was a lack of comprehensive information on the effectiveness of funding. The necessary conservation measures were too often delayed or inappropriately defined. Monitoring and reporting systems were not adequate and there was no specific performance indicator system for the use of EU funding. Coordination between authorities and stakeholders in the Member States was not sufficiently developed. The ECA therefore made a number of recommendations to both the Commission and Member States for achieving full implementation of the Nature Directives, financing and accounting for the costs of *Natura 2000* and improved measuring of the results achieved by *Natura 2000*.

B.2.6 Other EU financial instruments and expenditure

Other EU financial instruments comprise a relatively broad spectrum of smaller funds and programmes that are funded out of all the EU budget headings (bar the special headings *Administration, Compensations* and *Negative Reserve*). OFI finances are not provided to applicants out of allocations to individual Member States, but directly from the EU on the basis of public competition. If an applicant wants to access this funding, in most cases[188] his project must succeed in direct international competition.

The goal of the support provided under OFIs is to deliver more effective solutions to common problems in the EU's various policies while boosting cooperation between Member States and their entities. The usual conditions for the award of support are the establishment of **partnerships between entities** from different countries and also **European added value** that gives **supranational significance** to projects.

OFIs represent just a small part of EU budget expenditure (approx. 10–15%) and are usually administered directly by the appropriate unit of the Commission[189] under direct centralised management. Contact points at the coordinators of the specific programmes are established in the Member States. OFIs are mainly funded through a wide spectrum of **Community programmes**; other sources of financing include the **IPA**[190], the ***European Union Solidarity Fund***[191] or **funds** for the **EU's migration and asylum policies**[192] and **internal security policy**[193].

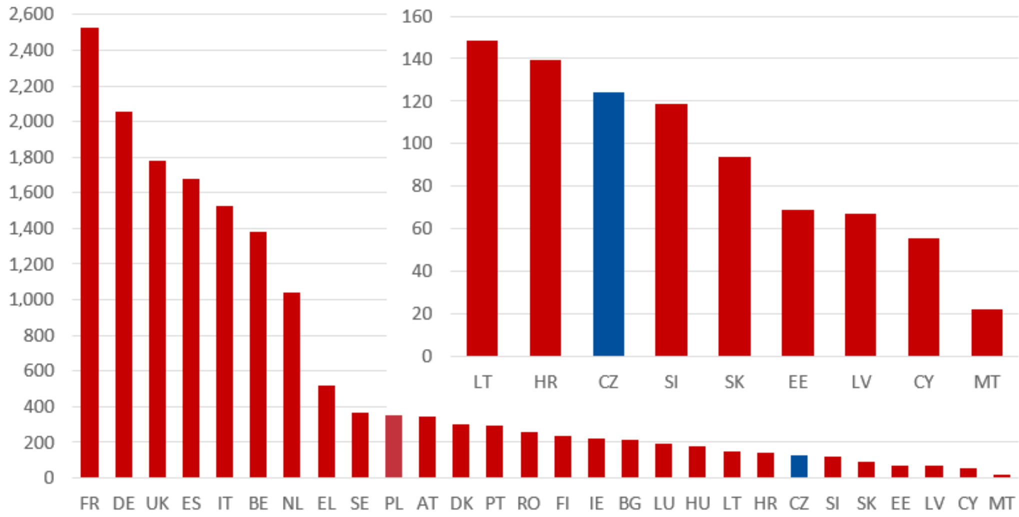
EU budget expenditure channelled directly into the activities of **"decentralised agencies"**[194], which are independent legal entities established for the purpose of specific tasks under EU law, also stands outside OFIs.

B.2.6.1 Other financial instruments in the EU budget for 2015

More than €16.3 billion was channelled into EU Member States under OFIs in 2015. That was an increase of almost 36.8% over 2014. That amount accounts for more than 12.5% of total EU budget expenditure channelled into Member States.

188 OFIs also include EU programmes some of which function on the principle of national envelopes, or certain sums are directly allocated to a given Member State/area.
189 Mainly by the Commission's directorates-general (DG).
190 *Instrument for Pre-Accession Assistance*.
191 The Fund was established to help regions affected by natural disasters (floods, forest fires, earthquakes, storms and catastrophic droughts).
192 *Asylum, Migration and Integration Fund* (AMIF).
193 *Internal Security Fund* (ISF).
194 The one decentralised agency based in the CR is the *European GNSS Agency*, which manages public interests related to European global navigational satellite systems programmes, the European Geostationary Navigation Overlay Service (EGNOS) and the *Galileo* system.

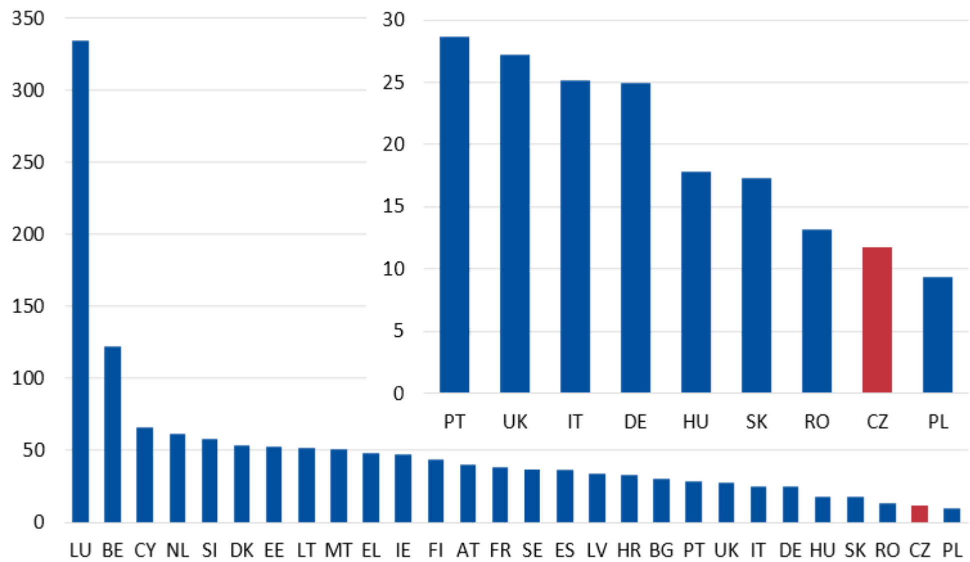
Chart 15: Member States' drawdown from OFIs in 2015 (with close-up section) (CZK million)



Source: *EU budget 2015 – Financial Report*, Commission 2016.

Given the relatively small volume of funds distributed under OFIs and the large differences in the population sizes of Member States, and taking into account how the money is used and the goals achieved through OFIs, the level of OFI drawdown per capita is particularly informative.

Chart 16: Drawdown from OFIs per capita in Member States in 2015 (with close-up section) (€)



Source: *EU budget 2015 – Financial Report,* Commission 2016; Eurostat (population as at 1 January 2015), December 2016.

Luxembourg is regularly the clear leader in the OFI per capita drawdown ranking (€334.56 in 2015), followed by Belgium (€122.13 in 2015). With the exception of 2014, when the CR came 22nd within the EU-28 and obtained €16.32 per capita, the country has traditionally been at the very bottom of the EU ranking, along with Poland and Romania. In 2015 the CR obtained €11.75 per capita, just 36.75% of the EU-28 average. Even though (if we discard the relatively successful year 2014) a value of at least 15% greater than usual was attained, the very low success rate of Czech applicants in public competition for OFI support must be stressed. The amount obtained in the CR under OFIs represented just 0.76% of the total drawdown from these sources across the EU.

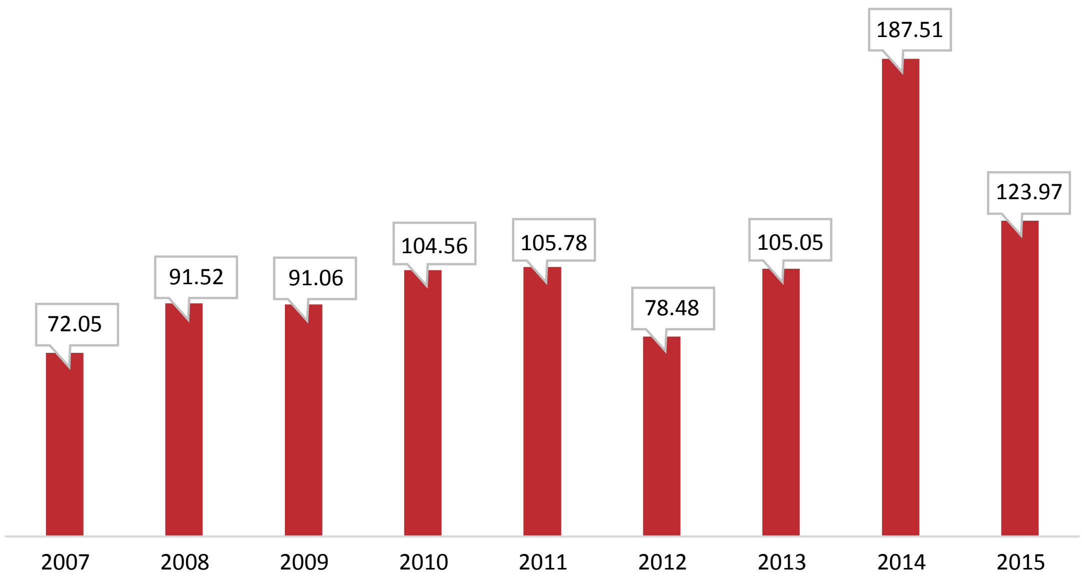
The reasons for the low involvement of Czech applicants in centrally managed EU programmes was discussed by the Czech government, which examined the information presented to it[195]. The presented information gives the following reasons:

- greater competition in the international arena, and thus a lower probability of success;
- absence of overall coordination and methodological guidance at national level;
- subsidies from programmes financed out of the ESIFs are more accessible than the subsidies that can be obtained from centrally managed instruments, while the lower rate of EU co-funding also plays a role;
- potential applicants' awareness of the possibility of obtaining funding from Community programmes is insufficient;
- centrally managed programmes have a lower priority for top-level representatives of state administration or are not attractive to them;
- low administrative capacity of the national contact points of the relevant programmes and insufficient communication at various levels, including a problem of sharing and communication on the part of the Commission.

B.2.6.2 Other EU financial instruments and expenditure in 2015

As mentioned above, entities in the CR have for long failed to obtain significant funding under OFIs. In 2015 these revenues totalled €123,973,970[196] (the equivalent of CZK 3.38 billion[197]).

Chart 17: Drawdown from OFIs in the CR in the years 2007 to 2015 (€ million)



Source: EU budget reports – Financial Reports for 2007–2015, European Commission 2008–2016.

Chart 17 shows clearly that the first years of the 2007–2013 programming period brought a gradual increase in drawdown by entities in the CR, but annual drawdown has stagnated since 2010. The exceptions are 2012, when there was a pronounced fall, and 2014, when drawdown

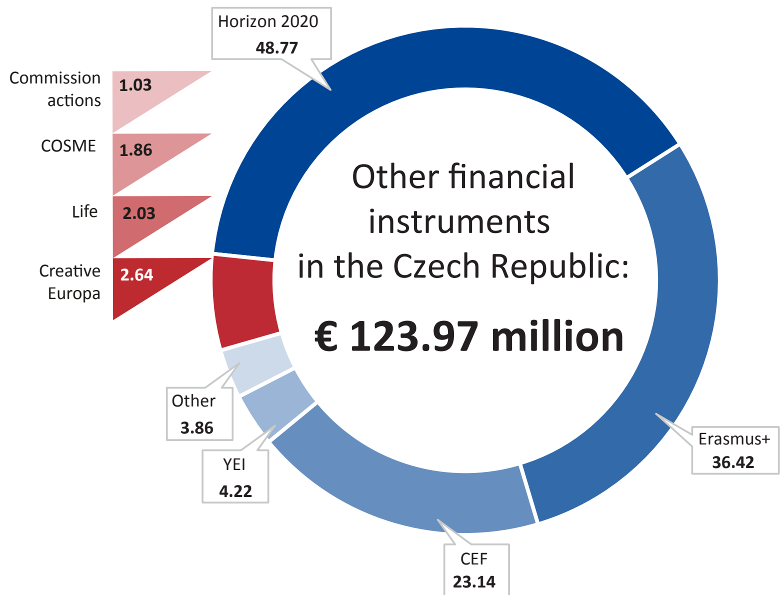
195 *Information for the Government of the CR on the benefits of cohesion policy and starting points for its future form after 2020*, MfRD, ref. no. 12874/2017-22.

196 *EU budget 2014 – Financial Report,* Commission 2015; see http://ec.europa.eu/budget/figures/interactive/index_en.cfm.

197 The ECB's average annual exchange rate for 2015 was used: 27.279 CZK/€.

from OFIs increased sharply, with the *Galileo* and *EGNOS*[198] programmes alone bringing almost €72,178,000[199] into the CR.

Chart 18: Utilisation of other financial instruments in the CR in 2015 (€ million)



Source: *EU budget 2015 – Financial Report*, European Commission 2016.

NB: Full names of the financial instruments abbreviated in the chart: Horizon 2020: *Horizon 2020 – Framework Programme for Research and Innovation*; Erasmus+: *Erasmus+ (Education, Training, Youth and Sport)*; CEF: *Connecting Europe Facility*; YEI: *Youth Employment Initiative*; Life: *Life (Environment and Climate)*; COSME – *Competitiveness of Enterprises and Small and Medium-sized Enterprises*; Commission Actions – *actions funded on the basis of the Commission's privileges and specific powers vested in the Commission*. In 2015 Czech entities also drew down funding from other financial instruments grouped under the heading *Others* in the chart.

B.2.6.3 Audit work by the EU authorities in the field of OFIs in the period under scrutiny

The SAO did not conduct any audits focusing on OFIs in the period under scrutiny. The SAO does, however, regularly monitor the issue of other financial instruments and several related audits can be expected in the coming period.

In the period under scrutiny the European Court of Auditors issued five special reports[200] from audits primarily targeting OFIs and their use in EU-28 countries. Entities in the CR did not feature in any of the audit samples. The Czech Republic is mentioned in some of the special reports, however, most notably in Special Report No. 14/2016. This report declared that the Commission had achieved significant progress in setting out EU initiatives promoting Roma integration and that all the visited Member States (Bulgaria, Hungary, Romania and Spain) had drawn up their own national strategies for Roma integration by 2012. Shortcomings in these strategies persist, however. Most of the audited projects achieved their general goals, but these goals were often not specifically targeted at Roma citizens. The European Court of Auditors registered a number of improvements in this area for the 2014–2020 programming period.

198 *European Geostationary Navigation Overlay Service*.

199 Entities in the CR obtained just a further €6,338,000 under these programmes for the 2007–2013 period, i.e. more than 11 times less than in the single year 2014.

200 Special Report No. 3/2016 – *Combating eutrophication in the Baltic Sea: further and more effective action needed*; Special Report No. 14/2016 – *EU policy initiatives and financial support for Roma integration: significant progress made over the last decade, but additional efforts needed on the ground*; Special Report No. 22/2016 – *EU nuclear decommissioning assistance programmes in Lithuania, Bulgaria and Slovakia: some progress made in 2011, but critical challenges ahead*; Special Report No. 28/2016 – *Dealing with serious cross-border threats in the EU: important steps taken but more needs to be done*; Special Report No. 33/2016 – *Union Civil Protection Mechanism: the coordination of responses to disasters outside the EU has been broadly effective*.

C. Other activities related to the EU's financial management

C.1 Legal matters

C.1.1 The SAO´s recommendations concerning changes to the legal environment

In interdepartmental consultation processes pursuant to the Government Legislative Rules the SAO issued statements on draft legislation concerning it as an organisational component of the state or linked to its competence. The SAO received for assessment 181 draft legislative amendments and related materials linked to legal regulations in 2016. It issued specific comments, based mainly on audit findings, on 70 of them.

In 2016 the legislative process for a new **Act on Public Procurement** was completed, thus transposing into Czech law the three EU directives regulating public procurement. The Act was promulgated under no. 134/2016 Coll. and entered into force on 1 October 2016. Most of the SAO's comments on the government draft of this Act were incorporated into the text.

Another draft law responding to the outputs from the SAO's audits and adopted in 2016 and promulgated in the Collection of Laws was **Act No. 186/2016 Coll., on gambling games** (which responded in part to the results of audit no. 13/35).

As regards consulted government bills that were not put before the government by their author in 2016, in June 2016 the SAO issued fundamental comments on a **draft amendment of the Act on the Budgetary Rules**, which is supposed to regulate in greater detail the subsidy provision process in connection with Supreme Administrative Court judgment 9 Ads 83/2014 – 46. The bill was withdrawn by its author, the Ministry of Finance, and a modified draft of the legislation was presented for consultation in December 2016. This modified draft was discussed by the government on 22 March 2017 and put before the Chamber of Deputies of Parliament on 23 March 2017 (parliamentary print 1071). The comments issued on the draft by the Supreme Audit Office were accepted.

C.1.2 Implementation and transposition of European Union law in the CR

C.1.2.1 State of transposition of EU legislation in the CR

Upon entering the EU the Czech Republic assumed the obligation to honour all the commitments of a Member State. These include legislative obligations stemming from Article 4 (3) of the *Treaty on European Union*, which requires Member States to take any appropriate measure, general or particular, to ensure fulfilment of the commitments arising out of the Treaties or resulting from the acts of the institutions of the Union. Legislative commitments consist in the proper and timely implementation of EU law into national law, if its nature so requires. Implementation and monitoring thereof are done in different ways, depending on the kind of EU legal legislation. In the case of EU directives, both their transposition by Member States and the subsequent notification of the national transposing regulations to the Commission are assessed.

The state of transposition in the CR in 2016[201] compared to the previous period is shown in Table 16.

201 The details can be found on the Commission's website: http://ec.europa.eu/internal_market/scoreboard.

Table 16: State of transposition of EU legislation in the Czech Republic

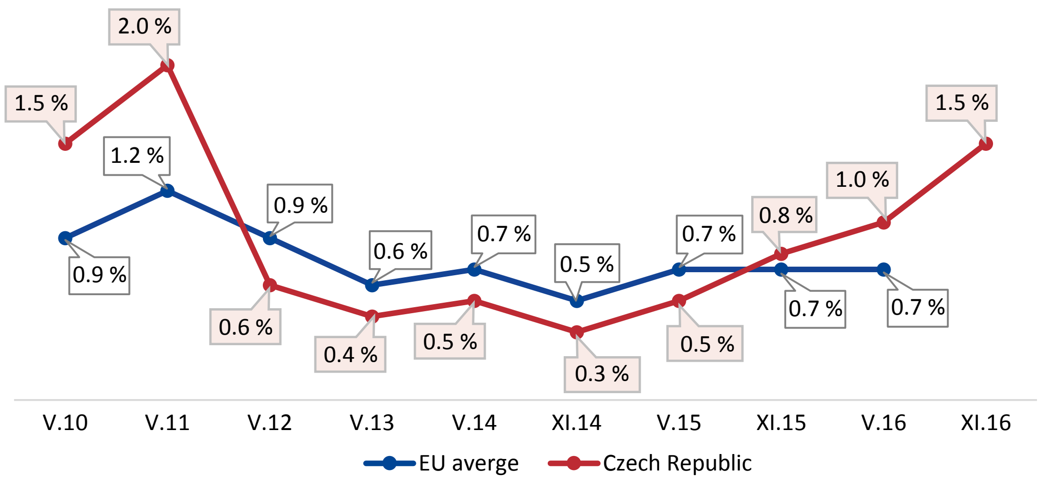
Indicator	State in November 2015*	State in May 2016**
Transposition deficit (%)	0.8	1
Overdue directives (number)	9	10
Average delay (months)	6.8	not stated

* Source: http://ec.europa.eu/internal_market/scoreboard, data published in July 2016.

** Source: *Czech government report on the state of transposition of EU legislation in the CR for 2016.*

According to the assessment done in November 2015, **the transposition deficit grew** from 0.5% to 0.8%, while the EU average stands at 0.7%. According to Czech government data[202], in May 2016 the transposition deficit increased further to 1%, with a further rise to a value of 1.5% expected by the end of the year. Conversely, **the average transposition delay fell** by more than two months, according to data from November 2015, and was far below the EU average (10.1 months).

Chart 19: Evolution of the transposition deficit in the Czech Republic in the years 2010 to 2016 compared to the EU average



Source: Commission, http://ec.europa.eu/internal_market/scoreboard, *Czech government report on the state of transposition of EU legislation in the CR for 2016.*

NB: The amount of the transposition deficit for the CR in November 2016 is the expected value.

As regards the state of transposition of all directives, i.e. including directives going beyond the area of the internal market, as of 30 November 2016 the CR registered **20 directives** (the Czech government report for 2015 only mentioned 12) **whose transposition deadline had passed** and for which the notification process had not been completed. The various authorities were responsible for the transposition deficit as follows:

- Ministry of Industry and Trade 3 directives;
- Ministry of Justice 3 directives;
- Ministry of Transport 2 directives;
- Ministry of Finance 2 directives;
- Ministry of Labour and Social Affairs 2 directives;

202 *Czech government report on the state of transposition of EU legislation for 2016,* approved by Czech government resolution no. 74 of 25 January 2017.

- Ministry of the Interior 2 directives;
- Ministry of Health 2 directives;
- Czech Mining Office 1 directive;
- Ministry of Culture 1 directive;
- Ministry of Agriculture 1 directive;
- Ministry of Environment 1 directive.

The *Single Market Scoreboard* website monitors the number of infringement proceedings linked to either non-notification of transposition regulations or poor transposition of single market directives.

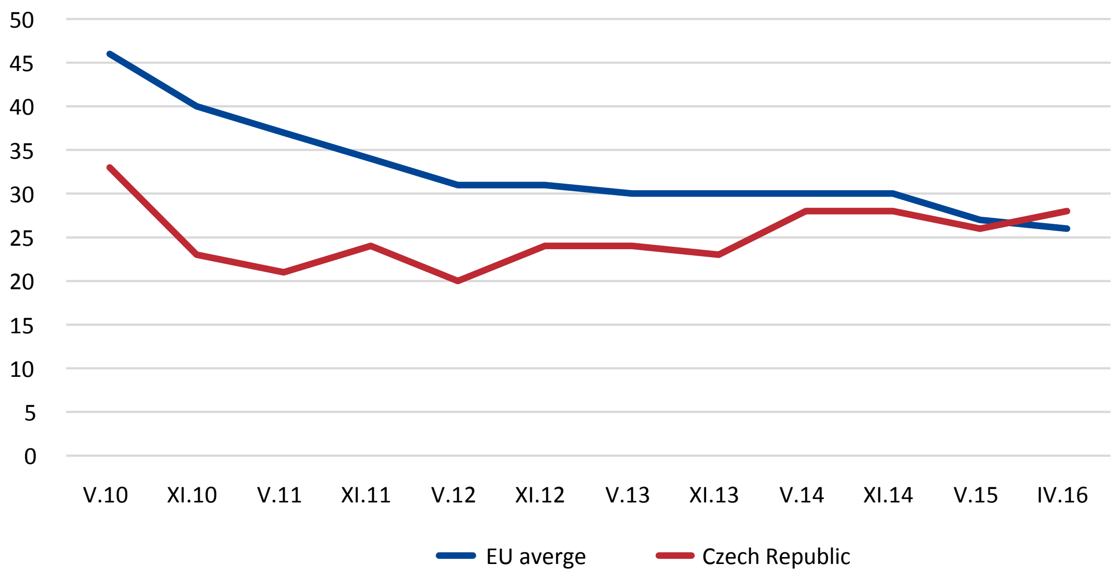
Table 17: State of infringement proceedings brought against the CR by the EU

Indicator	State in May 2015	State in November 2015
Pending cases (number)	26	28
Average case duration (months)	29.4	33.3
Compliance with court rulings (months)	19.2	19.2

Source: Commission, http://ec.europa.eu/internal_market/scoreboard.

This result for the CR was in no way exceptional in terms of the number of cases open, but the CR ranks among the one third of Member States with an above-average number of cases. Transport and the environment, in both of which eight cases are open, are problematic sectors. The average duration of proceedings increased compared to the previous period because of the low number of cases closed (just two) and slightly exceeded the EU average (30.7 months). The duration of compliance with court decisions remained unchanged and slightly below the EU average (21 months).

Chart 20: Evolution of infringement cases in the Czech Republic in the years 2010 to 2016 compared to the EU average



Source: *Single Market Scoreboard, Performance per Member State, Czech Republic*, (Reporting period: 2004–2015), http://ec.europa.eu/internal_market/scoreboard/_docs/2015/09/member-states.

C.1.2.2 National economic risks arising from inadequate transposition of EU directives

The Czech Republic's transposition deficit and number of infringements have been growing in the latest period under scrutiny.

For that reason, the SAO has repeatedly reiterated the risks that the CR consequently faces. A failure to transpose of EU directives or poor transposition results in directives having direct effect, in liability for damages caused by individuals or organisations due to non-transposed or badly transposed directives and in TFEU infringement proceedings[203].

C.1.2.3 Resolution of errors in the implementation of EU regulations and transposition of EU directives

The SAO's audit conclusion from audit no. 15/23 – *Management of state property and state funds allotted to projects concerning IT and communication technology at the Ministry of Transport* stated the following:

Inadequate implementation of an EU regulation

"Agenda of the Register of Road Transport Operators – Article 16 (5) of Regulation (EC) No 1071/2009 of the European Parliament and of the Council establishing common use rules concerning the conditions to be complied with to pursue the occupation of road transport operator provides that Member States shall take all necessary measures by 31 December 2012 to ensure that the national electronic registers are interconnected and accessible throughout the Community through the national contact points in such a way that a competent authority of any Member State is able to consult the national electronic register of any Member State. In the Commission's opinion, the Ministry of Transport, under whose remit the said activities fall, did not ensure access to the national electronic registers by the required date. For that reason, on 10 November 2015 the Commission filed an action against the Czech Republic with the Court of Justice of the European Union. In addition to the CR, the Commission filed actions against three other Member States."

Failure to achieve the purpose of an EU directive

"Agenda of Driving Licences – Pursuant to Article 7 (5) (d) of Directive 2006/126/EC of the European Parliament on driving licences, the CR should have made use of the EU Driving Licence Network (RESPER) for the purpose of facilitating checks as of the moment of its launch (19 January 2013). This connection was not operational as of the date of the end of the audit. The exchange of information about documents under RESPER should have contributed to revealing forgeries of driving licences in a Member State where the applicant had committed no offences that would have led to suspension of their licence. In the Commission's opinion, the CR did not fulfil the required measures and the Commission, after numerous reminders, filed an action against the CR with the Court of Justice of the EU on 19 November 2015. In addition to the CR, the Commission filed actions against six other Member States."

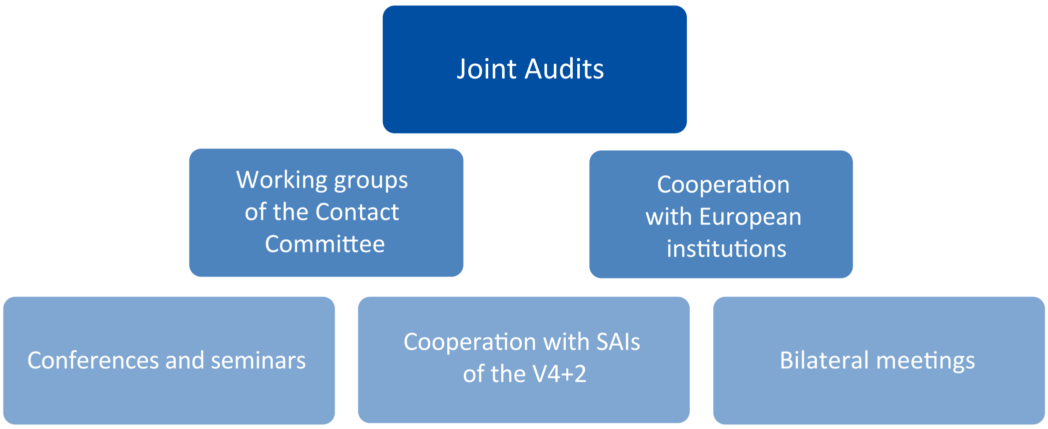
203 In the case of an infringement in 2013 the Czech Republic was at risk of the application of sanctions mechanisms by Court of Justice of the EU. If the situation is not remedied despite a repeated request by the Commission, the Court may in its judgment impose a flat-rate fine and penalty payment running into the € millions on the Member State. The size of the fine and penalty depend on the length of time in which the Member State was remiss in its duty stemming from Community law, on the seriousness of the infringement and the "national factor" (the economic and political circumstances of the case). The minimum flat-rate fine in the case of the Czech Republic is €1,773,000. This sum is multiplied by the seriousness coefficient, however. The minimum penalty for the CR is €2,500 per day until such time as the CR remedies the situation. However, even this sum is multiplied by the seriousness coefficient and the duration of the infringement. The court's practice makes it reasonable to expect that the flat-rate fine and penalty in this case could be approx. €10,000 per day (i.e. approx. CZK 8.25 million per month) and a one-off sum of €2 million (CZK 55 million).

The audit conclusion of audit no. 15/23 was discussed by the Czech government[204], which noted the audit conclusion. At the same time, it noted the MoT's opinion on the audit conclusion and instructed the transport minister to implement the measures set out in the opinion.

The MoT expressed the following opinion on the SAO's finding: *"The MoT has already undertaken an evaluation of the connection of the Central Register of Drivers and the Register of Road Transport Operators to European systems, thus eliminating the risk of financial or other punishment of the CR on these grounds."* In the first case the Court of Justice of the EU closed the proceedings; proceedings are still ongoing in the second case.

C.2 International activities of the SAO

The SAO's international activities relating to agendas linked to the CR's membership of the EU or direct cooperation with the SAIs of Member States mainly comprised the activities/events presented in the following diagram.



Every year, the most important activities include joint audits with the SAIs of other Member States. The year 2016 was no different in this regard. The Supreme Audit Office conducted a joint audit with the SAI of the Slovak Republic in the field of excise duties. The principal objectives of the meetings between experts of the SAO and SAI SR were to exchange outputs from the compared administrative indicators and administrative duties and to finalise draft texts for the joint audit conclusion. The final report was due to be signed and published in March 2017.

In 2016 the SAO also cooperated with the supreme audit institutions of countries seeking to join the EU. In this regard the SAO organised a meeting with the SAI of Albania, which was also attended by senior representatives of the two institutions. The main topics of discussion were the organisation of audits and audit work itself, i.e. including the preparation, performance and subsequent assessment of audits.

In 2016 the SAO also conducted bilateral talks with other foreign institutions representing public interests in financial matters. The SAO hosted a meeting with representatives of the International Monetary Fund dealing with the utilisation of ESIF finances in the Czech Republic. The SAO met with Commission representatives to discuss strategic planning in public procurement. Another important event in terms of cooperation in the field of the management

204 Czech government resolution no. 984 of 7 November 2016, *on the Audit Conclusion of the Supreme Audit Office from Audit No. 15/23 – Management of state property and state funds allotted to the projects concerning IT and communication technology at the Ministry of Transport.*

of EU finances was the regular visit by a member of the ECA to the Czech Republic. Newly elected member of the ECA Jan Gregor acquainted the SAO with the ECA's annual reports on the implementation of the EU budget and European development funds for 2015.

Every year, SAO representatives take part in several seminars and conferences dealing with the management of public funds. Examples of these in 2016 were the ECA seminars on public sector accounting and seminars on climate and energy. In addition, the SAO sent a representative to a conference on EU financial instruments and their use and to a seminar organised by the European Academy for Taxes, Economics and Law focusing on public construction and renovation projects.

At the multilateral level, the SAO organised a meeting between the SAIs of V4 countries[205], Austria and Slovenia, which took place at Lednice from 5 to 7 September 2016. The meeting centred on the issues of obtaining data for audit purposes, data analysis and ways to use the processed data for international comparison of the performance of national economies. The quality of the obtained data, their information value and their use to create performance indicators that can be used at international level was discussed. At the meeting, SAO representatives presented a proposal for an international project focusing on the use of comparable information for creating indicators that would help monitor the performance of public administration in individual countries and would provide an overview on a broader international scale. The project entitled *Benchmarking Information Exchange Project* (BIEP) was subsequently adopted and most of the concerned institutions participated in it during 2016.

The involvement of SAO experts in the work of international European agencies is also important. Since 2015 SAO representatives have been members of the **college of auditors of the European Defence Agency**, where they take part in reviewing the Agency's budget and attend all its meetings.

C.2.1 Audit missions by European institutions in the CR

The ECA fulfils the key role in the external audit of EU budget finances. 15 ECA audit missions took place in the CR in 2016. The SAO coordinated the exchange of information between the ECA and the audited entities, with SAO auditors taking part in the missions as observers. In selected cases the SAO also assists the ECA by acquiring materials for the studies being drawn up through surveys or by verifying information.

Annex 2 provides an overview of audit missions done by the ECA, including one correspondence enquiry.

SAO auditors did not take part in any Commission audit missions in 2016. The focus and times of Commission audit missions in the CR during 2016 are given in Annex 3.

C.2.2 International cooperation in the context of Contact Committee activities

Activities linked to the Contact Committee are an integral part of the SAO's European international cooperation. Through its working groups, the Contact Committee, which is composed of top-level representatives of supreme audit institutions in the EU and the ECA, gives its members the chance to present and gain experiences with audit of European finances.

The central theme of the Contact Committee meeting in 2016 was EU energy policy and climate. The event featured a seminar where the participants learnt about audits and other activities of SAIs focusing on the transposition of EU regulations into national law and Member

205 Czech Republic, Hungary, Poland and Slovakia.

States' energy efficiency measures and their impact on the environment. SAO representatives delivered a presentation on the subject of *Energy Savings* at the seminar. This presentation drew on the results of audit no. 15/02 – *State finances provided for support of energy savings*.

In 2016 SAO representatives were mainly active in the *Working Group on Structural Funds*, which conducted a parallel audit to assess the implementation of the *Europe 2020* strategy objectives through OPs co-financed out of the ESF in the fields of employment and education. The form and content of the proposed joint report, taking into account national outputs, was discussed.

Another working group the SAO is an active member of is the *Working Group on Value Added Tax.* This working group focuses on two priority areas: monitoring VAT trends, with the emphasis on problems when measuring losses caused by fraud, and monitoring the strategy of the fight against VAT fraud at EU level. At meetings of the working group in 2016, SAO representatives shared information regarding legislative amendments in the field of VAT, new trends in tax fraud and the results of direct audit work. The meetings also examined the preparation of a framework for a joint audit targeting VAT administration in the field of e-commerce that will be conducted jointly with the SAI of Germany in 2017.

Last but not least, the Supreme Audit Office took part in the work of the *Lisbon/Europe 2020 network*, both by sharing information during the year and by attending meetings at which national audits targeting the implementation of the *Europe 2020* strategy were presented and best practice in the fields of methodologies and risks in audits of the use of ESIFs for improving competitiveness was highlighted.

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Appendix č. 1: Overview of SAO audits completed in the period from 1 April 2016 to 31 March 2017 and partly or wholly focused on EU Funds

Audit No.	Audit subject	Published in the *SAO Bulletin* (Issue/Year)
15/09	*Funds spent on education support, consultation and promotion within the Ministry of Agriculture*	4/2016
15/17	*Funds spent on measures related to streamlining of tax and insurance collection and administration, mainly within the project "Setup of single collection point for state budget revenues.*	4/2016
15/26	*EU and State budget funds spent within technical assistance for the activities related to publicity and promotion of operational programmes and projects implemented in the programming period 2007 – 2013.*	4/2016
15/33	*Excise Duty Administration*	1/2017
16/01	*EU and state budget funds earmarked for financing of interventions within the Operational Programme Enterprise and Innovation with focus on the fulfilment of objectives*	1/2017
16/02	*Funds earmarked for ICT and crisis management systems of units of the Integrated Emergency System*	1/2017
16/06	*Funds earmarked for modernisation of motorway D1*	1/2017
16/10	*Funds provided for the improvement of nature and landscape*	1/2017
16/11	*State budget funds earmarked for creation of equal opportunities for persons with disabilities*	3/2017
16/14	*EU and state budget funds earmarked for support of local development within the Leader initiative via the Rural Development Programme*	3/2017
16/16	*Funds earmarked for the interoperability on the current railways*	3/2017

Appendix 2: Overview of audit missions of the European Court of Auditors in the Czech Republic in 2015 – 2016

Year		Date of execution	Audit subject (programme)	Audit type (DAS/ performance audit)	Audit form (on-the-spot/ /survey)
2015	1*	January 24 – 27	*ERDF, OP Research and Development for Innovation*	DAS	on-the-spot
	2	August 24 – 27	EAGF	DAS	on-the-spot
	3	September 7 – 15	CF, OP En	DAS	on-the-spot
	4	October 20 – 23	ESF, OP EC	DAS	on-the-spot
	5	November 9 – 13	EAFRD	DAS	on-the-spot
	6	November 18 – 20	Audit regarding DAS in 2015	DAS	on-the-spot
		January	Survey in the context of performance audit on farm income statistics and performance indicators.		survey
		March	Performance audit of state aid: *„Does the Commission pay attention to breach of EU rules for state aid in the cohesion area?“*		survey
		April	Performance audit of financial instruments: *„Have financial instruments been an efficient mechanism to provide EU funding in the regional, social, transport and energy policy areas?“*		survey
		July	Survey in connection to audit of the Land Parcel Identification System		survey
		September	Audit of conditionality for answering the question: *„Is the management and control system for conditionality simple and efficient?“*		survey
		October	Performance Audit on Closure: *“Is the closure of the 2007-13 Cohesion and Rural Development programmes designed to achieve its effective implementation?“*		survey
		December	Performance Audit on *Natura 2000* network		survey

Year		Date of execution	Audit subject (programme)	Audit type (DAS/ performance audit)	Audit form (on-the-spot/ /survey)
2016	1	4/1 – 8/1 11/1 – 15/1	EFRR, OP *Enterprise and Innovation*	DAS	on-the-spot
	2	15/2 – 19/2	ESF, OPEC	DAS	on-the-spot
	3	29/2. – 4/3	ERDF, ROP SW	DAS	on-the-spot
	4	14/3 – 18/3	CF, OPEn	DAS	on-the-spot
	5	2/5 – 4/5 11/7 – 15/7	Performance audit on guarantee instruments of loan portfolios financed from the EU Budget	Performance Audit	on-the-spot
	6	17/5 – 20/5	Support for rural development from EAFRD	DAS	on-the-spot
	7	6/6 – 8/6	Measurements supporting drawdown from ERDF/CF and ESF	Performance Audit	on-the-spot
	8	16/6 – 17/6	DAS 2016	DAS	on-the-spot
	9	23/8 – 24/8	DAS 2016	DAS	on-the-spot
	10	29/8 – 1/9	DAS 2016, financial audit of EAGF	DAS	on-the-spot
	11	20/9 – 23/9	Support for rural development from EAFRD	DAS	on-the-spot
	12	29/9 – 1/10	OP Enterprise and Innovation	DAS	on-the-spot
	13	10/10 – 19/10.	Projects of productive investments and support of enterprise within ERDF	Performance Audit	on-the-spot
	14	24/10 – 27/10.	CF, OPEn	DAS	on-the-spot
	15	28/11. – 2/12.	CF, OPT	DAS	on-the-spot
		February	Survey in line with ECA audit concerning a new requirement for Certification Bodies provide opinions on the legality and regularity of spending under the Common Agricultural Policy at Member State level.		survey

Note: * Audit mission began with the first visit in December 2014 and continued with the second visit in January 2015.

Appendix 3: Overview of European Commission´s audit and fact-finding missions in the Czech Republic in 2015 –2016

Year	DG	Audit subject	Audit number	Audit subject	Main findings	Mission complete/incomplete, accepted measurements
2015	Regio	ROP SW	MA 2015/CZ/REGIO/ C4/1416/1	Audit of MCS functionality according to article 60 and 72 EC Regulation No. 1083/2006; Verification of PC 2 sufficient operation selection and PC 4 sufficient management control.	PC 2 assessed by category 2, PC 4 by category 2 with the exception of public procurement where management controls were carried out before 31 August 2012 were reimbursed after this date.	Complete, findings accepted
	Mare	OPR7+	MA 2015/CZ/Mare/F1/1 AB 2015/CZ/Mare/F1/1	Assurance on MCS efficient functionality , focused on AB, partly on MA.	MA draft report; 9 findings identified, assessed by category 2. AB draft report; 2 findings identified, assessed by category 2.	Complete, not applicable , AB remedied most of the shortcomings.
	Regio	ROP MS	AB 2015/CZ/REGIO/ J4/1473/1	Gain assurance on system functionality 2007–2013 through scrutiny of audit bodies activity.	Category 2, shortcomings identified (ineligible expenditure), inadequate procedures within performed audits.	Complete, finding accepted
	Regio Mare	PCA	PCA 2014/CZ/REGIO/ C4/1392/1 2015/DT/MARE/F1/1	Audits of fund reclaim	Category 2, Procedural shortcomings, inadequate procedures.	Complete, findings accepted
2016	Regio	Closure of ROP SE ROP CB OPT	AB 2016/CZ/REGIO/ C4/1557/1	Gain assurance on system functionality 2007–2013 through scrutiny of audit bodies activity, including the processes closing the programming period.	One irregularity identified in the process of closure (inadequate determining of estimated - expected rate of error on the sampling of operations). Category 2, shortcomings identified (ineligible expenditure), inadequate audit procedures.	Incomplete, not applicable
	Empl	Closure of OPPA OPEC OP HRE	AB MAPAR EMPG307CZ0092	Scrutiny of MA, PCA and AB readiness for closure of OPPA, OP HRE and OPEC	Risk areas identified	Incomplete, not applicable
	Empl Regio	OP RDE	MA, PCA, AB Observations of the Commission designation	Scrutiny of MA and PCA designation for OP RDE	Risk areas identified	Incomplete, not applicable

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