

Report on the activities of the sixth and seventh European Development Funds

PART I

**Observations concerning activities
under the sixth and seventh European Development Funds (*)**

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(*) The Commission's replies are on page 157.

IMPLEMENTATION OF THE SIXTH AND SEVENTH EDFs UP TO 31 DECEMBER 1997

1. The European Development Funds (EDFs) trace their origin back to international agreements drawn up between the Member States of the European Union and 71 African, Caribbean and Pacific (ACP) countries and to Council decisions relating to the association of 24 overseas countries and territories (OCTs). The Commission is responsible for the administration of the EDFs without prejudice to the European Investment Bank's responsibilities for the administration of certain forms of aid.

2. In 1997 the sixth⁽¹⁾ and seventh EDFs⁽²⁾ were being implemented concurrently because although, in

(1) The Lomé III Convention (OJ L 86, 31.3.1986).

(2) The Lomé IV Convention (OJ L 229, 17.8.1991).

principle, each one was limited to five years, there is no time-limit on the spending of the appropriations allocated. Only when the Commission considers that the implementation of a particular fund is nearing completion does it transfer the balance to a subsequent Fund.

3. *Table I.1* shows the utilisation of the sixth and seventh EDFs as at 31 December 1997. For the financial year 1997, the payments amounted to 1 212,7 Mio ECU, whilst the net commitments reached 616,0 Mio ECU. The corresponding amounts for 1996 had been 1 317,4 Mio ECU and 964,9 Mio ECU respectively. Twelve years after it came into force, disbursements from the sixth EDF represented 85,6 % of its resources; at the same stage of the fifth EDF they represented 87,6 %. The payment rate for the seventh EDF stood at 55,6 % at the end of the seventh year of implementation; for the sixth EDF it stood at 63,9 %.

Table I.1 — Utilisation of the sixth and seventh EDFs as at 31 December 1997*(Mio ECU)*

Resources and utilisation (ACP + OCT)	Sixth EDF	Seventh EDF	Total
Initial allocation	7 500,0	10 940,0	18 440,0
Resources collected	8 103,3 ⁽¹⁾	5 703,5 ⁽²⁾	13 806,8
Resources to be collected from Member States	0,0	5 940,1	5 940,1
Transfers of resources between sixth and seventh EDF	(181,7)	181,7	
Net resources	7 921,6	11 825,3	19 746,9
Payments prior to 1997	6 603,8	5 536,2	12 140,0
1997 payments	173,8	1 038,9	1 212,7
Decisions remaining to be settled	756,0	3 743,4	4 499,4
Utilisation	7 533,6	10 318,5	17 852,1
Transfers to eighth EDF	(39,0)	(253,0)	(292,0)
Balance available for re-use	349,0	1 253,8	1 602,8
Advances made for eighth EDF			
CDI		25,3	25,3
Stabex		76,2	76,2
Payments made for eighth EDF			
CDI		21,2	21,2
Stabex		72,9	72,9

⁽¹⁾ Including resources transferred from the fourth EDF⁽²⁾ Including resources transferred from the fifth EDF.

Source: On-line accounting system (OLAS).

4. The financial protocol for the seventh EDF expired on 1 March 1995, and on 3 November 1995 the ACP-EC Council of Ministers decided that the balances outstanding for the financial instruments relating to the system for stabilising export earnings (Stabex), to the special financing facility for mineral products (Sysmin), as well as to structural adjustment support, emergency aid and assistance for refugees, would all remain allocated to their respective objectives until used up.

5. On 4 November 1995, the ACP States and the Member States of the European Union signed an agreement amending the fourth Lomé Convention. After ratification of this agreement, the corresponding eighth EDF, for which an overall amount was fixed for

ACP countries and OCTs at 13 167 Mio ECU, entered into force on 1 June 1998 ⁽³⁾.

6. In 1995, it was agreed that, of the resources allocated to the eighth EDF, 292 Mio ECU was to come from transfers from previous EDFs of which 13 Mio ECU coming from the balances of the closed fourth EDF. This decision, however, only partly resolves the problem of unpaid outstanding balances from closed EDFs ⁽⁴⁾. In fact, as at 31 December 1997, these outstanding balances amounted to 335,9 Mio ECU, i.e. the funds transferred from the fourth to the sixth EDFs (123,1 Mio ECU) ⁽⁵⁾ and from the fifth to the seventh EDFs (444,2 Mio ECU) ⁽⁶⁾ had given rise to only 231,4 Mio ECU of payments, i.e. 40,8 % of the transfers. This being so, the Commission should

⁽³⁾ See OJ L 156, 29.5.1998, p. 107.⁽⁴⁾ Already mentioned in paragraph 12.07 of 1996 annual report (OJ C 348, 18.11.1997).⁽⁵⁾ Reduction by 1,6 Mio ECU compared to 1996.⁽⁶⁾ Reduction by 12,7 Mio ECU compared to 1996.

propose to the Council a suitable mechanism to ensure that in future appropriations are not left unused.

7. In 1997 again a number of payments have been made on behalf of the eighth EDF which was not yet ratified in 1997 (see paragraph 20).

OTHER OBSERVATIONS

Introduction

8. In the course of the 1997 DAS audit, a number of problems were identified which did not have an implication for the statement itself, but have an impact on the soundness of the financial management. These are treated below.

Non-respect of procedures

9. As mentioned in Part II of this report concerning the statement of assurance there is a high incidence of formal errors in that the legislation applicable to the EDF (conventions, internal agreements, financial regulations) was not followed. Moreover, in a considerable number of transactions the Court found that the Commission did not properly apply the EDFs' internal rules.

10. Changes to contractual provisions as regards the period of performance, period of contract, or currency of payment, are frequently made by all parties concerned (Commission, national authorising officer (NAO), beneficiary) without written notification. Moreover, usually no justification in writing as regards the part of the contract payable in foreign currency is provided. That makes the management and follow up of projects unnecessarily difficult and could have negative financial consequences in case of legal disputes.

11. Many payment orders were issued by NAOs, without the date of signature. Equally the date of endorsement by the delegation was often not indicated. In a number of cases where the dates were indicated, the contracts were endorsed by the delegation before signature of the NAO.

12. Contrary to internal rules, service contracts included contingencies and did not respect applicable ceilings for per diems. The replenishment of imprest accounts for work programmes was not, as prescribed, limited to justified expenditure, but included additional advances as well.

13. The high number of cases in which the legislation and/or the internal instructions were not respected may be a symptom of unnecessary and sometimes unrealistic rules which render the administration of the EDFs less coherent and less reliable. While the Commission's services should adhere to the rules, the whole set of the EDFs' regulations and internal rules should be examined to assess their appropriateness.

Liquidated damages in case of delayed performance

14. In two contracts it was found that no rate nor maximum amount was specified for liquidated damages in case of delayed performance. This deprives the contracting authority of the possibility of claiming damages if such occur. However, even when the contracts contain clauses on delayed performance, the rights and penalties prescribed are not exercised. It is generally left to the NAO's discretion whether to apply these rules. The audit revealed that out of 62 cases examined there were 10 contracts with delayed performance. In none of these cases was the right to claim damages (amounting to 0,7 Mio ECU) exercised⁽⁷⁾. The Commission should be more vigilant and should require the NAO to provide justifications in cases where the rights on liquidated damages are not exercised.

Treasury management

15. Although improvements of the treasury management have been made during 1997, a number of problems still remain unresolved.

16. Payments made locally in the ACP States are initially recorded on the basis of the bank statements received from the national paying agents in a suspense

(7) In three cases it was even a contractual obligation to claim these penalties (see Part II paragraph 37(a)).

account. Expenditure is subsequently regularised and attributed to projects on the basis of supporting documents received from the delegations and cleared as final expenditure after checks made by the authorising officer and the financial controller. This procedure is not, however, uniformly applied. Some staff of the Commission do not record the payments made by the national paying agents until they receive all the supporting documents. As a result the balances of some local bank accounts shown in OLAS are overstated during the year. At year end, the differences between the OLAS figures and the actual bank balances are booked as bank reconciliation items to give a true and fair view of the bank accounts⁽⁸⁾.

17. Contrary to Article 319.1 of Lomé IV, five ACP States⁽⁹⁾ do not have a national paying agent bank account to execute local payments. For one of these countries⁽¹⁰⁾ the local payments are executed by the Commission's central services in Brussels from European paying agents.

18. In contrast to the situation concerning all other European paying agency accounts, there has not yet been a fresh tender for the continued operation of the Stabex bank account, which was opened in 1994 for one year and subsequently tacitly renewed year by year.

19. Contrary to contractual provisions which do not allow bank charges, available balances have been reduced by such charges in one European and 12 ACP paying agent institutions. The Commission should not have accepted these charges and the amounts should have been booked in a transitory account⁽¹¹⁾.

20. The bank balance on the account with the National Housing and Savings Bank of Liberia has had no movements since 1990 and no bank statements nor any other supporting documentation were available as at 13 October 1998. As it is unlikely that this amount can be recovered⁽¹²⁾ the EDF authorising and accounting officers should write it off.

⁽⁸⁾ Booked on account 6 1 6 0504.

⁽⁹⁾ Angola, Comoros, Djibouti, St Christopher and Nevis and Uganda.

⁽¹⁰⁾ Uganda.

⁽¹¹⁾ Amounting to 4 139,35 ECU.

⁽¹²⁾ Balance of 1 316,32 ECU.

AUDIT EXECUTED ON RISK CAPITAL OPERATIONS FINANCED FROM EDF RESOURCES

Introduction

21. During 1997, the Court has executed an audit on risk capital operations (RCOs), the results of which will be published in Special Report No 2498. This chapter gives a summary of the findings of the audit.

22. Risk capital constitutes a method of financing that also exists under both the Lomé Conventions. It allows reimbursable financial assistance to be given under favourable conditions to priority sectors in ACP States and overseas countries and territories in particular where the beneficiaries' capacity to borrow does not allow financing from the own resources of the EIB.

23. It is used for financing investments in both the public and private sectors given directly or indirectly in the form of:

- (a) individual loans, loans via an ACP State or global loans via a financial intermediary;
- (b) loans with participating rights;
- (c) equity participations.

24. The funds form part of the EDF but are administered by the EIB on behalf of the Community and in accordance with the Bank's statute and the financial regulations related to the EDF⁽¹³⁾. The amounts earmarked for risk capital operations (RCOs) under the Lomé III and Lomé IV Conventions are respectively 615 and 850 Mio ECU.

25. The terms of risk capital operations depend on the characteristics of the individual projects or programme financed but shall be more favourable than those of subsidised loans⁽¹⁴⁾ and in the case of loans the interest

⁽¹³⁾ See Articles 10(2) and 15(1) of the internal agreement on the financing and administration of Community aid under the Lomé IV Convention.

⁽¹⁴⁾ Loans from the Bank's own resources benefiting from an EDF interest subsidy.

rate shall be less than 3 % under Lomé IV⁽¹⁵⁾. In case of on-lending the interest margin is to be used for development purposes after administrative costs, and exchange rate and financial risks have been taken into account.

26. Amounts decided upon, committed (net) and disbursed as at 31.12.1997⁽¹⁶⁾ are as follows:

(in Mio ECU)

	Amount decided	%	Amount of net commitment	%	Amount disbursed	%
Lomé III	645 ⁽¹⁾	107	501	83	495	82
Lomé IV	787	95	756	92	411	50
Total	1 432	100	1 257	88	906	64

⁽¹⁾ Including amounts decided upon but for which initial commitment has been annulled.

Conduct of the audit

27. The audit has been conducted on the basis of the tripartite agreement concluded between the EIB, the Commission and the European Court of Auditors and has taken into account the recommendation of the European Parliament inviting these three institutions to make regular and frequent on the spot audits of actions realised by the EIB under mandate.

28. The Court examined 42 RCOs of which 33 projects were visited on the spot comprising an examination of the operations of financial intermediaries (FIs) and of the final beneficiaries of the risk capital financing.

29. Although the Commission's filing system has improved in the course of the Court's audit, the information kept by the Commission was still not complete and documentation had to be made available to the Court directly by the Bank. However, important information was provided at such a late stage that it hampered an efficient conduct of the Court's audit.

⁽¹⁵⁾ Under Lomé III the interest rate shall not be higher than 8 %.

⁽¹⁶⁾ ACP States only.

Conclusion

30. The manner in which risk capital operations have been prepared, implemented and monitored by the Bank does not give rise to observations. Nevertheless, the transparency and effectiveness of the operations can still be improved.

31. The criteria, which should guide the allocation of risk capital resources, are very general. The Bank is thus more or less free to choose between risk capital or its own resources in making loans. The justification of the decision to use risk capital funds does not clearly emerge from the project appraisal documentation.

32. The use of different types of financing (direct loans, loans via an ACP State, global loans) has led to unequal treatment of final beneficiaries: while some beneficiaries benefit from the 3 % maximum interest rate stipulated in the Lomé IV Convention, others have to pay market rates. Though not the only determining factor, the effects of exchange rate fluctuations play an important role in setting interest rates above the 3 % level. These effects and thus the justification for higher interest rates can be calculated only after loans have been fully repaid. In addition, in the case of loans with participating rights, the total remuneration to the EIB — being at least partly dependant on the result of the beneficiary enterprises — could well exceed the 3 % limit.

33. Provisions concerning the use of the interest margin by the financial intermediary are often not clear. The Bank should ensure that finance contracts stipulate precisely how the amount of the interest margin is to be used and that any such use is in compliance with the provisions of the Lomé IV Convention.

34. Support to the private sector through global loans has been given mainly to existing — instead of to emerging — SMEs, which moreover often benefitted from financing from the FIs' other resources.

35. An *ex post* evaluation system is needed to provide information about the viability of operations having benefitted from risk capital finance and their real

contribution to the economic and social development of the ACP States. Such an evaluation system should be developed in cooperation between the Bank and the Commission.

36. In addition, the Commission should play a more active role at the appraisal stage and regarding the evaluation of the overall effects of RCO on the development of the ACP State. Guidelines should be developed setting out the responsibilities of and the procedures to be followed by the services concerned.

37. The preceding recommendations are made in the context of improving the existing systems of manage-

ment of RCOs. However, alternative systems should be considered. As a matter of fact, the Commission's role in the management of the RCOs seems to be limited in practice to an exchange of information with the Bank. The Commission is not involved in a variety of tasks (appraisal, accounting, monitoring and evaluation) which should fall within its responsibilities for the financing of risk capital operations. The Court therefore suggests that consideration should be given to the possibility of entrusting the full responsibility for RCOs to the Bank with no involvement of the European Development Funds. In this context it is noted that repayments of and interest on risk capital funds are not credited to the EDFs at present.