Czech Republic
Supreme Audit Office

NKÚ

EU REPORT 2018

REPORT ON THE EU FINANCIAL MANAGEMENT IN THE CZECH REPUBLIC

SEPTEMBER 2018

Supreme Audit Office
Jankovcova 2
170 04 Prague 7
tel.: +420 233 045 111
fax: +420 220 808 094
www.nku.cz

Contents

Appendices:

Editor‘s note:

The editorial deadline for the *EU Report 2018*, the subject of which is the financial management of the EU funds in the Czech Republic, was set at 31 March 2018. In exceptional cases, data available after this date have also been used. However, these figures are for information only and are not subject to comparison.

The *EU 2018 Report* is based on the proven concept of summarising information from the point of view of the Supreme Audit Office (SAO) on the development of the financial management of the European Union (EU) funds in the Czech Republic (CR) over the last twelve calendar months, i.e. from April 2017 to March 2018 (period under scrutiny).

The data and information presented on financial resources relating to both the revenue and expenditure side of the EU budget as well as to the national budget of the Czech Republic have been requested from the relevant Czech implementing bodies in order to ensure they are up-to-date, comprehensive and coherent. The data on the overall financial management of the EU budget as well as the situation in individual EU member states (MS) have been taken from available summary reports published by the European Commission (the “Commission”) and its bodies for the financial year 2016 as more recent data were not available.

The Section on audits conducted by the Supreme Audit Office (SAO) includes findings from audit conclusions approved by the SAO Board in the period under scrutiny. The overview of audits completed in this period is presented in Annex 1. In several cases, the outcomes from the SAO‘s monitoring and analytical activities relate to longer periods.

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 2017.

Unless specified otherwise in the *EU Report 2018*, the Czech koruna/euro exchange rate published by the European Central Bank (ECB) as at 29 December 2017, i.e. 25.535 CZK/€, has been used.

Opening message from the president of the Supreme Audit Office

Dear Readers,

We are in the year 2018 and the fifth year of the 2014-2020 programming period.

At this point I would very much like to say that the Czech Republic has learned from its past mistakes and that the drawdown of funds is no longer associated with the problems that our audits have frequently pointed out in the past. Unfortunately, I would not be telling the truth. Even in the fifth year of the current programming period, the drawdown of European funds in the Czech Republic is not something we can be proud of. The use of European funds is still associated with long-standing challenges - for example, high administrative demands, a long project approval process, or general and vague objectives from which we have no way of knowing how the billions from Europe are actually helping us. Last but not least, the slowness of our drawdown.

At the end of March 2018, the value of funds in the applications for interim payments sent to the Commission for individual programmes was only about 12% of the roughly CZK 570 billion prepared under the main allocation for the Czech Republic. This is a repeat of the situation we found ourselves in when the end of the previous programming period was approaching.

In all likelihood, we are rushing into a situation where the main criterion will be to report on how the Czech Republic has finally managed these European subsidies. What use is it when such an intense attack on European resources can and probably will be accompanied by mistakes, wastefully spent funds, or support for projects that should never really have got beyond the planning stage?

Moreover, I view the inability to efficiently draw down European funds as all the more critical in view of the future of EU funding and the significant losses that our country faces. There will be fewer and fewer allocated, and thus easily accessible subsidies. And if we want to compensate for this loss by drawing on other Community programmes and funds, we will have to be able to compete with other EU applicants with the quality of our projects. The lessons learned from our programme management audits in the Czech Republic do not fill me with optimism in this respect.

When in a year's time I speak again to you as readers of this publication, I would be very happy if I were able to say that the Czech Republic has finally learned its lesson and that the old problems are beginning to be behind us. If it turned out that this was just too black a scenario that eventually did not transpire.

Either way, we will not have to wait long for an answer. Meanwhile, in this year's edition, please take a look at what has emerged from our recent audits on the funds provided by the European Union and how we are doing in matters related to them.

Miloslav Kala,
SAO President

List of abbreviations

AIS	Audit and Information System
AB	Audit Body (MoF-Dept. 52)
AFCOS	Anti-Fraud Coordination Services
AR 2016	ECA's Annual Report concerning the 2016 budget implementation
CAP	Common Agricultural Policy
CB	Certification Body
CC	Contact Committee
CCP AFCOS	Central Contact Point of the AFCOS network
CF	Cohesion Fund
CLLD	Community-led Local Development
CMO	Common Market Organisation
CNB	Czech National Bank
Cohesion policy	Economic, territorial and social Cohesion Policy
Commission	European Commission
Council	Council of the European Union
Court of Justice	Court of Justice of the European Union
CR	Czech Republic
CRAB	Central Register of Administrative Buildings
DAS	Statement of Assurance (Déclaration d’assurance)
DESI	Digital Economy and Society Index
DG EMPL	Directorate-General for Employment, Social Affairs and Equal Opportunities
DG MARE	Directorate-General for Maritime Affairs and Fisheries
DG Regio	Directorate-General for Regional and Urban Policy
EAFRD	European Agricultural Fund of Rural Development
EAGF	European Agricultural Guarantee Fund
ECA	European Court of Auditors
ECB	European Central Bank
EDF	European Defence Fund
EFTA	European Free Trade Association
EIA Directive	Directive on Environmental Impact Assessment: Directive 2011/92/EU of the European Parliament and of the Council of 13 December 2011 on the assessment of the effects of certain public and private projects on the environment
EIB	European Investment Bank
EMFF	European Maritime and Fisheries Fund
EP	European Parliament

ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
EU	European Union
EUSF	European Union Solidarity Fund
GD	Grant Decision
GDP	Gross Domestic Product
GNI	Gross National Income
IB	Intermediate Body
ICT	Information and Communication technologies
II	Integrated Instruments
IMS	Irregularities Management System
IOP	Integrated operational programme
IROP	Integrated Regional operational Programme for 2014-2020
IS	Information System
ITDP	Integrated Territorial Development Plans
ITI	Integrated Territorial Investments
LAG	Local Action Group
MA	Managing Authority
MCS	Management and Control System
MEYS	Ministry of Education, Youth and Sports
MfRD	Ministry for Regional Development
MoA	Ministry of Agriculture
MoD	Ministry of Defence
MoE	Ministry of Environment
MoF	Ministry of Finance
MoI	Ministry of the Interior
MoIT	Ministry of Industry and Trade
MoLSA	Ministry of Labour and Social Affairs
MS	Member State
NCA	National Coordination Authority (MfRD)
NFP	National Forestry Programme to 2013
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
OPEn	OP Environment 2014-2020
OPF	OP Fisheries
OP HRE	OP Human Resources and Employment
OPPA	OP Prague-Adaptability
OP PGP	OP Prague – Growth Pole of the CR
OP RDE	OP Research, Development and Education

OP R&DI	OP Research & Development for Innovation
OPT	OP Transport
OPT7+	OP Transport 2007-2013
OPTA	OP Technical Assistance 2014-2020
other irregularities	irregularities of non-fraudulent nature
PA	Priority Axis
Partnership Agreement	Partnership Agreement for the 2014-2020 programming period
PCA	Paying and Certifying Authority
PP7+	2007-2013 Programming Period
PP14+	2014-2020 Programming Period
PPA	Public Procurement Act
R&D	Research & Development
RDP	Rural Development Programme
RDP7+	Rural Development Programme 2007-2013
RMD	Road and Motorway Directorate
ROP	Regional Operational Programme NUTS II
SAI	Supreme Audit Institution
SAIF	State Agricultural Intervention Fund
SAO	Supreme Audit Office
SAPS	Single Area Payment Scheme
Semester	European Semester
SFTI	State Fund of Transport Infrastructure
SME	Small and mediums-sized enterprises
SR	ECA’s Special Report
Strategy of MoA	Strategy of the Ministry of Agriculture of the Czech Republic to 2030
TOR	Traditional Own Resources
Transposition Report	Report on the transposition of legal commitments arising from the Czech Republic's membership in the European Union for 2017
VAT	Value Added tax
VAT Action Plan	Plan entitled “Towards a Single EU VAT Area: Time to Adopt a Decision“
2018 Report	2018 Report on the Czech Republic

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

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

Summary

Budgetary Matters and Protection of the EU's Financial Interests

The EU Budget for 2016 was made up of total **revenues** of € **144.09 billion** and **expenditure** of € **136.42 billion** (including € 4.63 billion[1]). **The Czech Republic received** a total of **€ 4.69 billion** from the EU budget (including the Commission's administrative costs and the costs of the Commission's decentralized agencies in the Czech Republic) and **contributed** € **1.73 billion. The net position of the Czech Republic for the year 2016 was € 2.92 billion.** According to the MoF press release of 31 January 2018, the **net position of the Czech Republic for the year 2017** was a total of **€ 2.11 billion**; the lower value related to the completion of the 2007-2013 programming period (PP7+). The Commission has not yet published the budget implementation figures for 2017.

For 2016, EU Member States reported 1,339 irregularities of a fraudulent nature, of which the Czech Republic reported 53 cases. In the category of irregularities of a non-fraudulent nature (other irregularities) 15,691 cases were reported, of which 536 were reported by the Czech Republic.

The Commission launched the **2017 European Semester**[2] by publishing the ***Annual Growth Survey for 2017*** and outlined economic policy priorities with an emphasis on social justice and growth. Within the outlines of the recommended priorities, in April 2017 the **Czech Republic submitted** the government-approved documents entitled ***2017 National Reform Programme for the Czech Republic*** and the **Convergence Programme for the Czech Republic** (April 2017) to the **Commission,** which forwarded them with the recommendations **to the Council of the European Union** (the Council). **The Council recommended that the Czech Republic should secure the long-term sustainability of public finances** in the face of an ageing population **and increase the effectiveness of public spending** through the fight against corruption and inefficient public procurement procedures.

Implementation of strategic documents by the Czech Republic was investigated by the Commission, which issued the ***2018 Report on the Czech Republic***[3] (2018 Report), assessing progress on the structural reforms recommended by the Council. The result of the overall assessment was the statement that the **Czech Republic had made some progress,** supported by increased effectiveness of public finances and increased efficiency of public procurement procedures. The adoption of measures for the pension system was evaluated as of limited progress.

Sector matters

- **EU budget revenues**

In 2017, the fight against tax fraud continued. **The Commission has put forward a package of legislative proposals introducing the final VAT system.** The measures taken should reduce cross-border fraud by 80%. In the digital tax system, the **Package of Proposals introduces a process that supports a single digital market and** introduces **new rules for profit distribution between individual MS.**

1 This is expenditure covered by an appropriation from assigned revenue resulting from decisions on accounts closing, irregularities and the milk levy.

2 The EU's 2017 political timetable, according to which MS negotiate their budgetary and economic plans.

3 *2018 Report on the Czech Republic* - Commission Working Document, SWD (2018) 202 final version - dated 7 March 2018.

- **Expenditure co-financed by the European structural and investment funds (ESIF)**

Over CZK 700 billion was earmarked from the EU budget in PP7+ for the Czech Republic, of which 96.4% was used, the remaining **approximately CZK 26.5 billion is an estimate of the allocation not drawn down**, which will be reflected in the Commission's decommitment. The final settlement will be influenced inter alia by the completion of so-called phased projects.

The total allocation of EU funds earmarked for the Czech Republic in the 2014-2020 programming period (PP14+) is € 23.87 billion (approx. CZK 606 billion). **Drawdown is encountering problems,** which is evident, for example, from a comparison with other MS, in which the Czech Republic ranks in the less successful half. By the end of March 2018, the volume of funds in legal acts concluded for aid granting/transfer was only 52% of the main allocation (i.e. the total allocation less 6% of the performance reserve), and in interim payment applications sent to the Commission, only 12.3% of the main allocation. **In 2018, Czech implementing bodies will have to cope with the obligation to meet the financial obligations resulting from the application of the n+3 rule and the obligation to reach milestones if performance reserve is to be allocated.** The Ministry for Regional Development (MfRD) as the National Coordination Authority (NCA) has assessed the risks of implementing the *Partnership Agreement for the 2014-2020 programming period* (Partnership Agreement) and has divided ESIF co-financed programmes into three risk categories, see sub-chapter B.2.2.4.

- **Expenditure on direct payments and common market organisation**

In 2017, payments under the first pillar of the Common Agricultural Policy (CAP) accounted for nearly CZK 24.35 billion in the Czech Republic, of which more than CZK 22.98 billion was contributed from the EU budget. **The major part consisted of direct payments of CZK 23.17 billion** (of which CZK 22.35 billion from the EU budget), **which are mainly applied in the Czech Republic under the single area payment scheme** (SAPS). Financial support under the Common Market Organization (CMO) with spending of approximately CZK 1.18 billion was mainly aid for the production of livestock and fruit and vegetables, compensation for losses, intervention purchases and storage aid.

Results of SAO auditing and monitoring activities

During the period under scrutiny, the Board of SAO approved audit conclusions from 13 audits focused on EU budget funds. 98 entities were inspected, **with established deficiencies estimated at CZK 842.92 million**, of which **CZK 55.52 million were notifications sent to tax administrators.** A total of **620 identified deficiencies** were described in the audit conclusions covering all types of audits performed (performance audits, financial audits and legality audits), of which 93 cases of infringements of legal regulations and other standards were identified within the audits of legality and operational regularity. The regulations governing public procurement were those most often violated, followed by regulations for setting up and functioning of the management and control system (MCS), statutory standards defining eligibility/ineligibility of expenditures and regulations concerning accounting and reporting. The findings gained from individual audits as well as the monitoring results are detailed in Section C.

Since the beginning of 2015, the SAO has been monitoring the measures adopted within discussion of audit conclusions at the meetings of the Government of the Czech Republic. **By the end of March 2018, the government had discussed a total of 52 audit conclusions** focused on EU budget funds and the **Managing Authorities (MA) had proposed 240 measures to remedy the identified deficiencies.** Of these, **46 measures have already been clearly implemented**, another **13 have been implemented in part,** and for **135 of the proposed measures the**

SAO has no conclusive and complete information on the status of their implementation. A total of 46 measures have failed to be implemented, not least because they are essentially amendments to legislation, which is a change of a long-term nature for which a time limit is difficult to establish.

Risks defined by the SAO in the field of EU finance management

Based on the results of audits focused on EU-co-financed programmes and projects and on the basis of analytical materials from on-going monitoring of individual aid sectors, the **SAO has defined a total of 19 risks** that may have a negative impact on drawdown of funds from the EU budget. These risks may continue to slow down the drawdown of the allocation and prevent reaching the milestones set for the end of 2018 - see Section D

Audits by other external audit bodies in the Czech Republic

In order to provide comprehensive information on the implementation of aid from EU funds in the Czech Republic from the point of view of the external audit authorities, **the SAO** in the *2018 EU Report* also **presents the results of AB and ECA audits and opinions**. In the course of 2017, the **Audit Body** carried out operations audits in accordance with EU legislation and assessed the functioning of the MCS of each programme. It issued **an unqualified opinion for seven operational programmes (OP), a qualified** opinion for **two OP**s and for **one OP it declined to give an opinion because** its expenditure had not been certified.

In connection with the Statement of Assurance **for 2016, the ECA performed in the Czech Republic audits of 24 Cohesion Policy operations and 12 operations in the field of natural resources.** In both fields, **approximately one third of operations were affected by error.** Over the period under scrutiny**, the ECA performed 31 performance audits. Entities from the Czech Republic were included** in the audited sample **in four cases.**

Legal matters

In the Czech Republic in 2017, the **transposition deficit increased to above EU average, with as many as 17 directives in delay.** The average delay time has decreased slightly.

A. Budgetary matters and protection of the EU's financial interests

The European Union budget is a key instrument for the implementation of European policies, complementing national budgets and contributing to the fulfilment of the EU's shared political priorities and its ability to respond to the challenges it is facing.

A.1 EU budget 2016

On 24 February 2016, the EU's general budget for the financial year 2016 was published[4].

Table 1: Summary of the EU budget approved for 2016 **(€ billion)**

Appropriations by heading	Commitments	Payments
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.

In response to the Commission's proposals, the Council and the European Parliament (EP) adopted in the course of 2016 a total of six so-called amending budgets[5], which allowed the EU budget to be updated on an on-going basis in line with current developments.

When drawing up and implementing the budget, the Commission applies the principles of its own initiative, called the *EU Budget Focused on Results*. This initiative builds on the 2014-2020 performance frameworks and strikes a balance between rules on the one hand and performance and high added value on the other.

In June 2017, the Commission issued the *2016 Annual Management and Performance Report for the EU Budget*[6], providing details to the relevant EU bodies on the performance, management and protection of the EU budget. This report notes, inter alia, that although the rate of error is decreasing year on year, the ECA has not yet issued a positive statement of assurance as to its opinion on the legality and regularity of the payments made, since its estimate of the error rate is still above the 2% materiality level. However, the Commission considers a several-year analysis of these errors more appropriate. The projected total amount of the risk amount after all corrections is estimated to be less than 2% of the total eligible expenditure, which, according to the Commission, means that the Commission's multiannual control mechanisms ensure appropriate risk management related to the legality and regularity of the transactions

4 Adoption of the general budget of the European Union (EU, Euratom) 2016/150 for the financial year 2016, final version. *Official Journal of the European Union*, L 48, 24 February 2016.

5 See also *EU report 2017* (Section I), subchapter A.2.4.1.

6 Report from the Commission to the European Parliament, the Council and the Court of Auditors: *2016 Annual Management and Performance Report for the EU Budget*, COM (2017) 351 final version of 13 June 2017

and that the financial corrections and recoveries made in the following years ensure an overall protection of the EU budget (the protection of the EU's financial interests is dealt with in detail under subchapter A.3).

Information on actual budget implementation was subsequently published in the Commission's financial report[7] (specifically the Directorate-General for Budget) in autumn 2017.

A.1.1 The Commission's financial report on the EU budget 2016 implementation

The European Union's budget is mainly funded by so-called **own resources**[8]. In 2016, these funds represented almost 92% of the revenue side of the EU budget. Own resources are further subdivided into **traditional own resources**[9] (TOR), a **resource based on value added tax**[10] (VAT) and a **resource based on Gross National Income**[11] (GNI), which is the most significant.

While the "rules of the game" have not changed so far, despite certain efforts, for the other two types of resources, in terms of TOR, compensation to EU MS for the cost related to resource utilisation was reduced from 25% to 20% for the new multi-annual financial framework 2014-2020. This change had been ratified gradually, with the last amendment ratified by the MS only in 2016. Given that this was a retroactive measure, respective differences for individual MS were calculated down to 1 January 2014.

Resources based on VAT and GNI are funded from individual MS national budgets. The amount of EU revenue derived from these resources is affected by certain corrective instruments on the basis of which some MS contribute reduced payments from these resources to the EU budget. In 2016, these included the so-called **UK correction mechanism**[12] and **the absence of Denmark, Ireland and the UK in some areas of the security and citizenship policy**[13].

The size of the budget surplus from the previous year is usually less significant. However, in 2016, an **unusually high surplus of the 2015 budget** of almost **€ 10.57 billion**, i.e. a year-on-year increase of 682.96%, was transferred to the new budget.

---

7 *EU Budget 2016 – Financial report*, Publications Office of the European Union, 2017.

8 The total amount of own resources may not exceed 1.20% of the EU's gross national income.

9 Traditional own resources **(TOR)** include customs duties levied on imports of products originating from non-EU Member States, and sugar levies. On behalf of the EU, TOR are selected by MS themselves. In 2016, TOR (after a reduction in compensation for their selection) brought more than **€ 20.09 billion** to the EU budget (an increase of 7.26% compared with 2015).

10 **The VAT-based resource** is based on the application of a uniform rate of 0.3% for all MS (with the exception of Germany, the Netherlands and Sweden benefiting from a reduced rate of 0.15%); this rate is being applied to the harmonized VAT assessment base (application of this principle brought in 2016 a reduction in levies on this source for Croatia, Cyprus, Luxembourg and Malta). The total volume of the harmonized base is limited to 50% of the gross national income of MS. This source was almost **€ 15.90 billion** in 2016 (a year-on-year decline of 12.11%).

11 **The GNI-based resource** is variable and has been used since 1988 to adjust the gap between EU budget revenue and expenditure so that the budget as a whole is balanced. The single percentage applied to all MS in 2016 was more than 0.65%. This budget resource (net of all correction mechanisms - see below) was nearly **€ 96.16 billion** in 2016 (a year-on-year decline of 4.31%).

12 In 2016, the correction mechanism was **€ 5.87 billion**. The cost of these measures is borne by other MS, according to the share of their GNI in the European Union's GNI as a whole, with a share in the financing of this mechanism being reduced to one quarter of their share for Germany, the Netherlands, Austria and Sweden. The remaining three quarters of their share is paid by other MS according to the share of their GNI in the European Union's GNI as a whole.

13 Payments by Denmark, Ireland and the UK are reduced due to their refusal to participate in certain areas of legal and security cooperation. Given that the Commission calculates this adjustment during the year following the financial year, the 2016 budget reflected the 2015 reduction totalling to **€ 87.61 million**.

The remaining amounts on the revenue side of the EU budget are summed up in the so-called "**other revenues**" category. This includes revenues from fines imposed for breach of competition rules or other regulations, income taxes and other contributions from EU institutions staff or contributions from non-member states to EU programmes. The other revenues of the EU 2016 budget represent an amount of almost **€ 1.35 billion** (a year-on-year decline of 81.41%).

The expenditure of the European Union's budget is intended to cover both the needs of individual EU policies and the costs related to the operation of the EU institutions.

In the following text, **payment expenditure**[14] is reported without including expenditure covered by the assigned revenue appropriation[15].

The expenditure side of the budget consists of the following six chapters, the so-called headings covering EU policies:

1. *Smart, sustainable and inclusive growth*, with subchapters

   1a *Growth competitiveness and employment*[16],

   1b *Economic, social and territorial cohesion*[17],

2. *Sustainable growth: natural resources*[18],

3. *Security and Citizenship*[19],

4. *Global Europa*[20],

5. *Governance*[21],

6. *Compensations*.

The total EU budget expenditure in payments (i.e. spending to and outside EU Member States) **was € 131.79 billion in 2016** (including € 0.39 billion in EFTA[22] funds).

14 The expenditure side of the EU budget generally has **two levels: commitments** (i.e. amounts to be paid in the current or subsequent years) **and payments** (i.e. payments in the current year), where payment can only be made if it is linked to a valid commitment.

15 **Assigned revenue** is revenue (as referred to in Article 43 of Regulation (EC) No 1306/2002 of the European Parliament and of the Council) resulting from financial corrections under the clearance of accounts and conformity clearance decisions, irregularities and the milk levy. This appropriation is earmarked for the financing of the expenditure of the *European Agricultural Guarantee Fund.*

16 Appropriations for research, innovation and technological development, lifelong learning, SME support, or the development of transport, energy and digital networks to better link people in Europe. From this subchapter, **€ 18.46 billion** was paid in 2016 (a year-on-year increase of 11.10%).

17 Appropriations for building new infrastructure, training programs and cross-border cooperation and amounts to be invested in order to strengthen economic, social and territorial cohesion and increase the growth and development of regions which, compared to others, are lagging behind. Expenditure in this sub-chapter amounted to **€ 37.76 billion** (a year-on-year decrease of 25.90%).

18 Appropriations for agriculture, food, rural development, fisheries and environmental protection. In 2016, **€ 54.92 billion** was paid from this chapter (a year-on-year decrease of 3.02%).

19 Appropriations for combating terrorism and crime, managing migration flows and creating a common asylum system, but also protecting EU consumers and promoting European culture. This expenditure amounted to **€ 3.06 billion** (a year-on-year increase of 55.33%).

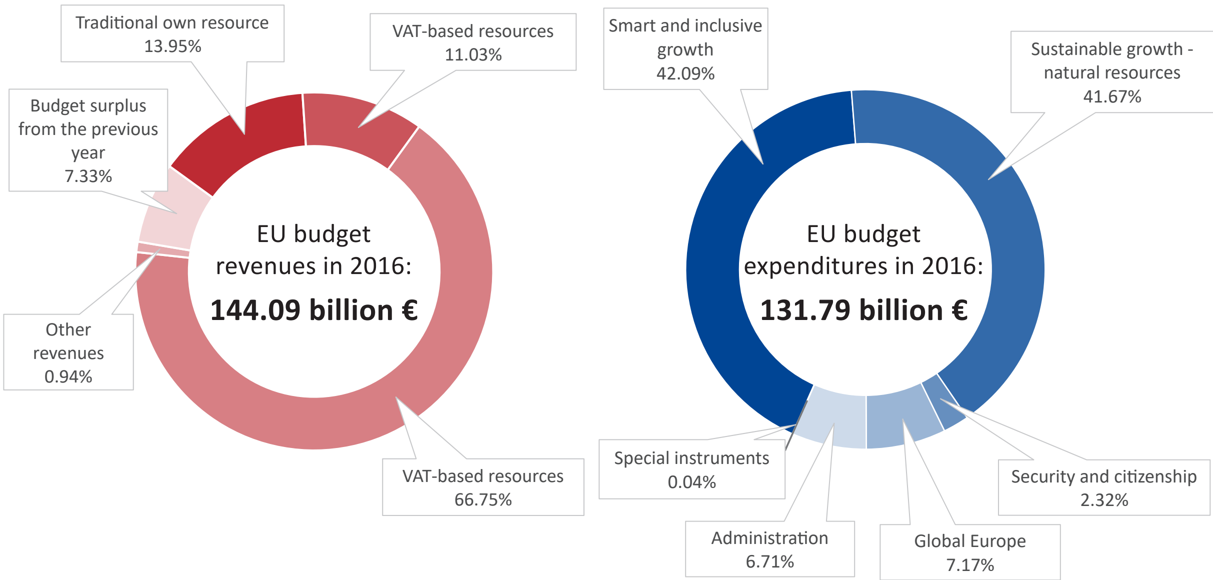
20 Appropriations to finance EU external policy (expenditure on EU cross-border activities, enlargement of the European Union, bilateral relations and humanitarian or development aid). In 2016**, € 9.45 billion** was released from this chapter (a year-on-year increase of 23.53%).

21 Expenditure mainly to cover staff salaries and administration of buildings of the EU Institutions amounted to **€ 8.85 billion** (a year-on-year increase of 3.51%).

22 EFTA is the European Free Trade Association, whose members are Iceland, Liechtenstein, Norway and Switzerland.

Of the special instruments[23], only **€ 0.03 billion**[24] was disbursed in 2016 (excluding expenditure associated with so-called assigned revenue). Expenditure of the ***European Development Fund***[25] is outside the EU budget.

Chart 1: Structure of the revenue and expenditure side of the EU budget in 2016



Source: EU budget 2016 – Financial Report, Commission 2017.

The above Chart shows that two largest chapters (*Smart, Sustainable and Inclusive Growth* and *Sustainable Growth: Natural Resources*) account for 83.76% of all EU budget expenditure, representing € 110.4 billion.

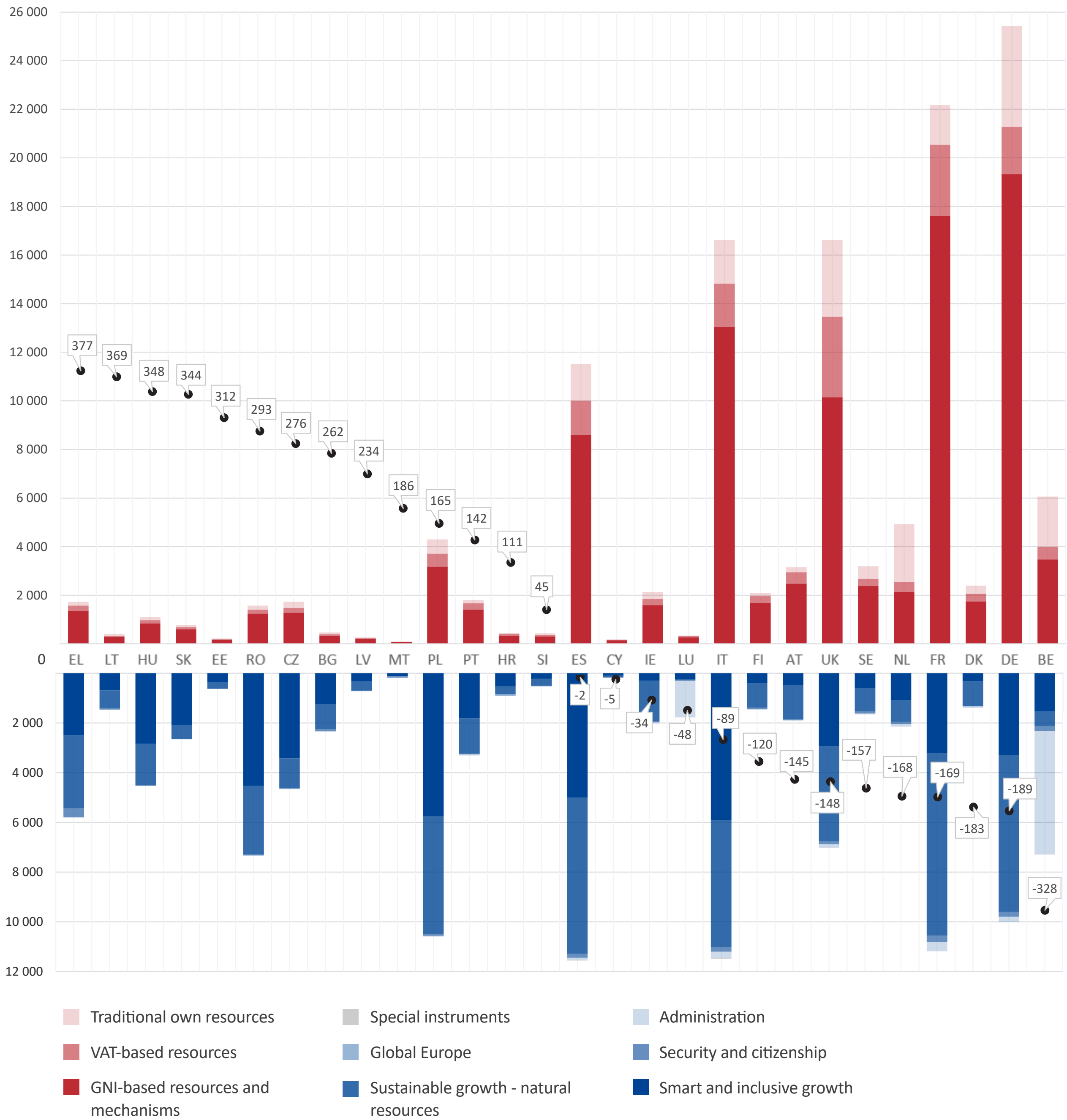
The compound bar Chart 2 shows both the size and structure of payments of individual MS into the EU budget, and their drawdown from the EU budget broken down into individual spending chapters (both in € million), and further the **net position of individual MS adjusted for administrative expenses (expenditure chapter 5) and for expenses on Commission decentralised agencies, calculated per capita** (in €). In this ranking, **the Czech Republic ranked seventh** (sub-chapter A.1.2.3 provides details on the Czech Republic's net position). From the point of view of the EU budget, **the Czech Republic is the so-called net beneficiary**, i.e. it is one of the MS that draws more money from the EU budget than contributes to it.

23 These instruments are the *Emergency Aid Reserve, the European Globalization Adjustment Fund, the European Union Solidarity Fund and the Flexibility Instrument*.

24 Year-on-year decline of 88.00%

25 *European Development Fund (EDF).* The Fund is intended to finance development cooperation and assistance that the EU implements with regard to the group of ACP countries (Africa, Caribbean, Pacific).

Chart 2: Structure and volume (€ million) of the revenue and expenditure side of the EU budget in 2016 and net position of individual MS (excluding administrative expenditure and expenditure for Commission decentralized agencies) per capita (€)



Source: EU budget 2016 – Financial Report, Commission 2017.

Note: The red bars show the volume (in € million) and the structure of EU budget revenues from individual MS, the blue bars show the volume (in € million) and the structure of EU budget expenditures for individual MS. The chart shows the net position (in €) of each MS calculated per capita, adjusted for the Commission's expenditure for payments from budget chapter '*Administration*'.

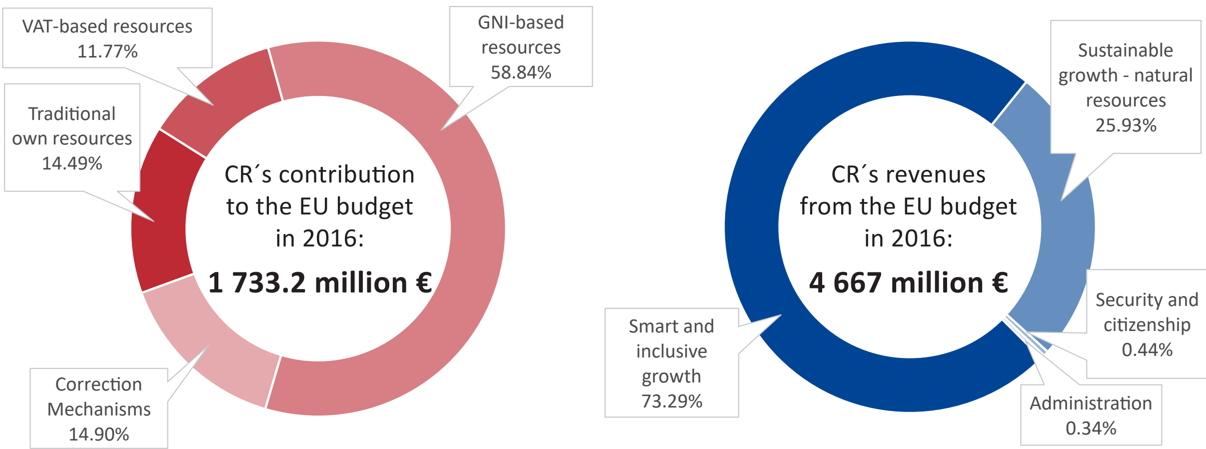
Adjustment of individual MS revenues for payments under chapter *Administration* (i.e. the reimbursement of the Commission's administrative costs) and for expenditures for decentralized agencies of the Commission has significantly reduced the level of the net position per capita practically only in the cases of Luxembourg (from € 2,441.48 to € - 48.15) and Belgium (from € 108.02 to -328,01 €).

A.1.2 European Union budget 2016 and its relation to the CR

A.1.2.1 CR's revenues and expenditure structure in relation to the EU budget

While the contributions to the EU budget (in terms of structure and volume) are defined by the relevant European regulations and by the development of national economies (especially the size of GNI and selection of VAT and import duties), the structure and size of revenues depend on the maturity and focus of each MS's economy, as well as on their ability to draw down the allocations for the area of *economic, social and territorial cohesion* (Cohesion Policy) and their capacity to make use of the resources within the EU operational programmes.[26] Expenditure on payment made from the EU budget to the Czech Republic represents, from the point of view of the Czech Republic, its revenues, which are listed below and exclude EU expenditure related to the so-called assigned revenue.

Chart 3: CR's revenue and expenditure structure in relation to EU budget 2016



Source: EU budget 2016 – Financial Report, Commission 2017.

The chart shows that most of the revenue streaming to the Czech Republic from the EU budget comes from chapter *Smart, Sustainable and Inclusive Growth*. In 2016, this amount was in excess of € 3.4 billion, while the second largest chapters in terms of volume (*Sustainable Growth: Natural Resources*) represented a revenue of "merely" € 1.2 billion. These two budget chapters again accounted for over 99% of the Czech Republic's revenue from the EU budget.

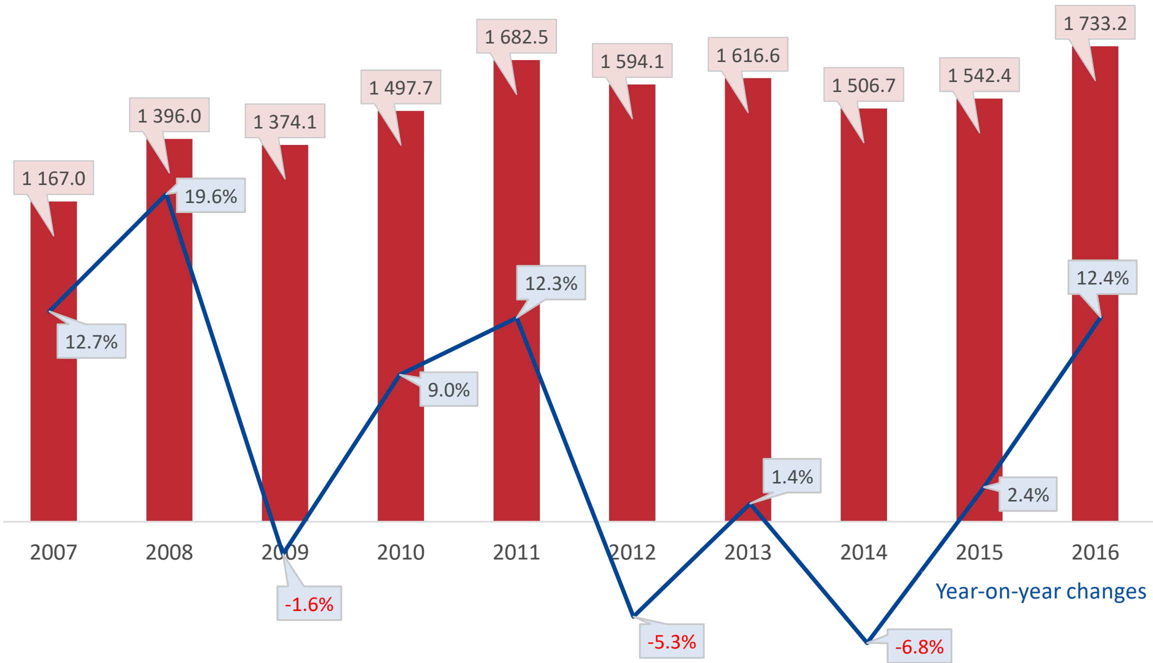
A.1.2.2 Development of CR's revenues and expenditure in relation to the EU budget until 2016

From 2004 until the end of 2016, **the Czech Republic paid a total of € 17.7 billion to the EU budget**. In 2016, contributions to the EU amounted to more than € 1.7 billion, which is historically the highest amount. The year-on-year increase of almost CZK 191 million is mainly the result of the improving performance of the Czech economy.

The evolution of the volume of payments to the EU budget from the Czech Republic (see Chart 4) is relatively even and basically mirrors the CR's economic development. Greater fluctuations (e.g. in 2011, 2014 and in 2016) were caused by extraordinary factors, specifically the extraordinary revision of national accounts by the Czech Statistical Office and the introduction of Czech National Bank's (CNB) extensive interventions in the foreign exchange market.

26 Union programs are relatively small-scale programs, the funds of which are mostly allocated directly by the EU (outside the MS allocation) on the basis of a public tender.

Chart 4: CR's contributions to the EU budget (€ million) and year-on-year fluctuations (%) in 2007–2016

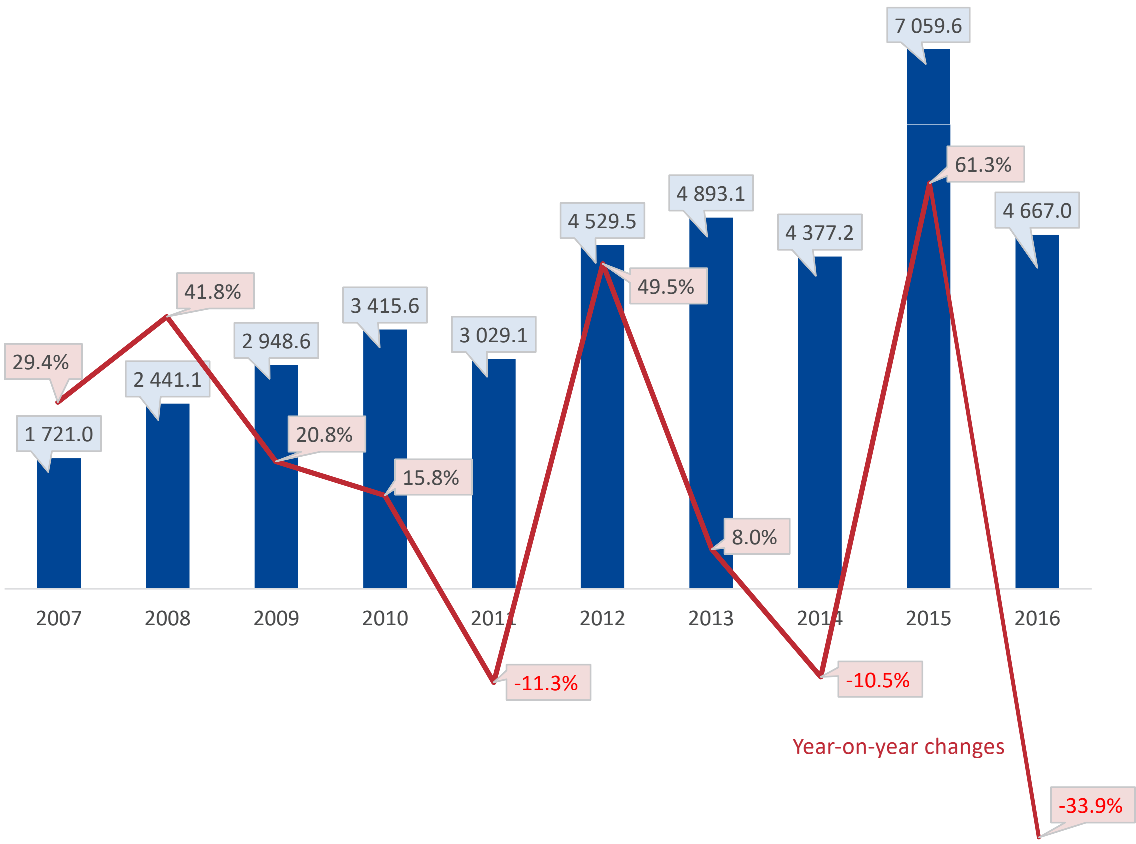


Source: *EU budget 2016 – Financial Report*, Commission 2017; previous reports of the Commission on the EU Budget 2008–2016.

From joining the European Union until the end of 2016, the Czech Republic received a total of **€ 42.3 billion from the EU budget**, of which nearly € 4.7 billion was received in 2016. While this figure represents a year-on-year decline of almost 34%, it should be noted that the level of drawdown in 2015 was significantly affected by the massive uptake of the PP7+ allocation. In just one year, the Czech Republic used more than a fifth of the allocation set for the whole programming period.

Disregarding the extremely high value in 2015, the Czech Republic's drawdown from the EU budget had been more or less even since 2012, as shown in the chart below.

Chart 5: CR's revenues from the EU budget (€ million) and year-on-year fluctuations (%) in 2007–2016



Source: *EU budget 2016 – Financial Report*, Commission 2017; previous reports of the Commission on the EU Budget 2008–2016.

A.1.2.3 CR's net position in relation to the EU budget

From the accession of the Czech Republic to the EU until the end of 2016, **the cumulative value of the CR's net position**[27] **reached € 24.6 billion**, i.e. CZK 665.04 billion[28]. Throughout this period, the Czech Republic was a net beneficiary.

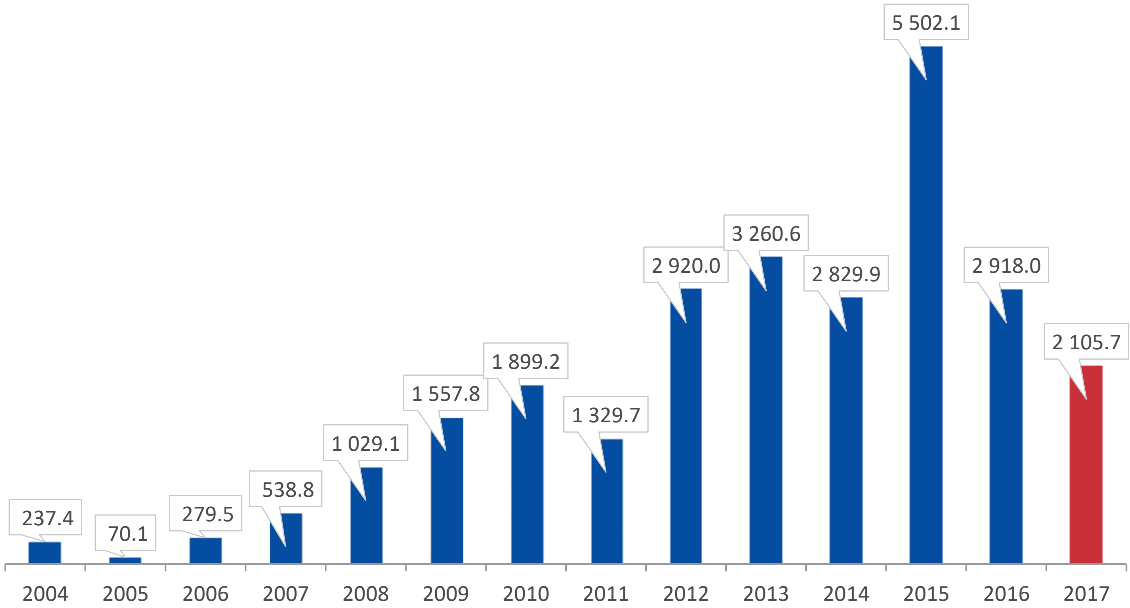
The Czech Republic achieved the highest historical value of its net position in 2015 (€ 5.50 billion). The main reason for this record amount was the massive final drawdown of the rest of the cohesion policy allocation within the 2007-2013 programming period; another important factor was that a large part of amounts in payments claims in 2014 was only paid by the Commission in the course of 2015. **In 2016, drawdown of funds from the previous programming period was no longer so massive** (less than a half of the 2015 amount), **and drawdown of funds allocated for PP14+ had only just started.** These factors, together with the increase in contributions to the EU budget (see above), caused a **year-on-year decrease in the Czech Republic's net position by 46.97%. The net position value in 2016 amounted to almost € 2.92 billion.**

27 The net position was calculated as the difference between the CR's total revenue from the EU budget (less revenues from chapter *Administration* and its older equivalents, and revenues assigned to the Commission's decentralized agencies) and the CR's total expenditure in terms of payments to the EU budget (including TOR less selection compensations).

28 The ECB's average annual 2016 exchange rate was used for the conversion: 27,034 CZK / €.

The following Chart shows the development of the Czech Republic's net position included in the Commission's official sources for 2004-2016, as well as its net position in 2017, as reported by the Ministry of Finance[29] (the last chart bar).

Chart 6: CR's net position in 2004–2016, including MoF data for 2017 (€ million)



Source: *EU budget 2016 – Financial Report*, Commission 2017; previous reports of the Commission on the EU Budget 2005–2016; MoF data for 2017 published on 31 January 2018.

Note: Data for 2004-2006 include contributions to the Commission's decentralized agencies.

At the end of January 2018, the MoF published a press release stating that the net position of the Czech Republic for 2017 was CZK 55,443.30 million, i.e. € 2,105.71 million[30]. The Commission had not published the data by the editorial deadline for the EU Report 2018, however, it may be expected that official EU data will not differ significantly from those published by the MoF.

According to the abovementioned press release, CR's total revenues from the EU budget amounted to CZK 97,852.45 million and CR's total payments to the EU budget reached CZK 42,409.15 million in 2017. The press release states that the significant decrease in the CR's net position was mainly the result of the concentration of payments of the ending PP7+ in 2015 and 2016, while in 2017 CR's revenues from the European Union were mainly those from the new programming period then just commencing.

29 The press release *The Czech Republic obtained CZK 79.6 billion more from the EU budget than it paid in,* was released on 31 January 2018 http://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2018/ceska-republika-ziskala-v-roce-2017-z-ro-30913.

30 CBN's average 2017 exchange rate was used for the conversion: CZK 26,330 / €.

A.1.3 European Court of Auditor's annual reports for 2016

The role of the EU's external auditor is assumed by the European Court of Auditors, which is independent of the bodies, institutions and entities it audits. Its status and tasks are specified in Section 7 of the *Treaty on the Functioning of the European Union (TFEU)*[31]. Under Article 287 of the TFEU, the ECA is required 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.

In accordance with the relevant provisions of the TFEU (Article 287 (1) and (4)), Regulation (EC) No 966/2012 of the European Parliament and of the Council (Articles 148 (1), 162 (1) and Regulation of the Council No 215/2008[32] (Articles 43, 48 and 60), the ECA approved its annual reports[33] for the financial year 2016 at its meeting on 13 July 2017. The annual reports, together with the competent authorities' replies to the ECA's comments, were submitted to the EP and the Council for discharge, certifying the Commission's due fulfilment of its obligations in the budget implementation.

The key statements of the ECA's *Annual Report concerning the 2016 budget implementation* (AR 2016)[34] are the ECA Statement of Assurance (DAS) regarding the EU's annual accounts and the statements on the legality and regularity of the transactions underlying the accounts.

Based on its audits, the ECA gave, among others, the following opinions:

- *"We believe that **the European Union's (EU) Consolidated Financial Statements for 2016 accurately represent, in all material respects, the financial position of the European Union** as of 31 December 2016, the results of its operations, cash flows and changes in net assets for the year in accordance with the Financial Regulation and accounting rules based on internationally accepted accounting standards for the public sector."*
- *"In our opinion**, the revenues** underlying the Financial Statements for the financial year 2016 **are in all material respects legal and regular."***
- *"In our opinion, **subject to** the effect of the fact stated in the basis for the opinion, subject to the legality and regularity of the payments underlying the Financial Statements, **the payments** underlying the Financial Statements for the financial year 2016 **are in all significant (material) respects legal and regular.**"*

The aforementioned opinions of the ECA on financial statements and revenue are, in principle, the same as in previous years. **However, for the first time since 1994, the ECA gave a qualified opinion, instead of a negative opinion, with regard to the reliability of the underlying operations.** A substantial part of the audited expenditure in 2016 was no longer burdened by a material error rate. The total estimated error rate in payments from the EU budget had steadily decreased in the three years under review, from 4.4% in 2014 to 3.1% in 2016.

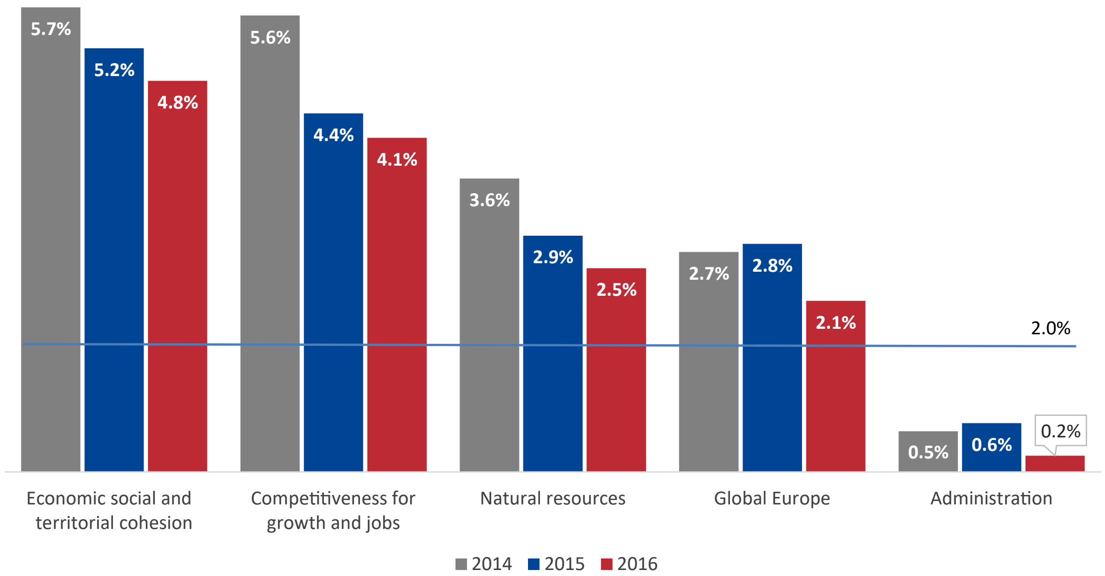
31 Art. 285 et seq. of the consolidated version of the TFEU, Official Journal of the European Union, C 115, 9 May 2008.

32 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.

33 Annual Report of the Court of Auditors on the implementation of the budget for the financial year 2016 and the Court of Auditors' annual report on the activities financed by the eighth, ninth, tenth and eleventh European Development Funds (EDFs) for the financial year 2016, Official Journal of the European Union C 322 of 28 September 2017.

34 *Official Journal of the European Union* of 28 September 2017, Part IV. *Information of the institutions, bodies, offices and agencies of the European Union*, Section C 322/01.

Chart 7: Comparison of estimated error rates for individual EU expenditure areas in 2014-2016



Source: ECA´s annual reports on the budget performance in 2014, 2015 and 2016, ECA 2015–2017.

Note: The ECA works with a 2% level of materiality.
In 2014 (prior to the change of the Common Agricultural Policy legal framework), cross-compliance[35] was also included in the testing of operations for the last time; the errors predicted for this area accounted for 0.6 percentage points of the total estimated error rate in the *natural resource area*.
The estimated error rate in the area of *economic, social and territorial cohesion* does not include the quantification of payments for financial instruments[36] of € 2.5 billion, which the ECA expects to have not incurred during the eligibility period as defined in Article 56 (1) of Council Regulation (EC) 1083/2006. These payments would represent an estimated error rate of 2.0% for total EU expenditure.

The chart shows a relatively **significant decrease in the estimated error rate of operations in all expenditure areas.** The chart further shows that only the *administration* expenditure area indicates an estimated error rate below the materiality level; therefore, the ECA noted that expenditure on *administration* (as opposed to other expenditure areas) is not burdened by a significant (material) error rate.

The ECA analysed in detail the results of the audit and published the following information in the Annual Report 2016:

- The management method has no significant impact on the error rate.
- In the case of so-called payment entitlements[37], where the payment depends on the fulfilment of certain conditions, the estimated error rate was 1.3% in 2016. For the reimbursement of costs where the EU reimburses eligible costs of eligible activities, the estimated error rate was substantially higher, i.e. 4.8%. In both categories, however, a significant year-on-year decrease was recorded, i.e. by 0.6 and 0.4 percentage points respectively.

---

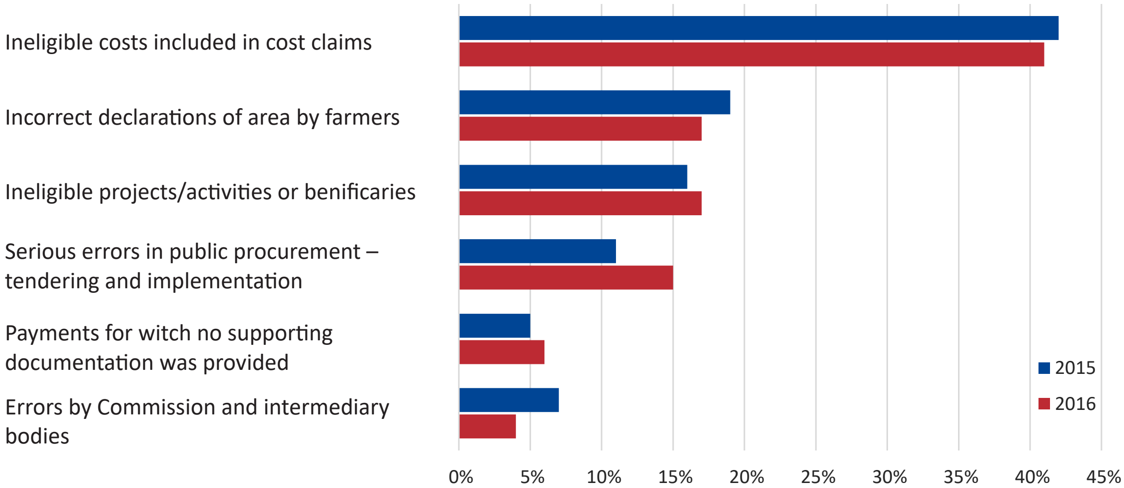
35 The payment of direct payments and other aids is subject to meeting the conditions of the so-called good *agricultural and environmental condition of agricultural land* and compliance with the mandatory requirements set for *the environment and the public, animal and plant health*.

36 Financial instruments support investments through loans, guarantees, capital and other risk management mechanisms, possibly in combination with technical support, interest rate subsidies or guarantee fee subsidies within the same operation.

37 E.g. scholarships, wages of EU staff, direct support in agriculture, etc.

The ECA compared the frequency of individual types of errors found between 2015 and 2016 - the results of the comparison are shown in the following chart.

Chart 8: Breakdown of total estimated error rate by error type



Source: ECA annual repor on budget performance in 2015 a 2016, ECA 2016 and 2017.

A.2 Evolution of the EU budget after 2016

A.2.1 The EU budget 2017 and its amending budgets

The EU budget for 2017 was adopted by the European Parliament on 1 December 2016 when the EP confirmed the agreement with the Council, which approved it on 28 November 2016.[38] **This budget sets expenditure of € 157.86 billion in commitments and of € 134.49 billion in payments**, leaving a reserve for unforeseeable requirements in the amount of € 1.1 billion.

The approved budget reflected the situation caused by the **migration and refugee crisis**, and increased the amount allocated to MS within the commitment appropriations for this field by **over 11%** compared to 2016. The area of **boosting economic growth and creating jobs** also received an increased amount, namely by **12%** compared to the previous year. The approved EU budget for 2017 includes **€ 500 million for the package of measures to support milk producers** and other areas of livestock production.

Table 2: Summary of the approved EU budget 2017 **(€ billion)**

Appropriations by heading	Commitments	Payments
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 Europea Union, L 51, 28. února 2017.

38 Source: http://www.consilium.europa.eu/cs/policies/eu-annual-budget/2017/.

In the course of the year, the budget is adjusted to reflect current developments by means of so-called amending budgets, adopted by the Council and the EP against the Commission's proposal.

During 2017, six amending budgets were approved [39]:

- Amending budget 1 allocated € 70.40 million to the United Kingdom, Cyprus and Portugal in commitment and payment appropriations from the European Union Solidarity Fund (EUSF) to help remedy the damage caused by natural disasters.
- Amending budget 2 included a surplus of € 6.40 billion of the 2016 to the EU budget.
- Amending budget 3 increased the commitment appropriations for the *Youth Employment Promotion Initiative* by € 500 million and approved the change in the establishment plan of the Agency for the Cooperation of Energy Regulators and the SESAR 2 Joint Undertaking.
- Amending Budget 4 released funds from the EUSF of almost € 1.20 billion to help Italy in response of the series of earthquakes that hit the country between August 2016 and January 2017.
- Amending budget 5 provided funding for the *European Fund for Sustainable Development* after the EP and the Council approved its legislative basis. This amending budget also took into account the results of the review of the multiannual financial framework in its mid-term and increased the annual contingency reserve by € 20 million at 2011 prices. Both of these measures combined raised the volume of commitment appropriations by € 297.8 million, without increasing the volume of payment appropriations.
- The purpose of amending budget 6[40] was to adjust the revenue and expenditure sides of the budget to current developments. On the expenditure side, the volume of payment appropriations (for most of the EU budget headings) decreased, commitment appropriations were released (for *sustainable growth: natural resources*) and unused commitment appropriations and advance payments (which are unnecessary in 2017) were released for the EUSF. On the revenue side of the budget, the forecast of each EU revenue type was revised and fines recovered were included. As a result, individual MS contributions to the EU budget were reduced.

A.2.2 EU budget 2018 and its amending budgets

On 30 November 2017, the Council and EP separately approved the agreement reached on 18 November 2017 in the Conciliation Committee on the 2018 budget, thus adopting the EU budget for 2018.[41]

Total budgeted expenditure on commitment appropriations amounted to € 160.11 billion (a year-on-year increase of 0.2%) **and € 144.68 billion in payments** (a year-on-year increase of 14.1%). The significant increase in payment appropriations was mainly due to the fact that the PP14+ drawdown is expected to reach full pace in 2018. A reserve of € 1.6 billion was left in the budget to respond to any unforeseen requirements.

Investing in competitiveness, employment and growth remains a budget priority, notably by increasing the funding for *Horizon 2020* (annual increase by 8.4%), the *Connecting Europe Facility* (increase by 7.9% increase) and the COSME programme to support small and medium-sized enterprises (SMEs) (increase by 1.4%). Other priorities include support for

39 Source: http://ec.europa.eu/budget/biblio/documents/2017/2017_en.cfm.
40 This last amending budget was adopted and published in the *Official Journal of the European Union* only on 25 January 2018.
41 Source: http://www.consilium.europa.eu/cs/press/press-releases/2017/11/30/2018-eu-budget-adopted/.

young people, for example through an increase in funds for *Erasmus+* (up by 12.1%) and an increase in budgeted amounts for the *Youth Employment Promotion Initiative.*

The budget also reflects the need to better address migration and security issues, therefore security and citizenship agencies will receive 8.9% more funds than in 2017.

Support has also been increased for the environmental and climate measures - the LIFE programme budget has been increased by 5.9%. **The EU budget also strengthens the strategic communication capacity of the European External Action Service** in order to step up the fight against disinformation.

Budgetary reductions are, on the other hand, on pre-accession assistance to Turkey, given the situation in this country in terms of democracy, the rule of law, human rights and freedom of the press.

Table 3: Summary of the approved EU budget 2018 **(€ billion)**

Appropriations by heading	Commitments	Payments
1. *Smart and inclusive growth:*	77.53	66.62
1a *Competitiveness for growth and jobs*	22.00	20.10
1b *Economic, social and territorial cohesion*	55.53	46.52
2. *Sustainable growth: natural resources*	59.28	56.08
3. *Security and citizenship*	3.49	2.98
4. *Global Europe*	9.57	8.91
5. *Administrative expenditures* (for all EU institutions)	9.67	9.67
Special instruments	0.57	0.42
Total appropriations	**160.11**	**144.68**

Source: Official Journal of the European Union, L 48, 24th February 2018.

By the *EU Report* 2018 editorial deadline, one amending budget for the EU budget 2018[42] was adopted, relating to the release of almost € 104.17 million from the EUSF to provide assistance to several MS affected by natural disasters (the earthquake in Greece, the hurricane in the French overseas territories and the forest fires in Spain and Portugal).

A.3 Protection of the EU's financial interests and the fight against fraud

In July 2017, the Commission published a report on the protection of the EU's financial interests for 2016[43], which it submitted to the European Parliament and the Council in cooperation with MS. This Annual Report[44] contains information on the measures taken by the Commission and the MS[45] during 2016 to combat fraud. It also presents the results of the measures taken to protect the financial interests against irregular expenditures and evasion in the area of collection of duties and other charges.

42 Source: http://ec.europa.eu/budget/biblio/documents/2018/2018_en.cfm.

43 Report from the Commission to the European Parliament and the Council: *Protection of the financial interests of the European Union - Fight against fraud, Annual report* 2016, COM (2017) No 383 final of 20 July 2017.

44 The Commission submits reports annually pursuant to Article 325 (5) TFEU.

45 Member States assume responsibility for taking anti-fraud measures, resulting from the overwhelming share of shared expenditure management (about 74%) and in relation to collection of revenues from traditional own resources.

The report states that the Council, the EP and the Commission reached agreement in 2016 after four years of negotiations, on a proposal for a directive on fight, conducted in criminal law manner, against fraud affecting the financial interests of the EU. On the other hand, unanimous consensus has not yet been reached in the Justice and Home Affairs Council on the establishment of the European Public Prosecutor's Office, so a number of MS have decided to proceed with enhanced cooperation. On the expenditure side of the EU budget, the system of Early Detection and Exclusion of economic operators (EDES[46]) has been applied and a revision of the Financial Regulation has been proposed to make it simpler. On the revenue side of the budget, a revised Council Regulation 515/97[47] on mutual assistance between customs authorities establishing a database on the movement of containers and a database on goods entering or leaving the EU or in transit, has been adopted. The Commission has also adopted a VAT Action Plan entitled "*Towards a Single EU VAT Area: Time to Adopt a Decision* (VAT Action Plan)", including, amongst other things, a solution to step up the fight against fraud.

The Member States adopted a number of anti-fraud measures in 2016, particularly in the area of public procurement, conflict of interest and corruption. The harmonization of national public procurement regulations with the EU law was announced by ten MS, including the Czech Republic. A total of nine MS, including the Czech Republic, adopted a national anti-fraud strategy during this period and sent it to the Commission. A number of MS also adopted measures to improve the Anti-Fraud Coordination Services (AFCOS[48]).

In 2016, the Commission, i.e. The European Anti-Fraud Office (OLAF)[49] received reports of **a total of 19,080 irregularities**[50] of both fraudulent and non-fraudulent nature (other irregularities) representing **a total of € 2.97 billion, of which € 2.43 billion related to the EU budget expenditure.** The number of reported irregularities decreased by 15% compared to 2015, while total financial amount of irregularities decreased by 8%. **1,410 reported irregularities were of fraudulent nature** (6% of all irregularities reported) representing a **total amount of € 391 million** (13% of the total amount of reported irregularities).

Member States that administer about 75% of EU budget expenditure under shared management have an obligation to report to OLAF both fraudulent and non-fraudulent irregularities through the IMS Irregularities Management System[51]. Irregularities relating to expenditures incurred under the direct management of the European Union budget by the Commission are reported through the ABAC accounting system.[52]

46 *Early Detection and Exclusion System*.
47 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.
48 Anti-Fraud Coordination Service.
49 Office européen de lutte antifraude.
50 Member States are required to notify the Commission of any suspicion of fraud and any irregularities exceeding € 10 000 from EU sources.
51 *Irregularities Management System*.
52 *Accrual Based Accounting*.

Table 4: Numbers and respective financial amounts of cases of suspected fraud and other irregularities reported by EU MS through IMS in 2016

Budget sector (expenditures/revenues)		Number of fraud suspicions	Volume of fraud suspicions (€ million)	Number of other irregularities	Volume of other irregularities (€ million)
Agriculture	EU	413	61.86	3 420	211.26
	Out of which CR	14	0.85	42	2.75
Cohesion and fisheries policies	EU	407	236.90	8 090	1 826.26
	Out of which CR	37	30.47	414	112.33
Internal policies total	EU	0	0.00	4	0.64
	Out of which CR	0	0.00	0	0.00
Pre accession policy	EU	6	1.83	43	0.53
	Out of which CR	0	0.00	0	0.00
Expenditures total	**EU**	**826**	**300.59**	**11 557**	**2 038.69**
	Out of which CR	**51**	**31.32**	**456**	**115.08**
Revenues total	**EU**	**513**	**82.98**	**4 134**	**453.76**
	Out of which CR	**2**	**0.14**	**80**	**5.30**
Total	**EU**	**1 339**	**383.57**	**15 691**	**2 492.45**
	Out of which CR	**53**	**31.46**	**536**	**120.38**

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

Note: EU data exclude third countries or expenditure directly managed by the Commission.

Compared to 2015, the number of fraud notifications reported by Member States in the area of revenue (-16%) and expenditure in agriculture (-3%) decreased, while they increased slightly in the field of expenditure within the cohesion and fisheries policies (+4%) and significantly for expenditure managed directly by the Commission (+880%). The number of notifications of other irregularities declined in the year-on-year comparison, particularly for expenditure within the Cohesion and Fisheries policies (-23%) and in agriculture (-17%), while the number of notifications for expenditure managed directly by the Commission increased (+16%). While the number of notifications of other irregularities decreased (-8%) on the revenue side, the reported financial amounts increased (+30%).

For the year 2016, the Czech Republic reported a total of 51 cases of suspected fraud on the expenditure side amounting to € 31,319,598 and two cases of suspected fraud on the revenue side amounting to € 140,600. Compared to 2015, the number of reported cases remained virtually the same, the reported financial amounts, however, almost doubled. Cases under the Cohesion and Fisheries Policies accounted for more than 70% of all reported cases and as much as 97% of the total financial amount.

The Czech Republic reported a total of 456 cases of other irregularities for expenditure amounting to € 115,079,639 and 80 irregularities for revenue totalling € 5,298,065. Compared to 2015, the number of reported cases decreased by approx. one third and the total financial amount reported decreased by more than a half. Also in the group of other irregularities, cases under the Cohesion and Fisheries Policies accounted for 91% of the total number of notifications and for 97% of the total financial amount.

In the Czech Republic, it is the Ministry of Finance, i.e. Department 69 - Analysis and Reporting of Irregularities - that fulfils the role of a Central Contact Point of the AFCOS (CCP AFCOS) network. According to the data published by the Ministry of Finance [53] CCP AFCOS reported a total of **507 fraudulent and non-fraudulent irregularities** through IMS representing a total amount of **€ 146,399,236.**

Table 5: Numbers and financial amounts of reported irregularities by individual programme periods

Programming period	Number of irregularities	Irregularities in €
2004–2006	3	711 861
2007–2013	503	145 673 395
2014–2020	1	13 780
Total	**507**	**146 399 236**

Source: Report on the results of financial audits in the public sector in 2016, MoF, Juni 2017.

CCP AFCOS as the national partner helped OLAF to exchange information and, in particular, to provide documentation requested for projects directly investigated by OLAF's representatives. In 2016, these were 29 projects.

CCP AFCOS also assumes the responsibility of the contact point for sending information to the central database to exclude economic entities from the process of obtaining EU funds in accordance with Commission Regulation (EC, Euratom) No 1302/2008[54]. This Regulation entails the obligation to provide the Commission with information on persons convicted of offenses prejudicial to the EU's financial interests, on the freezing of convictions for such offenses. **In 2016, CCP AFCOS reported to the Commission on behalf of the Czech Republic a total of three cases of final convictions for crimes against the financial interests of the EU and for subsidy fraud.**

To reinforce the protection of financial interests by specific measures for the fulfilment of tasks in PP14+, a revision of the text of the current *National Strategy for the Protection of Financial Interests*[55], prepared by the MoF (No. MF-18592/2017/69), was adopted on 1 September 2017. The core of the strategy is to set up control mechanisms to prevent irregularities in the area of financial audit including internal audits, the fight against corruption, reporting and investigating irregularities and their remedy, including recovery of amounts related to the irregularities concerned and ensuring the EU funds are returned to the EU budget. The strategy states that in terms of the revenue side of the EU budget, the Czech Republic has long been among the countries which actively cooperate with OLAF, both in the field of reports on mutual cooperation and in the framework of joint customs operations, which in the past was reflected in setting amounts for reduced customs duties in the order of several tens of millions of CZK.[56] The priority for the current programming period will be, as in the past, an emphasis on proper detection and prevention of customs fraud. This will involve an active cooperation with OLAF and an active participation in joint customs operations including entering appropriate risk profiles into customs systems and an effective implementation of national post-clearance checks following mutual cooperation reports.

53 *Report on the Results of Financial Audits in the Public Sector for 2016,* taken into consideration by the Government of the Czech Republic in its Resolution of 10 July 2017 No. 511.

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

55 *The National Strategy for the Protection of the Financial Interests of the European Union* approved by the Government of the Czech Republic in its Resolution No 535 of 14 May 2008.

56 In the years 2007-2016, a total of 673 irregularities exceeding € 10,000 for TOR were reported by the Directorate General of Customs to the Commission represeting an amount of approximately € 49 million.

Fight against fraud by means of criminal law

In July 2017, EP and Council Directive 2017/1371 on the fight against fraud to the EU's financial interests by means of crimina law[57] was adopted, laying down minimum rules for the definition of criminal offenses, sanctions and limitation periods. The Directive further establishes the jurisdiction of the future European Public Prosecutor's Office (EPPO)[58]. This will, in particular, include investigation and prosecution of VAT offenses related to the territory of two or more MS with total damage of at least € 10 million, and further the fight against transnational crime damaging the interests of the EU, including the misuse of European subsidies. At the meeting of the Justice and Home Affairs Council held on 12 October 2017, the Ministers of Justice of individual MS gave final approval to the establishment of the Office, which should become operational in 2020.

A.4 Measures to implement the EU budget 2017

A.4.1 Coordinated measures of EU economic policy

The annual coordination of EU economic governance is carried out through the so-called European Semester (Semester). The EU's role in the semester is to create a favourable environment by improving regulations and focusing its policy on the priorities contained in the Commission Work Program. For MS, the semester is an impetus for implementing the reform programmes.

The European Semester was launched in 2017 with the release of the ***Annual Growth Survey for 2017***[59]. In this analysis, the Commission states that there were a number of positive events in the EU in 2016 indicating the revival of the European economy and its resistance to shocks. In all MS, the employment rate rose, investment grew, the average level of the general government deficit decreased, and the level of public debt stabilised. On the other hand, the growth of the gross domestic product (GDP) and productivity did not reach full potential and the level of investment continued to fail to reach the pre-crisis levels. There was a significant imbalance between individual MS and in a number of cases the convergence within MS and between them was suspended.

The Commission, in line with its Work Programme for 2017[60], appealed to the MS to concentrate their efforts on the following key elements of the economic policy and to focus on achieving social justice and growth:

1. **Support for investment**
   - Improve the functioning of the financial sector to ensure that SMEs have an equal access to finance for growth and innovation; remove weaknesses in the banking sector and ensure banks' profitability by enhancing the importance of out-of-court and insolvency frameworks to deal effectively with cases of defaulting loans; to accelerate

57 Directive 2017/1371 of the European Parliament and of the Council of 5 July 2017 on combating criminal offenses against the financial interests of the Union, *Official Journal of the European Union*, L 198, 28 July 2017.

58 European Public Prosecutor´s Office

59 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank: *Annual Growth Survey for 2017*, COM (2016) 725 final of 16 November 2016.

60 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: *Commission Work Programme for 2017. For a Europe that protects, strengthens and defends*, COM (2016) 710 final of 25 October 2016.

activities to ensure banks' financial stability, inter alia, in the area of a single security facility (*Single Resolution Fund*);
- Increase the impact of funding from the *European Strategic Investment Fund* to support an investment plan for Europe. By 2022, this fund should double the volume of investment to € 630 billion; focusing investment on a more efficient use of energy resources and on human capital and social structure;
- Remove barriers to investment by deepening the single market and creating a stable and predictable business environment (e.g. by completing work on the energy union, capital markets union, single market strategies and a single digital market, etc.); to invest more in knowledge, innovation, education and information and communication technologies (ICT);
- Make use of the advantage of global markets and investments, creating about 30 million jobs for EU businesses.

2. Structural reforms implementation

- Create quality jobs and increase skills by creating favourable conditions for greater labour market participation; reform labour markets by increasing female participation, removing unjustified pay gap between women and men, improving the inclusion of disadvantaged groups and tackling discrimination against immigrants; address the influx of migrants by introducing appropriate structures to facilitate integration and adapt their skills to local market conditions; continue with measures to tackle youth unemployment and modernize education and vocational training, including entrepreneurship and digital skills; wage setting systems should be effective in creating jobs and adapted to labour productivity development;
- Revise social protection systems to improve labour market participation and strengthen employment security and income compensation; set up tax and benefit systems to improve incentives to work so that working pays off; pension systems should reflect increasing life expectancy and, in coordination with new labour market measures, enable people stay in employment until higher age; continue the health care system reforms and protection of the population from poverty and social exclusion;
- Deepen the single market and expand national markets with the removal of regulatory and administrative barriers, particularly in the area of services; introduce reforms to facilitate the spread of new technologies with an impact on productivity growth; coordinate procurement between entities at different levels to achieve savings and conduct public procurement audits to tackle unfair procurement; redirecting capital and labour resources to new activities, particularly in the area of services; adapt the legislative environment to new ways of doing business, minimize bans and ensure a high level of consumer protection; introduce modern tax systems supporting growth with an opportunity to reduce labour taxation.

3. Responsible fiscal policy

- The MS should set their fiscal policies to achieve a long-term sustainability of public finances and, at the same time, to promote economic recovery; support demand stabilisation and ensure a long-term debt sustainability; after reforming pension systems and ensuring their resilience, adopt accompanying policies including support for supplementary pension income; with regard to population aging, ensure healthcare systems sustainability.

4. Next steps

- Reinforce the implementation of key reforms using available instruments at EU level and intensify the dialogue between individual MS with the Commission in order to implement the recommendations adopted by the Council.

With regard to the priorities outlined in the *Annual Growth Survey for 2017*, the Czech Republic prepared basic strategic documents, i.e. the National Reform Programme and the Convergence Programme. ***The National Reform Programme of the Czech Republic 2017*** [61] was approved by the Government of the Czech Republic on 24 April 2017 and submitted to the Commission for consideration on 25 April 2017. At the same time, the Government approved the **Convergence Programme of the Czech Republic**[62] and submitted it to the Commission on 28 April 2017.

The Council of the European Union, on the basis of the Commission's recommendation[63] published in the context of the European Semester 2017, **issued its recommendations and opinion to both documents simultaneously**[64], referring to the interdependence of both programmes.

The Council noted that, according to the forecast for 2017 and 2018, the Czech Republic would comply with the provisions of the Stability and Growth Pact[65]. **In the long run, however, the country faces medium risks in the area of fiscal sustainability.** These risks, with an impact on public spending, are related to the aging of the population and the increase in long-term expenditure in the health care system and the pension system. While the Czech Republic has adopted a Budget Accountability Act in January 2017 to address the weaknesses of the fiscal framework, it has not yet established an independent supervisory authority. The Act is also rated as one of the weakest within the EU. The Council also mentioned shortcomings in a systematic prosecution of corruption and lack of competition in public procurement. In the Council's view, the business environment suffers from considerable regulatory burden and a number of administrative barriers; for example, procedures for granting building permits need to be simplified. Also, the Tax Code needs to be simplified. The utilisation rate for eGovernment services is rated as one of the lowest in the EU. The Council also noted that despite an increased R&D intensity, the level of results has not yet improved. The results of education are assessed as generally good, with persisting inequalities in the education system perceived as an obstacle.

After reviewing the submitted Convergence Programme and taking into account the recommendation of the Commission, **the Council made the following recommendations to the Czech Republic for 2017-2018**:

1. **Ensure long-term sustainability of public finances** in the face of an aging population; increase public spending efficiency, specifically by means of fighting corruption and eliminating inefficient public procurement procedures;
2. **Remove obstacles to growth,** in particular by simplifying procedures for granting building permits, further by reducing administrative burden on businesses, introducing key eGovernment services, improving the quality of R&D and supporting employment for groups that are under-represented in the labour market.

61 *The National Reform Programme of the Czech Republic 2017* (prepared by the Office of the Government of the Czech Republic, is linked to other strategic documents at the national level, e.g. *the Action Plan for Support of Economic Growth and Employment*) was approved by the Government of the Czech Republic at the meeting of the Committee for the European Union on April 24 2017.

62 Convergence Programme of the Czech Republic, prepared by the MoF in April 2017 and approved by the CR's Government Resolution of 24 April 2017 No. 314 within the framework of the *Budgetary Strategy of the Public Institutions Sector of the Czech Republic.*

63 Recommendation for the Council Recommendation on the National Reform Programme of the Czech Republic for 2017 and the Council Opinion on the Convergence Programme of the Czech Republic of 2017, COM (2017) 503 final of 22 May 2017.

64 Council Recommendation of 11 July 2017 on the National Reform Programme of the Czech Republic for 2017 and Council Opinion on the Convergence Programme of the Czech Republic, 2017 (*Official Journal of the European Union,* 2017 / C 261/03, 9 August 2017).

65 Only the preventive part of the *Stability and Growth Pact* currently applies to the Czech Republic.

A.4.2 Implementation of the CR's National Reform Programme and the Convergence Programme in 2017

In March 2018, the Commission published a Commission's departments' Working Paper entitled *The Czech Republic Report 2018*, assessing the economy of the Czech Republic based on the annual growth analysis and assessing the progress in the structural reforms recommended by the Council as well as the progress in meeting national reform priorities. The 2018 Report states:

1. **Economic situation** – the real GDP growth accelerated to 4.5% in 2017, mainly as a result of rapid wage growth supporting a robust increase in household consumption. For the next period, GDP growth should stabilize at about 3% per annum. The slowdown in the dynamics will be the result of the lack of human resources. GNI per capita (at PPP) reached 82.6% of the EU-28 average at the end of 2016, while reaching higher economic convergence was slowed down by a rise in price levels which was faster than in other MS. Inflation in 2017 reached 2.4% and was higher than in the eurozone. Investments showed a wide-ranging growth (above the EU average in relation to GDP) and household expenditure grew by 3.5% in 2017. Household income inequality[66], which is one of the lowest in the EU, remained at a steady level. Shortage of labour force stimulated wages increase and, on the other hand, restricted production. The Czech Republic's trade balance was markedly positive (7.5% of GDP) in 2016, and the Commission forecasts further stable growth in 2017-2019 (around 6.9% in 2019). Public finances reported a budget surplus, which is expected to be achieved also in the next two years. Tax revenues increased; on the other hand, the increased public expenditure on salaries in the public sector (in particular salaries of teachers) and on pensions and social security benefits will fully manifest itself in 2018. The debt-to-GDP ratio should continue to decline and reach 32.5% in 2019.
2. **Progress in the implementation of the recommendations for the Czech Republic** – The Commission evaluated the implementation of the Council recommendation for the Czech Republic for 2017 as part of the process initiated by the introduction of the European Semester 2011. The result of its overall assessment was expressed in **the opinion that the Czech Republic had made some progress**[67]. This opinion is based on the following partial assessments of the implementation of the Council recommendations:
   - **Ensure long-term sustainability of public finances - some progress** has been made in increasing the efficiency of public spending and addressing inefficiencies in public procurement procedures**, limited progress** in addressing the long-term sustainability of public finances (pension system measures);
   - **Remove obstacles to growth - some progress** has been made in all the sub-areas, i.e. in the context of simplifying the procedures for issuing building permits, introducing eGovernment services, improving the quality of research and development, and supporting the employment of groups under-represented in the labour market.

66 In 2016, the earnings of the 20% richest were approximately 3.5 times higher than earnings of the 20% poorest

67 Progress assessments use the following categories: **no progress** - no measures announced or adopted; **limited progress** - measures responding to the recommendation reported in a limited extent; **some progress** - measures responding to the recommendation partially adopted or significant effort still needed for their implementation; **significant progress** - measures responding to the recommendation adopted, most implemented, **implemented in full** - all measures corresponding to the recommendations implemented.

3. **Reform priorities in the Czech Republic** – The Commission made the following statements in the 2018 Report on the individual priorities defined in the *National Reform Programme of the Czech Republic 2017*:

   - **Public finance and tax system** – tax revenues evolved favourably, VAT fraud declined, a high tax burden for low-income individuals remained. The tax burden for the self-employed was lower than that for employees; however, the use of flat-rate costs as well as their levels were gradually reduced. For 2018, the Czech government envisages reducing the regulatory burden and modernising the income tax legislation. The fiscal framework of the Czech Republic was significantly strengthened by the new Act on budgetary responsibility[68] and in January 2018 the National Budget Council was appointed as an independent fiscal institution overseeing compliance with fiscal rules. The long-term sustainability of public finances has improved, but the expected rise in pensions as well as expected increase in life expectancy remain risk factors. This relates to the expected increase in health care expenditure, the average growth of which will be higher than the average growth rate in the EU.
   - **Financial sector** – the Czech Republic's financial system, in which banks hold 74% of all assets and 84% of total capital, shows a high level of capitalization, profitability and liquidity; for example, the share of defaulting loans (2.9%) is well below the EU average (4.6%). Banks boost profitability by saving operating costs; the main risk to financial stability could be unfavourable developments in the property market, as mortgage loans account for 58% of loans granted to the private sector. The insurance sector is stable in the long run, the capital market is weaker compared to economies of similar size and its potential is not fully utilized.

     Residential property prices rose steadily from the end of 2016 with price index increased by 13% year-on-year, making the Czech housing market among the fastest growing in the EU. The CNB analysis of mid-2017 evaluated the housing market as overvalued, and measures to reduce demand based on transferring the tax burden of property sales from the seller to the buyer failed to contribute to price decline. The affordability of housing, especially in Prague, deteriorated further, with price increase outpacing nominal income growth. On the other hand, mortgage lending has accelerated and the number of building permits issued for residential development increased slightly. Household debt has risen in recent years, but is still among the lowest in the EU.
   - **Labour market, education and social policy -** the labour market developed positively, the employment rate reached 78.9% in the second half of 2017 and was further rising. Unemployment fell to 2.5% and reached the lowest level in the EU. Gradually, labour shortage began to be apparent, directly affecting increased wages (7.1%). The potential of women in the labour market was insufficiently utilised, especially because of their need to care for children, caused by, among other things, insufficient number of childcare facilities for children under the age of three. While insufficient provision of care services continued, the situation regarding caring for dependent and elderly family members improved by introducing a three-month leave for carers. The employment rate of low-skilled workers is significantly lower than of those with medium and high-level qualifications. The situation for people with disabilities is similar. The shortage of labour is mitigated by influx of foreign nationals. In 2016, 433,000 foreigner nationals lived in the Czech Republic, of whom more than 60% were born outside the EU.

68 Act No. 23/2017 Coll., On the rules of budgetary responsibility.

The Czech Republic has long been among the countries with the lowest number of people at risk of poverty or social exclusion (13.3% in 2016). However, the number of socially excluded localities is gradually increasing, access to housing is becoming more difficult, and the number of heavily-indebted borrowers is rising. The legal framework for social housing planning is still missing.

In 2016, a reform to promote inclusion of pupils with special needs into mainstream education was implemented; its success would depend on sustainable funding and special training for teachers and assistants. As part of further support of inclusive education, compulsory pre-school education for the last pre-school year was introduced in September 2017, aiming at better inclusion of socio-economically disadvantaged children. The rate of early school leavers is increasing steadily (6.6%); although it is still below the EU average rate (10.7%), most MS record the opposite trend. Teachers' salaries, even after adjustments in 2017 (15% increase), remain relatively low; a new career system has not yet been adopted.

- **Investment** – investment was negatively affected by a number of issues including the difficulty in obtaining building permits, the complexity of the tax system and contract enforcement. Although the Czech Republic ranked 30 out of 190 countries in the World Bank ranking[69] for ease in doing business, i.e. relatively high compared to other EU countries, it ranked 127 in the building permit acquisition indicator, i.e. amongst the worst in the EU. Accelerating the procedure for issuing a building permit by incorporating the environmental impact assessment into the urban planning decision, i.e. into a joint urban planning decision and building permit, has removed some administrative barriers, but its benefit is considered questionable for large infrastructure projects. Insufficient legislation regarding land expropriation remains a significant obstacle.

  SMEs did not achieve the level of labour productivity improvement as large enterprises, as they tend to find it difficult to attract highly qualified workers compared to large enterprises which can offer higher wages and have access to foreign labour markets. In terms of business start-ups, the Czech Republic ranks to the EU average. Banks are increasingly interested in providing loans to SMEs; a new funding option is the National Fund to financially support SME and Innovation Projects.

  The slow drawdown of the European Structural and Investment Funds (ESIF) in PP14+ led to a decline in public investment co-financed by the EU in 2016 and 2017. The area of eGovernment remains below the EU average, which should be improved by the introduction of national electronic identification in mid-2018. The Government of the Czech Republic furthermore envisages an introduction of an interactive civil portal which will serve as a national access point to eGovernment services.

  In 2016, the regulatory framework for public procurement was amended, improving the transparency and integrity of the procurement process. Compared to 2016, the proportion of contracts awarded without a tender decreased from 21% to 10%, however, for most contracts, price remained the only or the decisive criterion of the awarding process. Public procurement was further professionalised through multi-level preparation of both contracting authorities and contractors. From mid-2018, an electronic procurement instrument (NEN[70]) will become compulsory.

69 Doing Business 2018: Reforming to Create Jobs, World Bank Group 2018
70 *National Electronic Instrument*

- **Sectoral policies** – The field of R&D in the Czech Republic recorded a progressive growth of high and medium-high tech production and knowledge-based services. Investment in R&D increased, mainly through foreign direct investment, which doubled over the last six years. On the other hand, there is a shortage of qualified human resources, and a poor link between academia and business. The management of the public research, development and innovation system was fragmented and the process of adopting the much-needed act on the support for the research, development and innovation was suspended.

  The telecommunications sector suffered from a deterioration in consumer market ratings and lags behind the EU average. Prices of services, especially of broadband connection, are well above the EU average.

  Investment in infrastructure remained below the EU average, which was reflected in gaps in the TEN-T[71] motorway network. Although the Czech Republic has the densest rail network in Europe, key cross-border connections are missing and the European Rail Traffic Management System (ERTMS[72]) has not yet been implemented.

  The process of improving the energy efficiency of residential buildings is slower than in the EU, although it has slightly accelerated for public buildings. The Czech Republic has already met the national targets of the Europe 2020 strategy regarding the share of renewable energy production; on the other hand, the use of biofuels in transport dropped to 6.5% (the target is set at 10%).

  Air quality remains a problem, emission limits are being exceeded especially in terms of solid particles (airborne dust). Although municipal waste production is below the EU average, the proportion of its recycling is also below the EU-28 average and waste is mainly deposited at landfill (53% in total vs. 25% in the EU-28).

71 Trans-European Transport Networks.
72 *European Rail Traffic Management System*.

B. Sector matters

B.1 EU Revenues

Own resources constitute a crucial part of the revenue side of the EU budget and their amount is set for each MS in the EU budget for the relevant financial year. These are revenues assigned to the European Union under Article 311 TFEU[73] in order to finance the EU budget.

A **High Level Group on Own Resources** was set up in 2014 to examine how the EU budget system can be more transparent, fairer, simpler and more democratically accountable. The final report and the group's recommendations were presented to the Council in January 2017 and the results of the group's work were published in April 2017[74]. The report **proposes that the EU focus more budget funding on its own resources than before, and reforms the EU budget on the revenue and expenditure sides to address new priorities at present**. The operating elements should be preserved (on the revenue side, it is traditional own resources and the source of gross national income, as well as budget balancing). **All discounts and rebates should be cancelled**. The Group also recommends introducing **alternative sources of EU income** that would not be perceived as contributions by Member States but would be directly related to EU policies. **These would include a reform of the VAT-based and income tax-based own resource, a tax on financial transactions and other financial options, as well as the taxation of energy-related, environment, climate and transport policy options.** Last but not least, other revenues, the importance of which has so far been neglected (revenues from auctions or other policies related to EU competences such as border controls or carbon leakage charges) could become an additional element of EU revenue.

In March 2017, the Commission presented the so-called **White Paper on the Future of Europe[75], which contains five scenarios for the EU reform:**

- Carrying on,
- Nothing but the Single Market,
- Those Who Want More Do More,
- Doing Less More Efficiently,
- Doing Much More Together.

One of the themes of the White Paper is also the future of EU finances; On this subject, the Commission has drawn up a discussion paper[76] following the conclusions of the High Level Group in January. Similarly, as the High Level Group, **the Commission regards the current funding approach as too complicated, opaque and marked by complex correction mechanisms.** There are a number of possible sources of revenue that can be used to finance the EU budget. Some sources may bring steady and significant revenue and lead to a real transformation of the revenue side; more modest revenues, which could however be more politically relevant or acceptable, could flow from other sources.

73 Consolidated version of the TFEU, *Official Journal of the European Union*, C 115, 9 May 2008.

74 High Level Group on Own Resources, Summary and Recommendation, EU Publication, ISBN 978-92-79-66584-4, April 7, 2017.

75 *White Paper on the Future of Europe and the Way Forward: Reflections and scenarios for the EU27 in 2025,* COM (2017) 2025 final of 1 March 2017.

76 *Discussion paper on the future of EU finances,* COM (2017) 358 final of 28 June 2017.

Every three years, **the European Commission submits to the EP and the Council a report on the procedures used in MS for the registration of taxable persons and for the assessment and collection of VAT, as well as on the results of their VAT control systems**. The eighth report[77] deals with developments in 2013-2016. VAT receipts are an important source of revenue for the Member States and EU budgets and are rising year on year.

In this report, it is **recommended to the MS tax administrations to monitor and evaluate the effectiveness and efficiency of the measures taken, continue with digitisation and automation, calculate and analyse the so-called VAT gap[78], unify VAT identification numbers, perform systematic checks on VAT registration data, and use all available instruments, including the mutual assistance mechanism, for VAT recovery.**

B.1.1 EU regulation regarding MS revenues

In 2017 efforts continued to **combat tax fraud, supported,** inter alia, **by deepening international cooperation, improving the European VAT system, and penalising multinational corporations for unlawful tax concessions**.

The Commission has made significant progress in increasing tax transparency and has taken action against tax evasion and avoidance. Gradually, the new EU-approved rules to address artificial tax practices and new regulations governing the transparency of financial accounts, tax decisions and multinational companies are coming into force. The Commission has already tabled a proposal to step up its fight against money laundering and a proposal that multinational companies will have to report on how much they have earned in each country and what taxes they have paid, as well as stricter rules on the sound management of the EU funds.

Information leaks, including the "Panama Papers" affair, have prompted the Commission to issue a **draft directive**[79] in June 2017, **amending for the sixth time Council Directive 2011/16/EU on administrative cooperation in the field of taxation**. The Commission has proposed a **new obligation to report potential aggressive tax planning before it is applied.** This obligation will apply to tax advisors and other persons who are responsible for the tax entity but also for the tax entities themselves. The aim of the directive is to discourage tax advisers and other intermediaries from designing and promoting these harmful practices. These rules **will apply to all EU Member States, all tax experts and any potentially harmful practices.** The new rules are expected to enter into force on 1 January 2019.

In the second half of 2017, the Commission focused its attention on taxation of cross-border sales in the EU. The new rules aim to simplify the fight against VAT fraud and ensure a more effective tax collection. As presented by the Commission's new study on VAT revenue shortfalls for 2015[80], the difference between the expected and actual VAT collection in the EU-28 was € 151.5 billion, equivalent to 12.8% of the total VAT tax. For the first time, the results of the study took into account the revenues resulting from the new VAT rules on the cross-border sale of electronic services, which entered into force on 1 January 2015 and which are based on the Commission proposal. Although VAT collection has been partially improved, the amount of the VAT gap has shown that the VAT system needs to be modernized. The existing VAT system has been in place since 1993 and had been designed as transitory; moreover, the EU's loses 50 billion € each year as a result of cross-border fraud.

---

77 *Report from the Commission to the Council and the European Parliament: Eighth report under Article 12 of Regulation (EEC, Euratom) No 1553/89 on VAT collection and control procedures*, COM (2017) 780 final of 18 December 2017.

78 The difference between the expected and actually collected VAT.

79 Proposal for a Council Directive amending Directive 2011/16 / EU as regards the mandatory automatic exchange of tax information in relation to cross-border measures to be notified, COM (2017) 335 final of 21 June 2017.

80 *Study and Reports on the VAT GAP in the EU-28 Member States: 2017 Final Report*, TAXUD/2015/CC/131, 18 September 2017.

Therefore, following the 2016 VAT Action Plan [81], **the Commission** has **proposed the biggest reform of the VAT system in the last 25 years.** The Action Plan has set the stage for the creation of a single European VAT area and has laid down the gradual steps needed for its implementation. In this context, **the Commission has presented a package of legislative proposals**[82]**, introducing the final VAT system**. The current system should be changed so that goods sold from one EU country to another will be taxed the same as when sold domestically. The Commission will thus reinstate the principle of VAT assessment related cross-border trade within the EU.

The new system should reduce cross-border fraud by 80%. In 2018, the Commission should **submit a detailed legal proposal to amend the VAT Directive**[83], which will contain technical details in order to implement the proposed VAT scheme. These technical measures will **introduce a new concept of so-called intra-EU delivery**, where the place of delivery will be located in the MS termination of shipment and the supplier will be responsible for payment. The measure also establishes a **single administrative point to enable the supplier to pay VAT** payable on deliveries of goods to another Member State in the **MS where he resides**. In this context, the summary reports introduced to obtain data for the VIES system[84]. The new proposals should then enter into force by 2019.

In October 2017, the Commission also reported [85] on measures adopted or to be adopted by the end of 2017 to adapt the VAT system to the global, digital and mobile economy, to support the needs of SMEs, to promote fair pricing policy, to stop cross-border fraud and to help MS eliminate VAT revenue losses. The transition to the final VAT system will take place in two phases in line with the VAT Action Plan. The first phase will cover VAT on inter-company supplies of goods within the EU, while in the second phase the final VAT regime will be extended to cover all cross-border supplies including services. The second phase will be introduced after assessing the five-year functioning of the first step of introducing the final VAT system.

The final VAT package of October 2017 also contains three “quick fixes” of the VAT Directive requested by the Council[86] with the intention of improving the current VAT system. These entail a simplification and harmonization of rules for goods in a consignment warehouse, recognition of the customer’s identification number for VAT purposes as a substantive legal condition for the exemption of intra-EU VAT supplies and simplification of rules to ensure legal certainty in the supply chain. The Council also called for the harmonization and simplification of the rules governing intra-EU goods transport documents needed to exempt intra-EU supplies of goods (in relation to a certified taxable person). This amendment was implemented by a proposal to amend Implementing Regulation (EU) No 282/2011[87].

---

81 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the VAT Action Plan: *Towards a Single EU VAT Area: Time to Adopt Decision*, COM (2016) 148 final of 7 April 2016; see the EU report 2017.

82 Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards taxable persons, COM (2017) 567 final of 4 October 2017; Proposal for a Council Directive amending Directive 2006/112 / EC as regards the harmonization and simplification of certain rules in the field of value added tax and establishing a definitive system of taxation applicable in trade between Member States, COM (2017) 569 final of October 4, 2017.

83 Council Directive 2006/112 / EC of 28 November 2006 on the common system of value added tax, *Official Journal of the European Union* L 347 of 11 December 2006.

84 *VAT Information Exchange System*.

85 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Follow-up to the VAT Action Plan, *Towards a Single European VAT Area: Time to Adopt Decisions*, COM (2017) 566 final of 4 October 2017.

86 Council Conclusions of 8 November 2016 on improving existing EU VAT rules on cross-border transactions (No 14257/16 FISC 190 ECOFIN 1023, 9 November 2016).

87 Proposal for a Council Implementing Regulation ammending Implementing Regulation (EU) No 282/2011 as regards certain exemptions for intra-Community transactions, COM (2017) 568 final of 4 October 2017.

Following the four basic principles (Fight Against Fraud, Single Contact Point, Transition to "Destination Country" and Less Bureaucracy) introduced in October 2017 and following the VAT Action Plan, the Commission presented in November 2017 new instruments[88] to increase the resilience of the European VAT system against fraud and to eliminate legal loopholes that make large-scale frauds in this field possible. **These include joint processing and analysis of Eurofisc data, improvement of the operational framework for coordinated controls between MS, development of data exchange between tax administrations in the Member States and law enforcement authorities at the EU level, tackling fraud involving the dual VAT regime applicable to cars by improving access to vehicle registration data and combating fraud related to customs procedures Nos 42 and 63.** Submitted proposals should result in improved cooperation between MS, thus addressing VAT fraud, including online fraud, more quickly and efficiently.

The legislative innovations adopted by the Council in the field of income taxes in 2017 include **the Directive on mechanisms for addressing hybrid mismatches involving third countries**[89] and **the Directive on the regulation of tax dispute resolution mechanisms**[90]. The first may be included in the **EU's efforts to combat tax avoidance** as it extends **the scope outside MS and introduces new types of mismatch,** such as hybrid transfers. The second Directive **unifies the rules, particularly deadlines, in the field of tax dispute resolutions related to double taxation in the EU.** It imposes an obligation on MS to bring into force administrative and legal provisions necessary to achieve compliance by 30 June 2019.

In March 2018, the Commission introduced **new rules to ensure the taxation of European businesses' activities in the digital sector in a fair manner**, while at the same time contributing to economic growth, contained in the following two new legislative proposals:

- reform of corporate income tax rules so that profits are taxed where businesses show interaction with users that is of significant magnitude and is implemented through digital channels[91];
- introduction of a temporary tax on the main digital activities that currently escape tax altogether in the EU [92].

With the **package of proposals**, the European Union is **introducing a holistic approach to the digital tax system that will support a single digital market and** will be reflected in international debates in finding solutions at a global level.

The digital platform will be either in digital form and therefore taxable or have a permanent virtual office in MS if it meets at least one of the following criteria: its annual revenue in MS exceeds € 7 million, it has more than 100,000 users in the tax year in MS or signed more than 3,000 digital service contracts with business users in the tax year. The new rules will also change how profits are split between individual MS. **The new system will thus ensure a true link between the place where the digital gain arises and the place where it is taxed.** The measure could be included in the scope of the Common Consolidated Corporate Tax Base (CCCTB[93]).

88 Amended proposal for a Council regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, *Towards a common EU VAT area: Time to adopt a decision*, COM (2017) 706 in its final version of 30 November 2017.

89 Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatch with third countries, *Official Journal of the European Union*, L 144, 7 June 2017.

90 Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute mechanisms in the European Union, *Official Journal of the European Union*, L 265, 14 October 2017.

91 Proposal for a Council Directive laying down rules on the taxation of legal entities in the event of a major digital presence, COM (2018) 147 final of 21 March 20187.

92 Proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final of 21 March 2018.

93 *Common Consolidated Corporate Tax Base*.

Introducing a temporary tax on some digital activity revenue will ensure that some activities that are currently not sufficiently taxed may be taxed immediately by MS and therefore used as a revenue source. These include revenues from the sale of advertising space on the Internet, digital mediation activities that allow users to communicate with each other, facilitating the sale of goods and services, and revenue from the sale of data obtained from information provided by users. Tax revenue would be collected by the MS where the users are located. The tax liability would only apply to companies with an annual minimum income of € 750 million worldwide and an income of € 50 million in the EU. The single rate across the EU should be 3%.

In the field of excise duties, an implementing regulation[94] was adopted in June 2017, which repealed Commission Implementing Regulation (EU) 2016/1867. The repealed Implementing Regulation introduced a single common procedure for the complete denaturing of alcohol by introducing the use of a common denaturant. It was also intended to replace all the different denaturing practices used in each MS **in order to prevent tax evasion, tax avoidance and abuse of the tax system.**

In April 2017, **the Commission issued a report**[95] **on the implementation and evaluation of the Directive laying down the general arrangements for excise duty**. The report mentions a **number of issues relating to trade and transport between MS with selected products** subject to excise duties.

B.2 Expenditure co-financed by the European Structural and Investment Funds

B.2.1 Closure of the 2007–2013 programming period

Of the amount originally allocated to the Czech Republic from the EU funds for PP7+ totalling to over CZK 700 billion, approximately 96.4% will be used. For the entire programming period, the MfRD expects an under-execution totalling to approximately CZK 26.5 billion. The table below shows an estimate of the under-execution at the end of each programming period for individual programmes, including Regional Operational Programmes NUTS II (ROP) and the *Rural Development Programme 2007-2013* (RDP7+). However, these figures are estimates as the Commission will only notify the Commission of the final level of under-execution in the so-called full closure of financial settlement of the programmes.

94 Commission Implementing Regulation (EU) 2017/1112 of 22 June 2017 amending Regulation (EC) No 3199/93 on the reciprocal recognition of procedures for the complete denaturing of alcohol for the purposes of exemption from excise duty, *Official Journal of the European Union* L 162, June 23, 2017.

95 Report from the Commission to the Council and the European Parliament on the implementation and evaluation of Council Directive 2008/118 / EC of 16 December 2008 on the general arrangements for excise duty, COM (2017) 184 final of 21 April 2017.

Table 6: Estimated under-execution of PP7+ allocation by programme (€ million)

Programmes	Abbreviation	Under-execution		
		At the end of the period	Total	Total (in %)
OP *Technical Assistance*	OP TA	15.60	45.76	26.01%
OP *Resesarch and Development for Innovation*	OP RDI	67.32	309.85	14.96%
ROP *North-West*	ROP NW	38.78	93.42	12.25%
OP *Prague – Adaptability*	OPPA	12.73	13.01	11.33%
OP *Fisheries 2007–2013*	OP F	2.69	2.69	9.92%
OP Education for competitiveness	OP EC	63.79	174.13	9.83%
OP *Environment*	OP En	0.00	274.66	5.58%
OP *Cross-border Cooperation CR–Poland*	Interreg CR–PL	8.38	8.38	3.82%
Integrated operational programme	IOP	41.30	45.17	2.79%
ROP *South-West*	ROP SW	4.25	4.25	0.67%
OP *Human Resources and Employment*	OP HRE	0.00	4.35	0.23%
Rural Development Programme CR 2007–2013	RDP	4.46	4.46	0.16%
Other OP	-	0.00	0.00	0.00%
Total		**259.30**	**980.13**	**3.31%**

Source: MoF – Dept. 55 National fund[96] /PCO/, April 2018.

Note: Column *At the end of the period* includes estimated values of budget under-execution at the end of the PO7 + and cancellation of the Commission's 2015 commitment (i.e. the allocation for 2013 when applying the n+2 rule). Column *Total* represents the total estimated size of the under-execution of the allocated amount and cancellation of the commitment for the entire PP7+. Column *Total* (in %) indicates the ratio of total under-executed resources to the original allocation within individual programmes.

In other OPs, i.e. OP *Transport* (OPT7+), OP *Enterprise and Innovations*, ROP *Moravia Silesia*, ROP *Southeast*, ROP *Central Moravia*, ROP *Northeast*, ROP *Central Bohemia* and OP *Prague - Competitiveness*, under-execution of allocations is not expected.[97]

Drawdown of the PP7+ allocation may also be affected by the so-called **phased projects**, the implementation of which has been split between two programming periods and which cover three OPs [98]. The risk of these projects includes potential problems with the completion of the second phase within PP14+, which would result in ineligibility of expenditure certified in the first phase of PP7+. A threat to these projects may also be the risk of possible financial corrections applied in the second phase, which may then have a retroactive effect on the drawdown in the first phase.

The status of phased projects within OPs in PP7+[99] is as follows:

- A total of ten small phased projects are registered under the **OP *Environment* for the 2007-2013 programming period** (OPEn7+), of which 8 projects have already completed the phase II. With regard to the two remaining projects, legal acts have been issued and the projects are under implementation.
- In **OPT7+**, six large phased projects are registered, of which two projects have been completed. Three other projects are under implementation and for one project the legal act on aid granting/transferring has been issued. Within this programme, 20 small phased projects are also being implemented, of which 17 have already completed phase II. For the remaining projects, legal acts have been issued and the projects are under implementation.

96 Department 55 of the Ministry of Finance performs the activities of the payment and certification authority.
97 The list in this chapter does not contain information on the Czech Republic's *Rural Development Programme for 2007-2013* - see subchapter B.3.
98 OPEn7+, OPT7+ and OP RDE.
99 The project statuses are based on the screening of phased projects at the MA of individual OPs as of 31 March 2018.

- Within the OP ***Research and Development for Innovation* (OP R&DI)**, two large phased projects are registered. The second phases of ELI (*Extreme-Light-Infrastructure*) and SUSEN (*Sustainable Energy*) projects are being financed. For SUSEN, the final report was presented in August 2017 for the entire project implementation period. The implementation of the ELI project has been extended until the end of 2018 due to delays on the part of contractors. The change in the timetable was approved by the Monitoring Committee of OP *Research, Development and Education* in October 2017.

B.2.2 2014–2020 programming period

B.2.2.1 CR's allocation

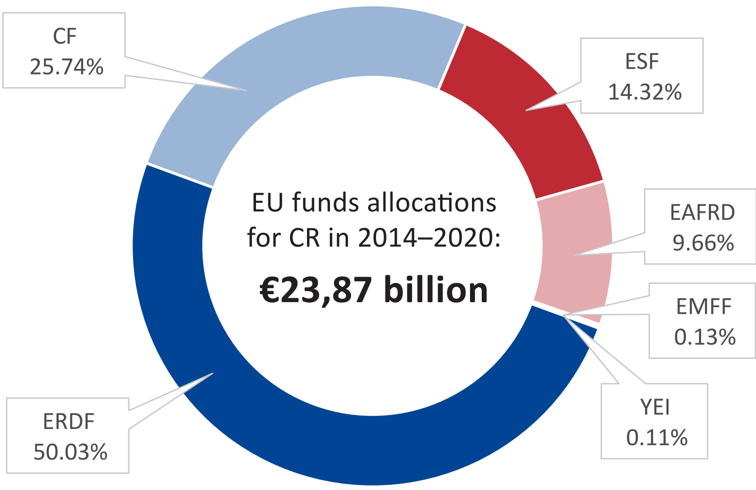
According to the Commission's data [100] the Czech Republic is currently drawing ESIF funds of a total allocation of almost € 23.87bn. Including national co-financing, a total of € 32.4 billion is available.

Table 7: Breakdown of total ESIF allocation by Fund **(€ million)**

EU Funds	Abbrev.	Allocation EU	National resources	Total
European regional development fund	ERDF	11 940.69	5 166.73	17 107.42
Cohesion Fund	CF	6 143.95	1 084.23	7 228.18
European social fund	ESF	3 416.40	786.16	4 202.56
European agricultural fund for rural development	EAFRD	2 305.67	1 464.96	3 770.63
European maritime and fisheries fund	EMFF	31.11	10.05	41.16
Youth Employment Initiative	YEI	27.20	2.40	29.60
Total		**23 865.02**	**8 514.53**	**32 379.55**

Source: Commission, https://cohesiondata.ec.europa.eu/countries/CZ, as at 9 May 2018.

Chart 9: Proportion of individual ESIFs in the EU allocation



Source: Commission, https://cohesiondata.ec.europa.eu/countries/CZ, as at 9 May 2018.

These funds are drawn by means of ten national programmes.

100 See https://cohesiondata.ec.europa.eu/countries/CZ – as at May 2018.

Table 8: Main allocations from the EU budget to national programmes (CZK million)

Programmes	Abbreviation	Managing authority	Main allocation
Integrated regional operational programme	IROP	MfRD	110 792.6
OP *Transport*	OPT	MoT	108 663.7
OP *Enterprise and Innovation for Competitiveness*	OP EIC	MoIT	103 400.3
OP *Research, Development, Education*	OP RDE	MoEYS	66 085.0
OP *Environment*	OPEn	MoEn	63 659.6
Rural Development Programme 2014–2020	RDP	MoA	55 252.2
OP *Employment*	OPE	MoLSA	51 269.0
OP *Technical assistance*	OPTA	MfRD	5 326.1
OP *Prague – Growth Pole of the Czech Republic*	OP PGP	Prague City Hall	4 812.8
OP *Fisheries 2014–2020*	OPF	MoA	742.7
Total			**570 004.0**

Source: MS2014+, OP managing authorities, as at 31 March 2018.

Note: Exchange rate of 25,398 CZK/€ was applied.

B.2.2.2 Main allocation drawdown[101]

Since the beginning of PP14+, a total of 683 calls had been launched cumulatively for all programmes as of 31 March 2018, with allocation of CZK 617.0 billion (EU contribution), which represents 108.2% of the main allocation of CZK 570.0 billion (EU contribution). The highest volume of calls in terms of absolute values were launched for OPT, followed by IROP and OP EIC.

Table 9: Drawdown of ESIF funds in % of the main allocation as of 31 March 2018 by programme (in %)

Programme	ESIF Funds				
	Registered applications	Finances in legal acts to grant payments	Finances in reimbursed applications	Finances billed in payment applications	Finances in applications for interim payments sent to the Commission
RDP	70.6	47.5	37.8	33.2	31.3
OPE	114.4	75.2	32.3	24.0	21.2
OPTA	81.3	58.1	27.3	25.1	21.2
OPT	94.0	55.1	26.8	22.0	18.3
OPEn	109.3	46.0	15.1	11.5	10.1
OP EIC	107.9	43.7	9.1	6.5	6.6
OPF	83.4	32.3	9.9	9.9	5.9
OP RDE	162.9	57.0	19.7	6.8	5.7
IROP	105.8	48.9	4.6	5.0	3.4
OP PGP	111.7	43.5	16.5	3.4	1.8
Total	**108.1**	**52.0**	**18.6**	**14.1**	**12.3**

Source: MS2014+, OP managing authorities, as at 31 March 2018.

At the end of March 2018, i.e. in the fifth year of the programming period, the volume of funds in the interim payment applications reached 12.30% of the main allocation.

101 The main allocation together with the performance reserve (6%) constitute the total allocation.

B.2.2.3 *Implementation of the n+3 rule and the performance framework*

2018 is the first year of the Czech Republic being confronted with the fulfilment and evaluation of its financial and material commitments to the Commission, i.e. the potential for meeting the n+3 rule and the performance framework milestones. Failure to comply with the n+3 rule means a loss of funds; failure to achieve milestones means inability to fully utilize the potential of the so-called performance reserve, i.e. about 6% of the total allocation at the level of each Priority Axis.

Table 10: The state of meeting the n+3 rule for 2018 as at 31 March 2018 (EU contribution) (€ million)

Programme	Allocation in 2015 (n+3 rule)	Interim payments up to 2018	Payment applications sent to 31 January 2018	Achieving the limit	Remains to be drawdown in 2018
RDP	443.59	69.17	680.26	168.9%	0.00
OPE	558.97	213.38	427.71	114.7%	0.00
OPTA	60.47	22.82	44.55	111.4%	0.00
OPT	1 191.99	451.77	782.11	103.5%	0.00
OPEn	669.07	259.34	253.56	76.7%	156.16
OP EIC	1 106.16	422.39	267.03	62.3%	416.74
OP RDE	706.97	269.96	148.24	59.2%	288.77
OPF	8.07	3.03	1.72	58.9%	3.31
IROP	1 185.24	452.58	147.49	50.6%	585.17
OP PGP	51.49	19.66	3.41	49.5%	28.42
Total	**5 982.00**	**2 184.10**	**2 756.08**	**82.6%**	**1 478.58**

Source: *Information on the level of utilising the EU funds in the 2014-2020 programming period,* submitted to the Council for European Structural and Investment Funds, NCA as per MF-PCO data, April 2018.

As shown in Table 10, as of 31 March 2018 half of the programmes reported the state of meeting the n+3 rule for 2018 below 75%. On the other hand, four programmes reached the 2018 drawdown limits already at the end of the first quarter.

The performance framework means financial dependency on the speed and quality of drawing, i.e. the introduction of clear and measurable milestones[102] and target values for all programmes. In addition to financial indicators, output indicators should be selected for each Priority Axis (PA), Union Priority (OPF) or Priority Area (RDP). For those activities where a slow start-up phase could be expected (e.g. large projects), key implementation steps should be used instead of milestones as indicators to monitor (for 2018) the correct direction and extent of meeting the targets. Managing Authorities and MfRD should regularly monitor how the milestones and targets are being met by comparing the actual status and the progress of drawdown with their set values. Pursuant to Article 21 of the General Regulation[103] the Commission, in cooperation with the Member States, will review the performance of

102 A milestone in programme management is clearly defined as a major event occuring in the course of the programme. This is a moment of time when achieved proportion of the programme's results is verified and measured. A milestone thus serves for the purpose of control or deciding on remedy. Milestones are intermediate objectives that are directly related to meeting a specific objective of an investment priority. They should be reached by 31 December 2018 and will be assesed in 2019.

103 General Regulation - 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 and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

programmes in each MS in 2019, taking into account the performance frameworks established for the programmes concerned. In doing so, it will assess the achievement of the milestones of the programmes at the level of the priorities, based on the information and evaluation provided in the annual implementation reports to be presented by the Member States in 2019.

Pursuant to Article 22 of the General Regulation, a **performance reserve of CZK 36,119.70 million**, approximately 6%[104] of the total allocation, i.e. CZK 606,128.80 million[105], was set for all programmes funded in the Czech Republic with ESIF participation. The performance reserve is allocated only to those programmes and priorities that have achieved their milestones. Where the priorities have reached their milestones, the amount of the performance reserve set for that priority shall be considered definitively allocated on the basis of the Commission's decision under paragraph 2. If the performance review shows that a serious failure occurred in the implementation of the performance framework, the Commission may suspend, completely or partially, the interim payments for the PA.

As part of an ongoing evaluation of the fulfilment of financial and material milestones, the National Coordinating Authority, following consultation with the MA, identified in February 2018 PAs and Union's Priorities potentially at risk. Priority axes of the programmes listed in Table 11 are rated as posing the highest risk.

Table 11: Priority axes with potential risk and their performance reserves (€ million)

Programme	Priority axe	Name of the priority axe	Fund	Type of region	Performance reserves EU share
OP EIC	PA 3	*Efficient energy management, development of energy infrastructure and renewable energy sources, support for the introduction of new technologies in the field of energy management and secondary raw materials.*	ERDF	MRR	76.00
	PA 4	*Development of high-speed access networks to the Internet and information and communication technologies.*	ERDF	MRR	44.00
OP RDE	PA 2	*Development of higher education institutions and human resources for research and development.*	ESF	MRR	18.69
	PA 2	*Development of higher education institutions and human resources for research and development.*	ESF	VRR	2.34
OPEn	PA 4	*Protection and care of nature and landscape.*	ERDF	MRR	21.10
	PA 5	*Energy savings.*	ERDF	MRR	1.20
IROP	PA 3	*Good territorial management and streamlining of public institutions.*	ERDF	VRR	1.45
	PA 4	*Community-led local development.*	ERDF	MRR	24.10
OP PGP	PA 2	*Sustainable mobility and energy savings.*	ERDF	VRR	3.63
	PA 3	*Promoting social inclusion and combating poverty.*	ERDF	VRR	0.75
Total					**193.26**

Source: *Information on the state of implementation of EU funds in the 2014-2020 programming period,* submitted to the Council for the European Structural and Investment Funds, NCA, April 2018; approved OP programming documents.

Note: MRR – less developed regions, VRR – more developed regions.

104 Art. 22 (1) of the general regulation provides: "The performance reserve shall be between 5 and 7% of the share for each priority under the programme, with the exception of technical assistance priorities and programmes for financial instruments in accordance with Article 39. The total amount of the performance reserve allocated to ESI funds and region categories is 6%. Amounts corresponding to the performance reserve are set out in the programmes, broken down by priority and, where appropriate, by ESI funds and categories of regions."

105 Source: MS2014+, MA, data as at 31 March 2018.

Consistent application of the rules of the General Regulation would, under the unchanged conditions, affect approximately € 193 million, i.e. approximately CZK 5,600 million at the current exchange rate[106]. Failure to achieve milestones does not necessarily mean a loss for the Czech Republic as the affected amount may be used towards better-performing operations in other priority axes.

B.2.2.4 Risks of implementing the Partnership Agreement for 2018

The MfRD, together with other implementation structure entities[107], conducts regular evaluations of the implementation of the Partnership Agreement and submits reports to the Government of the Czech Republic, which also include the programme risk assessment. The 2017 annual report with data as of 31 December 2017 shows the following status.

The results of the assessment indicate that current risks that affect the drawdown of funds on a horizontal level include the following facts:

- The Commission assesses the transposition of the European Environmental Impact Assessment Directive into the national legal order as "incorrect"; therefore, there is a risk that the spending on related projects will not be reimbursed by the Commission but will have to be reimbursed from national resources;
- Drawdown in the field of improving energy efficiency, such as thermal insulation of (especially public) buildings, is failing despite the fact that this field has been allocated a considerable amount within PP14+;
- Drawdown for the Czech Republic's high-speed Internet coverage is considerably delayed against the timetable.

The multi-criteria risk assessment of programmes for PP14+ carried out by the NCA and the programme MA in February 2018 based on data as of 31 December 2017, has generated the following up-to-date programme breakdown by the risk degree.

Table 12: Degree of risk of programmes according to data as at 31 December 2017

Degree of programmes´ risk	Programme
High-risk programmes	IROP
	OP EIC
	OP PGP
Medium-risk programmes	OPF
	OPTA
	OP RDE
	OPEn
Low-risk programmes	OPT
	OPE
	RDP

Source: Annual Report on the Implementation of the Partnership Agreement for 2017, issued in April 2018.

As a result of the evaluation, the NCA identified the risks outlined in the following overview. Given the purpose of the EU Report and its limited scope, the overview outlines neither the context of the risks nor corrective measures defined for their elimination. Detailed information is included in the above-mentioned report.

106 CNB exchange rate as of 16 May 2018 at CZK 25.55 / €.

107 The NCA, in co-operation with ESIF implementation bodies, in particular the MoF and the Managing Authorities, prepared the *Annual Report on the Implementation of the Partnership Agreement for 2017* based on data as of 31 December 2017.

High-risk programmes

IROP:

- Ineligibility of expenditure in relation to the Commission's reasoned opinion on the EIA[108], where the Commission believes that the environmental impact assessment of projects has not been carried out in accordance with the requirements of the EIA Directive. The Commission thus requests the elimination of payment applications for projects affected by this opinion;
- Insufficient potential to meet the n+3 rule, where the current low level of drawdown is primarily in funds accounted for in payment requests (2.8% of the main programme allocation) and funds in the interim payment requests sent to the Commission (2.6% of the main programme allocation);
- Insufficient absorption capacity, drawdown in the specific target 2.5 *Reduction of high energy consumption in the housing sector* is still problematic;
- Insufficient potential to meet financial and material milestones, especially in PA 3 - *Good territorial governance and improving efficiency of public institutions* and PA 4 - *Community-led Local Development* (CLLD), where high-risk financial milestones have been identified, and in PA 2 - *Improving Public Services and living conditions for the inhabitants of the regions* and PA 3 - *Good territorial governance and improving efficiency of public institutions*, where high-risk material milestones have been identified;
- Delayed implementation of financial instruments. By the end of 2017, the MA had not chosen an administrator of these instruments and tender documentation had not been completed.

OP EIC:

- The audits identified risk related to the legality and regularity of expenditure; they also identified serious deficiencies that have led to the occurrence of irregularities; also, a high error rate of 6.58% of the sample of operations was identified[109];
- Insufficient absorption capacity in some areas, which is reflected in the low level of fulfilment of related calls. Particularly significant is the insufficient absorption capacity in the field of energy efficiency, where expected results of the Partnership Agreement may not be achieved. In the case of high-speed Internet support, there is a mismatch between MA and potential beneficiaries from the ICT sector regarding the support settings and technical parameters of the call;
- Failure to maintain a uniform methodological environment;
- Insufficient potential to meet the n+3 rule, with negative assessment of poor achievement of the 2018 drawdown limits by means of requests sent to the Commission and the long administrative processing of aid applications, which is 365 days per programme;
- Insufficient potential to meet financial milestones of the performance framework for PA 3 - *Efficient energy management, development of energy infrastructure and renewable energy resources, support for the introduction of new technologies in the field of energy and secondary raw materials* and PA 4 - *Development of high-speed Internet access networks and information and communication technologies*, due to the low level of drawdown in legal acts, i.e. in billed or certified resources;

---

108 Environmental Impact Assessment.

109 In a letter dated 5 April 2018, the Commission warned the OP EIC Managing Authority about potential payment suspension.

- Risk of expenditure ineligibility in relation to the Commission's reasoned opinion on the EIA, as this opinion affects the certification of resources of projects concerned;
- Errors within the call management process and project evaluation and selection.

OP PGP:

- Insufficient potential to meet the n+3 rule, the primary reason being the low level of drawdown according to funds accounted for in payment requests (only 2.9% of the main allocation) and poor achievement of the 2018 drawdown limits by means of requests sent to the Commission;
- Excessively long administration of aid applications, i.e. 308 days for the whole programme
- Insufficient potential to meet material milestones of the performance framework; the most problematic material milestones identified by NCA were those for PA 2 - *Sustainable Mobility and Energy Savings* and PA 3 - *Promoting Social Inclusion and Fighting Poverty*;
- Insufficient absorption capacity;
- Insufficient administrative capacity; the turnover rate is the highest of all MAs.

Medium-risk programmes

OPF:

- Insufficient potential to meet the n+3 rule;
- The MA was the only one failing to implement the measure requiring to report at least 40% of the main allocation in funds in legal acts for aid granting/transfer by the end of 2017;
- Insufficient absorption capacity;
- Reaching financial and material milestones of Union Priority 3 - *Support for the implementation of the Common Fisheries Policy*; no single project was committed as of 31 December 2017.

OPTA:

- Delaying a decision on potential under-execution of funds for projects following MS2014+ which is the result of suspended reimbursement of expenditure for these projects in the programming document (i.e. impossibility of reimbursing related expenses to beneficiaries and entering these in the PCO summary applications) within PA 2 - Commission's *Common Monitoring and Evaluation System (CMES)*;
- Relatively long preparation and implementation of public contracts co-financed by OPTA within the MfRD;
- Possible failure to comply with the n+3 rule after 2020.

OP RDE:

- Insufficient potential for compliance with the n+3 rule, in particular the current level of drawdown according to funds accounted for in payment requests, or inadequate fulfilment of the drawdown limit (n+3) for 2018 by applications sent to the Commission;
- Insufficient potential to meet financial and material milestones of the performance framework, especially PA 2 - *Tertiary Education, Research and Development*;
- Lengthy administrative processing of aid applications within PA 2;
- Delayed preparation of the planned large *Mephared II* project, which may jeopardize its timely and successful implementation.

OPEn:

- Ineligibility of expenditure in relation to the Commission's reasoned opinion on the EIA as the Commission requires payment applications for projects affected by this opinion to be eliminated;
- Failure to comply with the n+3 rule, since interim implementation of the n+3 rule for 2018 was only at 68.6% on 31 December 2017;
- Long administration of aid applications;
- Insufficient potential to meet material and financial milestones of the performance framework, especially for PA 3 - *Waste management and material flows, environmental burden and risks*, PA 4 - *Protection and care for nature and landscape* and PA 5 - *Energy savings*;
- Infringement of the uniform methodological environment in the field of financial flows, as the MA fails to properly report irregularities.

Low-risk programmes

OPT:

- Serious deficiencies in the legality and regularity of expenditure, the occurrence of irregularities and a high error rate of 7.26%, with a significant impact on the state budget. Corrections resulting from the programme's high error rate must be paid from the state budget, given the nature of the beneficiary concerned (state institution – Road and Motorway Directorate – RMD);
- Ineligibility of expenditure in relation to the Commission's reasoned opinion on the EIA, where the Commission considers that the project of environmental impact assessment has not been carried out in accordance with the requirements of the EIA Directive. The Commission therefore calls for the elimination of payment claims for projects affected by this opinion;
- Failure to comply with the timetables for implementation of major projects. In the field of priority transport projects, only two of the 13 projects started in 2017.

OPEm:

- Lower achievement of financial and material milestones - PA 2 - *Social inclusion and combating poverty* and PA 4 - *Effective public administration*.

RDP:

- Insufficient potential to meet material milestones, in particular in terms of the "number of farms involved in co-operation of short supply chains / local markets" within priority area 3 - *Supporting the organization of the food chain, including processing and marketing of agricultural products, animal welfare and risk management in agriculture*;
- Insufficient potential to meet the milestones in priority area 6 - *Promoting social inclusion, poverty reduction and economic development in rural areas*.

On April 5, 2018, the Commission sent a warning letter to the MA of OP EIC, and on 10 April 2018 also to the MA of OP Transport. The reason was a higher error rate established by audits in 2016-2017 (see subchapter F.1). **In the case of OP EIC, the Commission recommends not to submit any further payment claims until corrective and preventive measures are adopted and reviewed**, with the exception of expenditure related to the implementation of financial instruments. **In the case of OPT, the Commission requires corrective measures to be adopted and assurance provided that expenditure affected by the errors is not and will not be included in payment claims sent to the Commission until it is corrected. On 16 May 2018, the Permanent Representation of the Czech Republic to the EU received a response to the warning letter from the OPT MA to be handed over to the Commission.**

B.3 Expenditure on direct payments and common market organisation

Direct payments and the common market organisations are financed by the *European Agricultural Guarantee Fund (EAGF).* This support accounts for nearly 75% of the CAP budget.

According to data[110] provided by the State Agricultural Intervention Fund (SAIF), CZK 24.35 billion was disbursed under the first pillar of the CAP in the Czech Republic in 2017, of which EU funds amounted to approximately CZK 22.98 billion.

Table 13: Amounts disbursed under the first pillar of CAP in 2017 (CZK million)

Expenditures	EU´s contribution	CR´s contribution	Total
Direct payments	22 349.18	820.15	23 169.33
Common market organisation	633.72	543.56	1 177.28
Total	**22 982.90**	**1 363.71**	**24 346.61**

Source: SAIF data – CAP budget for 2017 and its drawdown as at 31 December 2017.

B.3.1 Direct payments

The development of agriculture is supported mainly by direct payments. Farmers receive these payments on condition that they comply with the rules on the welfare and health of humans, animals, plants and the environment. The Czech Republic applies mainly the SAPS scheme under which farmers receive payments per hectare of farmed land. The amount of aid is not related to the volume of agricultural production. In addition to the basic SAPS payments, other payments are available focused on greening, young farmers, areas with natural constraints and on support for selected sectors/commodities of livestock and crop production facing difficulties. Each MS decides independently which sectors/commodities are to be supported. In addition to the aid from the EU budget, farmers may also receive transitional national aid, aiming to match the level of support in the selected commodities, which was set higher in the original EU countries than for farmers in the Czech Republic within the Single Area Payment Scheme.

In 2017, the Commission introduced several changes to the direct payment scheme, adopted also by the Czech Republic. One of the major changes was the possibility of repealing the "active farmer" condition. This condition for granting direct payments and subsidies within the Czech Republic's organic farming has been repealed as of 2018. Furthermore, the Commission abolished the requirement for livestock breeding intensity for receiving selected aid; limits of arable land area for greening; and introduced a ban on the use of plant protection products on nitrogen-binding crops.

110 The data source is a document entitled *Budget for the Common Agricultural Policy and Marketing for 2017* and its drawdown as of 31 December 2017, compiled by the SAIF.

In 2017, the SAIF paid farmers both direct payments against applications from past years (including the discontinued separate sugar payment and special aids) and payments against 2017 applications. **The total value of direct payments in 2017 was 23.17 billion**, i.e. about CZK 1 billion less than in 2016. This decrease is the result of, in particular, the reduced unit rates for all direct payment aid, amplified by the appreciation of the Czech koruna in 2017.[111] At the same time, the number of applications for voluntary support for selected sectors continued to increase, resulting in decreased rates for these supports.

SAPS accounts for the largest proportion of direct payments. With a disbursement of CZK 11.80 billion, it accounts for more than 50% of the total direct payment envelope. The second largest item is the greening payment, amounting in 2017 to almost CZK 6.76 billion, i.e. 29% of the total amount. CZK 3.43 billion, i.e. less than 15%, was paid for the support of selected sectors/commodities.

B.3.2 Common market organisation

The common market organisation is divided into two main areas, i.e. crop and livestock production. It applies to individual agricultural primary products and products after first processing and its purpose is to regulate the supply of agricultural products and to secure income for farmers. The CMO instruments include financial support, grants, production quotas, intervention purchases, storage support and support for agricultural product promotion. Within CAP, CMO represents a financially less important area.

In 2017, the Ministry of Agriculture (MoA) paid a total of almost CZK 1.18 billion for CMO. Of this amount, the largest proportion were financial aids amounting to CZK 748.43 million, of which the largest part was paid for emergency measures in livestock production. These measures were intended to offset the losses of milk and pork producers caused by the pan-European milk market recession and low pork and milk FITs. A total of CZK 335 million was paid for these measures in 2017. Another significant component of the CMO was the aid for fruit and vegetable production, including fruit and vegetable supplies to schools (approximately CZK 198 million) and school milk consumption (approximately CZK 56 million).

Compared to 2016, CMO expenditure decreased by about 40%. The most significant decrease was achieved in intervention purchases of dairy products. The decrease in expenditure was also the result of the termination of temporary aid for breeders of dairy cows and sows.

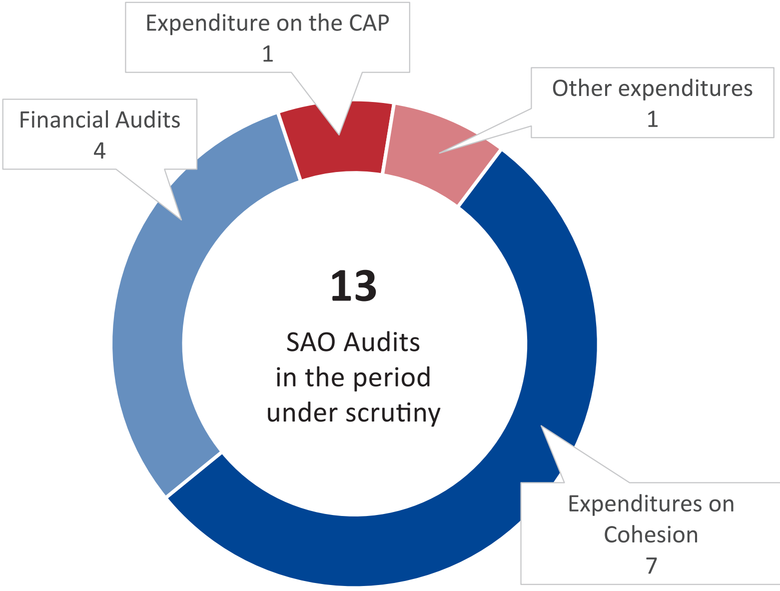
111 The CZK/€ exchange rate in 2016 was 27,021/1 and fell by CZK 1.04/€ in 2017.

C. SAO auditing and monitoring work in the period under scrutiny[112]

C.1 Overview of SAO audit work

In the period under scrutiny (April 2017 to March 2018), the SAO Board approved a total of **13 audits** that were, fully or in part, focused on EU budget appropriations (audits under scrutiny). An overview of these audits is included in Annex 1.

Chart 10: Breakdown of audits in the period under scrutiny by their focus



Source: *SAO Bulletin* for 2017 and 2018.

In the period under scrutiny, **nine audits focused on aid provided from the EU budget to the Czech Republic** [113]. Of these, **four** audits were conducted as **performance audits** (Audits No. 16/12, No. 16/26, No. 17/02 and No. 17/03) and **two** as **legality audits** (Audits No. 17/05 and No. 17/06**).** The remaining **three audits** (Audits 16/13, 16/32 and 17/09) **included elements of both of these audit types.**

Audits No. 16/12, 16/26 and 17/03 primarily examined the **setting and the functioning of various information systems (IS) used by the state administration**. The other **six audits** focused primarily on **project auditing**. **Four of those** (Audits No. 16/32, No. 17/02, No. 17/06 and No. 17/09) also scrutinised the **MCS settings of respective programmes**, and the **MCS functioning** was also verified within Audits No. 16/32, No. 17/06 and No. 17/09.

---

112 The information provided in this chapter is based primarily on the data published in the SAO's audit conclusions and on data stored in the *SAO Audit Information System*.

113 **Audit No. 16/12 -** *Preparation of a uniform methodological environment for EU funding drawdown in the 2014+ programming period, Audit No. 16/13 - Funds spent on development of education in the Czech Republic*; **Audit No. 16/26** - *Expenditure on the operation and the use of immovable property, including expenditure on the provision of information support related to the management, operation and maintenance of immovable property;* **Audit No. 16/32** - *Expenditure on the operation and the use of immovable property, including expenditure on providing information support related to the management, operation and maintenance of immovable property;* **Audit No. 17/02** - *Support for social housing as a part of the social inclusion policy;* **Audit No. 17/03** - *Health information systems administered by the organisational units of the Ministry of Health*; **Audit No. 17/05** - *Construction, modernisation and reconstruction of motorways;* **Audit No. 17 / 06 -** *State budget funds and EU funds spent on forestry support*; **Audit No. 17/09** - *Construction projects for the repair, modernisation and development of class I and II road networks in selected regions, co-financed from the UE funds and national resources*.

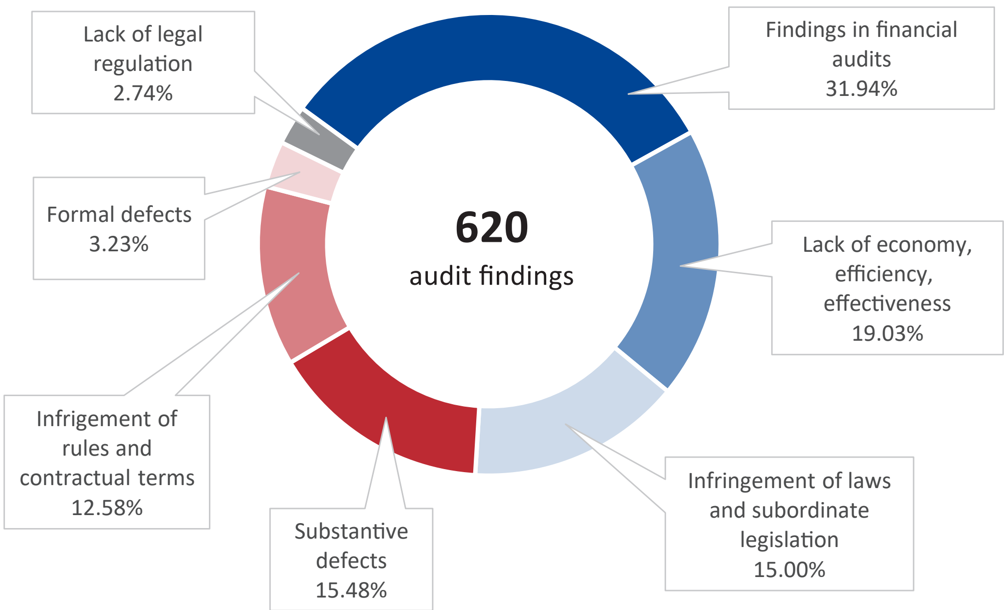
Four audits were **financial audits** [114], i.e. audits of final accounts of selected budget chapters.

Within the abovementioned audits, a total **of 98 entities (audited persons)** were audited, with many subjected to more than one audit (in particular, the Ministries performing the role of MAs of individual programmes co-financed from the EU budget); therefore, these audited persons are included in the total sum several times. The SAO found **deficiencies in 50 audited persons** (here also the number of audited persons reflects the number of audits performed, i.e. more than one), i.e. 51.02%

As a result of the audits, the SAO arrived at a total of **620 audit findings** (both quantifiable and non-quantifiable). The **detected deficiencies were worth a total of CZK 842.92 million**, of which deficiencies worth a total of **CZK 55.52 million** were assessed as **enforceable** and, together with one non-quantifiable finding, were passed on to relevant tax administrators to be dealt with further.

No criminal complaint was filed as a result of the audits**.**

Chart 11: Breakdown of audit findings by category



Source: SAO audit information system.

The audit findings made in the course of four financial audits (included in the *Findings in Financial Audits* category) fall into other type groups shown in Chart 11 (in the vast majority of cases, they constitute a violation of accounting laws or regulations). These findings, however, differ significantly from those made in other types of audits and are therefore reported here

114 **Audit No. 16/25 -** *Final Account of the 2015 State Budget Chapter Ministry of Industry and Trade, Ministry of Industry and Trade Financial Statements for 2015 and data submitted by the Ministry of Industry and Trade for Evaluation of the state budget implementation for 2015*; **Audit No. 16 / 29 -** *Final Account of the 2016 State Budget Chapter Ministry of Labour and Social Affairs, Financial Statements of the Ministry of Labour and Social Affairs for 2016 and data submitted by the Ministry of Labour and Social Affairs for evaluation of the state budget implementation for 2016*; **Audit No. 17/08 -** *Final Account of the 2016 State Budget Chapter Ministry for Regional Development, Ministry for Regional Development Financial Statements for 2016 and data submitted by the Ministry for Regional Development for the evaluation of the state budget Implementation for 2016*; **Audit No. 17/18 -** *Final Account of the 2016 State Budget Chapter Ministry of the Environment, the Ministry of the Environment Financial Statements for 2016 and the data submitted by the Ministry of the Environment for the evaluation of the state budget implementation for 2016.*

separately. They mostly constitute errors in managing the accounts of individual ministries (budget chapter administrators) with no direct monetary impact or physical effect on the legality of the operations performed.

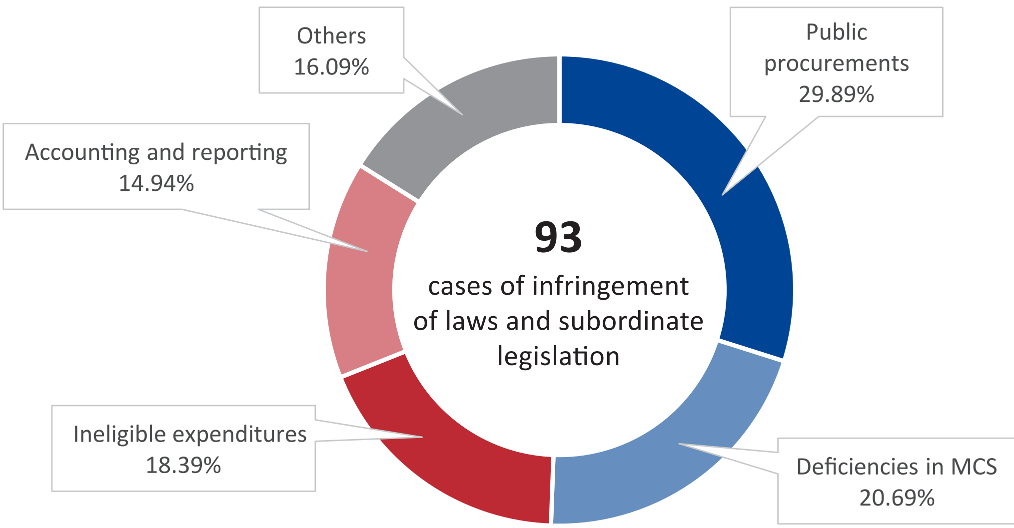
Similarly, findings classified in the *Economy, Efficiency and Effectiveness* category, i.e. cases found to be in breach of the "3E" rule are reported separately, irrespective of the type of audit applied (legality or performance audit). In this category, the SAO made a total of 118 non-quantifiable findings within the audits in question.

The *Material Misstatement* category includes findings related to failure to update the management documentation or failure to set the unit cost/eligible expenditure limits for acquisition investment. The *Formal Misstatement* category includes, for example, lack or ambiguity of data of lesser significance in legal acts, etc.

Out of the total of 620 audit findings, the SAO noted 93 cases of violation of statutory and subordinate standards (European standards, laws, DLs published in the Collection of Laws and the Czech Republic's Government Resolutions). For this category of findings, tax administrators received notifications worth a total of CZK 39.60 million.

Chart 12 provides an overview of the SAO audit findings relating to breach of statutory and subordinate standards classified by breach category, taking into account the regulation primarily breached. This means that, for example, a finding related to the violation of the Public Procurement Act[115] and consequent occurrence of ineligible expenditure qualified as a violation of the Budgetary Rules Act (Budgetary Rules)[116] would be included only in the *Public Procurement* category.

Chart 12: Type and rate of occurrence of breach of laws and regulations in audits under scrutiny



Source: SAO Audit Information System.

The chart shows that public procurement regulations (30 cases) **were the most often violated**. The *Other* category mainly includes violation of provisions of specific standards in audits under scrutiny (education, healthcare and state administration information systems) and of the Archives Act[117].

115 Act No. 137/2006 Coll., On Public Procurement.
116 Act No. 218/2000 Coll., On Budgetary Rules and on Amendments to Certain Related Acts (Budgetary Rules).
117 Act No. 499/2004 Coll., On Archiving and File Service and on Amendments to Certain Acts.

The following examples illustrate audit findings from the most significant groups of statutory and subordinate standards violation (using the Chart 12 classification)

Public procurement

Audit No. 16/13 revealed that the contracting authority, which was a state organisational unit, failed to sign a contract with the contractor in accordance with the provision of section 82 paragraph 2 of the PPA as the signed contract did not reflect the bid of the winning tenderer regarding the parameter *Application availability for Live partial service fulfilment'*.[118] Such conduct was contrary to the principle of transparency under the provisions of § 6 of the PPA. The contracting authority thus used part of the funds unduly under the provisions of section 3 e) of the Budgetary Rules and the SAO assessed such conduct as a breach of budgetary discipline under provisions of section 44 (1) a) of the Budgetary Rules up to CZK 385,385.

The same contracting authority failed to properly award a public contract for the provision of services for a data centre operation and its telecommunication infrastructure for the state school-leaving examinations ('maturita'). The service was provided based on a contract arising from a negotiated procedure without publication, which was not awarded in accordance with the Public Procurement Act. The SAO assessed the contracting authority's conduct as a breach of budgetary discipline. During the period of the contract performance from November 2014 to September 2016, the contracting authority spent a total of CZK 83 million.

Deficiencies in the management and control system

Within Audit No 16/32, the SAO found that during the approval of projects aimed at promoting mutual cooperation of municipalities doubts were raised about the justification of the need for such support for the target group and these doubts were not removed in their entirety. For one of the projects, the Ministry of Labour and Social Affairs (MoLSA) earmarked CZK 600 million within a call for project submission intended for the only possible applicant (umbrella NGO/association). For launching such narrowly focused call, the Ministry of Labour and Social Affairs did not have objective evidence proving its desirability and usefulness. The main reason for launching the call was to ensure the drawdown of cash resources from PA 4 of OP *Human Resources and Employment* (OP HRE).

Ineligible expenditure

Audit No. 16/32 established that an aid applicant requested a grant to conduct, among other things, training to improve the management skills of the members of the project implementation team. The project application stated that the purpose was an improvement of management and project management skills of selected eight members of the implementation team, at the start of the project (July 2013) with anticipated price of CZK 240,000 CZK incl. VAT. However, the description of the team members' qualifications clearly showed that the individuals' experience and skills were sufficient for the performance of the activity.

The SAO found that the training had been delayed by over a year, i.e. was completed (in October 2014) at a time when the project had already been over half-way through its implementation. The actual cost of the training reached nearly CZK 200,000, with 11 members of the implementation team taking part.

118 The contract failed to contain the guaranteed value of the parameter in question (99% guaranteed in the bid), on the basis of which the contracting authority evaluated this part of the bid as the most advantageous.

The SAO assessed these facts and noted that expenditure of CZK 199,650 on training was not necessary for the project implementation as the training had been completed with a considerable delay. The beneficiary failed to proceed in accordance with the Grant Decision (GD) and violated the obligation set out in the GD, as he claimed an eligible expenditure that was not necessary for the implementation of the project. Consequently, the beneficiary breached budgetary discipline under the provisions of the Budgetary Rules. The beneficiary's conduct also led to the occurrence of so-called irregularities.

Within Audit No. 17/06, the SAO found that a beneficiary of grant from RDP7+ failed to provide true project information in the grant application for introduction of preventive measures in forests and the elimination of damages caused by floods. The SAIF failed to recognise the discrepancy, provided the grant in the required amount and in doing so committed a breach of budgetary discipline in the amount of CZK 9,494,819.

During this audit, the SAO also established that another recipient failed to create a new job, thus failing to meet the grant conditions.

The MoA failed to set the limits for eligible expenditure for most forestry project measures. Preferential project selection criteria for some controlled sub-measures failed to consider the project desirability, quality and benefits.

C.1.1 SAO audits on revenues

The SAO pays continued attention to the revenue side of the EU budget (see previous EU reports), also at the level of international cooperation (e.g. Audit No. 15/33[119] was a joint audit carried out by the SAO and the Supreme Audit Office of the Slovak Republic - see *EU report 2017* - Section I). However, in the period under scrutiny, the SAO completed no audit focused directly on the sources of the revenue side of the EU budget. Nevertheless, the SAO audit work touched upon this field in the period under scrutiny.

As part of its recommendations to the National Reform Programmes, the Council has long accused the Czech Republic of high labour taxes (caused by social contributions) and high administrative costs affecting tax subjects, with no significant change in this filed achieved. In 2017, the SAO completed Audit No. 16/21[120] in which it examined the procedure of financial authorities when administering personal income tax and the effectiveness and efficiency of the tax administration in connection with the legislative changes adopted. In line with the above-mentioned Council recommendations, the SAO noted that the Income Tax Act is ambiguous in this field, containing a large number of exceptions, which complicate tax administration on one side, and on the other increase the administrative burden on taxpayers, thus failing to contribute to effective tax collection. In the period under scrutiny, the Act was not simplified - on the contrary, new tax allowance, tax-benefit progression reflecting the number of children and solidary tax increase were incorporated into the Act, and conditions for reporting the tax base were amended.

119 Audit No. 15/33 - *Excise Duty Administration.*

120 Audit No. 16/21 - Individual Income Tax Administration with Focus on the Effects of Legislative Changes on State Budget Income.

C.1.2 SAO audits on cohesion policy expenditure

Audit No. 16/12 – *Preparation of a uniform methodological environment for drawing on EU support in the 2014+ programming period*

This audit is included separately in the *Other* category in Chart 10. As it was addressed in detail in the previous edition of the EU Report (see EU Report 2017, Section II, Chapter E.4), the audit will not be commented on.

Audit No. 16/13 – *Funds spent on development of education in the Czech Republic*

This audit combined the legality and performance audit procedures. It examined the efficiency, economy and effectiveness of the use of funds spent on the development of education in the Czech Republic, focusing on systems and tools for evaluating the quality of educational programmes and the results of the education system.

The audited amount was almost CZK 116.11 million, of which CZK 98.69 million was from the EU budget.

From 2011 to September 2016, the Ministry of Education, Youth and Sports (MEYS) spent a total of CZK 1,179.1 million on the preparation and implementation of assessment tools. The SAO audit results showed that in 2011-2015, the assessment tools had not contributed to an effective fulfilment of strategic objective of the education system, i.e. to improve the quality of education. One of the key assessment tools for primary education was a national periodic testing of the level of knowledge of pupils of years 5 and 9 in primary schools, which, however, the MEYS failed to introduce. For secondary schools, a common (state) part of maturita exam was implemented as an assessment tool from school year 2010/2011 onwards. However, the MEYS fulfilled only some of its objectives (it failed to introduce mandatory maturita examination in mathematics in selected fields by 2014 and failed to ensure the comparability and objectivity of the results of the common part of maturita). Furthermore, students' results achieved in the common part of maturita have not been considered in university admissions.

The Czech education system thus continues to miss regular feedback regarding the education quality, both for those responsible for education and for other actors involved in the education system, i.e. a feedback which would contribute to improving the evaluation of effective use of funds annually spent on the education system. **This absence of feedback may have a negative effect on the motivation of schools to improve the quality of education they provide.** Neither is their motivation supported by the system of regional education funding, which has so far failed to reflect qualitative indicators.

Based on the results of this audit, two notifications were submitted to tax administrators in the aggregate amount of CZK 2.98 million, and another submission was made as non-quantifiable.

Audit No. 16/26 – *Expenditure on the operation and use of immovable property, including expenditure on providing information support related to the management, operation and maintenance of immovable property*

The purpose of this performance audit was to check the efficiency and effectiveness of the operation and use of immovable property under the Ministry of the Interior (MoI) and to provide information support for data collection, analysis and decision making to optimise the property cost of the area under review.

The audited amount was CZK 554.50 million, of which CZK 254.12 million came from the EU budget.

The Central Register of Administrative Buildings (CRAB) shall, according to the State Property Act[121], serve the state institutions to ensure an efficient and economical use of buildings. According to the data recorded in the CRAB 2015 database, state institutions' expenditure on the administration of more than 3,000 buildings reached a total of CZK 3.4 billion.

Based on the audit findings, the SAO noted that requirements for an efficient and effective use of funds to manage immovable property used by state institutions are not met. The reasons for this state of affairs were found to include an insufficient link between the management of the transition to centralised administration and the coordination of the actual property management at the ministerial (MoI) and above-ministerial levels, where competences and responsibilities for the property management were found to be separated. Another reason was found to be insufficient data quality and information support settings. Although more than CZK 500 million was spent on CRAB and the MoI's information system (*Real Estate Management* - REM) in 2010-2016, these information systems are unable to provide a comprehensive evaluation of the effectiveness and efficiency of the property management and utilisation. In addition, CRAB does not provide reliable information for making decisions on optimising the property management. The SAO is of the opinion that the current use of the abovementioned information systems failed to achieve the full scope of expected objectives and benefits. As a result of incomplete and incorrect data and their incompatibility, determining indicator values for assessing effectiveness as well as determining the optimum target level of real estate management and utilisation is impossible. The SAO considers some of the deficiencies to be of fundamental nature. Without their remedy, an effective and efficient real estate management and utilisation cannot be considered.

Audit No. 16/32 – *EU and national budget funds earmarked to support the development of cooperation between municipalities and the development of local partnerships*

This audit included both performance and legality audit elements. It was aimed at examining whether funds earmarked for a systematic support of the development of cooperation between municipalities and the development of local partnerships were provided and used in accordance with law and with regard to effectiveness, efficiency and economy.

The audit was comprehensive in its nature. It focused on checking the MCS setting and functioning, and on two supported projects. The audited amount was CZK 619.40 million, of which CZK 530.27 million was from EU funds.

On the part of the Ministry of Labour and Social Affairs and the Ministry of the Interior, aid from the OP HRE in the amount of almost CZK 620 million was provided for municipality cooperation, namely for two competing projects, in an uncoordinated manner. These project outputs (i.e. strategic documents, methodical guides, collections of examples of good practice, etc.) were prepared for a total of 186 administrative municipal districts with extended jurisdiction and 72 areas of local action groups (LAGs); on 38% of the area in question the two projects were being implemented concurrently. Furthermore, the SAO determined that personal relationships existed between members of the implementation teams involved in the project activities and that some of the outputs were in some parts identical.

The main objectives of both projects aimed at supporting the development of cooperation between municipalities and the development of local partnerships were **not measurable or time-defined and consequently, neither their benefits nor impact can be evaluated**. These project outputs and their values do not in any way indicate any progress in municipality cooperation or the degree of meeting the project purpose. **The implementation of the project outputs** (strategic documents) and resulting action plans are not **binding** for the **target groups**,

121 Act No. 219/2000 Coll., On property of the Czech Republic and its representation in legal relations.

i.e. municipalities, voluntary municipal associations and associations of municipalities and non-profit organizations. Therefore, there is a significant risk that these action plans will never be used by the target group.[122]

The beneficiaries were committed to completing key activities (organisation of workshops, training courses) and to produce planned outputs (methodical and strategic documents) that were implemented in line with set values. However, the SAO also determined a breach of the conditions set out in the grant decision.

Some of the facts identified within the audit were already established by the SAO in previous audits, i.e. recurrent shortcomings in the project selection and approval process; setting the project objectives in relation to their intended purpose; and in the subsequent evaluation of their impacts. With regard to the long-term persistence of these shortcomings, the SAO considers them to be a significant systemic deficiency in the management of the Czech Republic's public finances. On the basis of the identified deficiencies, two notifications were submitted to the tax administrators in the aggregate amount of CZK 1.58 million.

Audit No. 17/02 – *Promoting social housing as part of the social inclusion policy*

The audit was conducted as a performance audit with the objective to examine whether selected interventions in social housing contributed to an effective elimination of the causes of social exclusion or social exclusion threat.

The audit focused on both the MCSs setting and the review of individual projects. At the system level, the audited volume of funds amounted to CZK 3,078.77 million, of which CZK 2,616.95 million came from the EU funds. At the project level, the audited volume amounted to CZK 130.81 million, of which CZK 111.19 million came from the EU funds.

The SAO established that the existing housing support for low-income or otherwise disadvantaged groups of population, implemented in the form of controlled interventions, fails to effectively contribute to addressing the causes of social exclusion or social exclusion treats.

Support from the MoLSA is mainly based on the provision of housing contributions and housing allowances. While these payment entitlements help reduce the number of people at risk of poverty or material deprivation by compensating for income shortfalls, and thus prevent, in some cases, social exclusion, they do not address the cause of its occurrence. **Reviewed interventions displayed deficiencies in their current setting and management that reduce their effectiveness.** The SAO concluded that controlled interventions may contribute to addressing the causes of social exclusion or social exclusion threats only if their setting is modified, they become interlinked and are in synergy with the affordable housing support.

The audit also revealed **deficiencies in the intervention monitoring and subsequent impact evaluation.** The SAO therefore recommended for the MoLSA to initiate such indicator setting and measuring which would allow for a regular evaluation of the intervention effectiveness as well as their impact on social exclusion and social housing.

Audit No. 17/03 – *Health care information systems administered by organisational units of the Ministry of Health*

This performance audit aimed to examine whether the management and coordination of the health care information systems ensure their economical and effective operation and development.

---

122 In the SAO questionnaire survey of a sample of municipalities, almost half of respondents stated that they did not consider the documents created within the projects to be beneficial, were not aware of them at all and did not use them.

The audited volume was CZK 400.61 million, of which CZK 297.48 million was received from EU sources.

The SAO concluded that in some cases the administration and coordination of selected healthcare registers failed to secure their cost-effective and efficient development and subsequent operation. The Ministry of Health, in its capacity as a guarantor of healthcare computerisation, failed to define a binding strategy in time to co-ordinate healthcare projects, including healthcare registers. This contributed to establishing healthcare registers which subsequently failed to fulfil their purpose. While developing two of these registers, the law in the field of public procurement was breached. One of these new registers failed to become fully functional by August 2017, i.e. the time of the audit completion, although it should serve as the basis of the new concept of data collection from healthcare insurers.

Another serious systemic deficiency presenting a considerable risk to the overall development of healthcare computerisation in the Czech Republic is considered by the SAO to be the current solution of coordination and implementation of the *National eHealth Strategy of the Czech Republic 2016-2020* by the Department of Informatics of the Ministry. **The Ministry failed to create the planned national e-Health Centre equipped with the required expertise.** In the field of the healthcare sector computerisation, various entities have submitted as many as 93 projects worth a total of CZK 3,879 million. To ensure that these projects contribute to the achievement of the national strategy goals, they need to be coordinated.

The identified quantifiable deficiencies accounted in total for almost CZK 26.84 million; this amount was notified to the tax administrator.

Audit No. 17/05 – *Construction, modernisation and reconstruction of motorways*

This audit was performed as a legality check, aiming to verify whether the plans for motorway network construction are being implemented and whether the projects meet their objectives and related costs.

The audited amount at project level was CZK 1,750.09 million, of which CZK 543.82 million was from EU sources.

On the basis of the facts established, the SAO noted that the conceptual goals for the construction of the motorway network had not been achieved, and that the pace of construction fails to provide a guarantee that the entire motorway network planned to be completed by the anticipated deadline, i.e. by 2050, will be accomplished. The slow pace of construction was caused mainly by the problems on the part of the investor (RMD) with the acquisition of the planning and building permits. Preparations for motorway constructions between obtaining the environmental impact assessment approval and the final building permit covered an average period of 13 years, i.e. four years longer than that established in the previous, similarly focused Audit No. 12/18 [123].

However, the SAO also established that the objectives and parameters of the completed motorway constructions had been achieved. Construction prices were 33% to 55% lower than anticipated by RMD in the tendering process. **The average cost of construction of one kilometre of motorways was CZK 152 million. It was lower by CZK 188 million compared to the data contained in Audit No. 12/18.** RMD did not have effective tools for controlling and assessing construction prices, creating conditions for a cost-effective construction and determining the construction value in the tendering process. The comparison of the prices of selected construction items revealed that the prices contained in the binding documentation for estimating the value of construction work had been overestimated.

123 Audit No. 12/18 - *Funds intended for the construction of motorways and express roads.*

Audit No. 17/09 – ***Construction works undertaken to repair, modernise and develop category II and III road network on the territory of selected regions, co-financed from the EU funds and national resources***

The purpose of this performance audit was to examine whether repairs, upgrade and development of category II and III roads were implemented economically, efficiently and effectively, and whether the rules and conditions for the use of the EU and national resources were respected.

The audit focused on both the setting and functioning of the MCS and reviewing individual projects. The audited amount was CZK 741.32 million, of which almost CZK 521.10 million was from EU sources.

The funding of repairs, modernisation and development of category II and III roads from the State Fund of Transport Infrastructure (SFTI) was, unlike financing from EU funds, a non-systemic solution initially designed for one year. **While the audit did not establish that the funds in the audited sample had been spent inefficiently, it noted, however, that in several cases the projects lacked objectively measurable and verifiable targets.** Even the SFTI defined only the purpose of the funding and failed to set specific measurable targets. SFTI **failed to evaluate the overall benefit of the funding, the extent of category II and III road quality improvement, and the effectiveness of works completed.**

The beneficiaries did not systematically evaluate unit costs. They failed to create a reliable and effective tool for assessing the projected value of public contracts, while leaving the value of these public contracts to be set by external contractors without verifying to what degree the projected contract value was realistic.

C.1.3 SAO audits on expenditure on the Common Agricultural Policy

Audit No. 17/06 – ***EU and state budget funds spent on forestry support***

The purpose of this legality audit was to examine how the MoA, the SAIF and certain regional authorities administered and selected grant applications, how they monitored applicants' compliance with the grant conditions and how they monitored and evaluated the impact of the aid supplied. In addition, the SAO assessed whether the grants were spent in accordance with the law, expeditiously and economically.

The audit was comprehensive; both EU funds from rural development programmes as well as funds paid from the state budget as national grant titles were examined. The audit verified the setting and functioning of MCSs, horizontal measures, individual supported projects, and national funds disbursed for forest management. The audited volume totalled CZK 230.91 million, of which the European share was CZK 123.38 million.

Although the *National Forestry Programme up to 2013* (NFP), as the main strategic document covering the area under audit, was established only until 2013, the implementation of this programme continued in 2016 and 2017. As of the end of the SAO audit, i.e. by August 2017, the MoA had not performed an NFP evaluation (which should have taken place in 2016), had failed to update it or to create a new strategy. As a result, the SAO has recommended that the MoA evaluates the NFP and creates a new strategy that would respond to the current conditions in forestry.

The SAO has identified deficiencies in the implementation of PRV7+. These errors occurred mainly **in the area of project selection and setting the cost-effectiveness of disbursed funds** in a number of cases, the MoA failed to set a maximum limit for eligible expenditure and, with grants provided at 100% level, applicants did not have to restrict their spending too much[124]. The SAO has recommended that eligible expenditure limits are introduced for forestry operation projects or lower grant limit of less than 100% of eligible expenditure is set so that applicants are motivated to be more cost-effective and more efficient in project implementation.

The objectives of the broad PRV7+ horizontal forestry measures, in which only several dozens of applicants were involved, were not achieved.[125] In order to increase the interest of applicants in this measure, the conditions have been modified for PP14+ (the beneficiary's commitment to meeting grant conditions was shortened from 20 to 5 years and the grant rate was increased).

Within the audit outputs, one finding was assessed as enforceable, on the basis of which a notification of CZK 9.49 million was filed with the tax administrator.

C.2 SAO audit conclusions reviewed by the government

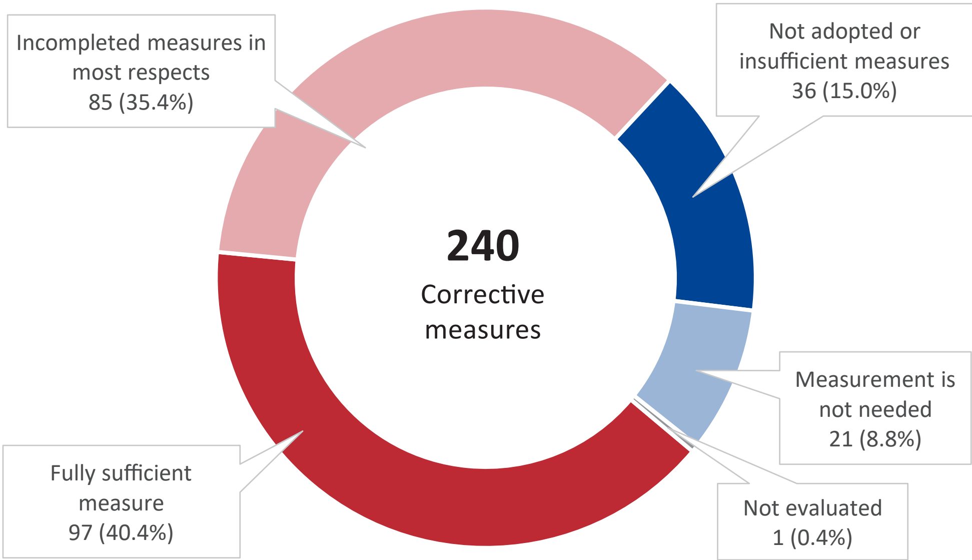
The SAO President is authorised to participate in meetings of the government pursuant to Section 8(7) of Act No 166/1993, on the Supreme Audit Office (the SAO Act), when audit conclusions and opinions on them are discussed. The audit conclusions are submitted at the meeting of the Government by its members, in accordance with a binding procedure laid down in the Rules of Procedure of the Government. The opinions of the submitting ministries, which are also the MAs of audited ESIF-funded programmes, are commented on by the SAO through the electronic eKLEP library. In the event that the SAO makes observations of a fundamental nature or directly opposes the proposed measures, a multi-round settlement process takes place. The SAO's observations thus directly affect the nature and scope of the measures proposed to remedy identified deficiencies.

The SAO has been systematically monitoring and analysing the implementation of the proposed measures to remedy the deficiencies identified in the SAO audit conclusions since 2015. As a result, from 2015 until the end of March 2018, the database of the SAO *Audit and Information System* (AIS) included data of 52 audits that were fully or partially focused on EU-funded programmes and projects. The monitored measures of 240 registered implementing bodies are divided into four categories according to their adequacy as assessed.

124 Examples include game viewing platforms built at an average price of CZK 300,000 or forest roads repaired after disaster, when the price of one metre of repaired road went as high as CZK 13,000. In one case where the repair of a connected section of forest road was financed under another measure with a fixed expenditure limit, the price of one metre of repaired road came to about CZK 3,000.

125 Subsidies from *the NATURA 2000 payments in forests* should result in the afforestation of agricultural land. Initially, **37,000 ha were planned for afforestation,** but during implementation of the programme the Ministry of Agriculture decreased the target value by 92% to 3,000 ha. In fact, **only 1,500 ha** of agricultural land has so far been **forested**.

Chart 13: Analysis of proposed measures to remedy the identified deficiencies submitted to the government



Source: AIS, March 2018.

Note: The segment of *Measure no longer required* represents deficiencies determined for example in PP7+ programming documents, but which are no longer present in PP14+ documents. These are also measures taken by the MA on the SAO's findings during an audit event, e.g. handing over notifications to tax administrators to address irregularities found by the SAO.

The SAO systematically monitors the status changes in all categories of measures and updated them in a separate AIS module[126]. The adequacy of the measures taken, their fulfilment and their effectiveness is analysed, in relation to monitoring the audit benefits and impact. At the same time, a brief description of the measure and the information source are provided. This analytical information serves to support the formulation of own-activity suggestions for the preparation of a draft audit plan. The scope of the measures to remedy the deficiencies identified by a previous audit and the assessment of their effectiveness is an integral part of the follow-up audit programme.

Monitoring of the status of implementation of 240 proposed measures as at the date of the editorial deadline showed that **46 proposed measures had already been fully implemented** and **13 in part.** The **SAO considers 46 further proposed measures to be uncompleted** (see below for details). The sources of this verified information include the reports submitted to the government by the respective ministers in accordance with the task assigned to them when discussing an SAO audit conclusion, government legislative proposals submitted to the commentary procedure and, in particular, the results of audits on remedial measures.

For the remaining 135 measures, a deadline for completion is in place, or only partial information has been available to be further verified, inter alia in follow-up audits.

An analysis of 46 uncompleted remedial measures showed that:

- in 18 cases, the implementing bodies refrained from adopting corrective measures, since these related to programmes of the then completed PP7+ and the deficiencies are no longer encountered in PP14+;
- in 12 cases, corrective measures have not yet been adopted, as the required changes will be achieved by approving strategic and conceptual materials, or possibly by amending legislation, so implementation of these changes is of a long-term nature;

126 RCAE Module - *Register of Completed Audit Events*.

- in 12 cases the MA failed to adopt corrective measures within the declared scope and deadlines, without the SAO being aware of a specific reason;
- in four cases, corrective measures were not adopted because the MA did not agree with the conclusion of the SAO.

Regarding the number of outstanding corrective measures, the Ministry of Regional Development (with 13 measures) leads the notional ranking list, followed by the Ministry of Education (10 measures). On the other hand, the completed corrective measures list is dominated by the MoA and its organisations (20 measures), followed by the Ministry of Education and the Ministry of the Interior (each with 9 measures).

C.3 SAO monitoring work

SAO audit plans are prepared annually on the basis of topics based on its own activities, and to a much lesser extent based on suggestions from the Chamber of Deputies of the Czech Parliament, the Senate of the Parliament of the Czech Republic, their bodies and the government of the Czech Republic[127]. Suggestions for own activity-based audits are formulated on the basis of detailed monitoring of audit issues, analysis of identified significant risks, determining current priorities, as well as findings of previous audits and an evaluation of remedial measures taken by the implementing bodies. The suggestions are selected taking into account the objectives of the SAO medium-term audit strategy, while trying to avoid potential time and material duplications arising from audit plans of other external audit bodies, in particular the AB[128] and the ECA.

The ESIF fund implementation through respective OPs is monitored by individual SAO audit departments according to the assigned management competence arising from the ministerial division of public administration. The findings from the monitoring of current facts concerning EU joint projects in selected ministries, and information on the development of specific areas of public administration that cross ministry boundaries, are presented later in this chapter.

C.3.1 Tax

In 2017 a new tax package was approved in the Czech Republic[129] , which, with effect from 1 July 2017 amended certain tax laws, in particular the Income Tax Act, the Value Added Tax Act and the Tax Code.

In the Income Tax Act[130] there was an increase in the value of the tax allowances on the second, or the third and next child and the introduction of lower (half) limits for the possibility of applying a percentage of income as the expenditure value. At the same time, it was possible to claim a rebate for a spouse and to apply a tax allowance for a child. Only for 2017 did the amendment allow taxpayers the choice of applying either: a higher percentage of their income as higher expenditure limits but without the possibility of deducting a rebate for a spouse or applying a tax allowance for a child; or following the new rules but with lower limits. Another significant change was the doubling of the maximum deductible amount of supplementary pension insurance paid, from CZK 12,000 to CZK 24,000. This is also related to an increase in the limit for the exemption of the employer's contribution to supplementary pension insurance and life insurance paid out to employees (the contribution is not subject to social and health insurance) from CZK 30,000 to CZK 50,000 per year.

127 The provision in Section 17(3) of Act No 166/1993, on the Supreme Audit Office.

128 The AB fulfils the tasks of an audit authority for EU support provided to the Czech Republic under the ESF, including the *Youth Employment Initiative*, the ERDF, the FS and the ENRF.

129 Act No 170/2017, amending certain tax laws.

130 Act No 586/1992, on income taxes.

This tax package has also recently expanded the range of taxpayers who can apply for flat-rate tax, an increase in the blood donation deductible of CZK 1,000 and set a similar regime as applied to labour agreements, for so-called small-scale work up to CZK 2,500. At the same time, the conditions for applying a tax allowance to a child have been tightened by the abolition of the possibility to include rental and capital gains in the eligible limit, as in the past there has been an increase in incomes through fictitious rents.

From the point of view of the Value Added Tax Act[131] the tax package, for example, has brought about the abolition of existing tax rules for corporations (formerly associations) without legal personality or the extension of the obligation to adjust the input tax deduction on the purchase of assets that were destroyed, lost or stolen, where this fact has not been properly documented. The tax package also introduced a provision into the Value Added Tax Act which defines the obligation to acknowledge tax on payments that take place before the tax date. This applies in particular to vouchers. There has also been a widening of the reverse-charge regime and in the fight against tax fraud to establishing the institute of the unreliable person, i.e. a person who seriously violates its obligations thereby threatening the proper administration and collection of tax.

In 2017 a finding of the Constitutional Court [132], removed two provisions regarding the audit report from the VAT Act. The Constitutional Court ruled as unconstitutional a provision imposing on the payer the obligation to show in the audit report "prescribed data needed for tax administration". However, the specific data forming the audit report were not provided by law, but by the tax authorities. That provision was abolished by the Constitutional Court as of 31 December 2017 and replaced by an amended provision in the Value Added Tax Act as of 1 January 2018.

Further, the court repealed the provision under which the call to submit an audit report (sent by e-mail) could be considered to have been delivered by the tax administrator as at the moment of sending. This amendment was repealed by the Constitutional Court as of the date of its publication in the Collection of Laws, i.e. as of 15 December 2017.

In the field of excise duties, the law on the protection of health from the harmful effects of addictive substances[133] repealed with effect from 31 May 2017, repealed the fourth section of the Excise Duties Act[134]. As a result of this law, there has been an increase in the type locations where smoking is forbidden. According to the explanatory memorandum to the draft law, the impact on excise duty on tobacco products due to smoking restrictions in restaurants, resulting in an estimated 5% reduction in tobacco product consumption, could mean a loss of state revenue of about CZK 2.1 billion (qualified estimate).

The amendment to the Act on Excise Duties with effect from 1 March 2017, resp. on 1 July 2017, in § 57, extended the tax advantage for mineral oils (diesel fuel with a share of bio-components and pure diesel fuel) consumed in crop production to mineral oils consumed in selected livestock and animal production activities, or in aquaculture.

Although the Czech Republic has long been criticised by the EU Council as part of its recommendations to the National Reform Programs for high taxes on labour (caused by social deductions) and high administrative costs for tax subjects, there has been no significant change in this respect. Based on the results of the SAO previous audit work and monitoring of the impact of the legislative changes adopted, it can be stated that the Income Tax Act

131 Act No 235/2004, on Value Added Tax.

132 Findings of the Constitutional Court ref. Pl. ÚS 32/15, published in the Collection of Laws on 15 February 2017 under No 40/2017

133 Act No. 65/2017, on the protection of health against harmful effects of addictive substances.

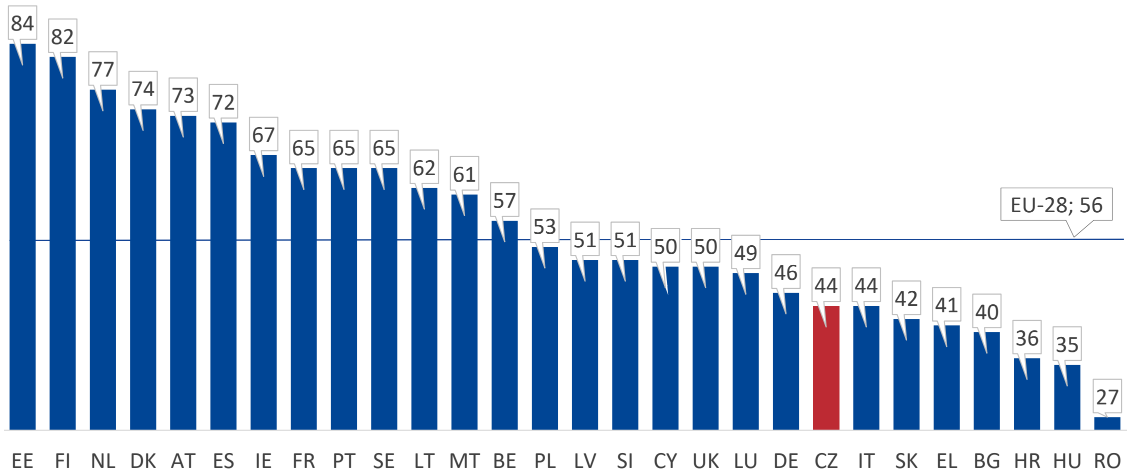
134 Act No 353/2003, on excise duties

is somewhat obscure in this area and contains a number of exceptions. Not only does this situation complicate tax administration, at the same time it increases the administrative burden on taxpayers, which does not contribute to effective collection of this tax. In the period under review, the law was not simplified, but instead, a new tax allowance was introduced into the Income Tax Act, a tax benefit based on the number of children, a solidarity tax increase, and there was a change in the conditions for reporting the taxable minimum.

C.3.2 eGovernment

The issue of eGovernment and the computerisation of public administration is one of the priorities of the SAO audit work. The importance of this issue is further amplified by the fact that this is one of the areas that the Commission monitors and evaluates each year through the Digital Economy and Society Index (DESI)[135]. In 2017, the Czech Republic ranked 18 out of a total of 28 Member States compared. According to the "digital public services" sub-indicator, which, in the framework of DESI, reveals the most about the level of eGovernment, the Czech Republic ranked only 22 despite the progress made. The Czech Republic's low position reflects, in particular, the fact that other member states are able to implement the required changes in the field of eGovernment development and to adopt the related legislation much more quickly.

Chart 14: Comparison of EU countries by the digital public service indicator in 2017

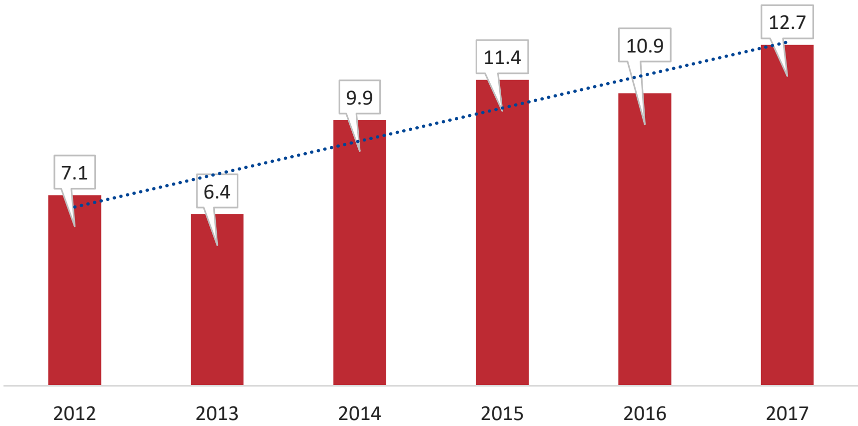


Source: The "*digital public service*" sub-indicator under DESI 2017, Commission.

The volume of funds spent on ICT from the state budget grew steadily between 2012-2017 and reached nearly CZK 13 billion in 2017. However, the SAO assumes that the actual value of ICT expenditure is even higher, as the total expenditure did not include budget lines which may include related expenditure other than only direct ICT expenditure.

135 The Digital Economy and Society Index 2017 composes the following aspects: connectivity, human capital, Internet use, digital technology integration, digital public services; Commission 2017; see https://ec.europa.eu/digital-single-market/en/desi.

Chart 15: Ministries' expenditure on ICT in 2012-2017 **(in CZK billion)**



Source: *Integrated Information System of the Treasury;* selection of budget lines Nos 5042, 5162, 5168, 5172, 6111, 6125.

In 2015 and 2016, the MfRD announced within the *Integrated Operational Program* (IOP) a total of six calls related to eGovernment and computerisation of public administration. The total financial allocation of these calls was CZK 10.7 billion. Within these calls, a total of 584 projects were registered, of which 214 projects were being implemented as at April 2018, representing a total CZK 4.5 billion of the budgeted cost.

Of the total allocation of e-Government calls for PP14+, 42% of funds were spent by 10 April 2018.

The key and long-term deficiencies in eGovernment and public administration computerisation, with a negative impact on efficiency, effectiveness and economy, include the development of new IS in public administration without prior detailed analyses of the needs, adequate preparedness of legislation and other conditions required for their efficient use. Furthermore, there are high IS acquisition and operating costs, however, their application, even in the longer term, fails to achieve defined objectives and expected benefits. Moreover, once the IS have been implemented, the cost incurred for their further development and adaptations tends to be several-fold higher than their acquisition cost. The dependency of IS administrators on a specific supplier is a continuing problem. This is partly caused by insufficient resolution of authorised licencing, which ultimately increases the development costs and makes changing suppliers difficult. The list of significant deficiencies further includes continued IS fragmentation, manifested in the failure to ensure IS data sharing across different public administrations, with a consequence of further increased administrative cost.

C.3.3 The Ministries of the Interior and Justice

In PO7 +, the Ministry of the Interior performed the activities of an Intermediate Body (IB) to implement the support from the structural funds for two OPs. The first was the IOP, the MA of which was the MfRD. The area of intervention under the MoI includes the development of the information society in public administration[136]. The projects supported activities related to the implementation of eGovernment services[137] (eGovernment) with a high level of use of modern ICT at the level of both central and local authorities, in order to bring about a qualitative change in the system of public administration and public services in line with the *Strategy of Effective Public Administration and Friendly Public Services 2007-2015*. The total allocation for the intervention was € 365.90 million (i.e. approximately CZK 9,349 million at the current exchange rate[138]). The outputs include 73 projects, 15 new computerised public administration registers created according to the EU methodology and four basic public administration registers. Problems in drawing the resources were caused by a high number of high-risk projects with delayed implementation and a high error rate found in audits of public contracts.

The second programme, in which the Ministry of the Interior acted as an IB, was the OP HRE, the MA of which was the MoLSA. The area of support under the MoI was called *Strengthening Institutional Capacity and Effectiveness of Public Administration*. It focused on interventions supporting increased institutional capacity, quality, efficiency and transparency of state administration[139] and regional public administration. The total allocation of the intervention was € 132.70 million (approx. CZK 3,391 million). With the support of these funds, 595 projects have been implemented within which 2,998 products have been innovated, 459,482 course graduates trained and 199,580 individuals supported. Drawdown difficulties were again caused by a high number of high-risk projects with delayed implementation and drawdown, a large number of project changes caused by changed priorities including withdrawal from project implementation and high error rate in public procurement procedures and personnel cost reporting.

Both of these OPs were to contribute to the implementation of the *Smart Administration* strategy (effective public administration and friendly public services).

In the 2014-2020 programming period, the Ministry of the Interior has been implementing projects from OP *Employment* aimed, among other things, at creating new effective instruments for social inclusion and combating poverty, professionalization, support and coordinated use of volunteers, especially in the field of social inclusion, development of civil service, introduction of elements of procedural management in public administration, coordination of project management within the Ministry of the Interior or development of open data area in the public administration environment. The MoI has been further implementing IROP projects.

136 Until 30 June 2012, the intervention area also included intervention areas 2.1 *Implementation of ICT in Territorial Public Administration* and 3.4 *Services in the field of security, prevention and risk management*.

137 The supported activities included the creation, development and maintenance of national basic and other relevant public administration registers, including a secure and protected access system, data sharing with central registers in public administration, and the creation of other relevant registers for territorial public administration, public administration, creation of access points for communication with information systems of public administration, electronisation of public administration services, in particular through the electronicisation of procedural procedures on individual agendas in the fields of justice, security, tax and customs administration, culture, education, health, transport, social care and electronic services of public administration.

138 The CNB exchange rate on May 15, 2018 was CZK 25.55 / €.

139 E.g. in particular, projects aimed at rationalizing administrative procedures, introducing a unified system of human resource management in public administration, improving the performance and quality of administrations by applying new management methods, quality and performance management tools, strengthening communication and coordination within the state administration and the development of dialogue with the citizen in order to ensure more efficient development and implementation of government policies.

These resources are mainly used by the Ministry of the Interior, the Fire Rescue Corps, the Police of the Czech Republic, the National Archives and the Administration of Basic Registers. The projects submitted by the Ministry of the Interior focus on, for example, the introduction of electronic law announcement tools and the creation of a verified and free-to-use database of past and current versions of legislation, including links to EU law (*eSbírka* system), tools for electronic creation and deliberation of legislation as amended (*eLegislativa* system) as well as new legislative and publication procedures based on the use of these advanced tools, reflecting necessary related changes to the law; and a secure distribution of classified and unclassified (sensitive) information in electronic form.

The implementation of projects in PP14+ is being delayed, mainly due to a longer process of support application approval. Delaying projects also affects the level of claims on unutilised expenditure, which amounted to about CZK 1 billion in the budget chapter of the Ministry of the Interior as at 1 January 2017. A similar situation in under-execution of OPE funds occurred again in 2017. The reason given by the Ministry of the Interior was the inability to fill posts in the project implementation teams caused by the current situation in the labour market. Fund under-execution in 2017 was further aggravated by repeated delays in public contract announcements and subsequent delays in their implementation.

The chapter of the Ministry of Justice, which has always been a beneficiary, included implementation of projects within the OPE (the beneficiaries are the Probation and Mediation Service and the Judicial Academy). The Ministry has also been implementing projects under IROP, e.g. part of the *eJustice 2020* project, the output of which should be the creation of an electronic information system of the insolvency register *eISIR* which introduces into insolvency proceedings a fully electronic entry and a fully electronic file.

C.3.4 Defence and Foreign Affairs

The Ministry of Foreign Affairs and the Ministry of Defence (MoD) were not and are not MA or IB of programmes. However, they are beneficiaries of EU financial resources. The expenditure co-financed by the EU for the years 2014-2017 was drawn by the MoD from the OPEn. This related to the implementation of projects focusing mainly on improving air quality, achieving energy savings and utilising waste heat. In addition to MoD, the beneficiaries were also Vojenské lesy a statky ČR, s. p (Military Forests and Homesteads of the CR, state enterprise), Vojenský výzkumný ústav, s. p. (Military Research Institute, state enterprise, and the Brno Military Hospital[140]. The most important event in financial terms was the gasification and decentralization of heat sources and thermal insulation of buildings in the Týniště nad Orlicí military complex. In the new programming period, MoD have been implementing projects (children groups) under the OPEm[141]. Vojenské lesy a statky ČR, s. p, have been implementing financially less significant projects within the OPEn [142]. Active use of ESIF funds should be a priority for MoD in PP14+, and projects focusing on better use of energy may contribute to operational savings for the MoD.

140 Beneficiaries have received funds under PA 2 - *Subsidy for Improvement of Air Quality*, PA 3 - *Subsidies for Sustainable Use of Energy Sources* and PA 6 - *Subsidies for Improvement of Nature and Landscape*.

141 PA 1 - *Promoting employment and adaptability of the workforce*.

142 PA 4 - *Protection and care of nature and landscape* and 5 - *Energy savings*.

EU Common Security and Defence Policy

In 2017, intensive cooperation continued to develop the EU common security and defence policy[143] . This involved primarily the implementation of measures based on the 2016 Security and Defence Implementation Plan[144] and the creation of the *European Defence Fund* (EDF). The implementation plan builds on the EU Global Strategy and focuses on three strategic priorities: 1) response to external conflicts and crises, 2) partner capacity building, 3) protection of the EU and its citizens. Specific measures to achieve these objectives included the launch of the Coordinated Annual Review on Defence (CARD)[145], creating the Permanent Structured Cooperation[146] (PESCO) with a view of strengthening defence cooperation between MS wishing to do so, the establishment of a Military Planning and Conduct Capability (MPCC) and the strengthening of EU Rapid Reaction Instruments, including EU Battlegroups[147] and civilian capabilities.

European Defence Fund

The EDF consists of two so-called windows, which are legally distinct but complementary. Both windows (the research window and the capability window) are being gradually deployed. Windows will be coordinated by a coordination committee, which will include representatives of the Commission, the MS, the European Defence Agency and, where appropriate, industry representatives. Support from the EU budget will be adapted to the stage of the relevant industrial cycle. The Commission has set up several financial and non-financial instruments which may support project implementation on the basis of cooperation between MS. It is also ready to support MS in specific procurement projects on a cooperation basis. These steps are part of a gradual shift towards closer defence cooperation in Europe, which will be consolidated in the upcoming multi-annual financial framework after 2020, when the EDF is expected to represent half of cooperation-based defence projects in Europe. In this respect, there is an opportunity also for the Czech Republic to acquire financial resources and actively engage in building the EU's defence capabilities.

C.3.5 Transport

The Ministry of Transport has been struggling with long-term problems related to traffic infrastructure, i.e. the failure to fulfil transport policies and construction delays. The plans for motorway network construction have not been met in recent years, and the current pace of construction does not guarantee that the motorway network will be completed by the set deadline, i.e. by 2050.

---

143 In 2015, MS spent € 203 billion on defense, and thus ranked second in the world in military spending after the United States. However, defense budgets are often used inefficiently due to the fragmentation of the European defense market, costly duplication of military capabilities, lack of industrial cooperation and interoperability.

144 *Implementation Plan on Security and Defense,* 14392/16 .

145 A coordinated annual defense review should provide a better overview at EU level on Defense spending, MS investment, and research efforts. The benefits of the review include better identification of deficiencies, deeper defense cooperation and a better and more coherent approach to defense spending planning.

146 Article 42 (6) of the *Treaty on European Union* stipulates that MS, whose military capabilities meet higher criteria and which have made more stringent commitments in this area with regard to the management of the most demanding missions, have established structured cooperation within the EU.

147 These are military units rapidly deployable in an operation. Battlegroups were created in 2005 but have never been deployed, due to political, technical and financial obstacles. In order to strengthen the EU's rapid response capabilities, EU leaders agreed on 22 June 2017 to bear the deployment of battlegroups as a common cost.

The main reason for the slow pace of construction of the transport infrastructure is the problem with the acquisition of planning and building permits. The SAO has long been highlighting the excessively long period of construction preparation and noted that sufficiently effective legislative measures had not been adopted to ensure a shorter preparatory phase; the preparatory phase of motorway construction kept becoming longer, to ultimately become as long as 13 years. The legislative process to remove this undesirable situation does not take place fast enough.

A total of 14 transport construction projects covering 111 km should be completed by 2020. These projects should have been started in 2017, but in mid-2017 their final building permits had not yet been obtained, putting their timely completion at risk. Amended Act No. 100/2001 Coll.[148] sets out an obligation to complete initiated EIA processes under the new legislation and introduces an obligation to obtain a binding opinion to verify projects amendments. The government of the Czech Republic issued a regulation setting out priority plans for the 12 most important motorway construction projects, for which the Ministry of the Environment (MoE) issued binding consents in the period from November 2016 to February 2017. Most of these construction projects should have been commenced in 2015 and 2016. However, by the middle of 2017, no final building permit had been issued for any of these 12 construction projects.

The motorway construction segment experienced a significant decrease in prices compared to previous years, i.e. from CZK 340 million to CZK 152 million per one standard km. Construction cost ranged from CZK 4,142 per 1 m^2 to CZK 8,268 per 1 m^2, which is comparable to the average construction costs in Germany (CZK 4,408 per m^2) and in Poland (CZK 8,065 per m^2). This may have been the favourable effect of the number of tenderers in the public procurement procedures, which ranged from nine to twelve. The overestimated valuation of construction project items remains a persistent deficiency; this should be an instrument for estimating a public contract value, for assessing construction project prices and creating conditions for their cost-effective implementation. The actual prices of completed projected were 33% to 55% lower than the estimated value in the public procurement documentation.

C.3.6 Employment

Projects co-financed by the EU are primarily focused on the development of human capital (support for employment, equal opportunities for women and men, further education, social inclusion and combating poverty ...) and public administration in the Czech Republic (streamlining of public administration and public services, promoting international cooperation and social innovation ...).

Within the OPEm, out of the eight financing priorities defined by the Partnership Agreement, the following are particularly significant:

- **01 – *Effective and efficient employment services that will help increase employment especially for vulnerable groups*** – More than 53,000 people (30% of the target value) have been supported, of which about 14,000 already received a certificate of education. Almost 10,000 supported participants are now active, i.e. they either look for work, are in education, or are already employed. In the field of modernising employment services, large system projects are being implemented, focused in particular on improving the functioning of labour offices as well as other institutions. In addition, projects in the field of professional business training were supported to ensure that workforce skills are in line with the labour market requirements and with the need to increase employee adaptability, as well as projects supporting childcare facilities aimed at improving the work life balance.

148 Act No. 100/2001 Coll., On Environmental Impact Assessment and on Amendments to Certain Related Acts.

- **02 – *A high-quality education system*** - (lifelong learning) that produces qualified and adaptable workforce, and includes, in particular, lifelong or specialised training for workers in social services as well as target groups at risk of being disadvantaged by various factors.
- **06 – *Transparent and efficient public administration with low administrative and regulatory burdens*** – Projects supported by central government and local authorities aimed at increasing the efficiency, expertise and transparency of public administration. In total, CZK 530 million was paid and 90 institutions were supported, which is about 40% of the target value. There was a significant increase in the number of registered aid applications in the field of eGovernment, however, drawdown has been relatively low. To improve insufficient efficiency of the judiciary, two projects aimed at the digitization of the national archives and the electronic collection of laws worth a total of CZK 425 million are being implemented.
- **07 – *A social system integrating socially excluded groups and preventing poverty*** – Announced calls covered the field of improving the situation in excluded localities as well as increasing accessibility and quality of social services. In 2017, an enormous interest was recorded in primary school infrastructure and interest-based, non-formal and lifelong learning (to address the situation in excluded localities), and nearly 300 projects were approved to promote a coordinated approach to socially excluded localities. Progress in terms of the number of registered and partially implemented projects has been recorded in the field of increasing the availability of social services. In social housing outside Prague, the beneficiaries' commitments reached 519 of supported dwellings, which is more than 10% of the target value. The first social flats have already been built/reconstructed also in Prague. In social business, interest in tangible investments grew compared to 2016, while the allocation for soft activities in this field failed to be utilised. Thanks to the aid of 178 *Community-Led Local Development* (CLLD)[149] strategies amounting to CZK 2.5 billion, significant progress has been made in addressing the needs of urban and rural areas.

From the point of view of material milestones, the highest levels of performance were achieved in PA 4 - *Effective public administration* (the more developed regions category), where in one case 270.0% of the milestone value was achieved. However, in this PA (the less developed regions category), a milestone with the lowest level of fulfilment (only 0.6% of its value) was identified. Other milestones are being achieved at 2.6% to 194.4% of their values.

As at 31 December 2017, a total of 3,596 legal acts under OPEm were concluded on granting/transferring aid worth a total of CZK 37.5 billion, which represented about 73% of the main allocation. At the end of 2017, payment claims for a total of CZK 9.3 billion were sent to the Commission.

Under the new arrangements for the Commission evaluating the compliance with the n+3 rule, performance is assessed at the programme-wide level. As of 31 December 2017, the n+3 rule for the 2018 under OPEm was complied with (101.2% of the drawdown value), i.e. the risk of losing unspent funds allocated for 2015 was eliminated.

C.3.7 Education and science, research and development

Projects co-financed by the EU in the field of science, research and development are implemented through OP RDE, the Managing Authority of which is the Ministry of Education, Youth and Sports. The key principle of the programme is the development of human resources for the knowledge economy and sustainable development in a socially cohesive society. The total financial allocation, including the performance reserve, is CZK 70.5 billion, with funding from the EU budget through the ERDF (approx. 55%) and the ESF (approx. 45%). From the beginning of the programming period to 31 March 2018, a total of 52 calls to submit grant

149 Community-Led Local Development.

applications were announced amounting to CZK 73.6 billion (111.3% of the main allocation). Until then, 6,933 projects worth CZK 37.6 billion (57% of the main allocation) had been supported by legal acts; the level of reimbursed claims amounted to CZK 13.0 billion (19.7% of the main allocation) and the level of funds in applications for interim payments sent to the Commission amounted to CZK 3.8 billion (5.7% of the main allocation).

As part of the implementation of the performance framework, zero **financial milestone** values for ERDF funded actions under PA 2 - *Development of Higher Education Institutions and Human Resources for Research and Development* were reported as at 31 December 2017. The highest achievement of financial milestone was reached at the target date in PA 1 - *Capacity building for high-quality research* in the less developed regions category, where 52.2% of financial milestone value was achieved, followed by financial milestone in PA 3 - *Equal access to high-quality pre-school, primary and secondary education* in the same category, where 44.9% of financial milestone was achieved. The fulfilment of the financial milestones for the remaining Priority Axes under OP RDE, in the fund/region category combination, did not exceed 10% of individual milestone values. This indicates that achieving financial milestones by the end of 2018 is at serious risk.

In terms of **material milestones**, zero values were reported as at 31 December 2017 in PA 02.2 in both region categories with regard to measures financed by the ERDF, as well as in PA 02.1. The highest level of milestone achievement was reported in PA 02.3 in the less developed region category, where 18.9% of the milestone was achieved. Achievement of material milestones in the remaining Priority Axes under OP RDE in the fund/region category combination did not exceed 4% of individual milestone values (with the exception of PA 3). Material milestones are thus also at serious risk of failing to be achieved, which may ultimately result in losing part of the performance reserve. The low level of drawdown as at 31 March 2018 also indicates that at the end of 2018, the n+3 rule may be applied with a potential withdrawal of the Commission commitment.

C.3.8 Environment

Measures to protect the environment in the Czech Republic are in line with the strategic documents (national and EU) implemented also with the help of the OPEn. The main objective of the OPEn is to protect and ensure a high-quality environment for the life of the Czech population, to promote an efficient use of resources, to eliminate the negative impacts of human activities on the environment and to mitigate the impacts of climate change. According to the programme document, the financial allocation under the OPEn is almost € 2,671.61 million, funded from the *Cohesion Fund* (CF) and the ERDF. From the beginning of the programming period until 31 March 2018, 102 calls were announced for aid applications for projects worth over CZK 67.9 billion. As at the same date, 3,693 projects worth almost CZK 29.3 billion (ESIF support without state budget contribution) were approved to be supported as a result of issued legal acts, accounting to 46% of the main allocation within the programme. 15.1% of the main programme allocation had been disbursed to beneficiaries. The largest amounts were disbursed under PA 2 - *Improving air quality in human settlements*; on the contrary, the smallest amounts were disbursed under PA 4 - *Protection and Care for Nature and Landscape*.

The monitoring of individual components of environmental protection shows that one of the most problematic areas in the Czech Republic is waste management. Only a small proportion of municipal waste (approx. one third) is recycled to be used as secondary raw material. More than half of the total municipal waste production is landfilled, mostly without subsequent use. Other priority areas for SAO systematic monitoring include air pollution, increasing energy efficiency and protection of nature and landscape. Recently, the field of measures adopted in connection with the impacts of climate change (floods followed by soil erosion, droughts and diminishing groundwater reserves) is becoming increasingly more important.

C.3.9 Agriculture and forestry

The MoA follows the government's agricultural policy, the programme statement of the government of the Czech Republic and the CAP. A deeper link between agriculture and rural renewal and development is becoming increasingly important.

As in the previous programming period, EU funds are one of the main sources of financing the sectoral development. In 2017, the expenditure of the Ministry of the Interior amounted to CZK 51.96 billion, of which EU sources accounted for CZK 31.73 billion. Total resources approved by the Government of the Czech Republic in 2018 amounted to CZK 50.27 billion, of which EU funds amounted to CZK 27.57 billion.

By a resolution of the Government of the Czech Republic of May 2, 2016 No. 392, the *Strategy of the Ministry of Agriculture of the Czech Republic to 2030* (Strategy of MoA) was approved. Priorities, objectives and measures of the Strategy of MoA are being implemented within the framework of relevant programmes and sub-measures (measures under the CAP, national subsidy programmes, programmes of the Supporting and Guarantee Agricultural and Forestry Fund, etc.), strategic documents for individual areas and sectoral organisations and within the relevant budgetary framework.

The Strategy of MoA responds to the ongoing changes in the climate conditions and to the immediate and long-term strategic tasks following the implementation of measures to mitigate the negative impacts of drought and water scarcity approved by the Czech government in July 2015. Increased incidence of extreme events adversely affecting the landscape water regime and the society needs, especially the increasing occurrence of floods, droughts and associated water scarcity, require adequate attention of the Czech government as well as a coherent comprehensive inter-ministerial approach to achieve a solution. The threat of drought is not only caused by climate change and the deteriorating state of the landscape, but unfortunately also by the current orientation of agricultural crop production, driven mainly by economic needs. This is a highly topical and increasingly serious society-wide issue and according to the SAO, there is a risk that measures adopted to fight drought and water scarcity are inconsistent and uncoordinated. The main actors in addressing this issue are the MoA and the MoE and, in cooperation with other ministries, they should address at least 50 tasks defined in the *Concept of the Protection from Drought in the Czech Republic*. This creates a risk of lack of systemic approach to the proposed, accepted and implemented measures and a risk of ineffective management. The question remains whether the Concept using implemented measures is not just a marketing tool, whether the adopted measures bring the desired benefit and whether costly measures (e.g. dam construction) are not favoured to those that would require minimum cost (e.g. good practices for agricultural and forest soil management, cultivation of traditional crops). The government of the Czech Republic has been striving to resolve the issues related to droughts and water scarcity by means of subsidy mechanisms.

As a result of aging forests, droughts and bark beetle gradation, the problems encountered in the forestry sector are reflected in the financial performance of the CR's forestry. The forestry is currently facing the biggest bark beetle disaster in the history of the Czech Republic. The Government of the Czech Republic started to address the situation in April 2018. The Ministry of Agriculture has adopted an amendment to the Decree on Forest Protection Measures accentuating the need to identify and dispose of affected trees. Sufficient forest renewal and modified cultivation practice are considered important measures to improve the forest situation.

Livestock production is another long-term problem in the Ministry of Agriculture; despite the state's help, livestock production is fighting for further existence. With the exception of beef, the Czech Republic is not self-sufficient in the livestock products; in the last few years, self-sufficiency has dropped to 38% in pork, 85% in milk and eggs and about 60% in poultry production. The worst situation is in pig breeding, where FIT of meat tends to be as much as ten percent below production costs. Dramatically increased agrarian imports (since joining the EU) have resulted in restricted domestic livestock production. Despite the MoA's efforts to support the livestock sector, the attempts to strengthen the main commodities and to increase livestock production, the structure of agrarian foreign trade has not improved. In 2016 and 2017, the MoA provided roughly CZK 4.4 billion in addition to standard measures to livestock breeders hit by the crisis caused by extraordinary low milk and pig meat FITs. The MoA expects to support livestock production by extraordinary measures in 2018 as well, to mitigate the impacts of the crisis. In February 2018, the Minister of Agriculture approved new subsidy programmes for the development and modernisation of breeding: 300 million CZK was earmarked just for pig breeding. However, in addition to subsidy measures, the situation could be improved with the help of preventing animal product imports at dumping prices and improving the imported product and foodstuff control mechanisms.

On the basis of the results of the audits performed in 2017, the Commission expressed reservations about certain administrative and control procedures applied in the Czech Republic. According to the Commission, the Ministry of Agriculture has failed to duly control the fulfilment of the "active farmer" condition and to ensure that grants are paid only to those actively engaged in farming with at least one third of their income generated in agricultural production. As a result, **the Czech Republic is at risk of losing European agricultural subsidies disbursed in the amount of CZK 7.5 billion.**

The 2014-2020 Rural Development Program (RDP) was approved by the Commission in May 2015. In June 2016, the Commission approved the second update of its programming document, which included, among other things, an increase in the allocation from the original amount of € 3.04 billion to almost € 3.55 billion. Of this amount, the European share is € 2.31 billion.

In 2017, the MoA disbursed CZK 10.70 billion to the beneficiaries through the RDP, with the largest part of the grant going to horizontal /non-project measures (about CZK 7.5 billion, i.e. 70%). Of this amount, the largest sums were provided for agri-environment-climate measures (CZK 3.22 billion) and measures for areas with natural or other constraints (CZK 2.23 billion). Of the project measures, the highest number of grants were provided for investments in tangible assets - a total of almost CZK 2.37 billion.

By the end of 2017, the Czech Republic had drawn more than € 680 million, i.e. 29.50% of the total European allocation[150] from the *European Agricultural Fund for Rural Development*, to cover expenditure on rural development support. Compared to other programmes

150 The data is based on the Capping control report - capping including 2017/4.Q issued by the Commission on 9 April 2018.

co-financed by ESIF, RDP is one of the most successful programmes in the Czech Republic. The crucial part of this success is the result of horizontal (flat rate) support payments to farmers paid at regular intervals based on a single application.

Compared to 2016 when over CZK 6 billion was disbursed to beneficiaries under the RDP, the amount of disbursed grants has increased. The number of reimbursed investment projects has increased significantly and, therefore, grant drawdown for project measures has increased.

By the beginning of April 2018, the MoA had announced a total of six rounds of receipts of grant applications under RDP project measures. The seventh round was announced on 3 April 2018 with a total allocation of CZK 1.6 billion to 13 sub-areas. The interest on the part of the applicants was considerable, with a total of 1,186 applications registered representing an amount of almost CZK 2.4 billion. The greatest interest was seen in the aid for young farmers who submitted 377 applications; all were recommended for further administration. The second greatest interest was for *Investment in non-agricultural activities* with 258 applications, followed by *Forest routes*, in which 145 applicants were interested.

Within the RDP, the SAIF disbursed almost CZK 21.66 billion as of March 31, 2018, of which CZK 4.22 billion was for project measures and CZK 17.44 billion for horizontal/non-project measures. A total of 80,000 grant applications had been reimbursed.

Table 14: Overview of the number of reimbursed applications/projects and disbursements under the RDP as of 31 March 2018

Non-project measures		Number of applications	Disbursements (CZK thousand)		
			EU contribution	CR contribution	Total
M8.1	*Forest investments*	82	3 656	1 220	4 876
M10	*Agri-environment climate*	24 554	4 690 913	1 563 640	6 254 553
M11	*Organic farming*	8 275	2 126 787	708 931	2 835 718
M12	*Natura 2000*	1 307	27 385	9 128	36 513
M13	*Payments for areas facing natural or other constrains*	41 059	5 307 640	1 769 213	7 076 853
M14	*Animal welfare*	1 514	607 427	619 707	1 227 134
	Total non-project measures	**76 791**	**12 763 808**	**4 671 839**	**17 435 647**
Project measures		**Number of projects**	**Disbursements (CZK thousand)**		
			EU contribution	**CR contribution**	**Total**
M1	*Knowledge transfer and information actions*	13	2 444	2 494	4 938
M4	*Investments in physical assets*	1 860	1 576 055	1 607 896	3 183 951
M6	*Farm and business development*	833	268 528	273 952	542 480
M8	*Investments in forest area development and improvement of the viability of forests (without M8.1)*	415	131 969	134 636	266 605
M16	*Cooperation*	5	92 400	94 267	186 667
M19	*Rural Development Programme LEADER*	8	1 781	1 002	2 783
M20	*Technical assistance*	78	17 472	17 824	35 296
	Total project measures	**3 212**	**2 090 649**	**2 132 071**	**4 222 720**
	TOTAL RDP	**80 003**	**14 854 457**	**6 803 910**	**21 658 367**

Source: SAIF documents from April 2018.

C.3.10 Fisheries

In 2014, a new Common Fisheries Policy entered into force, the main objective of which is to achieve economic, ecological and social sustainability of fisheries. It seeks to restore fish stocks, improve aquaculture and strengthen the position of fishermen in the market. OP *Fisheries* 2014-2020 (OPF), funded by the *European Maritime and Fisheries Fund* (EMFF), was approved by the Commission in June 2015. The allocation for the entire PP14+ is € 41.2 million (approximately CZK 1.05 billion), of which € 31,1 million is funded by the EMFF with the rest coming from national resources.

As of 31 March 2018, 11 calls had been announced within OPF. At the same date, the Ministry of Agriculture approved 274 grant applications amounting to CZK 316.07 million and reimbursed 115 projects in the amount of CZK 98.01 million, representing 9.3% of the total allocation (both European and national resources). In 2017, a total of CZK 81.60 million was disbursed from the OPF based on 80 grant applications.

Performance review milestones

Ministry of Agriculture data show that:

- The financial indicator in respect of Union priority 2 has already been met, the material milestone (number of projects) can potentially be met;
- No financial or material milestone has yet to be met in respect of Union priority 3, but these were set based on the value of just one project;
- The material milestone has already been met (and exceeded) in respect of Union priority 5, but the financial milestone has only been fulfilled at less than the 7% level.

The implementation of OPF and the management of the performance framework were negatively impacted by the delayed start of OP implementation when the EMFF Regulation was adopted approximately five months after the start of the programming period and the submission of the first grant applications only took place in October 2015. Also, (for the first calls in particular) there was less interest in the measures announced.

C.3.11 Regional development

Cohesion policy in PP14+ brings with it a new and, for regional policy, entirely crucial aspect in the form of a territorial dimension. This creates the prerequisites for ESIF support not to be comprehensive but to focus on issues related to urban and community development in selected areas that have their specific needs, problems or significant economic potential. Besides individual projects that will implement the territorial dimension, the so-called integrated instruments (II) are the new tool for drawing funds for the development of functional territories; these are: Integrated Territorial Investments (ITI)[151], *Integrated Territorial Development Plans (ITDP) and Community-Led Local Development based on the LEADER initiative*[152].

151 Integrated Territorial Investments.

152 *Liaison entre actions de développement de l´économie rurale*.

In all three types of II there was a primary problem in a delay with the whole process of evaluation and approval of territorial development strategies. For this reason, there has had to be a shift in project implementation and the drawing of grants and, in some cases, the implementation of milestones is also jeopardised. In 2016, no project was implemented within the II, and no drawdown of the financial plan or implementation of indicators was made.

The ITI and ITDP integrated instruments holders identify a number of issues threatening the implementation and optimal use of allocated funds. For example, during the IROP implementation process, in addition to the delay of announced calls, the process of evaluating integrated projects and issuing a legal act - by the Regional Development Centre and the IROP Managing Authority - is also extended. These are, in particular, areas where applicants are unable to carry out projects prior to the issue of a legal act. One example is social services infrastructure. A further challenge is the OP Transport calls for ITI and ITDP holders. Complications in the preparation of the relevant project plans and subsequent implementation, settlement of property-right relations, the involvement of more entities in II implementation, higher complexity of the technical solution, long project documentation preparation and frequent appeals by participants during the land planning or construction proceedings have the effect that the time for project implementation and completion does not match the financial plan.

In August 2016, a total of 12 OP Transport calls were announced for ITI and ITDP holders with a total allocation of EU funds of CZK 10.7 billion but by the end of April 2018 only five legal acts had been issued with a total allocation of funds from the EU budget of CZK 95.7 million.

One problem is also the low absorption capacity on the part of municipalities and cooperating entities, despite their originally declared interest during the preparation of integrated strategies when setting up the support planned for PP14+.

The II Strategies and Action Plans for PP14+, which should have served as supporting material for planning the future absorption capacity of municipalities and setting the financial plan for the individual programmes, are not binding on municipalities. There is, therefore, a considerable risk that they will not be used by the municipalities at all and their intended purpose will not be met. The SAO drew attention to these risks on the basis of Audit No. 16/32 results [153].

For the 258 strategies and 176 action plans, CZK 619 million was spent on two projects financed through OP HRE. Other local development strategies are being developed with CLLD support. In total, there are hundreds of strategies that do not adequately reflect real regional needs and the progress of mutual cooperation between municipalities in the development of the territory, and their resulting benefit and impact on regional development are not clear.

Insufficient absorption capacity is also seen in the level of utilisation of allocated funds for the implementation of II. The IROP Managing Authority announced a total of 12 calls for ITI and ITDP holders in 2016 and two more calls in 2017, with a total allocation of CZK 21.9 billion from EU funds. By the end of April 2018, 223 legal acts had been issued with a total allocation of EU funds of CZK 4.1 billion, of which only CZK 25.5 million were accounted for in payment applications.

153 Audit No. 16/32 – *European Union and state budget funds intended to support the development of mutual cooperation between municipalities and the development of local partnerships*.

This insufficient absorption capacity, caused by a change in conditions in the external environment (positive developments in the economy), and mainly connected with the drop in the unemployment rate in the Czech Republic, also had an impact on drawing on the funds allocated to II projects within the OPE. In 2016, the OPE MA announced a total of 4 calls for ITI and ITDP holders with a total allocation of EU funds of CZK 1 billion but by the end of April 2018 only 32 legal acts had been issued with a total allocation of funds from the EU budget of CZK 232 million.

The biggest problem is identified in the ITI projects under the OP EIC, where the renegotiation of the project evaluation process **leads to delays and postponement of calls for proposals.** Only at the end of 2017 did the NCA and the OP EIC managing authority mutually agree on the project evaluation implementation scheme, i.e. at a time when other MAs had already successfully evaluated integrated projects.

The OP EIC Managing Authority announced the first calls for ITI holders only in 2017, but temporarily suspended project evaluation and therefore no projects with an issued legal act have been recorded.

In addition, in early 2018, the call for ITI projects within the OP EIC was suspended due to a re-evaluation of the MIT's priorities in the context of the new management of the ministry, which is considered in this context to be a non-systemic solution which hinders the smooth implementation of the instrument.

The integrated CLLD instrument also faces serious problems, in particular through multi-fund financing and multiple stakeholder involvement in implementation. The end result is a complex and administratively demanding system. The systemic demands bring about a long delay in the implementation of local development strategies and the implementation of concrete projects focused on rural development and improving the quality of life in the countryside. This is also associated with a significant delay in the drawdown of subsidies. As of 31 March 2018, only 8 projects had been reimbursed to a value of approximately CZK 2.7 million in support of local development from RDPs. According to the SAO, there is a significant risk that a sufficient number of quality projects will not be implemented by the end of the period, and the allocation for the relevant programmes will not be exhausted. The risks of insufficient drawdown were also pointed out in the audit conclusion of the SAO from Audit No. 16/14[154].

C.3.12 Accounting and reporting of EU funds

Accounting data, along with budget data, are the key sources of information on facts related to EU project co-financing. However, unlike budget data, accounting data capture not only past cash flows but also receivables and liabilities related to co-financing. At the same time, co-financing costs and revenues are also recorded in the accounts, and it is also possible to assess the impact of co-financing on the financial result of entities that provide EU funds in the form of transfers. Some EU funds are provided in the form of so-called pre-financing, which is an approach whereby funds are first paid out of the state budget and after checking whether they have been spent in accordance with the rules, these pre-funded amounts are put forward to be reimbursed from the EU budget. It is in the accounting that one can find the information on the value of these so-called pre-funded amounts, i.e. the amounts of funds that may be put forward to the EU for reimbursement. Thus, accounting contains valuable information about the effects of relations with the EU arising from pre-financing in the state budget, as it is almost a rule that amounts pre-funded in one budget year are reimbursed only in the following year or later, which has a direct impact on the state budget balance.

154 Audit No. 16/14 – *European Union and state budget funds intended to support local development under the LEADER initiative, using the Rural Development Programme.*

The procedures for accounting and reporting of funds provided by the Czech Republic from the EU budget are laid down in accounting regulations. Only with effect from 1 January 2015 did an amendment to the Implementing Decree on the Accounting Act and Czech Accounting Standard No 703 - *Transfers* clearly define the role of the state organisational units conducting pre-financing of EU funds, which is decisive for the method of capturing operations in accounting. For 2015, it was thus possible to obtain from the accounting comparable data on the provision and receipt of funds received by the Czech Republic from the EU budget under pre-financing.

However, the accounting regulations continue to pose certain systemic risks for accounting and reporting EU funds, particularly in the field of financial corrections (overall corrections). Financial corrections or subsequent adjustments to EU co-financing rates of already implemented projects do not currently have clearly defined procedures for their inclusion in accounting. It is thus possible to encounter different models for capturing these operations, which of course have varying impacts on the data reported in the financial statements.

Compilation of financial statements for the Czech Republic

The accuracy of accounting information for state management at the highest level became significant at the time of preparation of the Czech Republic's 2016 financial statements compiled for the first time in full in 2017. The correct data from consolidation entities' accounts, also including those of the providers of transfers co-financed by the EU, are a core prerequisite for the actual compilation of these statements but, above all, they are absolutely crucial for any meaningful use of them. Data on the co-financing of EU projects is an important part of these.

D. Risks defined by the SAO in the EU funds management

In its *EU Report 2016*, the Supreme Audit Office presented its views on the risks to the implementation of the support provided in the Czech Republic with funds contributed from the EU's general budget in the PP14+.[155] Two years later, the findings from monitoring and audits performed by the SAO, ECA and the Commission, as well as the audits carried out by the Audit Body and the regular evaluations mentioned in the previous chapters (AB, NCA) contained herein, may be used to establish whether the risks have been eliminated or whether errors have occurred resulting in undesirable consequences. The risk areas that are listed below are not ranked in the order of significance.

1. Transposition of the European Environmental Assessment Guidelines

Legislative authorities of the Czech Republic failed to pay sufficient attention to the risk, although they had been aware of the need since the accession of the Czech Republic to the EU. The risk of insufficient transposition persists even following the adoption of Act No. 39/2015 Coll.[156]

The SAO noted that Act No. 39/2015 Coll. was the result of the effort to remove the transposition deficit to Directive 2011/92/EU[157] (EIA directive) of the European Parliament and of the Council, for which the Czech Republic was criticised in the context of the TFEU infringement concerning an incorrect transposition of the EIA Directive. The main benefit of the amendment was to avoid significant financial losses resulting from incorrect transposition and to sustain the possibility of drawing EU funds due to the fulfilment of the preconditions.

Two years later, the National Coordination Authority (NCA), based on the results of evaluation of the Partnership Agreement implementation, listed the fact that the Commission considered the transposition of the EIA Directive into national law as inappropriate as a topical risk affecting the drawdown of funds at the horizontal level. Therefore, there is a risk that the expenditure related to the projects concerned will not be reimbursed by the Commission and thus be funded merely from national resources. The threat is particularly significant for operations under the IROP and OPT.

In response to the Commission's reasoned opinion of 8 December 2017, the Czech Republic sent a response on 8 February 2018, in which it expresses its disagreement with the alleged deficiencies and demonstrates that all the provisions of the EIA Directive concerned have been fully implemented in the Czech legal order.

2. Information system for programme management and progress evaluation

The *MS2014 +* monitoring system continues to pose a risk for programme implementation, prolongs administration and raises the need for non-systemic measures at MA level.

Details of deficiencies in providing comprehensive support to users may be found in the conclusion of Audit No. 16/12.

155 The risks listed under numbers 5, 8, 10 and 18 were not mentioned in *the EU Report 2016.*

156 Act No. 39/2015 Coll., amending Act No. 100/2001 Coll., On Environmental Impact Assessment and on Amendment to Certain Related Acts (Environmental Impact Assessment Act), as amended, and other related laws.

157 Directive 2011/92 /EU of the European Parliament and of the Council of 13 December 2011 on the assessment of the effects of certain public and private projects on the environment.

The results of Audit No. 17/23[158] confirm that the risk continues to be topical. The SAO established that persistent deficiencies of *MS2014+* include inadequate reporting structures to provide information on the current state of drawdown of funds or on the state of fulfilment of the target values of the monitoring indicators. In 2017, i.e. in the fourth year of PP14+ implementation, the monitoring system continued to be relatively extensively modified, also on the basis of development requirements and error messages from the MA. The details will be commented on in the *EU Report 2019* as the audit conclusion was published only after the editorial deadline for the *EU 2018 Report*.

3. Setting and functionality of management and control systems

Deficiencies in the MCS configuration and functioning, especially in the case of the most significant programmes, present a significant risk with looming financial corrections affecting the state budget.

The AB expressed reservations to the MCS under OP EIC and OPT and described them as partially functional. In response to the AB findings, the Commission sent a warning letter to the Managing Authorities, as outlined in subsection B.2.2.4. Significant errors in the MCS settings and functionality for both OPs have also been identified by the SAO as a result of its audits and analyses.

The risk that errors in the MCS setting may also affect the CAP domain was confirmed by the ECA's audit findings included in its Special Report No. 7/2017[159]. It is clear from the published ECA's findings that significant deficiencies were identified in audits by certification bodies (CB) (including non-representative sample operations, inadequate substantive testing, incorrect use and underestimation of error rates) and, as a result, the opinions in important areas are not fully in accordance with auditing standards and rules.

4. Project evaluation and selection

Incorrect project evaluation and selection continue to pose a significant risk with a threat of financial corrections with an impact on the state budget.

Incorrect project evaluation and selection, low emphasis on high-quality project evaluation and assessment of projects desirability as well as their society-wide or regional benefits were indeed confirmed, as seen, for example, in the result of SAO audits focused on forestry support or the RDP7+ implementation. The ECA also noted that the MAs had not always applied selection procedures ensuring that preference is given to the best projects.

5. Time limits for application administration

The SAO has repeatedly noted that administration time is unacceptably long and that it presents a risk jeopardising the drawdown as well as the beneficiaries' legitimate interests.

The uniform methodological environment does not respect the recommendation to simplify the administrative burden for applicants and beneficiaries when using EU funds in PP14+ (this recommendation was taken into account by the Government of the Czech Republic in its resolution of 21 March 2012 No. 184). The MfRD argues and refers to the rights and legitimate

158 Audit No. 17/23 - *Energy efficiency improvement measures implemented under PA 3 of the Operational Program Enterprise and Innovation for Competitiveness 2014-2020*.

159 SR No. 7/2017 - *The certification bodies' new roles on CAP expenditure: a positive step towards a single audit model but with significant weaknesses to be addressed*.

interests of applicants guaranteed by the Constitution of the Czech Republic, although a fixed time limit for the administration of applications would be binding only for providers. The longest average time of aid application administration was identified in OP EIC. As of 31 December 2017, it was 365 days; on 30 April 2018 it was 347 days.[160] A disproportionately long time was also found under OP PGP as well as in case of several calls in OP RDE and OPEn.

6. Definition of project objectives

In many cases, competent authorities do not provide specific, measurable, achievable, relevant and time-based (SMART) objectives for supported projects. Consequently, the risk of failing to respect the principle of sound financial management (Article 30 (3) of Regulation (EC) No. 966/2012 of the European Parliament and of the Council persists[161]).

For example, the main objectives of projects aimed at mutual cooperation between municipalities and the development of local partnerships were neither measurable nor time-bound, and as a result, their benefits and impact cannot be evaluated. The project outputs and values are not representative of any progress in terms of cooperation between municipalities or the degree of achievement of the project purpose. The use of strategic documents and the resulting action plans are not binding for the target group, i.e. the municipality. There is therefore a considerable risk that they will not be used by the municipalities at all. On the other hand, the ECA noted (SR No. 10/2017[162]) that support for young farmers is often poorly defined and its expected result and impact are not specified.

7. Monitoring system set-up, monitoring and evaluating progress in meeting the objectives of the programmes and measures

Insufficient setting of the monitoring systems (missing indicators, indicators failing to show results or difficult-to-measure indicators) remains a significant risk. The MA are often content with just output indicators (number of supported entities, number of projects, number of purchased machines, number of square meters of renovated buildings, number of kilometres of new roads) while result and impact indicators are missing.

Examples include deficiencies in monitoring and subsequent assessment of impacts of social housing support as part of the social inclusion policy (Audit No. 17/02).

8. Achievement of objectives

In some areas, declared objectives are not being achieved and, therefore, the expenditure may be identified as ineligible for funding from the EU budget.

Within its audits, the SAO often identifies this, for example:

- Results of Audit No. 16/13 showed that the evaluation instruments prepared and implemented by the Ministry of Education, Youth and Sports in the period 2011-2015 failed to contribute to an effective fulfilment of the strategic objective for the education system, i.e. to increase the quality of education.
- Health care registers were acquired, which subsequently failed to fulfil their purpose

160 Data taken *from MS2014+* IS.
161 Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 laying down the financial rules to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002.
162 SR No 10/2017: *EU support to young farmers should be better targeted to foster effective generational renewal.*

(Audit No. 17/03). One new register failed to become fully functional by the time of the audit completion, although it is a basis of a new concept of data collection from health insurers.

- Conceptual plans for the motorway network construction were not being achieved, and the pace of construction fails to provide a guarantee that the planned motorway network would be fully completed by the anticipated deadline, i.e. by 2050 (Audit No. 17/05).
- The objectives of the horizontal forestry measures under RDP7+ (Audit No. 17/06) have not been met.

The evaluation of the implementation of the Partnership Agreement shows that drawdown in the field of energy efficiency improvement including thermal building insulation (especially in public buildings) is insufficient, even though considerable funds were allocated to this area in PP14+. Drawdown has not been going well in the areas of high-speed Internet coverage of the Czech Republic's territory, with a considerable delay against schedule.

9. Eligible expenditure limits

Absence of eligible expenditure limits presents a significant risk of uneconomic spending of European grants.

For example, SAO Audit No. 17/06 established that in most project measures to support the forestry with 100% grant for budgeted costs, the MoA failed to set maximum limits for eligible expenditure for construction work and delivery unit costs. Beneficiaries were thus not encouraged to proceed in the most economical way.

10. Phased PP7+ / PP14+ project

For projects with uncompleted second phase there is a risk that the complete project expenditure will be found ineligible.

Drawing down, or failure to draw down the PP7+ allocation may still affect projects the implementation of which has been split between two programming periods. These so-called phased projects occur in three OPs. For these projects, potential problems with the completion of their second phase in PP14+ may be identified as a risk, which may result in the ineligibility of expenditure certified in the first phase implemented in PP7+. These projects may also be under the risk of possible financial corrections applied in the second phase, which may then retrospectively affect the drawdown in the first phase.

11. Achievement of milestones in 2018

The risk of non-achievement of milestones set for individual programmes (individual axes) by the end of 2018 in the Partnership Agreement may result in the loss of entitlement to the so-called performance reserve.

The SAO points out that a consistent application of the rules of the General Regulation would mean, under unchanged conditions, that approximately € 355 million, i.e. about CZK 9,070 million, would be at risk. Priorities at risk are listed in Table 11 in sub-chapter B.2.2.3.

12. The n+3 rule

Failure to meet the n+3 rule poses a significant risk.

According to the data provided by the PCO, the lowest percentage of drawdown utilisation in 2018 (the n+3 rule) was achieved in OP PGP (49.5%), IROP (50.60%) and OPF (58.9%).

13. Absorption capacity

Insufficient absorption capacity resulting from an incorrect analysis of real needs poses a significant risk.

The SAO audits indicate that, in some programmes, insufficient absorption capacity is reflected in a low level of drawdown of ESIF funds. For example, the SAO established a low interest of applicants in horizontal (entitlement), particularly forestry-focused measures within the RDP. The reason is a highly complex administration for the applicant, long waiting times for grant payments and long-term commitment to complying with the conditions on the part of the applicant.

The NCA sees a risk of insufficient absorption capacity in some areas the OP EIC, OPF and IROP (specifically in Specific Objective 2.5 *Reducing energy consumption in the housing sector*).

14. Errors in operations

A significant part of the operations is burdened with errors, which may result in the expenditure being assessed as ineligible for financing from the EU budget.

Specific examples of SAO findings on uneconomic and ineligible expenditure are given in subchapter C.1. In certain OPs, the audit body found that the error rate was well above the set level of 2%. The error rate in OPT was 7.26% and in OP EIC 6.58%. The error rate may have a significant impact on the state budget.

In DAS 2016 audits, the ECA arrived at similar conclusions both in the area of *economic, social and territorial cohesion*, and in the area of *natural resources*.

15. Application of financial instruments

The application of financial instruments is being delayed, which puts the preparation for the new EU funding implementation system in the post-2020 period at risk.

With regard to the envisaged changes to the system of aid provided to MS based on reducing the proportion of non-repayable grants in favour of financial instruments, the significance of this risk is gradually increasing.

16. Application of integrated instruments

For all three types of II, the SAO identified delays in implementing the instruments at all stages (e.g. announcing calls, evaluating and approving regional development strategies and integrated projects, project implementation, etc.), especially in IROP, OPT and OP EIC.

Delays in call announcement prolong the process of evaluating the II projects and issuing legal acts for aid provision. An example is the social services infrastructure. Other problems include complications in project preparation and subsequent implementation, settlement of property rights, involvement of more entities in the implementation of II and highly complex technical solution, as well as low absorption capacity on the part of applicants and cooperating entities.

17. Programme priorities

In some aspects, the aid may not be defined in line with the real needs of the Czech agriculture and rural development, thus failing to provide an optimum support to those areas where it is needed most.

The MoA often fails to analyse the needs and the absorption capacity to be able to appropriately define the aid areas as well as the conditions for the RDP implementation. This results in the EU and CR funds not being used in those areas where they are most needed and failing to achieve maximum benefits, or the fact that applicants are not interested in them. In some cases of RDP grant rules, the MoA failed to define acceptance criteria which would adequately reflect the project desirability.

The findings of Audit No. 16/14 revealed a contradiction to the LEADER principle. Priorities and objectives were not based on the regions' real needs but had to conform to the conditions and measures set out in the OPs. In formulating the strategies, the LAGs should have considered the needs of the region, while also respecting the ESIF settings and taking into account the options offered by individual OPs. This means that the LAGs had to formulate the strategies in such a way that would meet the binding conditions set for measures within individual OPs.

Audit No. 14/26[163] established that the Ministry of Agriculture had financed construction of livestock production facilities without verifying whether the applicants' requirements were in line with their real needs (e.g. highly overestimated capacity of stables or reservoirs).

18. Correction of errors

Adoption and implementation of corrective measures is not a matter of course.

The SAO analysed the corrective measures for the period from 2015 to 31 March 2018; the outcome of the analysis is commented on in subchapter C.2.

19. EU programmes with European added value

Entities from the Czech Republic do not sufficiently use programme funds directly managed by the Commission.

Within the EU-28, the Czech Republic has long been one of the MS with the smallest drawdown from Union programmes per capita. The reasons for this were already explained by the SAO in subsection B.2.6 of Part I of *EU Report 2017*. Similarly, as with financial instruments, the potential of this form of aid will increase significantly in the next programming period, in particular compared to the aid provided by ESIF.

163 Audit No 14/26 - *Funds spent on the projects of the Rural Development Programme*.

E. Preparation of the multiannual financial framework for 2021-2027 as seen by a ECA member

The financial perspective is a matter close to my heart. In late 1990s, when I started working for the Ministry of Finance, my core task was to study the functioning of the European budget. Conclusions of the European Council of 24-25 March 1999, where Agenda 2000 and the financial perspective for 2000-2006 were approved, became the basis for understanding the fundamental principles and logic of the financial perspective. Within the negotiations on the Accession to the EU, I was in charge of the *Financial and Budgetary Provisions* Chapter and of financial issues of several other Chapters, particularly on the regional policy and agriculture. Negotiations on the Accession were finalised on 12-13 December 1999 at the meeting of the European Council in Copenhagen. In addition to the Copenhagen summit, I had the opportunity to participate in two other meetings where the financial perspective was being approved, both held in Brussels, in 2005 and in 2013. Currently, I focus on the preparation of the financial perspective for the period 2021-2027 from the point of view of the ECA.

JAN GREGOR

He graduated from the University of Economics in Prague, specializing in International Trade and European Economic Integration. In 1998, he joined the Ministry of Finance of the Czech Republic, where he worked for the Department of European Integration. In 2001, he was appointed Director of the National Fund, where he was also responsible for negotiations on the financial perspectives and frameworks and EU budget issues, including the EU's own resources system. From 2010, he was in charge, as the Deputy Minister of Finance, of the section of public budgets. He became a member of the ECA nominated for the Czech Republic on 7 May 2016. He works in Chamber V, which focuses on the EU funding and administration. He is also a member of the Audit Quality Control Committee, where he assesses the outputs of Chamber II *Investments for Cohesion, Growth and Inclusion*. In addition to the preparation of the Annual Report (Chapter 3. *EU Budget and Results*), he is involved in performance audits: *Real-estate policy of the EU institutions*, *The Future of the EU Budget*, *tackling radicalism that leads to terrorism*. He is a Brexit coordinator and a member of the editorial board of the ECA Journal.

For any audit institution, including the ECA, it is difficult to prepare a future-oriented document. As part of the ECA Strategy for 2018-2020, we have decided to further expand the types of prepared documents, including the so-called briefing paper. It was this type of document that has been selected for the preparation of the new multiannual financial framework for the period 2021-2027. The ECA had prepared a series of documents that had been published before the Commission proposal so that the Commission had the opportunity to consider the views and experience gained from our audits before publishing its proposal.

Within the expert structures of the ECA (Chamber V), I was entrusted with the preparation of a briefing paper on the future of EU finance, entitled *Reforming how the EU budget operates*. I have focused this document on financial management improvement, and transparency and accountability within the EU budgetary system. The ECA thus did not comment solely on political issues such as the size of the EU budget and the allocation of funds to individual policies.

The briefing paper is based on a large number of ECA outputs. It is based on two situational reports from 2014, i.e. the *Risks to the financial management of the EU budget* and the *EU accountability and public audit arrangements*. Oher sources included the ECA's Annual Reports 2014-2016, 16 Special Reports from 2015-2018 and six opinions from 1999-2017. Within the framework of the conclusions, I recommended six major proposals.

Proposal No. 1: European added value

The Commission should further develop the concept of European added value, ideally agree it inter-institutionally and apply it at every moment of the budget cycle. This concept should:

- Identify opportunities to use the EU budget for the creation of European added value;
- Assess the potential European added value of proposals for new spending programmes;
- Continue to develop the system of performance evaluation of expenditure programmes;
- Evaluate the risks and benefits of using financial instruments and guarantees for EU funding;
- Periodically evaluate and compare the added value generated by individual programmes as part of comprehensive reviews of public spending.

The concept of added value should provide a basis for reporting on costs, revenues and net positions resulting from EU membership. The Commission should therefore simplify the reporting of net positions on one hand, while on the other it is absolutely necessary that it is supplemented with an analysis of financial and non-financial benefits of the EU membership.

Proposal No. 2: The need to respond to changing circumstances

The capacity of the EU budget to respond to changing circumstances should be strengthened. Flexibility instruments should be used to cover the risks arising from unexpected events and possibly cover the guarantees provided by the EU budget, and not to fund unexpected delays in the implementation of the programs. The reserve system should contain a central reserve and sub-reserves to cover:

- long-term commitments to fund programs and instruments;
- contingent liabilities, such as budget guarantees;
- specific circumstances and unexpected events.

Proposal No. 3: Supplementing the next multiannual financial framework with a detailed annual plan

The Commission should supplement the multiannual financial framework with a medium to long-term financial plan, which would include:

- expected developments in major financial variables such as outstanding commitments, pre-financing and contingent liabilities;
- long-term estimate of payments;
- an overview of other sources that will be used to implement the EU policies by the Member States, international organizations as well as private sources;
- the programmatic assumptions underlying the proposed multi-annual financial framework;
- an overall economic and financial context;
- an assessment of the key risks to EU budgets and the amount of funds deferred in the framework of reserves.

This more detailed financing plan should be updated on a yearly basis to take account of current developments in the EU policies, the implementation of EU programmes and changing circumstances.

Proposal No. 4: Enhanced overall performance evaluation

The Commission should enhance the overall framework for evaluating the performance of EU budget spending by, in particular:

- unifying the EU's financial planning and its strategic priorities;
- defining the key financial and non-financial results to be achieved;
- reducing the total number of spending programmes and performance indicators;
- ensuring a sufficient and consistent legal basis for each programme as a basis for performance management and control;
- streamlining and balancing performance reporting, and increasing the availability and user-friendliness of performance data.

Proposal No. 5: Developing the principles of accountability and transparency for all EU-related institutions

The Commission and the EP should develop common principles for accountability, thereby enhancing transparency for all forms of EU funding. All extra-budgetary funds should be integrated into the EU budget and only exceptionally, if the status of institutions outside the budget is justified, it would be appropriate to apply the same principles to extra-budgetary institutions. As part of the 2014 Situation Report on the EU's accountability and public funds audit arrangements, the ECA defined five principles for accountability, transparency and auditing:

- a clear definition of roles and responsibilities;
- assuring leadership of achieving policy goals and resource use;
- democratic control and audit;
- feedback to enable system correction and enhancement;
- implementation of audit recommendations and supervision of their implementation.

Proposal No. 6: Extension of the ECA's mandate to all EU-related institutions

The ECA should obtain an audit mandate for all types of expenditure on EU policies, both at EU and national level. In particular, the ECA should be given a mandate for:

- auditing all EU institutions, including the European Defence Agency and the proposed European Monetary Fund;
- auditing all institutions established outside the EU legal order to implement EU policies, including the European Stability Mechanism (until its integration into the European Monetary Fund) and the European Investment Bank (EIB) operations not supported by the EU budget.

Following this document, the ECA prepared three further briefing papers on the Future of the Common Agricultural Policy, the Simplification of Research Programs and the Simplification of the Cohesion Policy Implementation System after 2020. The publication of these documents was timed so that the Commission could take them into account in its proposal. From these documents, from the ECA's annual reports and from the draft assessments of draft individual regulations for the period 2021-2027, the following recommendations may be derived:

- In the context of the amendment of financial management and the proposal for a new EU Supervision Regulation on the application of law in the Czech Republic, it is necessary to prepare a national system of conflict prevention in a timely manner. The effects of potential conflicts of interest will be very noticeable and may lead to the cancellation of part of the allocation for the Czech Republic.
- Given the tendency to redirect support from grants to financial instruments, maximum attention should be paid to setting up the system of financial instruments in the Czech Republic
- Financial instruments will only be accessible through the EIB or through national development banks operating in more than one country.
- The Commission's proposal on a greater degree of differentiation in co-financing rates will make it possible to link EU programmes with purely national spending (both public and private).
- As part of the Commission's efforts to simplify the implementation system, it is necessary to critically assess the setting up of the implementation structure and procedures and to make use of the opportunity for their streamlining and simplification in due time.
- Greater emphasis on European added value on the part of European institutions will make it necessary to take this element more into account when preparing programmes and selecting individual projects.
- In the context of the new EU Common Provisions Regulation and EU Priorities reflecting the shift towards greater support for soft projects rather than infrastructure projects, it is desirable that the setting of national priorities in the area of EU fund policy should maximize EU financial contributions and, at the same time, the benefit of co-financed projects for the Czech Republic.
- When approving individual projects, place emphasis on avoiding excessive negative impacts on the business environment. In some areas (printers, accommodation facilities), despite compliance with the public support rules, market distortion has occurred.
- It is appropriate to extend the eligibility rules for expenditure to cover aspects reflecting the evolution of the legislative environment at EU level, in particular the decision-making practice of the Court of Justice of the European Union.

The Commission published its proposal for a Multiannual Financial Framework on 2 May 2018. The proposal represents an amount of € 1,135 billion in commitments for the period 2021-2027, equivalent to 1.11% of the EU-27 gross national income[164]. The amount of the financial framework is roughly comparable to the current financial framework, taking into account the budgeting of the European Development Funds. In order to secure the financing of new expenditure, the Commission had to examine existing policies and propose savings for them.

In my opinion, the European budget should primarily be a tool for a long-term political unity of the EU. Unfortunately, several political risks may be identified in the Commission's proposal that need to be addressed, not only from the point of view of the Czech Republic but also from the overall perspective of the balance between advanced and less advanced MS. In particular:

- The proposal fails to address the long-term inequality of direct payments to farmers, and the criteria for allocation of rural development funds are not fully transparent or objective.

164 The EU-27 includes all MS after the withdrawal of the United Kingdom.

- The proposal introduces additional allocation criteria, thereby exacerbating the relative position of Central and Eastern Europe within the Cohesion Policy.
- The proposal further strengthens the role of central financial instruments, thereby limiting the amount of funds implemented under shared management.
- The proposal introduces tighter enforcement, which may have an asymmetric impact on individual MS.

In concluding, let us hope that the need to approve the multiannual financial framework unanimously would partially mitigate the asymmetric impact of the above risks.

F. Audit work of other external audit bodies in the Czech Republic

F.1 Results of work of the Audit Body

ESIF operating programmes in the 2014-2020 programming period

In 2017, the AB performed comprehensive audit work for all OPs with the exception of RDP (AB does not audit this programme) and OPF, where no certification was done for the financial year. The first regular audit for this OP will be conducted only in 2018. For PP14+, the main activities of the AB focused on preparing the annual audit report and the auditor's opinion on the individual programmes, i.e. on audits of operations, on the assessment of MCS functioning within individual programmes on the basis of completed audits of systems, and audits of financial statements for the accounting period from 1 July 2016 to 30 June 2017.

While audits of operations[165], within auditing the correctness of reported accounts, focused on the compliance of the operation implementation with the EU and Czech legislation and with publicity rules, the adequacy of the audit trail, the fulfilment of relevant monitoring indicators, etc., the audits of systems[166] focused mainly on the assessment of the functionality of the existing MCS set up by the relevant MAs or IBs, and the work of PCO and the *MS2014+* single monitoring system.

In 2017, the AB completed a total of 210 audits, of which 197 were audits of operations, 12 audits of systems, and one audit of accounts covering nine of the 10 OPs subject to AB auditing. **Ineligible expenditure was identified in 59 operations audits**, i.e. almost 30%. The most frequent deficiencies were established in the area of other ineligible expenditure (particularly in labour costs), i.e. in 35.18% of all cases, in financial terms, however, this represented only 1.88%. Deficiencies were also identified in the field of public procurement under the PPA or under the public procurement rules within individual operating programmes outside the PPA regime (26.13% of the total number of findings). These deficiencies accounted for 73.93% of all findings in financial terms of ineligible expenditure. Further findings were made in the field of missing supporting documentation (20.10% of the total number of findings). Major deficiencies were also identified in the field of revenue generating projects and in the field of **ineligible projects,** i.e. projects which should have not been supported by ESIF at all.

A total of 114 findings were made in the audits of systems, two of which were rated as of high-severity, 39 of medium-severity and 73 of low-severity. Two low-severity findings were identified in the audit of the financial statements. A **qualified opinion was issued based on the results of the audits in two OPs**, i.e. 20% of the total number of OPs; **an unmodified opinion was issued for seven OPs** and for **one OP, an opinion was refused to be issued** with regard to the state of the implementation (OPF - see above). The qualified opinion was issued within the OP EIC, referring to continued insufficiency of the MCS functionality of relevant OPs (conclusions of the system audits, higher error rate). The fields **of project evaluation and selection** and the **identification of ineligible expenditure continue to be assessed negatively.**

---

165 The operation audits for expenditure declared to the Commission for the accounting period are based on a representative sample. Statistical methods, a non-statistical approach were used to select the sample; the whole population (100% sample) was audited if the number of certified expenditure was low.

166 AB assessed the MCS in all MAs in terms of compliance with the requirements set by the General Regulation, i.e. whether the MCS functioned effectively and provided reasonable assurance that the statements of expenditure presented to the Commission were correct and the underlying transactions were legal and regular, and stated in the audit opion, with the exception of OP EIC.

The results of the MCS assessment are described in detail in the following table.

Table 15: The results of AB's MCS and programme error rate assessment

OP	Category of MCS		Opinion	Project error rate
Integrated Regional Operational Programme	functioning	some improvements needed	unmodified	0.38%
OP *Enterprise and Innovation for Competitiveness*	Functioning partially	significant improvements needed	qualified	6.58%
OP *Employment*	functioning	some improvements needed	unmodified	0.02%
OP *Prague – Growth Pole CR*	functioning well	none, or just minor improvements needed	unmodified	0.00%
OP Research, Development and Education	functioning well	none, or just minor improvements needed	unmodified	0.18%
OP *Environment*	functioning	some improvements needed	unmodified	0.16%
OP *Transport*	functioning	some improvements needed	qualified	7.26%
OP *Technical assistance*	functioning	some improvements needed	unmodified	0.54%
Interreg V-A Czech Republic – Poland	functioning	some improvements needed	unmodified	0.07%
OP *Fisheries 2014–2020*	functioning	some improvements needed	disclaimed	NR

Source: Information on current developments in the financial management of EU funds in the Czech Republic in 2017 from the perspective of the Audit Body, MoF, April 2018.

Note: For the projected error rate, the materiality level was set at 2%.

Within the audits of the cross-border cooperation and transnational cooperation programmes, the Czech Republic - Free State of Saxony cooperation programme was audited, i.e. the system and ten operations were audited, with six findings made (four of which with a financial impact).

General Programme 'Solidarity and Management of Migration Flows', programming period 2014–2020

In 2017, audit work was launched to review the accounts of the *Asylum, Migration and Integration Fund* and the *Internal Security Fund* for 2017. Based on the audit work carried out, an unqualified opinion was issued regarding the statement of accounts of both funds - the financial statements give a true and fair view and the EU expenditure claimed to be paid by the Commission are legal and correct. In the same year, a system audit was performed of the responsible authority[167]. A total of six findings within the system audit were identified, four of which were of medium severity and two of low severity. Medium-severity findings include out-of-date documentation and procedures that are followed by the responsible authority, insufficient definition of direct and indirect costs in the Handbook for Applicants and Beneficiaries, insufficient control of public procurement (negotiated procedure without publication) and insufficient setting of control procedures to verify monitoring indicators reported to the Commission. Six regular audits of operations were completed in 2017, with error rate below 0.01%

167 The responsible authority is the MoI.

F.2 ECA audit work

In its *Activity Report 2017*[168] the ECA states that its auditors completed 2,300 audit days with different EU bodies and spent a total of 3,670 days with on-the-spot checks in MS as well as outside the EU. The auditors spent the longest time in Spain (377 days), followed by Italy (371 days) and Poland (293 days). The CR ranked eighth (125 days).

F.2.1 DAS audits 2016

Annual report of the Court of Auditors on the implementation of the budget concerning the financial year 2016 (for details see chapter A.1.3) refers to the Czech Republic in relation to both Cohesion Policy expenditure and CAP expenditure.

In the field of *Economic, Social and Territorial Cohesion*, the ECA audited 180 operations across the EU, of which 24 in the Czech Republic (i.e. more than 13%). Of these 24 operations, ten were burdened with an error (eight non-quantifiable and two quantifiable errors). The errors found in the Czech Republic by the ECA were of the following nature:

- Ineligible expenditure - a quantifiable error with an impact of less than 20% of the value of the operation;
- Ineligible recipient - a quantifiable error with an impact exceeding 20% of the value of the operation[169].

In the area of *natural resources*, a total of 217 operations under EAGF and 163 operations in rural development, environment, climate and fisheries were reviewed within the EU (ECA also focused on performance review[170]). The Czech Republic appeared in both audit samples. Annual Report 2016 notes that in the Czech Republic, errors were also detected in this area, both in the case of EAGF operations[171] and in the case of rural development where of the 12 audited operations (more than 7% of all operations audited in this field) four were affected by a quantifiable error (up to 20% of the value of the operation)[172].

F.2.2 Special Reports in the period under scrutiny

In the period under scrutiny, the ECA published a total of 31 special reports. These reports present the results of selected performance audits and compliance audits focused on specific spending areas or on budgetary and management issues. In terms of their extent, they cover the full range of EU activities - focusing on both the revenue and the expenditure side of the European Union budget. Most of the SR addressed the expenditure chapters *Intelligent Growth and Inclusive Growth* (9) and *Sustainable Growth: Natural Resources* (8).

---

168 *Activity Report 2017*, The Publications Office of the European Union, 2018, see https://www.eca.europa.eu/cs/Pages/DocItem.aspx?did=45336.

169 In case of one ERDF-funded project, the call for proposals stated that only SMEs are eligible candidates. Audit of compliance with this condition revealed that the MA was making decisions on the basis of the recipient's statement and information from its monitoring system. However, this procedure failed to be adequate and aid was received by a recipient that was not a small or medium-sized enterprise.

170 A sample of 193 investment projects (audited in 2014-2016) was reviewed to verify whether the investments were made in accordance with the plan and at reasonable cost. Six projects in programming period 2014-2020 were reviewed to establish whether they would be suitable for simplified cost reporting. The ECA also addressed several issues related to the new ecological payment for 197 farms.

171 The CR's LPIS database did not contain any information on previous land use; therefore, automatic cross-checks could not be carried out to verify whether the arable land used for grassland has become permanent grassland, i.e. it was not possible to verify whether the required grant conditions were met.

172 In aids paid to CR's 'areas with natural or other specific constraints' (e.g. mountain areas), errors weren identified in relation to overvalued or ineligible area.

In the period under scrutiny, the **Czech Republic** and its entities were included **in four SR,** with two cases of so-called documentary (questionnaire) surveys (SR No. 10/2017[173] and No. 21/2017[174]) performed within the ECA audits of Czech entities. In the other two cases, the Czech Republic, i.e. its entities were directly in the control sample (SR No. 7/2017[175] and No. 20/2017[176]).

Special Report No. 7/2017

This audit focused on the role of the CB, which puts forward opinions on the legality and regularity of CAP expenditure at MS level. Although this framework is a positive step towards the Single Audit model, the ECA found that it also has significant shortcomings (including non-representative sample operations, inadequate substantive testing, misuse and underestimation of error rates). As a result, CB's opinions in important areas fail to be fully consistent with auditing standards and rules.

The Czech Republic was among the 13 Member States, where a total of 20 CB (as paying agents auditors) were examined. Since the 2015 budget year, the CB must also submit an opinion drawn up in accordance with internationally recognized auditing standards, indicating whether the expenditure claimed to be paid by the Commission is legal and correct. The budget year 2015 was the first year for the Commission to make use of the CB's more extensive scope of work regarding legality and regularity. However, the ECA established that the Commission's assurance model continues to be based on the results of audits carried out by the Member States. The CB opinion on legality and regularity was only one of the factors taken into account by the Commission in the calculation of the adjustments of error rate reported in the individual MS audit statistics.

Special Report No. 10/2017

The ECA found that support for young farmers is often poorly defined with no targets for expected results or impacts.

Support under the first Pillar of the CAP (Direct Payments) is not based on a proper needs assessment, it does not reflect the general objective of generation renewal support, it does not always reach farmers who need it, and sometimes is given to businesses where young farmers have only a small role. The aid is provided in a standardized form that does not reflect specific needs other than the need for additional income. The Common Monitoring and Evaluation Framework does not contain any performance indicators.

Support under the second Pillar (Project Measures) is mostly based on an unclear assessment of needs, but its objectives partly reflect the above-mentioned general objective. The amount of aid is usually tailor-made and adjusted to motivate for the specific measures implementation. Managing authorities have not always applied selective procedures to ensure that preference is given to the best projects (the minimum score was either too low or not set at all).

The ECA also noted that MS did not coordinate payments under the first Pillar of the CAP with support for young farmers under the second Pillar.

173 SR 10/2017 – *EU support to young farmers should be better targeted to foster effective generational renewal*

174 SR 21/2017 – *Greening: a more complex income support scheme, not yet environmentally effective*.

175 SR 07/2017 – *The certification bodies' new role on CAP expenditure: a positive step towards a single audit model but with significant weaknesses to be addressed.*

176 *SR 20/2017: EU-funded loan guarantee instruments: positive results but better targeting of beneficiaries and coordination with national schemes needed.*

While the Czech Republic was not included directly in the audit sample (questionnaire only), the general conclusions and the statistical values identified in the audit applied to it as well. While in the period from 2007 to 2013 the number of farmers under 44 years fell by 23.18% in the EU-27[177] as a whole, the Czech Republic recorded a decrease by as much as 52.35%.

Special Report No. 20/2017

The ECA analysed whether EU credit guarantees support the growth and innovation of small businesses by giving them access to finance. It came to the conclusion that the loan guarantee facility enabled the recipient companies to grow more in terms of total assets, as well as sales, labour cost and productivity. On the other hand, the *InnovFin* SME Guarantee has not been sufficiently focused on enterprises dedicated to research and innovation activities with a high potential for excellence. In addition, many businesses did not actually need the guarantee. However, the instruments were evaluated as improved, with certain shortcomings remaining.

Special Report No. 21/2017

The greening payment is a new type of direct payment to farmers brought about by the CAP reform in 2013. It was designed to reward farmers for a positive environmental impact not otherwise valued by the market.

The greening should go beyond the cross-compliance framework and create a baseline scenario for rural development measures, i.e. define an environmentally beneficial farming process that is required from a farmer who is involved in environmental measures under rural development without any reward. Remuneration can only be paid for services (commitments) that exceed the baseline scenario. In reality, this is not always the case and there are significant overlaps between greening, environmental measures under rural development and the so-called cross-compliance.

The Commission has not developed a full intervention logic for greening payments as a CAP contribution to the EU environmental and climate objectives. Neither has it set clear, sufficiently ambitious environmental objectives that greening should achieve. ECA's auditors have established that greening is unlikely to deliver significant environmental and climate benefits, in particular as a significant proportion of subsidized procedures would be applied even without this payment. They also noted that the results of this policy were unlikely to substantiate the significant complexity that greening brings to the CAP. This is partly due to the overlapping of the greening requirements and other environmental requirements of the CAP.

The Czech Republic and its entities were not included in the control sample but the ECA included it with nine other MS in a targeted documentary review of the risk of double financing from different types of aid under the CAP.

F.3 Audit missions of European institutions in the CR in 2017

In 2017, a total of 12 ECA audit missions took place in the Czech Republic. The Supreme Audit Office coordinated the exchange of information between the ECA and the audited entities, and SAO auditors participated in the mission as observers. The SAO assists the European Court of Auditors in some cases in obtaining inputs for studies conducted in the framework of surveys or in information reviews. An overview of completed ECA's audit missions is included in Annex 2.

The SAO auditors did not participate in any **Commission audit missions** in 2017. The focus and dates of Commission audit missions completed in the Czech Republic in 2017 are included in Annex 3.

177 No data available for Croatia.

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

G.1 Legal matters

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

G.1.1.1 Inter-ministerial commentary procedure

In 2017, the SAO received a total of 149 draft legislative changes and other materials related to legal regulation to be assessed. Specific observations, based primarily on the findings of its own audit activities, have been made to 45 of these documents.

Issues related to the financial management of EU funds mainly concerned proposals for amendments to government regulations aimed at ensuring **the implementation of new Commission regulations governing the conditions of the CAP** presented by the Ministry of Agriculture.

In 2017, the SAO also actively participated in the consultation process related to the revised version of the *National Strategy for the Protection of the EU's Financial Interests.*

Of the legislative documents commented on by the SAO in recent years, Act No. 367/2017 Coll., amending **Act No. 218/2000 Coll**., on Budgetary Rules and Amendments to Some Related Acts (Budgetary Rules), as amended, as well as other related acts were adopted in 2017. The Act that better regulates the process of granting aids and recoverable financial assistance from the state budget came into effect on 1 January 2018.

In its seventh parliamentary term, the Chamber of Deputies of the CR's Parliament did not conclude the discussions on the government bill amending Constitutional Act No. 1/1993 Coll., the Constitution of the Czech Republic, as amended by subsequent constitutional laws, and the bill amending **Act No. 166/1993 Coll., on the Supreme Audit Office**, as amended, and other related laws (Parliamentary Documents Nos 947 and 948). These bills extend the SAO scope of action to include audits of the management of public finances and resources provided from public budgets, as well as property of legal entities owned by the state or local authorities (with the exception of municipalities with no more than 10,000 inhabitants and legal entities with own participating interests). The category of "public finances" would also include "EU funds and other financial resources from abroad provided to the state on the basis of an international treaty". In line with the Government's legislative work plan for 2018, both of these bills were re-submitted in a partially amended form on 1 February 2018 to inter-ministerial commentary procedure; the Government has not yet discussed them.

In 2017, the government **bill on the management and control of public finances** (Parliamentary Document 1001) which, following the directly applicable EU regulations, and in order to complete the transposition of the Directive on requirements for budgetary frameworks of the Member States[178], should amend the management and control of public finances and replace Act No. 320/2001 Coll., on Financial Control in Public Administration and on Amendment to Certain Acts (Act on Financial Control), as amended, was not adopted (the Chamber of Deputies failed to outvote the rejection of the Act by the Senate).

178 Council Directive 2011/85 / EU of 8 November 2011 on requirements for the budgetary frameworks of the Member States.

G.1.1.2 Opinions on draft legislation pursuant to § 6 of the Act on the SAO

Both chambers of the Parliament of the Czech Republic and their bodies are entitled to request opinions from the SAO on the draft legislation on budgetary management, accounting, state statistics and control, supervisory and inspection activities. None of the aforementioned authorities made use of this entitlement in 2017 by means of submitting a formal request for an opinion. The SAO findings in relation to required legislative adjustments were presented in connection with the review of SAO audit findings at the Chamber of Deputies' Audit Committee meetings.

G.1.2 Implementation and transposition of European Union law in the Czech Republic

G.1.2.1 Transposition of legal commitments in the Czech Republic

Transposition deficit

Upon entering the EU, the Czech Republic assumed the obligation to honour all the commitments of a MS. These include legal commitments stemming from Article 4 (3) of the *Treaty on European Union*, which requires MS 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 transposition activity of each MS is monitored by the Commission and the results are processed in the interim evaluations entitled the *Single Market Scoreboard* (SMS), which are published twice a year on the relevant Commission web portal. The latest data for the Czech Republic were published in the Government *Report on the transposition of legal commitments arising from the Czech Republic's membership in the European Union for 2017* (Transposition Report).

Table 16: The status of transposition of EU legislation in the Czech Republic

Indicator	As at November 2015	As at May 2016	As at November 2016	As at may 2017	Anticipated state as at November 2017
Transposition deficit (%)	0.8	1.0	1.5	1.6	1.2
Delayed directives (number)	9	10	15	17	12

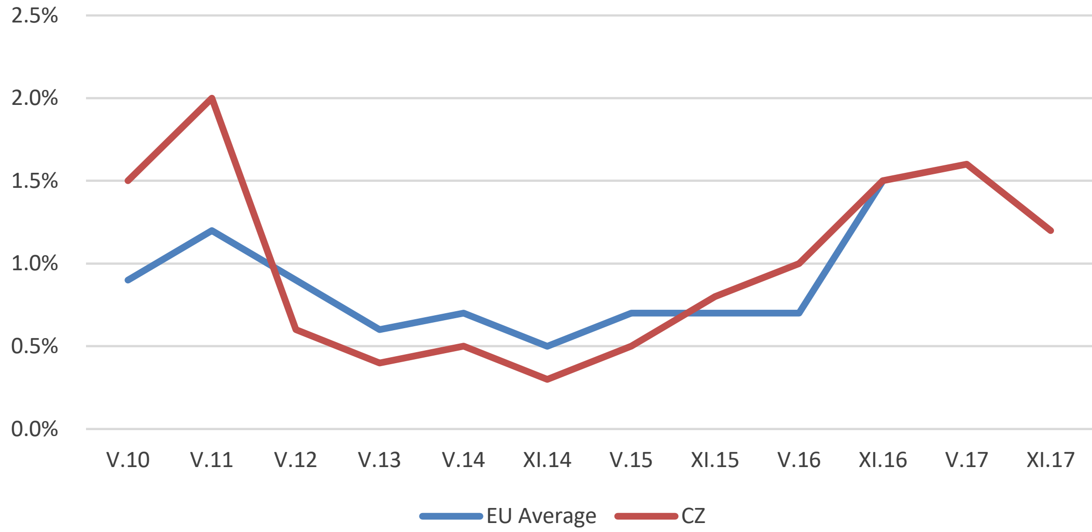
Source: http://ec.europa.eu/internal_market/scoreboard (editing 7/2017); the data given in the last two columns of the table come from the Acceptance Report.

According to the Commission, the average of the European Union's transposition deficit is 1.5%, but the proposed threshold (in the *Single Market Act* II) is only 0.5%. In the Czech Republic, this deficit has almost doubled compared to the previous comparable period (1.5% vs. 0.8%). For directives that should have been transposed by 30 November 2016, there is a transposition deficit of 21% in the Czech Republic, and for nine directives where the date of transposition was set for a period of up to three months prior to the applicable calculation date, the percentage is 67%. These figures show that the Czech Republic has problems with a timely transposition of directives.

Compared to nine directives with a transposition delay in 2015, 17 directives, including five in the field of social policy, were delayed in May 2017.

According to the Commission, the average delay in the transposition of directives in the EU is 6.7 months. In the Czech Republic, the average delay decreased from 6.8 months to 5.5 months, most of the delayed transpositions of the directives (14 out of 15) have a delay of less than two months and no more than two years.

Chart 16: Evolution of the transposition deficit in the Czech Republic in 2010-2017 compared to the EU average



Source: http://ec.europa.eu/internal_market/scoreboard; Transposition Report.

In the Transposition Report, the transposition of the Directive on Requirements for Budgetary Entities of the Czech Republic is mentioned as an example of bad practice, as it should have been transposed by the MoF by December 31, 2013. As at the date of the editorial deadline of the EU Report 2018, the bill amending Act No. 320/2001 Coll., on Financial Control in Public Administration and on the Amendment to some Acts (Act on Financial Control) as amended was not a valid part of the legal order of the Czech Republic.

Infringement

The Commission also monitors the number of proceedings opened as a result of failure to notify on transposition rules or an incorrect or uncompleted transposition of internal market directives (so-called “infringement”).

Table 17: State of infringement proceedings against the Czech Republic in the years 2015 and 2016

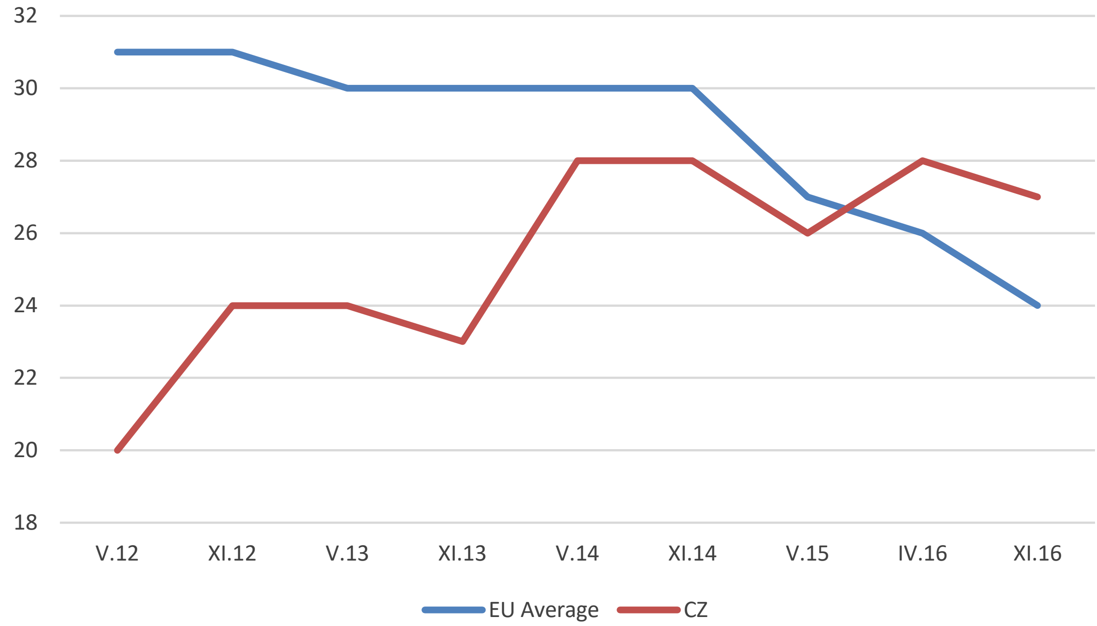
Indicator	State as at November 2015	State as at November 2016
Pending cases (number)	28	27
Average case duration (month)	33.3	37.1
Court rulings (month)	19.2	19.2

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

According to the Commission, there are 24 cases on average being discussed per MS. In terms of the Czech Republic, there are 27 cases pending, i.e. one less than in the comparable period of 2015, which represents a relatively stable outcome. Nevertheless, **the Czech Republic is in a group of 11 Member States with above-average number of cases related to the single market**. The fields of the environment (7 cases) and transport (6 cases), jointly accounting for 48% of all open cases, remain problematic.

The average length of discussions is 36.9 months within the EU and 37.1 months within the Czech Republic (i.e. 23 cases that have not yet been referred to the Court of Justice of the European Union). 41% of cases in the Czech Republic are older than three years (the oldest case, relating to the aviation industry, has been going on for 11 years).

Chart 17: Evolution of the number of infringements in the CR in 2012-2016 compared to the EU average



Source: Single Market Scoreboard, Performance per Member States, Czech Republic, (Reporting period: 2004–2016).

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

If the Commission identifies a violation of the law or is notified of it in a complaint, it seeks an agreement to eliminate the cause with the MS in the form of a structured dialogue (EU-Pilot). Member States may provide further factual or legal information at this stage. The aim is to find a swift solution in line with EU law and to avoid infringement proceedings. If MS does not agree with the Commission's position or does not take corrective action, the Commission may initiate formal infringement proceedings. This involves the following steps:

- The Commission will invite the government of the MS to comment on the case within two months.
- If the Commission does not receive the reply or the reply is unsatisfactory, the Commission shall state the reasons for its opinion that the MS has infringed EU law. Governments have two months to secure a remedy.

- If the Commission does not receive a reply or the reply is unsatisfactory, the Commission will ask the Court to open legal proceedings. Usually, however, the issue is resolved earlier.[179] If the MS fails to inform on the measures to implement the directive, the Commission may at this stage ask the Court to impose a lump sum and/or a penalty payment
- Within two years on average, the Court will decide whether or not the MS has violated EU law. The CR's government is obliged to adapt national rules or practices and to resolve the problem as soon as possible.
- If the MS continues to fail to make a remedy, the Commission sends another call. If the Commission does not receive a reply or the reply is unsatisfactory, the Commission may refer the matter to the Court of Justice and propose a flat-rate fine and/or a penalty payment to be imposed.

The Czech Republic's transposition deficit grew in the period under review. Also, the number of infringements remained above the EU average. **The SAO has repeatedly** (in the two previous EU reports) **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 with potential financial consequences.[180]

G.1.2.3 Evaluations performed by the Czech government

Through regular reports on the status of responsibilities allocation and compliance with the legislative obligations arising from the Czech Republic's membership of the European Union, for each quarter and each year the state of compatibility of CR's legislation with EU law is comprehensively assessed. These reports are designed to show the results of the legislative activities of individual ministries, both in relation to the transposition of directives and in terms of adapting Czech legislation to EU regulations. Reports are always submitted to a session of the government.

The Transposition Report was discussed by the Czech government on 24 January 2018 (Government Resolution No 61/2018).

179 Over the past few years, more than 85% of cases have been resolved without the need to open court proceedings.

180 In the case of an infringement in 2013 the Czech Republic was at risk of the TFEU sanctions mechanisms. 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. This sum, too, is multiplied by the seriousness coefficient, however. 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).

G.2 SAO international activities within the EU

In 2017, the SAO was involved in cooperation within the Contact Committee (CC), which is made up of the heads of EU Member States' supreme audit institutions (SAI) and the ECA.

In May 2017, contact staff of the SAIs held a meeting in Stockholm to prepare the CC annual meeting. In October, the SAO President and other representatives of the SAO attended a meeting of the CC in Luxembourg at the ECA headquarters; this also celebrated the 40th anniversary of the ECA's existence.

The main discussion topic was restoring the confidence of EU citizens in public institutions. Against this background, the meeting participants also discussed innovative SAI audit products and addressed the issue of stakeholder communication aimed at building confidence in national and multinational public institutions.

The SAI presidents also took part in a so-called in camera consultation, a pilot innovation of the CC, at which they had the opportunity to discuss at an informal level how SAIs are affected by the challenges currently facing the EU. The Supreme Audit Office presented the BIEP project and invited EU countries to cooperate in this international comparison project.

SAO representatives attended several of the working groups established within the CC:

Following the conclusions and discussions of the CC which took place in October 2016, SAO representatives took part in a workshop in January 2017 on energy and climate change challenges.

At the end of May, SAO representatives participated in a joint workshop of two working groups: *The Fiscal Policy Audit Network* and *The Europe 2020 Strategy Audit Network*. The subject of the seminar was to discuss and share the experience of individual SAIs in the area of fiscal policy. The results of the first parallel audit carried out by the Fiscal Policy Audit Network: *Key risks to the Sustainability of Public Finances* were also presented.

In June, SAO representatives took part in the EPSAS (*European Public Sector Accounting Standards*) Contact Group's working group monitoring the issue of the establishment of uniform accounting standards for the public sector within the EU, and in September they took part in "Sub-group 2" of the VAT working group. In particular, legislative changes in the area of VAT, new trends in tax fraud, the results of audit activities and an evaluation of e-commerce questionnaires sent to individual Member State tax administrations were presented at this meeting.

Sources and references

1. *White Paper on the Future of Europe and its Goals: Reflections and scenarios for the EU27 in 2025*, COM (2017) 2025 final of 1 March 2017.
2. *Discussion paper on the future of EU finances*, COM (2017) 358 final of 28 June 2017.
3. *Doing Business 2018, Reforming to Create Jobs,* World Bank Group 2018.
4. Recommendation for the Council Recommendation on the National Reform Programme of the Czech Republic for 2017 and the Council Opinion on the Convergence Programme of the Czech Republic of 2017, COM (2017) 503 final of 22 May 2017.
5. Council Recommendation of 11 July 2017 on the National Reform Programme of the Czech Republic for 2017 and Council Opinion on the Convergence Programme of the Czech Republic, 2017 (Official Journal of the European Union, 2017 / C 261/03, 9 August 2017)
6. *EU budget 2016 – Financial Report*, Official Journal of the European Union, 2017; previous reports of the Commission on the EU Budget 2008–2016.
7. EU reports 2013–2017.
8. *Implementation Plan on Security and Defence*, 14392/16.
9. *Information on the state of implementation of EU funds in the 2014-2020 programming period*, submitted to the Council for the European Structural and Investment Funds, NCA, April 2018.
10. *Integrated Information System of the Treasury*
11. Consolidated version of the *Treaty on the Functioning of the European Union, Official Journal of the European Union,* C 115, 9 May 2008.
12. *SAO´s Audit Information System.*
13. Audit conclusions published in the *SAO Bulletin*.
14. Convergence Programme of the Czech Republic approved by the CR's Government Resolution of 24 April 2017 No. 314.
15. *The National Reform Programme of the Czech Republic 2017* approved by the Government of the Czech Republic at the meeting of the Committee for the European Union on April 24 2017.
16. Documents MoF - Audit Authority, April 2018.
17. Documents MoF - PCO, April 2018.
18. Documents MfRD, April 2018.
19. Documents from MS2014+.
20. Documents of MoA, April 2018.
21. Documents of the State Agricultural Intervention Fund (SZIF), April 2018.
22. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the VAT Action Plan: *Towards a Single EU VAT Area: Time to Adopt Decision*, COM (2016) 148 final of 7 April 2016.
23. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: *Follow-up to the VAT Action Plan, Towards a Single European VAT Area: Time to Adopt Decisions*, COM (2017) 566 final of 4 October 2017.

24. Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank: *Annual Growth Survey for 2017*, COM (2016) 725 final of 16 November 2016.

25. Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: *Commission Work Programme for 2017. For a Europe that protects, strengthens and defends*, COM (2016) 710 final of 25 October 2016.

26. Approved programming documents of programs co-financed by the EU budget.

27. *Single Market Scoreboard, Performance per Member State, Czech Republic, (Reporting period: 2004–2016).*

28. *Study and Reports on the VAT GAP in the EU-28 Member States:* 2017 Final Report, TAXUD/2015/CC/131, 18 September 2017.

29. MoF press release of 31 January 2018 stating that the net position of the Czech Republic for 2017 was CZK 55.4 billion.

30. *Official Journal of the European Union.*

31. *Annual Report on the Implementation of the Partnership Agreement for 2017*, issued in April 2018.

32. *Annual Report of the Court of Auditors on the implementation of the budget for the financial year 2016 and the Court of Auditors' annual report on the activities financed by the eighth, ninth, tenth and eleventh European Development Funds (EDFs) for the financial year 2016,* Official Journal of the European Union C 322 of 28 September 2017.

33. *Annual Report for 2016 on management and performance of the EU Budget*, COM (2017) 351 final version of 13 June 2017

34. ECA annual reports on the implementation of the budget for the financial years 2014, 2015 and 2016, ECA 2015-2017.

35. Findings of the Constitutional Court of the Czech Republic published in the Collection of Laws.

36. Council Conclusions of 8 November 2016 on improving existing EU VAT rules on cross-border transactions (No 14257/16 FISC 190 ECOFIN 1023, 9 November 2016).

37. Report from the Commission to the European Parliament and the Council: *Protection of the financial interests of the European Union - Fight against fraud, Annual report 2016*, COM (2017) No 383 final of 20 July 2017*.*

38. *Report from the Commission to the Council and the European Parliament on the implementation and evaluation of Council Directive 2008/118 / EC of 16 December 2008 on the general arrangements for excise duty,* COM (2017) 184 final of 21 April 2017.

39. Report from the Commission to the Council and the European Parliament: *Eighth report under Article 12 of Regulation (EEC, Euratom) No 1553/89 on VAT collection and control procedures*, COM (2017) 780 final of 18 December 2017.

40. *Report on the Czech Republic 2018*, SWD (2018) 202 final of 7 March 2018.

41. *Activity Report 2017,* European Court of Auditors, was published by the Publications Office of the European Union, 2018.

42. *Report on the Results of Financial Controls in Public Administration for 2016*, taken into consideration by the Government of the Czech Republic in its Resolution of 10 July 2017 No. 511.

43. *Government Report on the Acceptance of Legislative Commitments resulting from the Czech Republic's Membership in the European Union for 2017,* approved by Government Resolution No. 61 of 24 January 2018.

44. Special reports by the European Court of Auditors published in the *ECA Bulletin*.

Web site used:

http://ec.europa.eu/budget/biblio/documents/2017/2017_en.cfm

http://ec.europa.eu/budget/biblio/documents/2018/2018_en.cfm

http://ec.europa.eu/internal_market/scoreboard

http://www.consilium.europa.eu/cs/policies/eu-annual-budget/2017/

http://www.eagri.cz

http://www.euractiv.cz

http://www.mfcr.cz

http://www.nku.cz

http://www.szif.cz

http://www.vlada.cz

https://cohesiondata.ec.europa.eu/countries/CZ

https://ec.europa.eu/digital-single-market/en/desi

https://eur-lex.europa.eu/homepage.html

https://www.eca.europa.eu/cs/Pages/DocItem.aspx?did=45336

Appendix 1: Overview of the SAO audits completed in the period from 1 April 2017 to 31 March 2018 and wholly or partly focused on EU funds.

Audit No	Audit title	Published in the SAO Bulletin (issue/year)
16/12	*Arrangements of unified methodological environment for drawdown of EU subsidy in the programming period 2014+*	4/2017
16/13	*Funds spent on development of education in the Czech Republic*	3/2017
16/25	*Closing account of the state budget chapter the Ministry of Industry and Trade for the year 2015, their financial statements and data for 2015 submitted for the assessment of fulfilment of the state budget 2015*	4/2017
16/26	*Expenditure on the operation and the use of immovable property, including expenditure on the provision of information support related to the management, operation and maintenance of immovable property*	6/2017
16/29	*Closing account of the state budget chapter the Ministry of Labour and Social Affairs for the year 2016, their financial statements and data for 2016 submitted for the assessment of fulfilment of the state budget 2016*	6/2017
16/32	*EU and state budget funds earmarked for the support of cooperation development between municipalities and local partnership*	6/2017
17/02	*Support of social housing as a part of the social inclusion policy*	3/2018
17/03	*Health information systems within the administration of organisational units of the state in the health department*	1/2018
17/05	*Construction, modernisation, and reconstruction of motorways*	1/2018
17/06	*EU and state budget funds spent on forestry support*	1/2018
17/08	*Closing account of the state budget chapter Ministry for Regional Development for the year 2016, the financial statements and data for 2016 submitted for the assessment of fulfilment of the state budget 2016*	1/2018
17/09	*Construction-like activity carried out with a view to modernising and developing the road network in selected regions which was co-funded from EU funds and national resources*	3/2018
17/18	*Closing account of the state budget chapter Ministry of the Environment for the year 2016, the financial statements and data for 2016 submitted for the assessment of fulfilment of the state budget 2016*	3/2018

Appendix 2: Overview of audit missions of the European Court of Auditors in the Czech Republic in 2016 and 2017

Year	Order	Date of the mission	Audit subject (programme)	Audit type (DAS / performance audit)	Audit form (on-the-spot / survey)
2016	1	15 – 19 Feb.	OP *Education for Competitiveness*	DAS	on-the-spot
	2	29 Feb. – 4 March	ROP *South-West*	DAS	on-the-spot
	3	14 – 18 March	OP *Environment*	DAS	on-the-spot
	4	30 June – 4 July, 29 Sept. – 3 Oct.	Implementation of the Water Quality Directive intended for consumption of people and Water Infrastructure Projects co-financed from European funds under the Operational Program *Environment*	performance audit	canceled
	5	2 – 4 May, 11 – 15 July	Performance audit of loan portfolio guarantee instruments financed by the EU budget	performance audit	on-the-spot
	6	17 – 20 May	Support for rural development from the EAFRD	DAS	on-the-spot
	7	6 – 8 June	Measures to support the drawdown of ERDF and ESF funds in the Member States for the period 2007-2013	performance audit	on-the-spot
	8	16 – 17 June	Audit of the Statement of Assurance for 2016	DAS	on-the-spot
	9	23 – 24 August	Audit of the Statement of Assurance for 2016	DAS	on-the-spot
	10	29 August – 1 Sept.	Financial audit of the European Agricultural Guarantee Fund	DAS	on-the-spot
	11	20 – 23 Sept.	Support for rural development from the *European Agricultural Fund for Rural Development*	DAS	on-the-spot
	12	29 Sept. – 1 Oct.	OP *Enterprise and Innovation*	DAS	on-the-spot
	13	10 – 19 Oct.	*„Have productive investment projects and business support under the ERDF achieved sustainable results?“*	performance audit	on-the-spot
	14	24 – 27 Oct.	OP *Environment*	DAS	on-the-spot
	15	28 Nov. – 2 Dec.	OP *Transport*	DAS	on-the-spot
2017	1	16 – 20 Jan.	*Integrated Operational Program* - ERDF	DAS	on-the-spot
	2	31 Jan. – 3 Feb.	OP *Human resources and employment*	DAS	on-the-spot
	3	6 – 10 Feb.	Support for rural development from the *European Agricultural Fund for Rural Development*	DAS	on-the-spot
	4	27 – 31 March, 24 – 28 April	Focus on results in the selection and monitoring of projects co-financed by the European Structural Funds and the *European Social Fund*	performance audit	on-the-spot
	5	4 – 7 April	ROP *South-West*	DAS	on-the-spot
	6	4 – 8 Sept.	Audit on air quality in Europe, in particular Directive 2008/50 / EC, on outer air quality and cleaner air for Europe	performance audit	on-the-spot
	7	11 – 15 Sept.	Audit of the Statement of Assurance for 2017 (DZS, MoEYS, Independent Audit Body).	DAS	on-the-spot
	8	3 – 4 Oct.	Audit of the Statement of Assurance for 2017 (Masaryk University)	DAS	on-the-spot
	9	9 – 13 Oct.	Audit of the Statement of Assurance on the Traditional Own Resources for the financial year 2017	DAS	on-the-spot
	10	16 – 20 Oct.	Audit of Commission systems to obtain assurance in connection with the work of certification bodies	DAS	on-the-spot
	11	24 – 25 Oct.	Audit of the 2017 Assurance Statement (BIC Plzeň, Limited Liability Company)	DAS	on-the-spot
	12	4 – 6 Dec.	Audit of Flood Prevention, Flood Protection and Flood Preparedness in the EU	performance audit	on-the-spot

Appendix 3: Overview of the Audit and Verification Missions of the European Commission carried out in the Czech Republic in 2016 and 2017

Year	DG	Auditee	Audit No.	Audit subject	State of the contradictory proceedings	Main findings	Measures taken
2016	DG Regio	ROP South-East ROP Central Bohemia OPT	AB 2016/CZ/REGIO/C4/1557/1	Gain assurance on system functionality 2007–2013 through scrutiny of audit bodies activity, including the processes of closing the programming period	Finished	One irregularity identified in the process of closure (inadequate determining of estimated - expected rate of error on the sampling of operations). Shortcomings identified (ineligible expenditure). Inadequate audit procedures).	Fulfilled
	DG EMPL	OPPA OPEC OP HRE	AB MAPAR EMPG307CZ0092	Review of the preparedness of the MA and certification and audit authority for the process of closing OPPA, OP HRE and OPCV	Finished	Identified risk areas.	Fulfilled
	DG EMPL DG Regio	OP RDE	MA, PCA, AO Observations of the Commission designation	Verification of MA and PCA designation for OP RDE	Finished	Identified risk areas.	Fulfilled
2017	DG EMPL	OP HRE	AO MAPAR EMPG307CZ0193	Review of AB's activities	Finished	Identified shortcomings in the methodological part and in identification of ineligible expenditure.	Fulfilled
	DG Regio	IROP	MA, PCA REGC414CZ0062	Early Prevention System Audits under the memorandum of planned investigations - PP14+	Unfinished		
	DG Regio	IROP	MA, PCA REGC414CZ0093	Audit of reliability of performance data under the memorandum of planned investigations - PP14+	Unfinished	No finding.	
	DG Regio	OP EIC	MA REGC414CZ0018	Audit of the early prevention system under PP14+	Finished	Shortcomings identified.	Fulfilled
	DG EMPL	OPPA, OPEC, OP HRE	AB EMPG307CZ0212	Missions to verify the annual audit report	Finished	No finding.	
	DG Mare	OPF	AB 2017/CZ/MARE/E1/1	Missions to verify the annual audit report	Unfinished		
	DG Mare	OPF	MA, PCA 2017/CZ/EPSA/MARE/E1	Preventive System Audit - PP14+	Unfinished		

Czech Republic | Supreme Audit Office | EU REPORT 2018