

## The EU Budget System

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### Financial Regulation

The budget enables the European Union (EU) to meet the needs for financing its programmes and projects in various policy areas. To finance its expenditure, the EU has its own resources (customs duties, agricultural levies, value added tax (VAT) and the resource based on gross national revenue (GNI). This Regulation lays down the rules applicable to the establishment and implementation of the general budget of the European Communities.

#### ACT

**Council Regulation (EC, Euratom) No [1605/2002](#) of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities [[See amending acts](#)].**

#### SUMMARY

This Regulation, which replaces the [1977 Financial Regulation](#), satisfies a need for rigour and a simpler legislative and administrative set-up in the management of the Community's finances. The scope of the new Financial Regulation is confined to stating the broad principles and basic rules governing the Community budget. The detailed technical arrangements are laid down in the rules for the implementation of the Financial Regulation, adopted by the Commission.

Besides the basic precepts of budgetary and financial management, the new Financial Regulation also lays down rules on the keeping and presentation of accounts, public procurement and the award of grants. It also establishes the rules governing the liability of authorising officers, accounting officers and internal auditors and sets out the arrangements for external control and the discharge procedure. Finally, the Regulation lays down special provisions applicable to the EAGGF Guarantee Section, the Structural Funds, research and external action.

## **BUDGETARY PRINCIPLES**

The Financial Regulation reasserts the budgetary principles enshrined in the EC Treaty and keeps exceptions to a strict minimum subject to strict conditions.

### **Principles of unity and of budget accuracy**

These principles mean that all Community revenue and expenditure, and that of the Union, when this is charged to the budget, are entered in the budget. This covers the revenue and expenditure of the European Community and the European Atomic Energy Community (Euratom) and the operational expenditure on implementing the provisions of the EU Treaty relating to the common foreign and security policy and police and judicial cooperation in criminal matters, where this is charged to the budget.

### **Principle of annuality**

This principle means that expenditure entered in the budget is authorised for one financial year only, which runs from 1 January to 31 December. However, this rule is relaxed by the distinction that is still made between differentiated appropriations and non-differentiated appropriations. The concept of differentiated appropriations, which, unlike non-differentiated appropriations, consist of commitment appropriations and payment appropriations, needs to be applied because some measures have to be spread over a number of years. Commitment appropriations cover, for the current financial year, the total cost of the legal commitments entered into for actions extending over more than one financial year. Payment appropriations cover payments made to honour these commitments in the current financial year and/or earlier financial years.

In principle, appropriations which have not been used at the end of the financial year for which they were entered are cancelled. It is, however, possible for such appropriations to be carried over to the next financial year, subject to conditions and limits laid down by the Regulation. This applies to appropriations for commitment of differentiated appropriations and non-differentiated appropriations not yet committed at the close of the financial year for which most of the preparatory stages of the commitment procedure have been completed by 31 December or where the relevant basic act was adopted in the final quarter of the financial year. Payment appropriations may also be carried over to cover existing commitments or commitments linked to commitment appropriations carried over. Non-differentiated appropriations corresponding to obligations duly

contracted at the close of the financial year are carried over automatically to the following financial year only.

If the budget has not been finally adopted at the beginning of the financial year, i.e. 1 January, the Regulation provides for the application of a "provisional twelfths system". In this case expenditure may be incurred monthly per chapter up to a maximum of one twelfth of the existing appropriations in the budget of the preceding financial year.

### **Principle of equilibrium**

This means that budget revenue and payment appropriations must be in balance, as the Communities are not authorised to raise loans in order to cover their expenditure. The balance from each financial year is entered in the budget for the following financial year as revenue in the case of a surplus or as a payment appropriation in the case of a deficit.

### **Principle of unit of account**

In principle, the euro is the unit of account for drawing up and implementing the Community budget and presenting the accounts. However, certain operations may be carried out in national currencies subject to conditions laid down in the rules for the implementation of the Financial Regulation.

### **Principle of universality**

The principle of universality means that total budget revenue covers total budget expenditure. This gives rise to two important rules: no assignment of revenue and no offsetting.

The no-assignment rule precludes the use of specific revenue to finance specific expenditure. The Financial Regulation allows exceptions to this principle, for example the Member States' financial contributions to certain research programmes and contributions from third countries to the Community's activities in the framework of the European Economic Area.

The no-offsetting rule means that revenue and expenditure cannot be adjusted against each other, thereby ensuring a comprehensive and exhaustive presentation of the budget. The total amounts of revenue and expenditure are therefore entered in the

budget, the only exceptions being those specifically authorised by the Financial Regulation or its Implementing Rules.

### **Principle of specification**

To avoid any confusion between the different types of appropriations, each appropriation must be earmarked for a specific purpose and assigned to a specific item of expenditure. The budget is divided into sections, titles, chapters, articles and items. However, since the institutions require a certain flexibility of management, the Financial Regulation lays down rules on the transfer of appropriations. An institution may be allowed to carry out a transfer autonomously or it may first have to submit it to the budgetary authority (the Council and Parliament) for information purposes or for a decision.

### **Principle of sound financial management**

This principle is defined by reference to the principles of economy, efficiency and effectiveness. In operational terms this entails defining verifiable objectives which are monitored using measurable performance indicators in order to make the transition from resource-based management to results-oriented management. The institutions must carry out ex ante and ex post evaluations in accordance with guidelines laid down by the Commission.

### **Principle of transparency**

The aim here is to ensure transparency in drawing up and implementing the budget and in presenting the accounts. One of the ways of practising transparency is to publish the budget and amending budgets in the Official Journal of the European Union. This is done two months after the budget is declared finally adopted by the European Parliament.

## **ESTABLISHMENT AND STRUCTURE OF THE BUDGET**

### **Drawing up the budget**

The institutions must draw up their estimates of expenditure and revenue and send them to the Commission by 1 July each year. These estimates are also sent to the budgetary authority for information.

The Commission places a preliminary draft budget before the Council by 1 September each year at the latest. The preliminary draft contains all the institutions' estimates and presents a general summary of the expenditure and revenue of the Communities. A letter of amendment to the preliminary draft budget may be laid before the Council.

The Council establishes the draft budget in accordance with the procedure laid down in Article 272(3) of the EC Treaty and places it before Parliament by 5 October of the year preceding that in which the budget is to be implemented. If the Council departs from the preliminary draft, it must attach an explanatory memorandum stating its reasons.

The President of the Parliament declares the budget finally adopted. From the date of this declaration, the Member States are liable for the sums they must pay as determined by the system of own resources.

The Financial Regulation allows for amending budgets to be drawn up in certain exceptional circumstances. The distinction between supplementary budgets and amending budgets has been abolished.

### **Structure and presentation of the budget**

The budget consists of:

- a summary statement of revenue and expenditure;
- separate sections subdivided into statements of revenue and expenditure for each institution.

Commission revenue and the revenue and expenditure of the other institutions is classified, according to their type or the use to which they are assigned, under titles, chapters, articles and items. The statement of expenditure for the Commission section is classified according to purpose. A title corresponds to a policy area and a chapter corresponds to an activity. The Regulation therefore introduces an "activity-based budgeting" method. The budget may not contain negative revenue.

The Commission section of the budget may include a "negative reserve" limited to a maximum amount of EUR 200 million, which may comprise commitment appropriations and payment appropriations.

The Commission section contains two reserves:

- one for emergency aid for third countries;
- one for Community loans and loan guarantees to third countries.

The summary statement of revenue and expenditure in the budget shows:

- the estimated revenue for the financial year in question;
- the estimated revenue for the preceding financial year and the revenue for year n-2;
- the commitment and payment appropriations for the financial year in question and the preceding financial year;
- the expenditure committed and the expenditure paid in year n - 2,
- a summary statement of the schedule of payments due in subsequent financial years;
- appropriate remarks on each subdivision.

The budget also contains an establishment plan for each section of the budget and shows borrowing and lending operations.

### **IMPLEMENTATION OF THE BUDGET**

The Commission implements the revenue and expenditure of the budget, on its own responsibility and within the limits of the appropriations authorised. A basic act of secondary legislation must first be adopted before the appropriations entered in the budget for any Community action may be used. However, the following may be implemented without a basic act:

- appropriations for pilot schemes of an experimental nature designed to test the feasibility of an action and its usefulness;
- appropriations for preparatory actions, designed to prepare proposals with a view to the adoption of future actions;

appropriations for one-off actions, or even actions for an indefinite duration, carried out by the Commission by virtue of tasks resulting from its prerogatives at institutional level pursuant to the EC and Euratom Treaties, other than its right of legislative initiative and under specific powers conferred on it by the Treaties;

- appropriations for the operation of each institution under its administrative autonomy.

### **Methods of implementation**

The Commission implements the budget:

- on a centralised basis:  
implementation tasks are performed either directly by its departments or indirectly by executive agencies created by the Commission, bodies set up by the Communities - provided that this is compatible with the tasks set out in the basic act - and, subject to certain conditions, national public-sector bodies or bodies governed by private law with a public-service mission;
- on a shared or decentralised basis:  
implementation tasks are delegated to the Member States (shared management) or third countries (decentralised management); the Commission applies clearance-of-accounts procedures or financial correction mechanisms enabling it to assume final responsibility for the implementation of the budget;
- by joint management with international organisations:  
certain implementation tasks are entrusted to international organisations.

As the Commission is responsible for implementation of the budget, it may not delegate any tasks of public authority involving the use of discretionary powers implying political choices. So bodies governed by private law, other than those with a public-service mission, may provide only technical expertise services and perform preparatory or ancillary tasks.

### **Financial players**

The Regulation lays down a **principle of segregation of duties**. The duties of authorising officer and accounting officer are therefore segregated and mutually incompatible.

The **authorising officer** is responsible for implementing revenue and expenditure in accordance with the principles of sound financial management and for ensuring that the requirements of legality and regularity are complied with. These duties are performed by the institution itself. It lays down in its internal administrative rules the staff of an

appropriate level to whom it delegates this task (authorising officers by delegation). The authorising officer by delegation puts in place the organisational structure and the internal management and control procedures suited to the performance of his/her duties.

Each institution appoints an **accounting officer** who is responsible for:

- proper implementation of payments, collection of revenue and recovery of amounts established as being receivable;
- preparing and presenting the accounts;
- keeping the accounts;
- laying down the accounting rules and methods and the chart of accounts;
- laying down and validating the accounting systems and, where appropriate, validating systems laid down by the authorising officer to supply or justify accounting information;
- treasury management.

### **Liability of the financial players**

Without prejudice to any disciplinary action, any authorising officer, accounting officer or imprest administrator may at any time be suspended temporarily or definitively from their duties. All authorising officers and imprest administrators are liable to disciplinary action and payment of compensation, as laid down in the Staff Regulations. Each institution must set up a specialised financial irregularities panel which will determine whether a financial irregularity has occurred and what the consequences, if any, should be.

### **Revenue operations**

An estimate of revenue constituted by own resources is entered in the budget in euros. It is made available in accordance with a specific Regulation.

An **estimate of the amount receivable** is first made by the authorising officer responsible in respect of any measure or situation which may give rise to or modify an amount owing to the Communities. By way of derogation, no estimate of the amount receivable is made before Member States make available own resources at fixed intervals. The authorising officer responsible issues a recovery order in respect of these amounts.

The authorising officer establishes the **amount receivable** by:

- verifying that the debt exists;
- determining or verifying the reality and the amount of the debt;
- verifying the conditions in which the debt is due.

The **authorisation of recovery** is the act whereby the authorising officer responsible instructs the accounting officer, by issuing a recovery order, to recover an amount receivable which he/she has established.

The accounting officer acts on **recovery orders** for amounts receivable duly established by the authorising officer responsible. Where a debtor has a claim on the Communities that is certain, of a fixed amount and due the accounting officer can recover the Communities' claims by offsetting them against equivalent amounts that the Communities owe. Where the responsible authorising officer by delegation is planning to waive recovery of an established amount receivable, he/she must ensure that the waiver is in order and complies with the principle of sound financial management and proportionality.

### **Expenditure operations**

Every item of expenditure is committed, validated, authorised and paid. Except in the case of appropriations which can be implemented without a basic act, the commitment of the expenditure is preceded by a financing decision adopted by the institution or the authorities to which powers have been delegated by the institution.

The **budgetary commitment** is the operation reserving the appropriation necessary to cover subsequent payments to honour a legal commitment. The legal commitment is the act whereby the authorising officer enters into or establishes an obligation which results in a charge. The budgetary commitment and the legal commitment are adopted by the same authorising officer, save in duly substantiated cases as provided for in the Implementing Rules.

**Validation of expenditure** is the act whereby the authorising officer responsible:

- verifies the existence of the creditor's entitlement;
- determines or verifies the reality and the amount of the claim;

- verifies the conditions in which payment is due.

**Authorisation of expenditure** is the act whereby the authorising officer responsible, having verified that the appropriations are available and by issuing a payment order, instructs the accounting officer to pay an amount of expenditure that he/she has validated.

**Payment** is made on production of proof that the relevant action is in accordance with the provisions of the basic act or the contract and covers one or more of the following operations:

- payment of the entire amount due;
- payment of the amount due in any of the following ways: pre-financing, which may be divided into a number of payments; one or more interim payments; payment of the balance of the amounts due.

The **time limits for expenditure** operations are laid down in the implementing rules, which also specify the circumstances in which creditors paid late are entitled to receive default interest charged to the line from which the principal was paid.

### **Internal auditor**

Each institution must establish an internal auditing function which must be performed in compliance with the relevant international standards. The internal auditor may not be either authorising officer or accounting officer. The internal auditor appointed by the institution is answerable to the latter for verifying the proper operation of budgetary implementation systems and procedures. He/she does not have the role of exercising control over these operations ahead of the decisions by the authorising officers; the latter now assume full responsibility for such decisions.

The internal auditor advises his/her institution on dealing with risks, by issuing independent opinions on the quality of management and control systems and by issuing recommendations for improving the conditions of implementation of operations and promoting sound financial management.

### **PROCUREMENT**

The Regulation sets out the scope of and the basic principles governing public procurement. It lays down advertising obligations and the procedures for procurement. All contracts must be in writing and concluded by a contracting authority, i.e. either by a Community institution acting on its own account or for a third-party beneficiary, or by that beneficiary or a third party acting on its behalf, in the external action field.

For the sake of transparency, the Commission is required to inform all applicants and tenderers of its choice. Persons supplying false or fraudulent information or caught by a conflict of interests can now be excluded from procurement. Details of such persons are entered in a database which is also accessible to the other European institutions.

## **GRANTS**

The Regulation sets out the scope of grants, the procedure for awarding them and the arrangements for payment and controls. Grants are direct financial contributions, by way of donation, from the budget in order to finance:

- either an action intended to help achieve an objective forming part of an EU policy;
- or the functioning of a body which pursues an aim of general European interest or has an objective forming part of an EU policy.

Grants are awarded subject to the principles of transparency and equal treatment. They may not be cumulative or awarded retrospectively and they must involve co-financing. Nor may the grant have the purpose or effect of producing a profit for the beneficiary. All grants awarded must be published annually with due observance of the requirements of confidentiality and security.

## **PRESENTATION OF THE ACCOUNTS AND ACCOUNTING**

The Community accounts comprise:

- the financial statements of the institutions;
- the consolidated financial statements, which present in aggregated form the financial information contained in the financial statements of the institutions;
- the reports on implementation of the budget of the institutions and the budgets of the bodies set up by the Communities;

- the consolidated reports on implementation of the budget.

By 15 June at the latest the Court of Auditors makes its observations on the provisional accounts of each institution and each body. Each institution and each body draws up its final accounts, on its own responsibility, and sends them to the Commission's accounting officer and the Court of Auditors by 1 July of the following year at the latest with a view to drawing up the final consolidated accounts.

After approving the final consolidated accounts, the Commission sends them to the European Parliament, the Council and the Court of Auditors before 31 July of the following financial year. The final consolidated accounts are published in the Official Journal of the European Union together with the statement of assurance given by the Court of Auditors by 31 October of the following financial year. The Commission regularly sends Parliament and the Council information on the implementation of the budget.

The institution's accounting system is the system serving to organise the budgetary and financial information in such a way that figures can be input, filed and registered. The accounts consist of general accounts and budgetary accounts. These accounts are kept in euros on the basis of the calendar year.

After consulting the accounting officers of the other institutions and bodies set up by the Communities, the Commission's accounting officer adopts the accounting rules and methods and the harmonised chart of accounts to be applied by all the institutions, offices and Community bodies. When adopting these rules and methods, the Commission's accounting officer is guided by the internationally accepted accounting standards for the public sector but may depart from them where justified by the specific nature of the Communities' activities.

## **EXTERNAL AUDIT AND DISCHARGE**

As the Court of Auditors is responsible for external audit, Parliament, the Council and the Commission inform it as soon as possible of decisions and acts adopted in respect of financial matters. It examines whether all revenue has been received and all expenditure incurred in a lawful and proper manner with regard to the provisions of the Treaties, the budget, the Financial Regulation, the Implementing Rules and all other acts adopted pursuant to the Treaties.

The Commission, the other institutions, the bodies administering revenue or expenditure on the Communities' behalf and the final beneficiaries of payments from the budget provide the Court of Auditors with:

- all documents concerning the award and performance of contracts financed by the Community budget and all accounts of cash or materials;
- all accounting records or supporting documents, and also administrative documents relating thereto;
- all documents relating to revenue and expenditure of the Communities;
- all inventories and all organisation charts of departments that the Court of Auditors considers necessary for auditing the budgetary and financial outturn report on the basis of records or on the spot;
- all documents and data created or stored on a magnetic medium.

Following a dialogue with the other institutions, the Court of Auditors produces an annual report then a special report containing an assessment of financial management.

On a recommendation from the Council acting by a qualified majority, the European Parliament gives a discharge to the Commission in respect of the implementation of the budget for year  $n$  before 30 April of year  $n + 2$ . The discharge decision covers the accounts of all the Communities' revenue and expenditure, the resulting balance and the assets and liabilities of the Communities shown in the balance sheet.

### **SPECIAL PROVISIONS**

The Regulation provides for a number of derogations applicable to the financial management of:

- the European Agricultural Guidance and Guarantee Fund (EAGGF), Guarantee Section;
- the Structural Funds;
- research and technological development activities;
- external action financed by the budget;
- the European offices (administrative structures set up by one or more institutions to perform specific cross-cutting tasks);
- administrative appropriations.

## FINAL PROVISIONS

The final provisions state among other things that:

- the Commission will adopt rules for implementing the Financial Regulation;
- every three years, or whenever it proves necessary to do so, the Financial Regulation will be the subject of a review, after recourse to the conciliation procedure, if the European Parliament so requests.
- the Commission will adopt a framework financial regulation for the bodies set up by the Communities and having legal personality which actually receive grants charged to the budget

## AMENDMENTS IN 2006

The amendments to the Financial Regulation made in December 2006, applicable with effect from 1 May 2007, are aimed at simplifying the financial rules in order to reduce administrative procedures. This simplifies access to financing for the [2007-2013 financial framework](#). The changes mainly concern grants and public procurement. Greater flexibility in the management of funds makes it possible to react immediately to humanitarian or crisis situations at the end of the year. The amending Regulation also contains provisions to improve public control, for example:

- the names of the beneficiaries of the Structural Funds, external aid programmes and appropriations from the agricultural funds must be made public;
- in order to prevent fraud and corruption, a database has been set up (shared with the other European institutions and the national authorities) of the organisations excluded from EU financing;
- the Member States' reports on the three-quarters of the EU budget that they manage will be improved thanks to the establishment of internal control systems.

## REFERENCES

Act	Entry into force - Date of expiry	Deadline for transposition in the Member States	Official Journal
Council Regulation (EC, Euratom) No <a href="#">1605/2002</a>	01.01.2003	-	Official Journal L 248 of 16.09.2002

<b>Amending act(s)</b>	<b>Entry into force</b>	<b>Deadline for transposition in the Member States</b>	<b>Official Journal</b>
Council Regulation (EC, Euratom) No <a href="#">1995/2006</a>	19.1.2007	-	Official Journal L 390 of 30.12.2006
Regulation (EC) No <a href="#">1525/2007</a>	27.12.2007	-	OJ L 343 of 27.12.2007

## RELATED ACTS

**Commission Regulation (EC, Euratom) No [2342/2002](#) of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No [1605/2002](#) on the Financial Regulation applicable to the general budget of the European Communities, [Official Journal L 357, 31.12.2002].**

The purpose of this Regulation is to follow up the new Financial Regulation and transpose its principles and definitions into practical rules. So it is here that the real rules of financial management are laid down, the new Financial Regulation having been simplified compared with its 1977 predecessor, with all detailed provisions being transferred to the Implementing Rules.

This Regulation was amended by:

- Commission Regulation (EC, Euratom) No [1261/2005](#) of 20 July 2005 [Official Journal L 201 of 2.8.2005];
- Commission Regulation (EC, Euratom) No [1248/2006](#) of 7 August 2006 [Official Journal L 227 of 19.8.2006];
- Commission Regulation (EC, Euratom) No [478/2007](#) of 23 April 2007 [Official Journal L 111 of 28.4.2007].

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For further information, please consult the website of the Commission's [Directorate-General for Budget](#) .