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REPORT FROM THE COMMISSION

Irregularities in the Management of Community Structural Funds in the New  
German Länder



## Irregularities in the Management of Community Structural Funds in the New German Länder

### Introduction

In its annual report concerning financial year 1993<sup>1</sup> the Court of Auditors included in chapter 7 ("Regional Sector") a passage (paragraphs 7.87 to 7.107 and 7.113) concerning European Regional Development Fund intervention in the new German Länder. The Court's findings are based, inter alia, on on-the-spot audits in three of the new Länder and East Berlin. The Commission's replies to the Court's observations are included in the same edition of the Official Journal.

The European Parliament adopted on 5 April 1995 its decision giving a discharge to the Commission in respect of the implementation of the 1993 budget<sup>2</sup>. The passage concerning the Structural Funds in the accompanying resolution includes the following:

"The European Parliament.....

Calls on the Commission to present, by 30 September 1995, a report on the irregularities in the eastern German Länder containing the following information:

- the percentage of irregularities in relation to the number of cases investigated (number and sums involved);
- the sums subject to the Article 24 procedure;
- the sums to be recovered and those already recovered;
- irregularities detected by the Commission and the Court of Auditors, on the one hand, and those notified by the national authorities in application of the Regulation on irregularities (1681/94);"

### Background

Following the unification of Germany on 3 October 1990 the Council adopted on 4 December 1990 a specific Regulation concerning the activities of the Structural Funds in the territory of the former German Democratic Republic<sup>3</sup>. The Regulation recognised that the special situation in that territory necessitated transitional measures providing for

<sup>1</sup> OJ n° C327 of 24.11.94

<sup>2</sup> OJ n° L141 of 24.6.95, page 58

<sup>3</sup> Regulation (EEC) n° 3575/90 (OJ n° L353 of 17.12.90, page 19)



derogations from the normally applicable rules concerning the Structural Funds, and acknowledged that Community action must be flexible during a transitional period.

The Regulation and the Community Support Framework adopted under it provided for the Community to commit expenditure of ECU 3000 million at 1991 prices in the new Länder and East Berlin over the period 1991 to 1993, distributed among the Funds concerned as follows:

European Regional Development Fund (ERDF)	1500	MECU
European Social Fund (ESF)	900	MECU
European Agricultural Guidance and Guarantee Fund (EAGGF) Guidance Section	600	MECU

The present report addresses the question of irregularities arising in the context of the operations co-financed by the Community under Regulation n° 3575/90. (Since 1 January 1994 the normal Structural Funds regulations have applied to operations in the new Länder and East Berlin, which now fall under Objective 1 of the Funds.)

It is appropriate to recall the unprecedented political, economic and administrative situation prevailing in the new Länder at the time of unification. Rapid action was essential to improve the economic situation, inter alia by major resource transfers from the rest of the Federal Republic and from the Community. Knowledge of economic conditions in the former German Democratic Republic was incomplete, as a result of which measures of assistance decided upon at the outset were not always appropriate. The former administrative structure had disappeared and new structures had to be put in place from scratch. Despite a major transfer of officials from western Germany to the new Länder, there was an inevitable shortage of knowledge and experience of the new applicable rules - including the provisions of the relevant Community law - and of the workings of the market economy.

The implementation of Regulation n° 3575/90, including the matter of irregularities, should be seen against this background.

#### Irregularities - a definition

For the purposes of the present report the Commission interprets the word "irregularity" as meaning a failure to respect a relevant Community rule<sup>4</sup>. In this context three points should be made. First, an irregularity does not necessarily have financial

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<sup>4</sup> This definition is without prejudice to the definition that will be adopted within the framework of Council Regulation (EC, Euratom) n° ... (1995) on protection of the Community's financial interests (cf. Art. 1)

implications. Second, many of the instances in question were more properly administrative or accounting problems, or problems of interpretation, associated with the difficult start-up period in the new Länder. Third, the definition does not extend the concept of 'irregularity' to cases where it might be alleged that an operation, carried out correctly from the viewpoint of financial management, did not constitute good "value for money". Preventing such cases depends on effective assessment, monitoring and evaluation rather than on financial management and control as such.

#### Irregularities and administrative problems discovered

This part of the report gives more detail about irregularities or administrative problems found in the new Länder. Most of the cases known to the Commission were discovered during on-the-spot checks carried out by the Commission's services under Article 23 of Regulation (EEC) No. 4253/88 as amended<sup>5</sup>. Information in tabular form about these checks and the irregularities discovered may be found at Annexes 1 and 2. In the course of these checks in the new Länder, the services more particularly responsible for the financial management of a given Structural Fund concentrate their attention on programmes and projects co-financed by that Fund ; while the on-the-spot checks by Financial Control (DG XX) tend to examine more general issues related to the nature and adequacy of the overall systems of audit and control in place in the Member States. Some joint checks take place in which both Financial Control and one of the managing services participate. The programme of visits is coordinated among the services concerned. UCLAF undertakes inquiries in certain cases of suspected irregularities and fraud.

##### a) in the area of the ESF (controls by DG V)

In the course of the on-the-spot checks in the new Länder carried out by DG V, no cases of serious irregularity were found except for the Flathus programme in Thüringen. This case involves a training programme for teachers where it appears that only part of the student fees were paid to the schools concerned. UCLAF is pursuing this apparent fraud and coordinating the administrative and judicial inquiries in collaboration with DG V.

##### b) in the area of EAGGF Guidance (controls by DG VI)

Of the on-the-spot checks in the new Länder carried out by DG VI on financial operations co-financed by EAGGF Guidance, two were joint visits involving also Financial Control. The main purpose of all the checks was to examine the management systems established in the new Länder. Some teething problems were found involving the

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<sup>5</sup> OJ n°L193 of 31.7.93, page 20

interpretation and correct application of Community rules by the regional and local authorities, which have now been resolved. Real irregularities or fraud by the beneficiaries or the responsible administrations leading to the suppression of projects or the recovery of sums paid were not found.

Weaknesses or irregularities discovered included, for example, lack of compliance with the rules on publicity and information ; failure to use standard forms for grant approvals, control reports, etc.; changes in the indicative financial plan not properly recorded in the minutes of the monitoring committee meeting ; and deductions from the grant amounts paid out to the final beneficiaries. In relation to this last point the Fund Regulation amendments of July 1993 have now provided for the full amount of the grant to go through to the final beneficiary<sup>6</sup>.

c) in the area of fisheries

In respect of projects for the processing of fishery products under Regulation (EEC) No. 4042/89<sup>7</sup> DG XIV carried out an on-the-spot check in Mecklenburg-Vorpommern in October 1994. No irregularity was found, but weaknesses in the control, management and administration systems were noted.

d) in the area of the ERDF (controls by DG XVI)

During on-the-spot checks in the new Länder by DG XVI, which acted as "lead department" for the operations under Reg. n° 3575/90, the following problems have been encountered :

i) numerous cases of failure to respect Community rules on public tendering, involving, in particular, failure to publish the market in the Official Journal of the European Communities. The Commission suspended the payments concerned under Article 24 of Regulation 4253/88. For 27 projects, involving Regional Fund assistance of 130 mécus, it was possible to substitute other projects. As regards the infringements of the public tendering rules, the Commission, given the entirely exceptional circumstances obtaining in the new Länder and the fact that the German authorities had expressly recognised the infringements, decided in December 1994 not to pursue infringements committed up to 31 October 1993. It also decided that any infringement committed after that date would be pursued in the normal way and that the repayment of Structural Funds credits might be required.

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<sup>6</sup> Article 21(3) of Regulation (EEC) n°4253/88 as amended.

<sup>7</sup> OJ n° L388 of 30.12.89

ii) German regulations on public finance allow a final beneficiary to include in his claims for grant not only expenses for which he can present paid invoices, but also the amount which he expects to pay on invoices during the next two months. The Commission noted that this practice tended to lead to excessive claims from final beneficiaries ; it has therefore obtained that the German authorities should only present expenses claims reflecting invoices paid by the final beneficiaries.

iii) weaknesses in the final beneficiaries' accounting systems, including cases of lack of correspondence between information in the central accounting system and expenditure found on the spot to have been made, and a case where a recipient was unable to present proper specific accounting for an ERDF-assisted project.

iv) documentation weaknesses. These include instances where the claim for assistance was incorrect or incomplete, including cases where the originals of parts of the documentation were not available on the spot, as well as other irregularities in respect of documentation.

v) in several cases expenditure ineligible for ERDF grant (e.g. recoverable VAT, second-hand investment goods) was found to have been included in expenses claims forwarded by the designated authorities to the Commission.

vi) in numerous instances the project realised did not correspond fully with the project for which Regional Fund assistance was originally requested. The modifications might reflect changes in the market situation for the product to be produced by the investment ; considerable delays in the realisation of an investment, involving physical changes to it ; or in one case grant paid on an investment project which was not eligible for Regional Fund assistance.

#### e) By Financial Control

Financial Control (DG XX) has carried out systems audits and other control operations in the new Länder, both independently and in cooperation with one of the managing services.

As regards EAGGF Guidance, Financial Control has taken part in three missions on the initiative of DG VI and three missions on its own initiative (two of them with DG VI and one with DG XIV).

In respect of the ESF Financial Control has made a control visit to each of the new Länder and to East Berlin, in most cases (four out of six) for systems audit purposes.

These showed that the designated authorities in the Länder generally had insufficient staff fully to ensure proper management and control of the ESF operations and had to depend on third parties financed under technical assistance. This situation cannot continue permanently and must be addressed properly. A problem was found of a certain confusion between forecast and real expense, the former sometimes being declared to the Commission instead of the latter, contrary to the rules. Thirdly, incorrect or incomplete requests for assistance were discovered in the course of the checks in East Berlin and Thüringen ; the necessary financial corrections were made.

Finally, Financial Control has made on-the-spot checks in respect of ERDF co-financed operations in Sachsen and Thüringen. The former is very recent and conclusions have not yet been drawn from it. In the case of Thüringen the following irregularities were discovered : inconsistency between declared expenses and the information in the accounting system ; missing supporting documents ; the declaration of ineligible expenses; and an instance (one of those referred to above in the context of DG XVI's checks) of failure to respect Community rules on public tendering.

In all, Commission services have so far carried out 36 on-the-spot checks in the new Länder.

The Court of Auditors, for its part, carried out checks in East Berlin and in Mecklenburg-Vorpommern, Sachsen-Anhalt and Thüringen. The Court's observations and the Commission's replies have already been published, as noted above. Based on the findings of the Court of Auditors, UCLAF is continuing its inquiries.

Commission Regulation (EC) No. 1681/94 of 11 July 1994<sup>8</sup> requires the Member States to report to the Commission, on a quarterly basis, any suspected irregularities which have been the subject of initial administrative or judicial investigations. No irregularities have been reported by the German authorities in respect of the new Länder and East Berlin.

The Commission is pursuing the problem of proper application of this Regulation.

#### Dealing with irregularities

It is necessary to be clear about the respective responsibilities of the Member States and the Commission in dealing with irregularities and administrative problems affecting the operations co-financed by the Structural Funds.

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<sup>8</sup> OJ No. L178 of 12.7.94, page 43



Primary responsibility for preventing irregularities and for taking action against those which nevertheless occur lies with the Member States under Article 23(1) of Regulation (EEC) n° 4253/88:

"In order to guarantee completion of operations carried out by public or private promoters, Member States shall take the necessary measures in implementing the operations:

- to verify on a regular basis that operations financed by the Community have been properly carried out,
- to prevent and to take action against irregularities,
- to recover any amounts lost as a result of an irregularity or negligence..."

Member States are also required to inform the Commission of the progress of administrative and judicial proceedings, in application of Reg. n° 1681/94.

Moreover, in conformity with the principle of assimilation provided for in Article 209A of the Treaty, the Member States are required to apply appropriate sanctions in the case of fraud affecting the financial interests of the Community to the same degree that they take such action in protecting their own financial interests.

The Commission is always at pains, in its relations with the Member States, to emphasise these fundamental Member State responsibilities ; most financial operations under the Structural Funds take place in the Member States and are conducted by or under the supervision and control of officials at various levels within the Member States.

For its part, the Commission, in particular by carrying-out on-the-spot checks, seeks to ensure that appropriate management and control systems have been established in the Member States and that these function correctly in practice. In respect of irregularities discovered, the Commission either requires the Member State to take the necessary corrective action (e.g. by presenting a revised declaration of expenses in cases of declaration of ineligible expenses) or takes the necessary action itself, which may include the reduction, suspension or cancellation of financial assistance through the procedure laid down in Article 24 of Regulation n° 4253/88. This point is dealt with in more detail later in this report.

At the end of an on-the-spot check the Commission normally holds a meeting with the responsible authorities in the Member States with a view to reviewing the findings. Detailed conclusions are subsequently sent to the Member States and frequently require

improvements and corrections to be carried out. The Commission also sends the Court of Auditors a detailed report on each on-the-spot check.

In addition to exercising this control function the Commission has made a considerable effort to help improve the knowledge of officials dealing with the Structural Funds in the new Länder. For example, Financial Control has organised four seminars in Germany in which new Länder programme managers participated. DG XVI organised a similar seminar in Brussels in June 1995. DG VI has organised three seminars in the new Länder. The Commission's on-the-spot checks also have a useful pedagogic function, and its participation in all monitoring committee meetings also makes a contribution in this area.

As noted above the Parliament requested the Commission to supply inter alia the following information :

- a) the percentage of irregularities in relation to the number of cases investigated (number and sums involved) ;
- b) the sums subject to the Article 24 procedure ;
- c) the sums to be recovered and those already recovered.

As regards point a), the Commission services, in the course of an on-the-spot check of the implementation of say an Operational Programme, will first examine the overall system through which the funds flow to the final beneficiary, checking that its construction is satisfactory on a theoretical basis. It will then select a number of projects forming part of the programme, and examine in detail the financial transactions and the accounting paperwork leading up to one or more specific expenses declarations to the Commission in respect of the Programme. Irregularities or administrative problems may be detected, but they cannot meaningfully be expressed in percentage terms. Moreover, the Commission's checks do not constitute exhaustive financial audits but have more the character of a systems analysis together with a check, on a sampling basis, of the correct practical application of the systems. It should also be noted that the Commission, in drawing up its programme of on-the-spot checks, uses risk assessment in order to direct its checking activity to areas where experience leads it to believe that irregularities may be more likely to be present. For this reason the incidence of irregularities discovered may well be greater than the average situation across the board. It is clear also that while the Commission's on-the-spot checks always include the Land authorities concerned, it is materially possible for the Commission to visit only a small proportion of all the numerous local authorities and beneficiary companies etc. to which payments are finally made. There is thus no suggestion that the irregularities in the table at Annex 2 constitute a complete

statement of all the individual irregularities which are likely to have occurred. Conversely, more than one irregularity may have been discovered at a given authority or beneficiary.

As regards b) and c) above : Article 24 of Regulation (EEC) No. 4253/88 provides that the Commission may, after a suitable examination in the context of the partnership, reduce or suspend assistance in respect of an operation co-financed by the Structural Funds if the examination reveals an irregularity or a significant change affecting the nature or conditions for the implementation of the operation for which the Commission's approval has not been sought.

The key point here is that under the operational framework of the Structural Funds - where the Commission is co-financing multi-annual programmes, not projects - sums related to projects affected by an irregularity can generally be re-used in the same Operational Programme so long as the programme is still running and subject to compliance with the provisions of Reg. No. 1681/94. In the new Länder the main example here is that of the projects where the public tendering rules had not been respected (see point d) i) on page 4 above). In general no formal operations of decommitment or recovery by the Commission are necessary during the life of the programmes ; any necessary accounting adjustments are made on the occasion of subsequent commitments or payments on the same programme. However, when the time comes to close the programmes it may well become clear that commitments or payments have not been fully used or relate to projects affected by an irregularity ; the appropriate decommitments or recoveries will then be made. The Commission emphasises, more generally, that all financial adjustments made necessary by irregularities are duly effected.

### Conclusion

This brief report has sought to give an account of the kinds of irregularity and administrative problem arising in the new Länder of Germany during the implementation - during a unique period - of Regulation no.3575/90. The differing responsibilities of Member State and Commission for dealing with irregularities has been explained, and the rôle of the Commission has been made clear. The Commission will continue, in respect of Structural Fund operations in the new Länder as in the rest of the Community, to play with full seriousness its own rôle in reducing irregularities to a minimum and in dealing appropriately - or requiring the national authorities to deal appropriately - with those which occur. This includes making, or requiring, the necessary financial adjustments. The Commission would emphasise again, however, the need for the Member State itself to spare no effort in preventing irregularities and dealing with them if they occur.

<b>COMMISSION ON-THE-SPOT CHECKS IN THE NEW LÄNDER</b>
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**ERDF**

1.	5 - 10 October 1992	Sachsen
2.	1 - 5 February 1993	Thüringen
3.	22 - 26 March 1993	Mecklenburg-Vorpommern
4.	21 - 25 June 1993	Sachsen-Anhalt, Brandenburg, Berlin
5.	28 Feb. - 4 March 1994	Mecklenburg-Vorpommern
6.	18 - 22 April 1994	Sachsen-Anhalt
7.	6 - 9 June 1994	Thüringen
8.	4 - 8 July 1994	Sachsen
9.	26 - 30 September 1994	Berlin, Thüringen
10.	30 Jan. - 3 Feb. 1995	Berlin
11.	15 - 18 May 1995	Sachsen

**EAGGF-Guidance Section**

1.	6 - 8 April 1992	Brandenburg
2.	8 - 10 April 1992	Mecklenburg-Vorpommern
3.	1 - 5 June 1992	Sachsen-Anhalt
4.	7 - 11 September 1992	Thüringen
5.	14 - 21 April 1993	Thüringen
6.	21 - 23 April 1993	Sachsen
7.	10 - 14 May 1993	Mecklenburg-Vorpommern
8.	7 - 11 February 1994	Berlin, Sachsen-Anhalt
9.	30 Jan. - 3 Feb. 1995	Brandenburg
10.	13 - 17 March 1995	Sachsen-Anhalt
11.	29 - 31 May 1995	Mecklenburg-Vorpommern
12.	31 May - 2 June 1995	Sachsen-Anhalt

**ESE**

1.	14 - 18 September 1992	Berlin
2.	24 - 29 January 1993	Brandenburg, Mecklenburg-Vorpommern
3.	8 - 12 March 1993	Thüringen
4.	5 - 7 July 1993	Berlin
5.	13 - 17 September 1993	Berlin
6.	27 Sept. - 10 Oct. 1993	Sachsen-Anhalt
7.	2 - 6 November 1993	Thüringen
8.	21 - 23 September 1994	Berlin
9.	7 - 11 November 1994	Sachsen
10.	21 - 24 November 1994	Sachsen
11.	7 - 12 March 1995	Sachsen
12.	2 - 5 May 1995	Mecklenburg-Vorpommern

**Fisheries**

1.	10 - 13 October 1994	Mecklenburg-Vorpommern
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**TYPES OF IRREGULARITY DETECTED**

Type of irregularity*	Berlin			Brandenburg			Mecklenburg-Vorpommern			Sachsen			Sachsen-Anhalt			Thüringen		
	ERDF	EAGGF	ESF	ERDF	EAGGF	ESF	ERDF	EAGGF	ESF	ERDF	EAGGF	ESF	ERDF	EAGGF	ESF	ERDF	EAGGF	ESF
A			1		2		2	1		2			2	3				2
B	1			3			3			2			3			3		
C				1														
D		1			1			1		3				2		4		
E					1													
F	1			1			2			4			2		2			
G										1								
H	1									4						1		
I														1				
J																	1	
K																		1
L		1			1						1			1				

\* See attached key

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**KEY**

**Types of irregularity**

- A. Application for aid incorrect or incomplete.
- B. Supporting documents missing or incorrect.
- C. Other irregularities in documents.
- D. Ineligible expenditure.
- E. Infringement of rules for the award of public contracts (excluding ERDF<sup>1</sup>).
- F. Implementation of the measure not in accordance with the rules.
- G. Accounts not submitted.
- H. Other accounting irregularities.
- I. Missing or late declaration.
- J. Failure to meet deadlines.
- K. Non-legitimate expenditure.
- L. Other irregularities.

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<sup>1</sup> For the ERDF, see para. d) i) of the Report.



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