

COURT OF AUDITORS



In accordance with the provisions of the Treaties (Article 45c(4) of the ECSC Treaty, Article 248(4) of the EC Treaty and Article 160c(4) of the EAEC Treaty) and the Financial Regulation of 21 December 1997 (Article 88), as last amended by Council Regulation (EC) No 2779/98 of 17 December 1998, as well as the corresponding provisions relating to the European Development Funds, the Court of Auditors of the European Communities, at a meeting on 14 and 15 October 1999, adopted its

ANNUAL REPORT

concerning the financial year 1998

(1999/C 349/01)

The report, together with the institutions' replies to the Court's observations, was transmitted to the authorities responsible for giving discharge and to the other institutions.

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CORRIGENDA

Corrigendum to the Court of Auditors' annual report concerning the financial year

(Official Journal of the European Communities C 349 of 17 November 1998)

(1999/C 35/02)

On page X of Annex I, Diagram I, under 'Total estimated revenue':

for: '82 357,7',

read: '82 365,5';

for: '102,9',

read: '95,0'.

The overall total remains the same.

On page XIX of Annex I Diagram IX is replaced by:

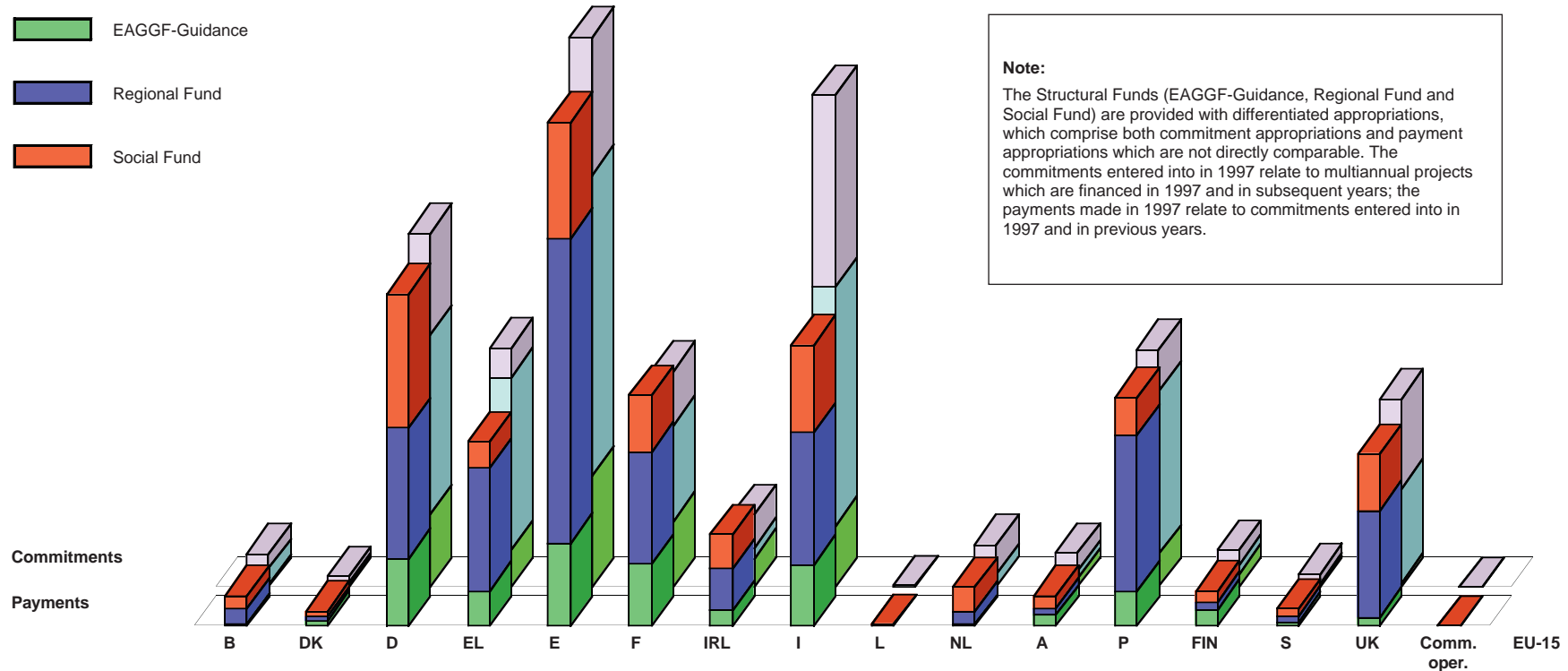
Diagram IX									
Financial perspective: breakdown of appropriations for commitments available from the 1997 budget and implementation;									
total appropriations for payments available from the 1997 budget and implementation									
<i>(million ECU)</i>									
Heading (by financial perspective headings) [the subsections (Ss), titles (T) and chapters (Ch) corresponding to the 1997 budget nomenclature are given in brackets]	Type of expenditure: - compulsory (CE) -non- compulsory (NCE)	Financial perspective 1997	Changes in		Difference: financial perspective - final appropriations	Utilisation of appropriations			Difference: financial perspective implemen- tation
			Final budget 1997 (after SAB)	Final distribution of appro- priations		Commit- ments contracted in 1997 against 1997 appro- priations	Non- automatic carry-overs to 1998	Total	
			(¹)	(²)		(³)	(⁴)	(⁵)	
(a)	(b)	(c)	(d)	(e)=(b-d)	(f)	(g)	(h)=(f+g)	(i)=(b-h)	
1. Common agricultural policy		41 805,0	40 805,0	40 761,0	1 044,0	40 423,0	—	40 423,0	1 382,0
Market expenditure (T B1-1 to B1-3 and B1-7)	CE		38 959,9	38 685,9		38 353,7	—	38 353,7	
Accompanying measures (T. B1-4 and 5)	CE		1 845,1	2 075,1		2 069,3	—	2 069,3	
2. Structural operations		31 477,0	31 577,0	31 477,0	- 0,0	30 077,6	—	30 077,6	1 399,4
EAGGF-Guidance (Ch. B2-10)	NCE		4 026,1	4 026,1		4 026,1	—	4 026,1	
Fisheries - FIFG (Ch. B2-11)	NCE		490,7	490,7		369,0	—	369,0	
ERDF (Ch. B2-12)	NCE		12 989,7	12 989,7		12 983,1	—	12 983,1	
ESF (Ch. B2-13)	NCE		7 639,1	7 639,1		7 639,1	—	7 639,1	
Community initiatives (Ch. B2-14)	NCE		3 273,4	3 173,4		1 949,1	—	1 949,1	
Trans.meas, innov.schem. and act.ag.fraud (Ch.B2-15,16,18 and 19)	NCE		301,1	301,1		259,7	—	259,7	
Other structural measures (T. B2-2)	NCE		—	—		—	—	—	
Cohesion Fund (T. B2-3)	NCE		2 749,0	2 749,0		2 748,9	—	2 748,9	
Financial mechanism (T. B2-4)	NCE		108,0	108,0		102,5	—	102,5	
3. Internal policies		5 603,0	5 696,7	5 670,7	(⁸) - 67,7	5 607,5	19,0	5 626,5	(⁹) - 23,5
Research (T. B6)	NCE		3 557,9	3 556,9		3 540,3	0,9	3 541,2	
Other agricultural operations (T. B2-5)	NCE		171,4	178,9		176,5	—	176,5	
Other regional policy operations (T. B2-6)	NCE		22,0	22,0		21,7	0,1	21,8	
Transport (T. B2-7)	NCE		21,6	21,6		21,6	—	21,6	
Fisheries and the sea (T. B2-9)	NCE		46,0	46,0		43,0	—	43,0	
Education, vocational training and youth policy (T. B3-1)	NCE		387,0	389,0		386,9	1,0	387,9	
Culture and audiovisual media (T. B3-2)	NCE		114,4	114,4		100,9	13,0	113,9	
Information and communication (T. B3-3)	NCE		110,8	120,8		120,2	0,4	120,6	
Other social operations (T. B3-4)	NCE		189,9	189,7		183,3	—	183,3	
Energy (T. B4-1)	NCE		38,6	37,6		37,3	—	37,3	
Euratom nuclear safeguards (T. B4-2)	NCE		15,8	15,8		15,8	—	15,8	
Environment (T. B4-3)	NCE		132,1	132,1		131,9	—	131,9	
Consumer protection (T. B5-1)	NCE		19,6	19,6		19,5	—	19,5	
Aid for reconstruction (T. B5-2)	NCE		3,9	4,0		4,0	—	4,0	
Internal market (T. B5-3)	NCE		225,6	201,1		195,0	1,0	196,0	
Industry (T. B5-4)	NCE		84,3	84,3		84,3	—	84,3	
Information market (T. B5-5)	NCE		—	—		—	—	—	
Statistical information (T. B5-6)	NCE		28,6	28,6		28,5	—	28,5	
Trans-European networks (T. B5-7)	NCE		481,9	481,9		475,7	2,6	478,3	
Cooperation in justice and home affairs (T. B5-8)	NCE		13,1	12,9		10,1	—	10,1	
Measures to combat fraud (T. B5-9)	NCE		32,5	13,7		11,1	—	11,1	
4. External operations		5 622,0	5 600,5	5 600,5	21,5	5 448,2	27,7	5 475,8	146,2
EDF (T. B7-1)	CE		—	—		—	—	—	
Food-aid and support operations (Ch. B7-20)	CE		151,0	175,7		175,4	—	175,4	
Humanitarian aid (Ch. B7-21)	NCE		379,0	354,3		348,2	—	348,2	
Cooperation with Asian developing countries (Ch. B7-30)	NCE		374,5	492,5		489,9	—	489,9	
Cooperation with Latin American developing countries (Ch. B7-31)	NCE		401,2	401,2		400,3	—	400,3	
Coop. with the dev. count. in sthn. Africa and S. Africa (Ch.B7-32)	NCE		255,7	255,7		254,5	—	254,5	
Cooperation with Mediterranean third countries (T. B7-4)	CE		145,0	145,0		142,4	—	142,4	
	CE		55,0	50,2		44,7	—	44,7	
	NCE		939,7	1 084,4		1 031,1	—	1 031,1	
Cooperation with CEEC (Ch. B7-50)	NCE		1 206,5	1 055,0		1 052,4	1,6	1 053,9	
Cooperation with NIS (former Soviet Union) (Ch. B7-52)	NCE		540,5	486,5		475,2	5,0	480,2	
Cooperation with former Yugoslavia (Ch. B7-54)	NCE		254,1	254,1		246,8	—	246,8	
Other cooperation measures (Ch. B7-51, 53 and T. B7-6)	NCE		407,7	398,7		370,5	13,1	383,6	
Human rights and democracy (T. B7-7)	NCE		78,6	90,1		89,6	—	89,6	
International fisheries agreements (Ch. B7-80)	CE		280,0	225,0		222,9	—	222,9	
Other external aspects and support expenditure (B7-81 to 87 and 95)	NCE		102,2	102,2		88,3	—	88,3	
Common foreign and security policy (T. B8-0)	NCE		30,0	30,0		16,1	8,0	24,1	
5. Administrative expenditure		4 352,0	4 285,1	4 285,1	66,9	4 206,2	4,5	4 210,7	141,3
Commission (Part A excluding pensions)	CE		8,6	7,9		7,5	—	7,5	
	NCE		2 369,7	2 366,8		2 327,5	—	2 327,5	
Pensions (Ch. A-19)	CE		421,1	424,7		424,7	—	424,7	
	NCE		0,2	0,2		0,2	—	0,2	
Other institutions	CE		5,0	4,9		4,8	—	4,8	
	NCE		1 480,5	1 480,6		1 441,5	4,5	1 446,0	
6. Reserve		1 158,0	1 032,0	1 202,0	(¹⁰) - 44,0	286,1	—	286,1	871,9
Monetary reserve (T. B1-6)	CE		500,0	544,0		—	—	—	
Guarantee reserve (T. B0-2)	CE		329,0	329,0		286,1	—	286,1	
Emergency aid reserve (Ch. B7-91)	NCE		329,0	329,0		—	—	—	
Negative reserve (Ch. B0-42 and 45)	NCE		- 126,0	—		—	—	—	
7. Compensation (T. B0-5)		212,0	212,0	212,0	—	212,0	—	212,0	—
Grand total appropriations for commitments	CE		42 766,7	42 734,4		41 801,0	—	41 801,0	
	NCE		46 441,7	46 474,0		44 459,5	51,2	44 510,6	
	(CE + NCE)	90 229,0	89 208,4	89 208,4	1 020,6	86 260,5	51,2	86 311,7	3 917,3
Grand total appropriations for payments	CE		42 910,2	42 972,8		41 885,6	(¹¹)	41 885,6	
	NCE		39 512,5	39 449,8		37 279,6	(¹²) 118,7	37 398,3	
	(CE + NCE)	85 807,0	82 422,7	82 422,7	3 384,3	79 165,2	(¹³) 118,7	79 283,8	6 523,2

(¹) Updated end-1997.(²) Difference due to EFTA commitments (68,3 + 1,9 Mio ECU), not covered by the "financial perspective" heading.(³) After distribution of provisional appropriations (Ch. B0-40).(⁴) Budgetary appropriations modified to take account of transfers from one budget heading to another.(⁵) Does not include operations financed from appropriations made available for re-use or carried over, or concerning services provided for third parties.(⁶) Covered by the transfer of 44 Mio ECU from Title B1-1 to the monetary reserve (T B1-6).(⁷) Payments made from 1997 budget appropriations.

On page XXIV of Annex I Diagram XIV is replaced by:

Diagram XIV
The Structural Funds: commitments entered into and payments made in 1997, in each Member State

(Mio ECU)



EAGGF-Guidance:	(¹)																	
(a) Commitments		26,4	17,0	719,8	369,0	1 109,1	649,9	284,3	608,7	1,1	13,7	83,6	322,9	129,9	14,8	44,8	0,1	4 395,1
(b) Payments		25,6	52,6	666,2	345,6	827,1	617,3	158,9	606,0	6,2	16,9	107,8	349,9	163,7	37,7	85,1	0,2	4 066,9
Regional Fund:																		
(a) Commitments		162,5	32,5	1 781,0	1 707,1	2 983,0	953,1	110,6	2 369,6	8,6	121,3	81,6	1 622,2	94,4	27,5	928,1	—	12 983,1
(b) Payments		150,8	40,6	1 302,0	1 218,7	3 017,5	1 111,5	407,7	1 313,7	4,5	131,5	68,6	1 547,5	76,6	67,8	1 062,2	0,2	11 521,4
Social Fund:																		
(a) Commitments		147,2	62,5	1 005,9	292,0	1 357,5	539,1	326,7	1 898,0	5,3	289,2	172,7	408,1	146,0	92,6	896,4	—	7 639,1
(b) Payments		128,2	54,5	1 319,7	261,4	1 151,6	559,3	338,7	869,0	4,8	240,7	122,2	365,2	104,0	68,5	555,6	—	6 143,4
TOTAL :	(²)																	
(a) Commitments		336,1	112,0	3 506,7	2 368,0	5 449,6	2 142,2	721,6	4 876,3	14,9	424,2	337,9	2 353,2	370,3	134,9	1 869,3	0,1	25 017,3
(b) Payments		304,6	147,7	3 288,0	1 825,7	4 996,2	2 288,1	905,2	2 788,7	15,5	389,1	298,7	2 262,6	344,3	174,0	1 702,9	0,4	21 731,7

(¹) Including the agricultural and fisheries sections of the EAGGF-Guidance Section (B2-10 and B2-11).

(²) Chapters B2-10 to B2-13 of the budget.

THE INSTITUTIONS' REPLIES

REPORT ON THE ACTIVITIES FINANCED FROM THE GENERAL BUDGET

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GENERAL INTRODUCTION

0.1. This annual report follows the format established last year with chapters dealing with revenue and each of the expenditure areas that fall under the headings of the financial perspectives. More emphasis is placed this year on following up the action that has been taken in response to the Court's previous reports, and the Court will continue to give particular attention to this aspect in its future annual reports. The chapters dealing with specific areas of revenue and expenditure include a specific appraisal in the context of the statement of assurance and are followed by a chapter containing and explaining that statement. Finally, the Court's observations concerning the activities of the sixth, seventh and eighth European development funds are presented separately.

0.2. The Court has continued its policy of placing more emphasis on publishing, in special reports, the results of audits which deal with specific subjects, especially from the point of view of sound financial management. Its purpose in doing so is to focus attention on specific areas in which the Community's financial management can be improved. The following reports have been published since the last discharge procedure:

- Special Report No 1/99 on the aid for the use of skimmed milk and skimmed milk powder as animal feed ⁽¹⁾;
- Special Report No 2/99 on the effects of the CAP reform in the cereals sector ⁽²⁾;
- Special Report No 3/99 on the management and control of interest rate subsidies by the Commission ⁽³⁾;
- Special Report No 4/99 on financial aid to overseas countries and territories under the sixth and seventh EDF ⁽⁴⁾.

A full list of the reports and opinions adopted by the Court in the last five years appears in Annex III of this report.

⁽¹⁾ OJ C 147, 27.5.1999.

⁽²⁾ OJ C 192, 8.7.1999.

⁽³⁾ OJ C 217, 29.7.1999.

⁽⁴⁾ OJ C 276, 29.9.1999.

0.3. Many of the audit findings that appear in this report confirm that, despite the reforms that have been made, the Commission all too often continues to use as the prime indicator of financial management performance the extent to which the appropriations allocated in the annual budget have been utilised. This cannot be the best indicator of performance. The Community institutions, and in particular the Commission, add value by implementing the Union's policies in favour of its citizens and the success of the Commission should be measured by the extent to which those policy goals are attained with the minimum of cost. Thus managers need to set their performance targets in terms of outputs, outcomes and the costs involved in achieving these. As a precondition, the objectives set for all Community activities must be as clear, as precise and as measurable as possible and appropriate tools must be put in place to measure their achievement. This change of culture and practice must be placed at the heart of the financial management reform process.

0.4. Where the Commission relies upon the Member States to manage its programmes on a day-to-day basis, the Commission has a responsibility arising from Article 274 of the Treaty to assure itself that this management is adequate. In such areas, the Court's annual and special reports regularly draw attention to serious and, on occasions, persistent weaknesses in Member States' management and control systems. In meeting the obligations imposed upon it by Article 274, the Commission must intensify its efforts to ensure that weaknesses are adequately addressed by the Member States.

0.5. It is not only in the Community institutions that the financial management culture needs to change. Despite the fact that Article 274 of the Treaty requires Member States to cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management and that Article 280 requires the Member States to take the same measures to counter fraud against the Community budget as are taken to protect the national financial interests, many serious weaknesses in the Member States' management and control of Community funds are mentioned in this report. Furthermore, there is evidence that Member States are often slow to react when these weaknesses are drawn to their attention by the Court or by their own auditors (for example, see paragraph 2.84).

0.6. In order to intensify the fight against fraud, the European Anti-Fraud Office (OLAF) has been established. As it did with its predecessor, the Court will continue to work closely with OLAF in the fight against fraud and in the protection of the Community's

financial interests, whilst at the same time continuing to carry out its audit function with regard to OLAF (see the Court's Special Report No 8/98 ⁽⁵⁾ on the Commission's services specifically involved in the fight against fraud). In its Opinion No 2/99 ⁽⁶⁾ on the Commission proposal to establish OLAF, the Court drew attention to the fact that the proposal did not address a number of the weaknesses identified in its special report.

0.7. Ten years ago, in its annual report concerning the financial year 1988, the Court noted that the package of measures adopted by the meeting of the European Council of 11 and 12 February 1988 seemed to represent an important turning point, promising reforms in Community finances of which one of the most important was the introduction of a regime of budgetary discipline ⁽⁷⁾. The Court went on to state that the improvement of Community systems of internal control was an essential condition for the success of the reforms ⁽⁸⁾.

0.8. Now, as the Community settles its third multiannual expenditure plan, the Court again draws attention to the need, as an important part of the process of administrative reform, to make fundamental improvements in internal control. As the Court pointed out, in the relevant sections of its Opinion No 4/97 on the Commission's proposed revision of the Financial Regulation ⁽⁹⁾, this requires a change in the balance of responsibilities of authorising officers, financial controllers and accounting officers, so that authorising officers in the operational directorates-general will carry full responsibility for the execution of commitments and payments. In this context, the internal audit function also needs to be greatly strengthened, while the personal responsibilities of financial controllers and accounting officers should be clarified.

0.9. At the same time, the Commission should ensure that there can be no question of authorising officers

⁽⁵⁾ OJ C 230, 22.7.1998.

⁽⁶⁾ OJ C 154, 1.6.1999.

⁽⁷⁾ Annual report concerning the financial year 1988, paragraph 1.23.

⁽⁸⁾ Annual report concerning the financial year 1988, paragraph 1.24.

⁽⁹⁾ OJ C 57, 23.2.1998.

accepting additional responsibilities without it having made available sufficient resources for their proper discharge. A better mastery of its human resources would allow the Commission to better redeploy and allocate its staff, taking account of its organisation and of the numbers and skills of staff needed for specific activities. It is also important that key policy and financial management tasks are carried out by officials who are fully answerable to the institution for their work. Whilst this report draws attention to specific staffing problems within the Commission in the areas of own resources (see paragraphs 1.39 — 1.40), EAGGF (see paragraphs 2.75 — 2.76) and external aid (see paragraphs 5.77 — 5.79), these are indicative of a general problem that needs to be addressed by the reform process.

0.10. In its statement of assurance on the 1998 accounts, the Court again draws attention to the problems associated with the Community's financial statements. On the one hand there are weaknesses in the accounting systems which result in the information presented being in some respects incorrect or incomplete. On the other hand, problems remain in the operation of management and internal control systems at each level of administration from the Commission, through intermediaries such as Member State authorities, down to the final beneficiaries. These give rise to a significant number of substantive and formal errors, so that the Court again declines to give a positive statement on the legality and regularity of the transactions underlying the Commission's payments.

0.11. The Court calls upon the Commission to rapidly continue and deepen the financial management reform process. In particular, the Court invites the Commission, in preparing a revised proposal for the revision of the Financial Regulation, to take full account of the recommendations made in its Opinion No 4/97, so as both to address the problems in the presentation of satisfactory financial statements, and to contribute to the strengthening of the management and control systems applicable to the Community's revenue and expenditure (see paragraph 0.8 above). Given that it will be a long time until a further fundamental revision of the Financial Regulation will be possible, it is important that the one currently being undertaken draws upon the necessary expertise, even if this means that the process takes longer.

REPORT ON THE ACTIVITIES FINANCED
FROM THE GENERAL BUDGET

CHAPTER 1 (*)

Own resources

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(*) The Commission's replies are on page 19.

GENERAL INTRODUCTION

1.1. In respect of traditional own resources, in addition to following up its previous observations, the Court's audit concentrated on the management of guarantees and securities in relation to the payment of customs debts and their utilisation in the context of customs control and the customs clearance of goods ⁽¹⁾. With regard to the value added tax (VAT) and gross national product (GNP) resources, the Court followed up its previous observations by looking more specifically at the VAT own resource assessment bases in relation to national VAT revenue and the verification of the compliance of national legislation with Community law.

⁽¹⁾ Work on this audit is continuing.

BUDGETARY IMPLEMENTATION

1.2. **Table 1.1** summarises Community revenue for the financial year 1998 and **Chart 1.1** shows the following:

- (a) that revenue for the financial year 1998 increased by 4,9 % compared with the financial year 1997 (80 547,7 Mio ECU), amounting to 84 529,7 Mio ECU, or 101,05 % of the revenue provided for in the definitive budget;
- (b) net traditional own resources (minus 1 567,9 Mio ECU of collection expenses) amounted to 14 110,7 Mio ECU, which represents 16,9 % of actual total revenue; these resources fell by 0,4 % compared with the financial year 1997 and can be broken down as follows:

Table 1.1 — Revenue for the financial years 1997 and 1998 — Analysis of budgetary implementation 1998

(Mio ECU)

Type of revenue and corresponding budget heading	Actual revenue in 1997	Development of the 1998 budget		Actual revenue in 1998	Rate of implementation of the final budget (%)
		Initial budget	Final budget		
	(a)	(b)	(c)	(d)	(e) = (d)/(c) x 100
1. Traditional own resources	14 172,27	12 815,28	13 743,18	14 110,68	102,67
— Agricultural levies (Chapter 10)	1 025,19	693,20	693,20	1 102,21	159,00
— Sugar and isoglucose levies (Chapter 11)	1 114,04	1 163,40	1 163,40	1 070,08	91,98
— Customs duties (Chapter 12)	13 607,74	12 382,60	13 413,60	13 506,24	100,69
— Collection expenses (Chapter 19)	- 1 574,70	- 1 423,92	- 1 527,02	- 1 567,85	102,67
2. VAT and GNP own resources	62 355,59	69 945,82	68 157,95	67 113,29	98,47
— VAT resources (Chapter 13)	34 918,97	34 134,54	32 752,78	32 684,94	99,79
— GNP resources (Chapter 14)	27 436,62	35 811,28	35 405,17	34 428,35	97,24
(of which in reserve)	(286,89)	(1 176,00)	(1 176,00)	(271,71)	23,10
3. Budgetary imbalances	- 114,90	0,00	0,00	55,37	
— UK correction (Chapter 15)	- 121,36	0,00	0,00	60,92	
— Result of definitive calculation of UK correction (Chapter 35)	6,47	0,00	0,00	- 5,55	
4. Balances and adjustments to balances in respect of previous years	- 1 112,38	0,00	0,00	999,22	
— VAT resources (Chapter 31)	- 567,49	0,00	0,00	401,52	
— GNP resources (Chapter 32)	- 544,89	0,00	0,00	597,70	
5. Surpluses available from the previous year (Chapter 30)	4 384,05	144,00	1 003,96	959,96	95,62
6. Refunds to Member States (Chapter 33)	- 7,59	0,00	0,00	- 29,38	
7. Miscellaneous revenue (Titles 4 to 9, with the exception of Article 630)	813,49	624,07	747,13	1 259,04	168,52
General total	80 490,53	83 529,17	83 652,23	84 468,17	100,98
Contributions from EEA States (to be entered in Article 630)	57,17	0,00	0,00	61,52	
Total including contributions from EEA States	80 547,70	83 529,17	83 652,23	84 529,69	101,05

Sources: 1998 budget and 1997 and 1998 revenue and expenditure accounts.

(i) customs duties amounting to 13 506,2 Mio ECU (gross), making up 86,1 % of gross traditional own resources (15 678,5 Mio ECU) ⁽²⁾;

(ii) agricultural levies amounting to 1 102,2 Mio ECU (gross), making up 7 % of gross traditional own resources;

(iii) sugar and isoglucose levies amounting to 1 070,1 Mio ECU (gross), making up 6,8 % of traditional own resources;

⁽²⁾ Net traditional own resources (14 110,7 Mio ECU) + collection expenses (1 567,9 Mio ECU) = Gross traditional own resources (15 678,6 Mio ECU).

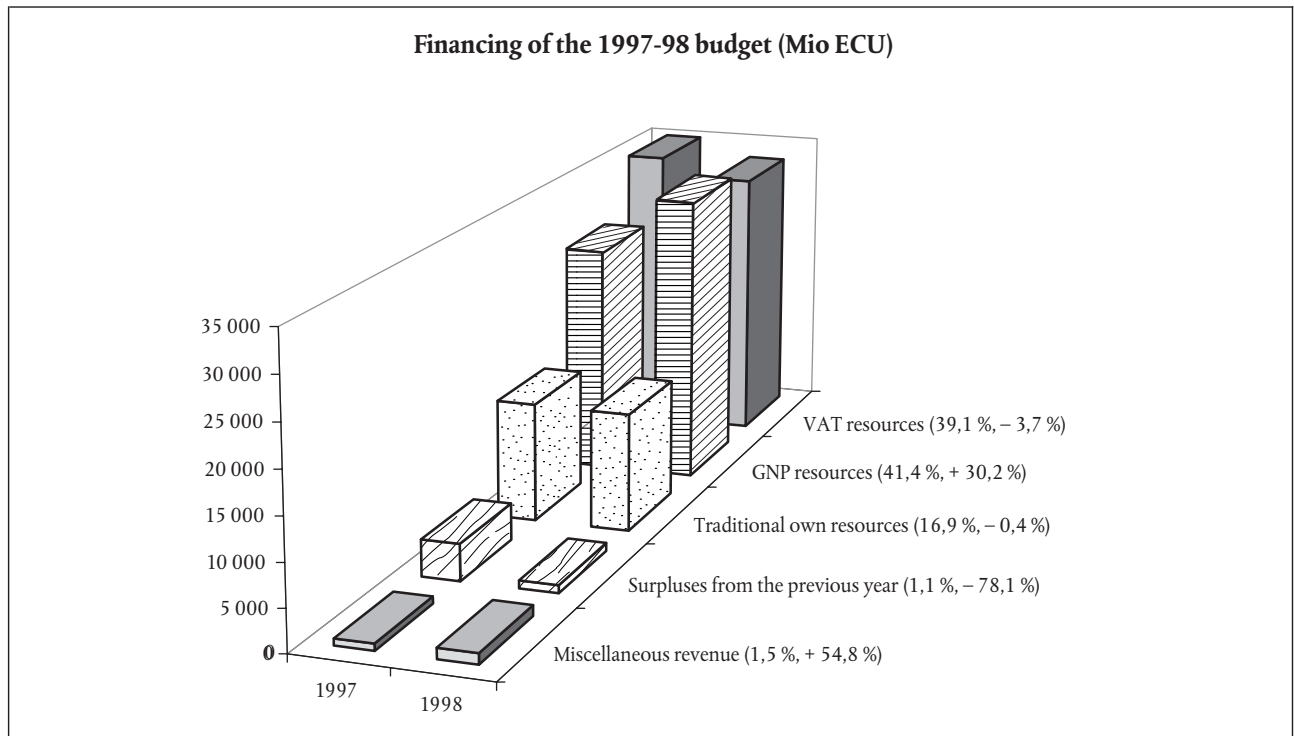
(c) taking into consideration balances and adjustments (401,5 Mio ECU), own resources from VAT amounted to 33 086,5 Mio ECU ⁽³⁾, or 39,1 % of total actual revenue; taking into account capping, actual revenue for this item fell by 3,7 % compared with the financial year 1997 (34 351,5 Mio ECU);

(d) taking into consideration balances and adjustments (597,7 Mio ECU), the GNP resource amounted to 35 026 Mio ECU ⁽⁴⁾ (of which 271,7 Mio ECU of

⁽³⁾ VAT own resource (33 086,5 Mio ECU) = VAT own resource for the financial year (32 685 Mio ECU) + balances and adjustments for previous years (401,5 Mio ECU).

⁽⁴⁾ GNP resource (35 026 Mio ECU) = GNP resource for the financial year (34 428,3 Mio ECU) + balances and adjustments for previous financial years (597,7 Mio ECU).

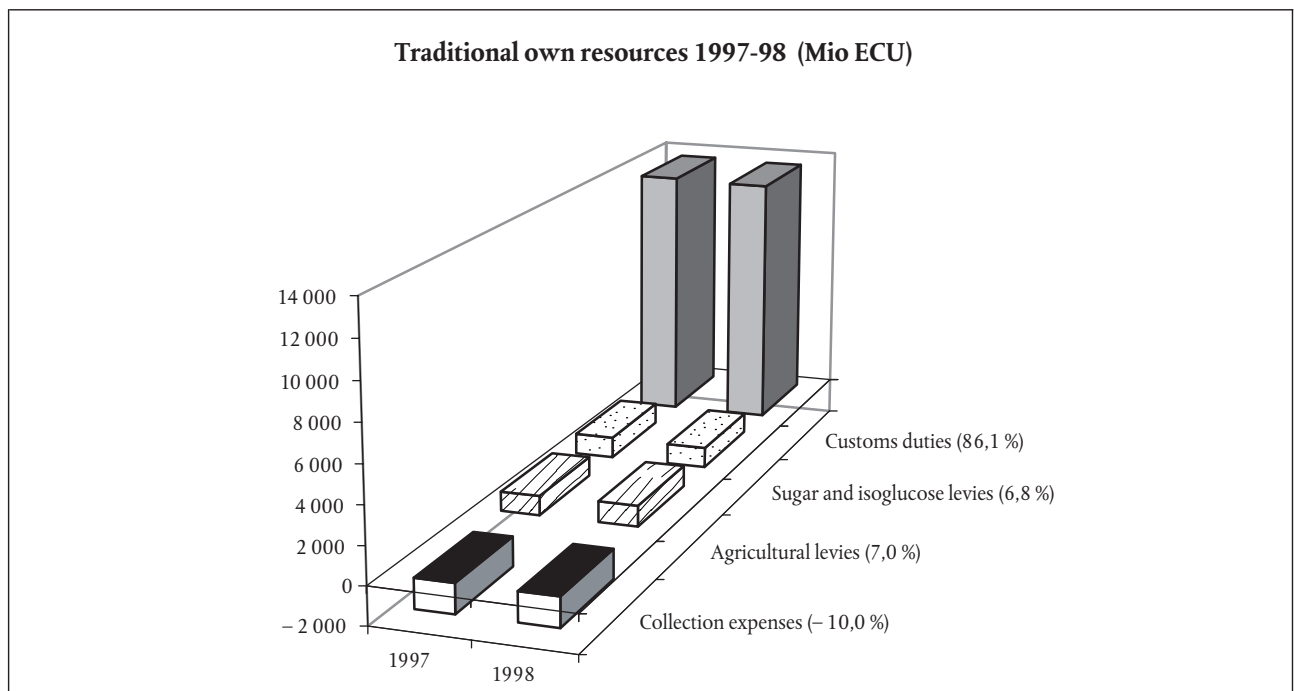
Graph 1.1 — Financing of the Community budget



NB: (x %, y %):

— x %: percentage of budget funds for the financial year 1998.

— y %: variations in 1998 as compared with 1997.



NB: (x %):

— x %: percentage of traditional own resources for the financial year 1998.

Sources: 1998 budget and 1997 and 1998 revenue and expenditure accounts.

reserves), or 41,4 % of total actual revenue; this resource increased by 30,2 % as compared with the previous financial year (26 891,7 Mio ECU); the function of this resource is to balance the Community budget and it is only called up to cover the balance between expenditure to be carried out and the other resources available;

- (e) the surplus available from the previous financial year (9 59,96 Mio ECU) and miscellaneous revenue (1 259,04 Mio ECU) represent 2,6 % of total actual revenue, or a 57,3 % fall compared with the financial year 1997.

SPECIFIC APPRAISAL IN CONNECTION WITH THE STATEMENT OF ASSURANCE

Traditional own resources

Applicable regulations

1.3. The specific regulations for traditional own resources include:

- (a) Council Decision 94/728/EC, Euratom of 31 October 1994 ⁽⁵⁾ on the system of the European Communities' own resources, and Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989 ⁽⁶⁾ implementing Council Decision 88/376/EEC, Euratom on the system of the Communities' own resources, as last amended by Council Regulation (Euratom, EC) No 1355/96 of 8 July 1996 ⁽⁷⁾;
- (b) Council Regulation (EEC) No 2913/92 of 12 October 1992 ⁽⁸⁾ establishing the Community Customs Code and Commission Regulation (EEC) No 2454/93 of 2 July 1993 ⁽⁹⁾ laying down provisions for the implementation of the Community Customs Code.

Scope of the audit

1.4. In the context of the statement of assurance, the audit of traditional own resources is based on the customs duties that are established and entered in the accounts (A accounts) of the Member States on the basis

of the declarations submitted by the customs authorities for the release of the goods for free circulation in the Community. By definition, the audit of the legality and regularity of the underlying transactions cannot take into consideration imports that have not been declared at customs or which have escaped customs surveillance. As part of its work programme for the protection of the financial interests of the Community, the Commission prepares each year a report in which it takes stock of the irregularities and frauds that have been observed by the Member States during their own investigations. In its latest report ⁽¹⁰⁾, the Commission mentioned the figure of 1 000 Mio ECU, corresponding to the cumulative amount of the customs duties at stake in cases of irregularity since the second half of 1993, the point at which the new anti-fraud strategy was introduced by the Commission.

1.5. The Court nevertheless takes into consideration the risk inherent in irregular imports. In the context of its other tasks, it has carried out specific audits centred on the evaluation of the procedures introduced by the Member States for collecting traditional own resources that are owed to the Community. The most recent audits were concerned with the application of risk analysis methods in customs checks ⁽¹¹⁾.

1.6. In addition to the amounts entered as revenue in the revenue and expenditure account (see **Table 1.2** and paragraph 1.3 above), the financial balance sheet shows amounts that have not yet been collected but have been entered in separate accounts (the B accounts). The Member States are responsible for keeping these separate accounts and are required to send quarterly reports on the subject to the Commission. Out of a total of 1 812,9 Mio ECU in claims on Member States as of 31 December 1998 (Volume IV, Chapter 3, Item VII. B.2 of the consolidated balance sheet, p. 50), 1 739,4 Mio ECU concerned customs duties, agricultural levies and sugar and isoglucose levies established by the Member States and entered in the separate accounts.

1.7. As of 31 December 1998, the balance of the B accounts (1 739,4 Mio ECU) showed a net gain of 377,4 Mio ECU (+ 27,7 %) compared with the previous

⁽⁵⁾ OJ L 293, 12.11.1994, p. 9.

⁽⁶⁾ OJ L 155, 7.6.1989, p. 1.

⁽⁷⁾ OJ L 175, 13.7.1996, p. 3.

⁽⁸⁾ OJ L 302, 19.10.1992, p. 1.

⁽⁹⁾ OJ L 253, 11.10.1993, p. 1.

⁽¹⁰⁾ Protection of the financial interests of the Community — the fight against fraud — Annual report on the financial year 1997, COM(1998) 276 final.

⁽¹¹⁾ Special Report No 13/98, OJ C 375, 3.12.1998.

Table 1.2 — Estimated and actual own resources in 1998, by Member State

(Mio ECU)

Type of resource		B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EU-15
Chapter 10 — Agricultural levies	estimated	50,0	7,2	98,1	7,6	55,0	50,3	4,5	46,9	0,3	114,4	10,0	40,0	9,0	19,9	180,0	693,2
	actual	39,4	8,7	163,0	8,8	34,1	62,5	0,7	72,9	0,7	175,5	14,4	43,5	8,9	25,8	443,3	1 102,2
Chapter 11 — Sugar and isoglucose levies	estimated	74,2	41,8	344,0	13,0	49,0	337,1	12,5	85,0	—	69,0	32,0	1,0	9,0	22,0	73,8	1 163,4
	actual	65,2	37,0	304,4	12,2	42,9	298,6	11,1	111,0	—	72,4	30,5	3,8	8,3	19,3	53,2	1 070,1
Chapter 12 — Customs duties	estimated	1 075,4	277,5	3 203,2	165,5	668,7	1 353,2	227,7	1 094,5	22,8	1 591,5	243,8	137,0	136,2	364,7	2 851,9	13 413,6
	actual	1 163,7	282,1	3 155,0	161,1	741,2	1 307,6	207,2	1 224,8	23,8	1 630,4	223,5	150,3	138,1	380,8	2 716,6	13 506,2
Chapter 19 — Costs incurred in collecting own resources	estimated	-120,0	-32,6	-364,5	-18,6	-77,3	-174,1	-24,5	-122,6	-2,3	-177,5	-28,6	-17,8	-15,4	-40,7	-310,5	-1 527,0
	actual	-126,8	-32,8	-362,2	-18,2	-81,8	-166,9	-21,9	-140,9	-2,5	-187,8	-26,8	-19,8	-15,5	-42,6	-321,3	-1 567,8
Chapter 13 — VAT resource	estimated	851,3	569,7	8 786,0	541,8	2 226,3	5 663,6	279,5	3 661,2	75,8	1 549,1	894,3	431,9	421,9	861,8	5 938,6	32 752,8
	actual	852,9	570,9	8 802,4	518,1	2 227,5	5 666,6	275,5	3 655,5	75,9	1 552,1	896,3	432,1	421,9	850,1	5 887,1	32 684,9
Chapter 31 — Surplus VAT resources from the previous financial year	estimated	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	actual	-10,7	-5,3	-876,7	37,9	163,6	-132,4	134,6	232,2	21,3	70,1	-32,7	8,9	15,0	99,1	676,5	401,5
Chapter 14 — GNP-based own resource	estimated	1 073,1	702,7	9 060,0	546,7	2 342,9	6 060,1	282,0	4 976,9	75,0	1 609,1	895,8	435,8	510,9	959,1	5 875,1	35 405,2
	actual	1 048,5	686,9	8 852,1	508,8	2 284,8	5 911,7	271,0	4 845,4	73,3	1 572,0	875,2	425,2	498,1	921,8	5 653,8	34 428,4
Chapter 15 — Correction of budgetary imbalances	estimated	134,7	88,2	660,8	68,6	294,1	760,8	35,4	624,8	9,4	202,0	112,5	54,7	64,1	120,4	-3 230,5	—
	actual	135,3	88,7	663,7	65,4	294,6	762,8	34,8	624,4	9,5	202,9	112,9	54,8	64,3	116,3	-3 169,5	60,9
Chapter 32 to 35 — Surplus GNP resources from the previous financial year	estimated	11,2	-2,5	16,0	-1,0	3,0	6,4	-1,6	-61,8	0,0	6,5	9,2	0,6	2,4	-1,8	13,4	—
	actual	-36,5	58,5	-68,8	16,1	45,5	-126,3	71,9	-43,8	14,7	16,9	-7,5	5,6	6,8	12,0	597,7	562,8
Total own resources	estimated	3 149,9	1 652,0	21 803,6	1 323,6	5 561,7	14 057,4	815,5	10 304,9	181,0	4 964,1	2 169,0	1 083,2	1 138,1	2 305,4	11 391,8	81 901,1
	actual	3 131,0	1 694,7	20 632,9	1 310,2	5 752,4	13 584,2	984,9	10 581,5	216,7	5 104,5	2 085,8	1 104,4	1 145,9	2 382,6	12 537,4	82 249,2

NB: It should be noted that the Member States, acting on behalf of the Communities, are responsible for the collection of the amounts due in respect of customs duties, agricultural levies and sugar and isoglucose levies.

financial year (1 362 Mio ECU). This net increase in the balance was due to the following:

- (a) an increase in new entries in the separate accounts amounting to 671,5 Mio ECU, or 49 % of the balance for the previous year (1 362 Mio ECU);
- (b) recoveries during the financial year to the extent of 199,2 Mio ECU;
- (c) cancellations or write-offs decided on during the course of the financial year to the extent of 94,9 Mio ECU.

1.8. As in the previous financial years, the Court also examined the procedures for the entry in the accounts and centralisation of traditional own resources.

Analysis of the findings

1.9. The Court's examination of the accounting and centralisation procedures for traditional own resources showed that certain established entitlements had not been made available to the Commission or had been made available with significant delays. Where the amounts were made available late, this should result in the payment of default interest by the Member States concerned.

1.10. As was the case in 1997 ⁽¹²⁾, the separate accounts kept by the Member States were characterised here and there by significant errors. The Court's audits showed that certain established entitlements that should have been entered in the A accounts and made available were actually kept wrongly in separate accounts. Certain customs debts had also been entered late in the separate accounts or had been entered twice or more. The Commission and the Member States must ensure that all established customs duties and agricultural levies that are not covered by guarantees or are contested are entered in the separate accounts for an appropriate value. Whereas the gross amounts shown in the financial balance sheet are likely to be understated, it is certain that the amounts actually recoverable are overstated. In actual fact, on the basis of the experience of recent years, the Court considers that only around 10 % of the customs debts booked in the separate accounts

are recoverable. The Commission, in application of the accounting principle of caution, should create a provision for part of the amount of the debts entered in the separate accounts so as to take into account the specific hazards related to their recovery.

Result of the audit

1.11. The checks carried out gave satisfactory overall results concerning the reliability of the accounts and the legality and regularity of the underlying transactions entered in the accounts (see paragraph 1.4). The errors found during the examination of the transactions underlying the revenue and expenditure account were generally minor and mainly concerned the legality and regularity of these transactions, but did not substantially affect the accuracy of the revenue and expenditure account.

1.12. The separate accounts kept by the Member States contained significant errors that affected the accuracy of the total amounts for claims given in the consolidated balance sheet.

VAT and GNP own resources

1.13. The VAT and GNP resources are affected by use of statistical data in the establishment of their assessment bases, which does not allow an audit, in the accounting sense, of the underlying data. In this connection, and on the basis of the VAT and GNP data used by the Commission, the Court's audit concentrated on the verification of the accuracy of the calculation of the contributions from each Member State during the various stages, from the initial budget to the final clearance, for the financial years concerned.

1.14. Taking into account this limitation, the Court obtained a reasonable assurance with regard to the reliability of the system for collecting the VAT and GNP resources set up by the Commission. Except for some problems with the monitoring of adjustments to the assessment bases, the effects of which have been rectified, the system enables the regular payment of own resources.

1.15. In spite of the initiatives taken by the Commission, it is still not able to know, with immediate effect,

⁽¹²⁾ Statement of assurance concerning activities under the general budget for the financial year 1997, paragraphs 8.13—8.14 (OJ C 349, 17.11.1998).

the position of its assets in the Member States. This may be at the origin of difficulties in cash management ⁽¹³⁾.

NATIONAL VAT REVENUE AND VAT OWN RESOURCE ASSESSMENT BASES

Introduction

1.16. The establishment of the assessment bases for the VAT resource depends on the amount of revenue collected by the Member States. A reduction in this revenue may result from a lack of effectiveness on the part of the national systems in their fight against tax avoidance. It may also be the result of differences in the application of Community law. As VAT is managed at a national level, it is up to the Member States to ensure that VAT is collected efficiently and in accordance with the regulations and within the required deadlines.

1.17. VAT is an important source of funding for both the national and Community budgets ⁽¹⁴⁾. Any differences in the application of the common VAT system may constitute one of the factors of distortion in the competition conditions faced by taxpayers in the various Member States.

1.18. The Court examined the Commission's monitoring of the development of VAT revenue in the Member States and the verification of compliance with Community law on the part of national VAT legislation. These are fields that have been the subject of observations on several occasions in the past ⁽¹⁵⁾.

⁽¹³⁾ Special Report No 6/98 on the assessment of the system of resources based on VAT and GNP, paragraph 3.58 (OJ C 241, 31.7.1998, p. 68).

⁽¹⁴⁾ The Berlin European Council (24–25 March 1999) decided on a reduction, as of 2002, of the VAT resource's share of the funding of the Community budget.

⁽¹⁵⁾ Development of VAT revenue: Annual report concerning the financial year 1995, paragraphs 1.92–1.103. Audit of compliance of national legislation: Annual reports concerning the financial years 1983 (paragraphs 3.14–3.20), 1984 (paragraphs 3.19–3.22), 1986 (paragraphs 4.9–4.10), 1988 (paragraphs 4.4–4.15) and 1995 (paragraph 1.68).

Fall in VAT revenue in the Member States

The Court's findings

1.19. Following its work in respect of the regime governing VAT on intra-Community trade, the Court had noted a significant fall in VAT revenue in 1993 ⁽¹⁶⁾. This fall could not be completely explained by technical or procedural factors. The question therefore was whether the new VAT regime for intra-Community trade was the direct cause of the fall in VAT revenue, in particular as the result of an increase in fraud and tax evasion.

1.20. In reply to the Court's observations ⁽¹⁷⁾, the Commission announced initiatives to enable it to monitor the development of revenue in the Member States more closely via a detailed examination of available information. In particular, it hoped to be able to go into the factors likely to explain this development in greater detail. On several occasions, the Council had also expressed a desire to examine VAT data in greater detail, in particular with regard to intra-Community trade ⁽¹⁸⁾.

1.21. The implementation of the monitoring of the trend of VAT revenue by the relevant Commission departments is neither complete nor coordinated. For this reason, it may happen that several Commission departments put forward requests of the same kind to the Member States.

1.22. In the context of this monitoring activity, the question of fraud and tax evasion was only tackled indirectly. Although it already had the necessary information, the Commission asked the Member States if they had carried out any studies on the discrepancies between theoretical revenue ⁽¹⁹⁾ and the revenue actually collected.

⁽¹⁶⁾ Annual report concerning the financial year 1995, paragraphs 1.92–1.103.

⁽¹⁷⁾ Annual report concerning the financial year 1995, reply to paragraphs 1.95–1.97.

⁽¹⁸⁾ Discharge recommendations concerning the financial years 1994 (Chapter 1, paragraph 4, subparagraph 3) and 1995 (Chapter 1, paragraph 2.2.1).

⁽¹⁹⁾ Theoretical VAT is calculated on the basis of the national accounts that the Member States draw up in accordance with a common framework, to wit the European system of integrated economic accounts (ESA). The Court's work in this field is contained in Special Report No 6/98, paragraphs 4.8–4.19 (OJ C 241, 31.7.1998).

1.23. In actual fact, in respect of monitoring, the Commission did no more than take note of the data and comments forwarded by the Member States on the subject of the discrepancy between estimated and actual revenue. On their own, such comparisons cannot explain the fall in VAT revenue and even less can they be used to confirm a possible increase in fraud and tax evasion. Furthermore, any analysis that rests entirely on arguments and data supplied by the tax authorities of the individual Member States cannot produce comparable conclusions.

1.24. For example, the replies from the tax authorities of the Member States might have suggested that none of them had observed an increase in fraud in connection with the regime for VAT on intra-Community trade. If so, though, this should have resulted in requests for explanations, especially given the contrary information available to the Commission on the scale of the phenomenon. There also exists some worrying information concerning the rise in certain kinds of fraud in intra-Community trade. It has even been said that the VAT system as a whole is strongly affected by fraud. Other work⁽²⁰⁾, including that carried out by the Court⁽²¹⁾, has shown that the problem of fraud and tax evasion requires particular attention.

1.25. This need for a more thorough investigation was expressed by a Commission department that is not directly responsible for monitoring VAT revenue. Thus, since the VAT regime on intra-Community trade was held by various sources to be the cause of increased fraud, this department did not exclude that non-cyclical (i.e. structural) factors might explain the fact that the level of revenue was lower than estimated. It did however also say that additional country-by-country analyses were needed to provide a more precise explanation of these structural factors. So far, no analysis of this kind has been carried out.

Conclusion

1.26. The initial objective, of examining more closely the factors likely to explain the fall in VAT revenue in

⁽²⁰⁾ The Commission is aware that the underground or black economy creates a significant problem for the taxation systems currently in force and that it seems to have increased in the course of the last decades (see COM(97) 559 final of 3 November 1997, p. 18 and COM(1998) 219 final of 7 April 1998, p. 5).

⁽²¹⁾ Special Report No 6/98 on the Court's assessment of the system of resources based on VAT and GNP, paragraphs 4.16–4.19.

the Member States and identifying any structural problems, has not yet been achieved. As for the incidence of fraud and tax evasion, the Commission still needs to carry out an independent in-depth analysis on the basis of a coordinated effort by its departments.

Verification of the compliance of national legislation with Community law

The Court's findings

1.27. The Member States, the European Parliament and the Council have, on several occasions, declared that they consider it important for Community directives to be transposed into national law correctly and in a timely manner⁽²²⁾. They have requested the Commission to provide effective monitoring of this matter.

1.28. The Commission has stated that the detection of violations of Community law constitutes one of its priority tasks⁽²³⁾. Several internal provisions have been adopted to make the examination of national legislation systematic. In particular, it has been provided that 'the examination of national transposing measures and provisions subsequently adopted by Member States shall be assessed for conformity with Community law, followed, where appropriate, by the opening of an "own-initiative" case'⁽²⁴⁾.

⁽²²⁾ Declaration No 19 of the Heads of States or Government attached to the Treaty of 7 February 1992. Resolution of the European Parliament of 9 February 1983 (OJ C 68, 14.3.1983). See also the resolutions of the European Parliament on the Annual Reports of the Commission on the control of the application of Community law in respect of 1994 (OJ C 65, 4.3.1996), 1995 (OJ C 55, 24.2.1997), 1996 (OJ C 56, 23.2.1998) and 1997 (OJ C 177, 22.6.1999, p. 56). The Council's recommendations concerning the discharge in respect of the financial years 1988 (Chapter 4, paragraph 1, subparagraph 2) and 1995 (Chapter 1, paragraph 2.1). The Amsterdam European Council of 16 and 17 June 1997, conclusions of the Presidency, Employment, competitiveness and growth, pages 9 and 10. The Cardiff European Council of 15 and 16 June 1998, conclusions of the Presidency, paragraph 17.

⁽²³⁾ Commission report on the follow-up to the comments accompanying the Council's discharge recommendations for the financial year 1995 (COM(97) 571 final of 21 November 1997, p. 50).

⁽²⁴⁾ Manual of operational procedures, seventh updating, March 1995, page 49.

Examination of national legislation and the detection of violations of Community law in the taxation field

1.29. The Court's audit at the Commission showed that it only implemented individual analyses of national legislation as a result of complaints, in the context of disputes or during the preparation of legislative proposals.

1.30. National VAT legislation, whether the basic legislation or subsequent amendments thereto, is not subjected to a systematic and documented examination enabling the verification of compliance and the detection of any infringements. In contrast with what the Commission has said in the past ⁽²⁵⁾, specific analyses entrusted to external experts have not been used for the detection of possible infringements in the national legislation adopted following the entry into force of the transitional scheme.

1.31. Those infringement procedures that have been opened are essentially the result of complaints from taxpayers, generally concerning double taxation or taxation that the complainant felt to be illegal.

1.32. An approach of this sort is liable to result in an incomplete intervention on the part of the Commission. It tends to stress individual situations and neglect infringements leading to no or lower taxation. In these cases, taxpayers have a less evident interest in coming forward, except where they wish to denounce a possible distortion of competition ⁽²⁶⁾.

The appraisal of compliance

1.33. As in the past and in spite of specific internal instructions to the contrary ⁽²⁷⁾, the Commission still fails to draw up appraisals of compliance of national legislation with Community law, even for internal purposes. In actual fact, all legislation that has not been the subject of an infringement procedure must, by default, be provisionally held to be compliant as long as no such procedure is tabled.

⁽²⁵⁾ Annual report concerning the financial year 1995, reply to paragraph 1.68.

⁽²⁶⁾ In the draft Council directive concerning the transformation of the VAT committee into a regulatory committee, real possibilities of double taxation, or even no taxation, are mentioned (see COM(97) 325 final of 25 June 1997, pp. 4–5).

⁽²⁷⁾ See paragraph 1.28.

1.34. The VAT system is characterised by a large number of national regulations and legal and administrative provisions adopted at different levels. In practice, the Commission reckons that it is impossible to obtain, and therefore examine, all these provisions. In spite of the assurances given by the Commission in 1986 ⁽²⁸⁾, not all the Member States comply with the requirement that they should forward their legislation.

1.35. Nevertheless, the Commission could draw up an appraisal of the compliance of the basic legislation available and the subsequent amendments adopted by the Member States. This would enable it to direct and formalise its departments' examination of the various systems.

1.36. The fear expressed by the Commission to the effect that its future freedom of movement might be undermined by an appraisal of compliance is not justified ⁽²⁹⁾. In actual fact, an appraisal of this kind would be limited to the provisions examined, thus allowing the case to be reopened where new information becomes available.

Delays in infringement procedures

1.37. The Court found a failure to comply with the deadlines provided in the internal rules on infringement procedures for around half of the files examined ⁽³⁰⁾. The delays observed at the various stages of the procedures ranged between a few months and several years. New procedures were adopted in 1996 in order to solve this problem.

1.38. This was the result of a number of causes. The delays were due to sustained differences in the appraisals of the various departments involved, particularly long assessment procedures and the time limits granted to Member States.

Operation of the departments

1.39. The degree of adjustment of the VAT legislation to the requirements of the single market and the question of the interpretation and application of the legislation are matters that fall under the responsibility of a

⁽²⁸⁾ Annual report concerning the financial year 1986, reply to paragraph 4.9.

⁽²⁹⁾ Annual report concerning the financial year 1988, reply to paragraph 4.8.

⁽³⁰⁾ These are all the files closed between 1995 and June 1998 and those that were still open at the latter date.

unit whose senior staff is nearly 50 % non-permanent. This percentage is noticeably higher than for the other units of the directorate-general responsible. This could result in a lack of continuity in the processing of files, in particular in respect of legislative proposals falling under multi-annual programmes.

1.40. A significant proportion of the non-permanent staff is made up of officials on secondment from national administrations for maximum periods of three years. The latter may be entrusted with tasks — if only for linguistic reasons — involving their own organisations of origin.

1.41. The Commission's responsibilities in such a sensitive field as taxation should be discharged via a structure enabling greater continuity and respect for its prerogatives.

Conclusion

1.42. The complete and accurate transposition of Community legislation into national law is an essential element of consistency and unity in the process of European integration, as the Member States, the European Parliament and the Council have not failed to point out. For this purpose, in accordance with the Treaties, the Commission possesses powers that must be exercised to the full if Community law is to be applied correctly.

1.43. However, in the field of VAT, there is no systematic examination of the national legal provisions and no appraisal of their compliance with Community law —

not even for internal purposes. This means that, in the absence of a positive assurance, the application of Community law is essentially appraised through the reactions of private citizens.

1.44. This situation constitutes a weakness in view of the Commission's responsibilities. A prior examination of the relevant legal provisions would enable it to act in a more preventative and global fashion and adopt useful measures with a better knowledge of the subject. The uniform application of VAT legislation would thereby be improved.

1.45. The Commission is, moreover, aware that the current differences in the interpretation and application of the common VAT system are undermining the neutrality of the system⁽³¹⁾. This is creating an extremely complex situation⁽³²⁾.

1.46. It would be useful for the Commission to revive its long abandoned practice of drawing up reports on the operation of the Common VAT system as such⁽³³⁾. It would, indeed, seem necessary for the individual analyses contained in the various different documents that it draws up to be periodically completed by means of an overall examination of the VAT system. This would provide a contribution to any discussion as to what corrective measures need to be taken.

⁽³¹⁾ COM(97) 325 final of 25 June 1997, pp. 1–2.

⁽³²⁾ COM(96) 328 final of 22 July 1996, p. 10.

⁽³³⁾ This obligation is provided for under Article 34 of Council Directive 77/388/EEC of 17 May 1977 (OJ L 145, 13.6.1977).

COMMISSION REPLY

SPECIFIC APPRAISAL IN CONNECTION WITH THE STATEMENT OF ASSURANCE

Traditional own resources

Analysis of the findings

1.9. Whenever the Commission learns, either as a result of its own inspections or of audits carried out by the Court of Auditors, that there has been a delay in making available traditional own resources default interest is imposed in accordance with Article 11 of Regulation (EEC, Euratom) No 1552/89.

Result of the audit

1.10-1.12. The Commission shares the Court's view that the Member States need to improve the way they keep the separate accounts. As this is a high-risk area, involving a very large number of underlying transactions, the Commission makes the systematic control of accounting procedures a matter of priority in its annual inspection programmes. The inspections generally result in the Member States making corrections. While most errors are basically of a one-off nature, it must be said that the accounting treatment of guarantees by some Member States is characterised by systematic errors resulting from the misinterpretation of Community legislation, particularly Article 6 of Regulation (EEC, Euratom) No 1552/89. The Commission is responsible for administrative and financial monitoring and has already demanded payment of considerable sums. Germany, however, was adamant in its refusal to alter its accounting procedure and the Commission has taken steps to initiate infringement proceedings under Article 226 of the Treaty.

As regards the reliability of the separate account, the Commission confirms that it overestimates the amounts the EU is actually likely to receive because some amounts have been entered in it for a long time although there is little hope of recovering them. The amendment to Regulation (EEC, Euratom) No 1552/89 currently being examined by the Council aims to strengthen the procedure of writing-off non-recoverable debts and should remedy the situation. However, as there are no data available at the moment to identify all the individual amounts on the basis of objective criteria (the length of time the debt has been outstanding, etc.), the Commission is unable to calculate the impact of the overestimate with any accuracy. For this reason it would be inadvisable to make a provision in the balance sheet at this stage. The Commission believes that,

in application of the accounting principle of caution mentioned by the Court, the accounts could indeed be made more transparent by inserting a note in the accounts alluding to the possible overestimate.

VAT and GNP own resources

1.15. As the Treasuries of the Member States are not members of SWIFT, statements are sent electronically only by the four Member States whose accounts pursuant to Article 9 of Regulation No 1552/89 are managed by their central banks.

One national Treasury sends files to the Commission electronically. The others send statements by post, fax or e-mail and time taken for them to be dispatched and to arrive varies greatly. In some cases, confirmation of the Commission's resources is fairly quick, while in others the statement of the current balance is not sent until after the end of the month.

We have learned that SWIFT is looking into the possibility of admitting national Treasuries as members, which would greatly simplify their transactions with the Commission.

NATIONAL VAT REVENUE AND VAT OWN RESOURCE ASSESSMENT BASES

Fall in VAT revenue in the Member States

The Court's findings

1.21 and 1.22. *Monitoring developments and interdepartmental coordination*

The Commission will present its initial report on the development of VAT revenue by the end of 1999; it will be drawn up in coordination with the departments concerned.

1.23-1.25. *Incidence of fraud and tax evasion*

Fraud and tax evasion are both complicated issues.

The Commission is aware of this situation and has taken a number of steps to make the Member States, the main parties concerned, more aware of the gravity of the situation, in particular for national budgets but also for operation of the single market.

Boosting cooperation between the Member States is still one of the Commission's priority objectives, as shown by the reports based on Article 14 of Regulation No 218/92 and Article 12 of Regulation No 1553/89 which the Commission has sent to the Council and Parliament and by discussions with the Member States within the SCAF and at the Fiscalis seminars.

Conclusions

1.26. The Commission has examined movements in VAT receipts and is aware that there are virtually no reliable and relevant sources of information outside the Member States. Its departments have made information visits to the Member States to hear their opinion and then identify the likely causes of these movements.

Following these visits, a working paper was presented to the working party consisting of the deputy directors-general for indirect taxation. The working party then adopted a procedure for monitoring revenue movements. Before the end of 1999 the Commission will present a report to this working party analysing changes in VAT receipts in the Member States.

The verification of the compliance of national legislation with Community law

The Court's findings

Examination of national legislation and the detection of violations of Community law in the taxation field

1.29-1.32. An *ad hoc* working party conducted a systematic review of some national VAT provisions between 1990 and 1993. This exercise was repeated to check the transposition of Council Directive 92/77/EEC of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC. It was found that the Member States have usually transposed Community provisions correctly. These operations also demonstrated that the systematic review of national legislation is a cumbersome process demanding considerable human resources and that the results, in terms of supposed infringements being detected, are usually negligible.

The Commission is also continuing its consideration of their impact on the budget.

Most infringement procedures are the result of complaints from taxpayers. This is because they are best placed to ascertain the practical application of legislation. However, this does not mean that the Commission's approach has been 'incomplete' but rather that, basically, infringements of Community law in this field consist of charging more tax than allowed by Community law.

The appraisal of compliance

1.33-1.36. When preparing its VAT controls, the Commission has to examine the main changes in the law to identify any cases of non-compliance. With the current state of the Commission's resources, it is unrealistic to consider appraising compliance systematically.

In practice, infringements concern secondary legislation or implementing measures (administrative instructions) which Member States are not legally obliged to report to the Commission.

Conclusion

1.42-1.46. It should be noted that VAT, as a tax which covers the consumption of virtually all goods and services, may, in view of its general nature, lead to differences in application.

Moreover, an *ad hoc* working party conducted a systematic review of national provisions between 1990 and 1993 in connection with the general provisions applicable in the VAT sector such as the sixth directive; this exercise was repeated when the transitional arrangements were introduced.

These operations demonstrated that the systematic review of national legislation is a cumbersome process demanding considerable human resources and that the results, in terms of supposed infringements being detected, are usually negligible.

The Commission is also continuing its consideration of their impact on the budget.

Given the size of the task they face in framing, interpreting and applying VAT legislation, the departments concerned, which have only limited human resources, are unable to conduct a systematic examination of all national legislation.

It should be noted that, in 1994, the Commission presented a report on the operation of the transitional arrangements for charging VAT ⁽¹⁾ which identifies the main problems of application for both operators and the national tax authorities.

⁽¹⁾ COM(94) 515 final, 23.11.1994.

In another Commission report published two years later in 1996 ('A common system of VAT — A programme for the single market') ⁽²⁾, Annex B appraises operation of the transitional VAT arrangements. As there has been no basic change in the situation since, the Commission does not intend to present a further report in the near future.

⁽²⁾ COM(96) 328 final, 22.7.1996.

CHAPTER 2 (*)

The common agricultural policy

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INTRODUCTION

2.1. This chapter concerns the 'Guarantee' Section of the European Agricultural Guidance and Guarantee Fund (EAGGF-Guarantee) and the expenditure charged to Chapter B2-51. It consists of four parts:

- (a) the implementation of the budget for the financial year 1998;
- (b) the specific audit of this area carried out in the context of the statement of assurance for the financial year 1998;
- (c) the clearance of the accounts for the financial years 1994 and 1997;
- (d) the follow-up to an earlier report on fruit and vegetables.

IMPLEMENTATION OF THE BUDGET FOR THE FINANCIAL YEAR 1998

Appropriations and expenditure for the financial year

Available appropriations

2.2. Initial appropriations for the EAGGF-Guarantee in the budget for the financial year 1998 ⁽¹⁾ amounted to 40 737 Mio ECU, including 500 Mio ECU for the monetary reserve. In addition, 200 Mio ECU earmarked for budget headings under sub-section B1 (see **Table 2.1**) appeared under Chapter B0-40 (provisional appropriations).

⁽¹⁾ Final adoption of the general budget of the European Union for the financial year 1998, OJ L 44, 16.2.1998.

2.3. Supplementary and amending budget No 1/98 ⁽²⁾ reduced the appropriations initially provided for the four main titles under sub-section B1 by 900 Mio ECU, and increased Chapter B1-31 (Food aid) by 400 Mio ECU.

2.4. During the financial year, there were a number of transfers from one item to another (597,9 Mio ECU), from one article to another (264,5 Mio ECU) and from one chapter to another (1 234 Mio ECU ⁽³⁾) (see **Table 2.2**). In absolute terms, these amendments amounted to 2 096,4 Mio ECU ⁽³⁾, or 5,2 % ⁽³⁾ of the initial budget (against 11,8 % in 1997). This significant fall in the amounts transferred in 1998 was due to the fact that, for most budget headings, the expenditure turned out to be far lower than the allocations (510,9 Mio ECU in appropriations, excluding the monetary reserve, had to be cancelled).

2.5. Final appropriations (excluding the monetary reserve) amounted to 39 659 Mio ECU (a fall of 578 Mio ECU compared with initial appropriations), which was below the ceiling provided in the agricultural guideline (see **Table 2.3**).

Amount of expenditure

2.6. Expenditure committed under sub-section B1 amounted to 38 748,1 Mio ECU (see **Table 2.1**). Neither the monetary reserve nor the provisional appropriations were used.

2.7. The table below shows the breakdown of this expenditure and the corresponding measures into three tranches:

⁽²⁾ OJ L 81, 26.3.1999.

⁽³⁾ All these figures are exclusive of the monetary reserve.

Table 2.1 — EAGGF-Guarantee 1998: initial appropriations, supplementary and amending budget, transfers and expenditure

(Mio ECU)

Chapter	Sector	As % of total initial appropriations	Initial appropriations ⁽¹⁾	Supplementary and amending budget No 1 ⁽²⁾	Transfers		Final appropriations	Expenditure committed					
					Total	Balance between chapters ⁽³⁾		Amounts	Automatic carry-overs to 1999	Overruns (underuse) compared with initial appropriations	As % of overrun (underuse) compared with initial appropriations	Overruns (underuse) compared with initial appropriations	As % of overrun (underuse) compared with initial appropriations
B1		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9) = (7) - (2)	(10) = [(7) - (2)] / (2) X 100	(11) = (7) - (6)	(12) = [(7) - (6)] / (6) X 100
10	Arable crops	41,6	17 102,0	0,0	1 254,4	850,0	17 952,0	17 945,2	0,0	843,2	4,9	- 6,8	0,0
11	Sugar	4,0	1 650,0	0,0	147,5	130,0	1 780,0	1 776,6	0,0	126,6	7,7	- 3,4	- 0,2
12	Olive oil	5,5	2 256,0	0,0	58,9	15,0	2 271,0	2 266,7	0,8	10,7	0,5	- 4,3	- 0,2
13	Dried fodder and grain legumes	0,9	374,0	0,0	6,0	5,0	379,0	377,5	0,0	3,5	0,9	- 1,5	- 0,4
14	Fibre plants and silkworms	2,1	860,0	0,0	15,1	12,0	872,0	869,8	0,0	9,8	1,1	- 2,2	- 0,3
15	Fruit and vegetables	4,7	1 921,0	- 135,0	15,9	- 242,0	1 544,0	1 509,5	0,0	- 411,5	- 21,4	- 34,5	- 2,2
16	Products of the vine-growing sector	2,0	806,0	0,0	4,9	- 50,0	756,0	700,0	0,0	- 106,0	- 13,2	- 56,0	- 7,4
17	Tobacco	2,4	995,0	- 110,0	0,0	0,0	885,0	870,3	2,3	- 124,7	- 12,5	- 14,7	- 1,7
18	Other plant sectors or products	0,9	352,0	0,0	40,6	3,0	355,0	354,0	0,0	2,0	0,6	- 1,0	- 0,3
Total Title B1-1		64,1	26 316,0	- 245,0	1 543,3	723,0	26 794,0	26 669,6	3,1	353,6	1,3	- 124,4	- 0,5
20	Milk and milk products	7,2	2 976,0	- 70,0	158,5	- 230,0	2 676,0	2 596,7	0,0	- 379,3	- 12,7	- 79,3	- 3,0
21	Beef/veal	14,1	5 786,0	- 115,0	125,3	- 470,0	5 201,0	5 160,6	0,0	- 625,4	- 10,8	- 40,4	- 0,8
22	Sheepmeat and goatmeat	3,4	1 413,0	0,0	143,0	128,0	1 541,0	1 534,6	0,0	121,6	8,6	- 6,4	- 0,4
23	Pigmeat	0,8	329,0	- 30,0	0,0	- 50,0	249,0	237,7	0,0	- 91,3	- 27,8	- 11,3	- 4,5
24	Eggs and poultrymeat	0,2	86,0	0,0	10,1	5,0	91,0	90,2	0,0	4,2	4,9	- 0,8	- 0,9
25	Other animal product aid measures	0,3	113,0	0,0	0,3	0,0	113,0	95,1	0,0	- 17,9	- 15,8	- 17,9	- 15,8
26	Fisheries	0,1	39,0	0,0	0,0	0,0	39,0	21,2	0,0	- 17,8	- 45,6	- 17,8	- 45,6
Total Title B1-2		26,1	10 742,0	- 215,0	437,2	- 617,0	9 910,0	9 736,1	0,0	- 1 005,9	- 9,4	- 173,9	- 1,8
30	Refunds on processed goods	1,3	532,0	0,0	47,1	30,0	562,0	553,1	0,0	21,1	4,0	- 8,9	- 1,6
31	Food aid	1,0	429,0	400,0	2,2	0,0	829,0	333,7	0,0	- 95,3	- 22,2	- 495,3	- 59,7
34	Interest to be paid to the Member States	—	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
36	Monitoring and preventive measures	0,1	45,0	0,0	0,0	0,0	45,0	40,4	10,8	- 4,6	- 10,2	- 4,6	- 10,2
37	Clearance of previous years' accounts	(1,7)	- 710,0	0,0	56,0	56,0	- 654,0	- 654,8	0,0	55,2	- 7,8	- 0,8	0,1
38	Promotion measures	0,2	95,0	0,0	0,0	0,0	95,0	45,0	1,6	- 50,0	- 52,6	- 50,0	- 52,6
39	Other measures	1,2	505,0	- 120,0	0,0	- 170,0	215,0	177,4	0,0	- 327,6	- 64,9	- 37,6	- 17,5
Total Title B1-3		2,2	896,0	280,0	105,3	- 84,0	1 092,0	494,8	12,4	- 401,2	- 44,8	- 597,2	- 54,7
40	Income aid	0,0	3,0	0,0	0,0	0,0	3,0	0,6	0,0	- 2,4	- 80,0	- 2,4	- 80,0
50	Accompanying measures	5,5	2 280,0	- 320,0	10,6	- 100,0	1 860,0	1 847,0	0,0	- 433,0	- 19,0	- 13,0	- 0,7
Subtotal		97,9	40 237,0	- 500,0	2 096,4	- 78,0	39 659,0	38 748,1	15,5	- 1 488,9	- 3,7	- 910,9	- 2,3
60	Monetary reserve	1,2	500,0	0,0	78,0	78,0	578,0	0,0	0,0	- 500,0	—	- 578,0	- 100,0
Total Subsection B1 ⁽⁴⁾		99,2	40 737,0	- 500,0	2 174,4	0,0	40 237,0	38 748,1	15,5	- 1 988,9	- 4,9	- 1 488,9	- 3,7
B2-51	Completion of the internal market ⁽⁵⁾	0,4	145,9	0,0	17,6	17,6	163,5	158,3	0,0	12,4	8,5	- 5,2	- 3,2
Total Subsection B1 + B2-51		99,5	40 882,9	- 500,0	2 192,0	17,6	40 400,5	38 906,4	15,5	- 1 976,5	- 4,8	- 1 494,1	- 3,7
B0-40	Provisional appropriations ⁽⁶⁾	0,5	200,0	—	—	0,0	0,0	—	0,0	- 200,0	—	—	—
Total Subsection B1 + B2-51 + B0-40		100,0	41 082,9	- 500,0	2 192,0	17,6	40 400,5	38 906,4	15,5	- 2 176,5	- 5,3	- 1 494,1	- 3,7

⁽¹⁾ General budget of the European Union for the financial year 1998 (OJ L 44, 16.2.1998).

⁽²⁾ OJ L 81, 26.3.1999.

⁽³⁾ Article 26(4) of the financial regulation.

⁽⁴⁾ No non-automatic carry-overs were carried out between 1997 and 1998.

⁽⁵⁾ Commitment appropriations.

⁽⁶⁾ Provisional appropriations concerning various budget headings under Subsection B1.

Source: Commission accounts.

Table 2.2 — EAGGF-Guarantee 1998: amendments to the amounts of the initial appropriations resulting from a supplementary and amending budget and from transfers

(Mio ECU)

Chapter	Sector	Initial appropriations ⁽¹⁾	Supplementary and amending budget No 1 ⁽²⁾		Transfers								Transfers and supplementary and amending budget		Final appropriations	Amendments compared with initial appropriations	
					From item to item ⁽³⁾		From article to article ⁽³⁾		From chapter to chapter ⁽⁴⁾		Total						
			Amount	% ⁽⁷⁾	Amount	% ⁽⁷⁾	Amount	% ⁽⁷⁾	Amount	% ⁽⁷⁾	Amount	% ⁽⁷⁾	Amount	% ⁽⁷⁾		Amount	% ⁽⁷⁾
B1		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10) = (4) + (6) + (8)	(11)	(12) = (2) + (10)	(13)	(14)	(15) = (14) - (1)	(16) = [(14) - (1)] / (1) X 100
10	Arable crops	17 102,0	0,0	0,0	270,9	1,6	133,5	0,8	850,0	5,0	1 254,4	7,3	1 254,4	7,3	17 952,0	850,0	5,0
11	Sugar	1 650,0	0,0	0,0	15,5	0,9	2,0	0,1	130,0	7,9	147,5	8,9	147,5	8,9	1 780,0	130,0	7,9
12	Olive oil	2 256,0	0,0	0,0	15,8	0,7	28,1	1,2	15,0	0,7	58,9	2,6	58,9	2,6	2 271,0	15,0	0,7
13	Dried fodder and grain legumes	374,0	0,0	0,0	0,0	0,0	1,0	0,3	5,0	1,3	6,0	1,6	6,0	1,6	379,0	5,0	1,3
14	Fibre plants and silkworms	860,0	0,0	0,0	0,5	0,1	2,6	0,3	12,0	1,4	15,1	1,8	15,1	1,8	872,0	12,0	1,4
15	Fruit and vegetables	1 921,0	-135,0	-7,0	15,9	0,8	0,0	0,0	0,0	0,0	15,9	0,8	-119,1	-6,2	1 544,0	-377,0	-19,6
16	Products of the vine-growing sector	806,0	0,0	0,0	4,7	0,6	0,2	0,0	0,0	0,0	4,9	0,6	4,9	0,6	756,0	-50,0	-6,2
17	Tobacco	995,0	-110,0	-11,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-110,0	-11,1	885,0	-110,0	-11,1
18	Other plant sectors or products	352,0	0,0	0,0	19,1	5,4	18,5	5,3	3,0	0,9	40,6	11,5	40,6	11,5	355,0	3,0	0,9
	Total Title B1-1	26 316,0	-245,0	-0,9	342,4	1,3	185,9	0,7	1 015,0	3,9	1 543,3	5,9	1 298,3	4,9	26 794,0	478,0	1,8
20	Milk and milk products	2 976,0	-70,0	-2,4	96,5	3,2	62,0	2,1	0,0	0,0	158,5	5,3	88,5	3,0	2 676,0	-300,0	-10,1
21	Beef/veal	5 786,0	-115,0	-2,0	125,3	2,2	0,0	0,0	0,0	0,0	125,3	2,2	10,3	0,2	5 201,0	-585,0	-10,1
22	Sheepmeat and goatmeat	1 413,0	0,0	0,0	15,0	1,1	0,0	0,0	128,0	9,1	143,0	10,1	143,0	10,1	1 541,0	128,0	9,1
23	Pigmeat	329,0	-30,0	-9,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-30,0	-9,1	249,0	-80,0	-24,3
24	Eggs and poultrymeat	86,0	0,0	0,0	0,0	0,0	5,1	5,9	5,0	5,8	10,1	11,7	10,1	11,7	91,0	5,0	5,8
25	Other animal product aid measures	113,0	0,0	0,0	0,1	0,1	0,2	0,2	0,0	0,0	0,3	0,3	0,3	0,3	113,0	0,0	0,0
26	Fisheries	39,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	39,0	0,0	0,0
	Total Title B1-2	10 742,0	-215,0	-2,0	236,9	2,2	67,3	0,6	133,0	1,2	437,2	4,1	222,2	2,1	9 910,0	-832,0	-7,7
30	Refunds on processed goods	532,0	0,0	0,0	16,4	3,1	0,7	0,1	30,0	5,6	47,1	8,9	47,1	8,9	562,0	30,0	5,6
31	Food aid	429,0	400,0	93,2	2,2	0,5	0,0	0,0	0,0	0,0	2,2	0,5	402,2	93,8	829,0	400,0	93,2
34	Interest to be paid to the Member States	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
36	Monitoring and preventive measures	45,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	45,0	0,0	0,0
37	Clearance of previous years' accounts	-710,0	0,0	0,0	0,0	0,0	0,0	0,0	56,0	-7,9	56,0	-7,9	56,0	-7,9	-654,0	56,0	-7,9
38	Promotion measures	95,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	95,0	0,0	0,0
39	Other measures	505,0	-120,0	-23,8	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-120,0	-23,8	215,0	-290,0	-57,4
	Total Title B1-3	896,0	280,0	31,3	18,6	2,1	0,7	0,1	86,0	9,6	105,3	11,8	385,3	43,0	1 092,0	196,0	21,9
40	Income aid	3,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	3,0	0,0	0,0
50	Accompanying measures	2 280,0	-320,0	-14,0	0,0	0,0	10,6	0,5	0,0	0,0	10,6	0,5	-309,4	-13,6	1 860,0	-420,0	-18,4
	Subtotal	40 237,0	-500,0	-1,2	597,9	1,5	264,5	0,7	1 234,0	3,1	2 096,4	5,2	1 596,4	4,0	39 659,0	-578,0	-1,4
60	Monetary reserve	500,0	0,0	0,0	0,0	0,0	0,0	0,0	78,0	15,6	78,0	15,6	78,0	15,6	578,0	78,0	15,6
	Total Subsection B1	40 737,0	-500,0	-1,2	597,9	1,5	264,5	0,6	1 312,0	3,2	2 174,4	5,3	1 674,4	4,1	40 237,0	-500,0	-1,2
B2-51	Completion of the internal market ⁽⁵⁾	145,9	0,0	—	0,0	0,0	0,0	0,0	17,6	12,1	17,6	12,1	17,6	12,1	163,5	17,6	12,1
	Total Subsection B1 + B2-51	40 882,9	-500,0	-1,2	597,9	1,5	264,5	0,6	1 329,6	3,3	2 192,0	5,4	1 692,0	4,1	40 400,5	-482,4	-1,2
B0-40	Provisional appropriations ⁽⁶⁾	200,0	—	—	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-200,0	-100,0
	Total Subsection B1 + B2-51 + B0-40	41 082,9	-500,0	-1,2	597,9	1,5	264,5	0,6	1 329,6	3,2	2 192,0	5,3	1 692,0	4,1	40 400,5	-682,4	-1,7

⁽¹⁾ General budget of the European Union for the financial year 1998 (OJ L 44, 16.2.1998).⁽²⁾ OJ L 81, 26.3.1999.⁽³⁾ Article 104(1) of the financial regulation.⁽⁴⁾ Article 26(4) of the financial regulation.⁽⁵⁾ Commitment appropriations.⁽⁶⁾ Provisional appropriations concerning various budget headings under Subsection B1.⁽⁷⁾ In % of the initial appropriations (column 1).

Source: Commission accounts.

Table 2.3 — Main financial data concerning the EAGGF-Guarantee for the financial year 1998

(Mio ECU)

Type	Amount	Difference compared with previous amount	Index
(1)	(2)	(3)	(4)
Agricultural guideline	43 263,0		100
Preliminary draft budget 1998	41 361,0	- 1 902,0	96
Initial appropriations (including the monetary reserve and provisional appropriations)	40 937,0	- 424,0	95
Final appropriations (including 400 Mio ECU for food aid for Russia, not originally provided for)	39 659,0	- 1 278,0	92
Expenditure committed for the financial year	38 748,1	- 910,9	90
Total differences		- 4 514,9	

Tranche of expenditure	Number of measures	Total expenditure	%
(1)	(2)	(3)	(4)=(3) × 100/ Total (3)
1 000 Mio ECU and over ⁽⁴⁾	7	15 573,0 (*)	38,9
100 to 999,9 Mio ECU ⁽⁵⁾	59	17 650,6	44,1
0 to 99,9 Mio ECU	653	6 819,8	17,0
TOTAL	719	40 043,4 ⁽⁶⁾	100

* Effected to the extent of 81,6 % in the first two months of the EAGGF financial year, i.e. before 1 January 1998.

⁽⁴⁾

Breakdown of the seven main measures

Reference	Chapter	Measures	Amount (Mio ECU)
B1.1051	Arable crops	Aid to producers of cereals not subject to the base area for maize (marketing year 1997/98)	7 481,8
B1.1041	Arable crops	Aid to producers of cereals not subject to the base area for maize (marketing year 1997/98)	2 065,3
B1.1210	Olive oil	Advances to large associated producers (marketing year 1996/97)	1 358,1
B1.1052	Arable crops	Advances (marketing year 1998/99)	1 342,3
B1.1100	Sugar	Refunds on sugar and isoglucose (marketing year 1997/98)	1 143,9
B1.1060	Arable crops	Set-aside related to per hectare aid (marketing year 1997/98)	1 093,5
B1.2120	Beef/veal	Suckler cow premiums for applications from the calendar year 1997 — Advances	1 088,1
Total			15 573,0

⁽⁵⁾ About half of these measures come under the same four chapters as the seven measures mentioned in note 4.

⁽⁶⁾ After the deduction of 1 295,3 Mio ECU (corresponding to 170 measures with negative balances) this does give the amount for expenditure shown under 2.6.

2.8. For the first time since 1994, net expenditure under sub-section B1 fell (4,1 %) compared with the previous financial year (see **Table 2.4**). Gross expenditure even fell by 5,3 %, as the two main sources of revenue, Chapter B1-37 (clearance of previous years' accounts) and Item B1-2071 (supplementary milk levy) also fell significantly (212,8 Mio ECU and 333,3 Mio ECU respectively).

2.9. **Tables 2.5** and **2.6** show breakdowns of the expenditure by type and by Member State. A summary of the EAGGF-Guarantee accounts is given in **Table 2.7**, and **Graph 2.1** shows the development of EAGGF-Guarantee expenditure over a period of 10 years.

Budgetary rules

2.10. The budget must be drawn up and implemented in accordance with a series of rules in order to guarantee compliance with the wishes of the Budgetary Authority and transparency in budgetary implementation. In the management of the EAGGF-Guarantee, several of these rules ⁽⁷⁾, in particular the general principles governing the Community budget, are not sufficiently observed.

The principle of universality

2.11. According to this principle ⁽⁸⁾, revenue may not be allocated to particular items of expenditure, and

⁽⁷⁾ See 'The public finances of the European Union — The characteristics, rules and workings of the European financial system', Commission, 1995.

⁽⁸⁾ See Article 4 of the Financial Regulation.

Table 2.5 — EAGGF-Guarantee 1998: expenditure committed by chapter and type

(Mio ECU)

Chapter	Sector	% ⁽¹⁾	Total	Refunds	First-category interventions: withdrawals, aid, premiums, private storage and levies							Secondcategory interventions: public storage					Food aid	Other expenditure
					Withdrawals	Countervailing price aid		Guidance premium	Private storage	Levy	Total	Technical costs	Financial costs	Losses		Total		
						Production	Processing and consumption							Devaluation of stocks	Others			
B1		(1) = (2)/tot. B1 X 100	(2) = (3) + (10) + (15) + (16) + (17)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10) = (4) + ... + (9)	(11)	(12)	(13)	(14)	(15) = (11) + (12) + (13) + (14)	(16)	(17)
10	Arable crops	46,3	17 945,2	429,4	1 262,6	14 899,2	279,9	0,0	0,0	-0,1	16 441,6	136,8	28,3	873,7	45,2	1 084,0	0,0	-9,7
11	Sugar	4,6	1 776,6	1 265,5	0,0	0,0	151,4	0,0	349,5	0,0	500,9	0,0	0,0	0,0	0,0	0,0	0,0	10,2
12	Olive oil	5,8	2 266,7	24,9	0,0	1 993,5	193,1	0,0	0,9	0,0	2 187,5	4,3	0,4	25,9	-4,5	26,1	0,0	28,2
13	Dried fodder and grain legumes	1,0	377,5	0,0	0,0	377,7	0,0	0,0	0,0	0,0	377,7	0,0	0,0	0,0	0,0	0,0	0,0	-0,2
14	Fibre plants and silkworms	2,2	869,8	0,0	0,0	869,8	0,0	0,0	0,0	0,0	869,8	0,0	0,0	0,0	0,0	0,0	0,0	0,0
15	Fruit and vegetables	3,9	1 509,5	58,3	138,3	308,3	644,9	71,4	0,0	0,0	1 162,9	0,0	0,0	0,0	0,0	0,0	0,0	288,2
16	Products of the vine-growing sector	1,8	700,0	41,2	312,9	0,0	132,6	15,1	54,9	0,0	515,5	2,8	0,1	122,9	18,6	144,4	0,0	-1,2
17	Tobacco	2,2	870,3	0,0	0,0	787,2	0,0	84,0	0,0	0,0	871,2	0,0	0,0	0,0	0,0	0,0	0,0	-0,9
18	Other plant sectors or products	0,9	354,0	49,6	0,0	146,6	0,0	0,0	0,0	0,0	146,6	8,3	2,1	51,9	-0,1	62,2	0,0	95,6
Total Title B1-1		68,8	26 669,6	1 868,9	1 713,8	19 382,3	1 401,9	170,5	405,3	-0,1	23 073,7	152,2	30,9	1 074,4	59,2	1 316,7	0,0	410,2
20	Milk and milk products	6,7	2 596,7	1 426,7	0,0	0,0	1 238,1	5,5	95,7	-212,4	1 126,9	7,0	5,0	124,7	-91,6	45,1	0,0	-2,1
21	Beef/veal	13,3	5 160,6	774,5	0,0	4 253,5	0,0	0,0	0,0	0,0	4 253,5	127,4	15,4	124,4	-121,7	145,5	0,0	-12,7
22	Sheepmeat and goatmeat	4,0	1 534,6	0,0	0,0	1 534,9	0,0	0,0	0,2	0,0	1 535,1	0,0	0,0	0,0	0,0	0,0	0,0	-0,6
23	Pigmeat	0,6	237,7	74,5	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	163,2
24	Eggs and poultrymeat	0,2	90,2	90,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-0,5
25	Other animal product aid measures	0,2	95,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	95,1
26	Fisheries	0,1	21,2	0,0	10,9	0,0	0,0	0,0	0,0	0,0	10,9	0,0	0,0	0,0	0,0	0,0	0,0	10,3
Total Title B1-2		25,1	9 736,1	2 366,4	10,9	5 788,4	1 238,1	5,5	95,9	-212,4	6 926,4	134,4	20,4	249,1	-213,3	190,6	0,0	252,7
30	Refunds on processed food	1,4	553,1	556,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-3,0
31	Food aid	0,9	333,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	334,6	-9,9
34	Interest to be paid to the Member States		0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
36	Monitoring and preventive measures	0,1	40,4	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	40,4
37	Clearance of previous years' accounts	-1,7	-654,8	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	-654,8
38	Promotion measures	0,1	45,0	0,0	0,0	0,0	45,1	0,0	0,0	0,0	45,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0
39	Other measures	0,5	177,4	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	177,4
Total Title B1-3		1,3	494,8	556,1	0,0	0,0	45,1	0,0	0,0	0,0	45,1	0,0	0,0	0,0	0,0	0,0	0,0	334,6
40	Income aid	0,0	0,6	0,0	0,6	0,0	0,0	0,0	0,0	0,0	0,6	0,0	0,0	0,0	0,0	0,0	0,0	0,0
50	Accompanying measures	4,8	1 847,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	1 847,0
Subtotal		100,0	38 748,1	4 791,4	1 725,3	25 170,7	2 685,1	176,0	501,2	-212,5	30 045,8	286,6	51,3	1 323,5	-154,1	1 507,3	334,6	2 069,0
60	Monetary reserve	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Total Subsection B1		100,0	38 748,1	4 791,4	1 725,3	25 170,7	2 685,1	176,0	501,2	-212,5	30 045,8	286,6	51,3	1 323,5	-154,1	1 507,3	334,6	2 069,0
B2-51	Completion of the internal market	—	158,3	—	—	—	—	—	—	—	—	—	—	—	—	—	—	158,3
Total Subsection B1 + B2-51		—	38 906,4	4 791,4	1 725,3	25 170,7	2 685,1	176,0	501,2	-212,5	30 045,8	286,6	51,3	1 323,5	-154,1	1 507,3	334,6	2 227,3
B0-40	Provisional appropriations ⁽²⁾	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Total Subsection B1 + B2-51 + B0-40		—	38 906,4	4 791,4	1 725,3	25 170,7	2 685,1	176,0	501,2	-212,5	30 045,8	286,6	51,3	1 323,5	-154,1	1 507,3	334,6	2 227,3
As % of total expenditure committed		—	100,0	12,3	4,4	64,7	6,9	0,5	1,3	-0,5	77,2	0,7	0,1	3,4	-0,4	3,9	0,9	5,7

⁽¹⁾ As % of the total expenditure committed under Subsection B1.⁽²⁾ Provisional appropriations concerning various budget headings under Subsection B1.

Source: Commission accounts.

Table 2.6 — EAGGF-Guarantee 1998: expenditure committed by type and Member State

(Mio ECU)

Member State	% ⁽¹⁾	Total amounts	Refunds		First-category interventions: withdrawals, aid, premiums, private storage and levies												Second-category interventions: public storage					Food aid		Other expenditure				
			Amount	% ⁽¹⁾	Withdrawals	% ⁽¹⁾	Countervailing price aid				Guidance premiums	% ⁽¹⁾	Private storage	% ⁽¹⁾	Levy	% ⁽¹⁾	Total	% ⁽¹⁾	Technical costs	Financial costs	Losses		Total	% ⁽¹⁾	Amount	% ⁽¹⁾	Amount	% ⁽¹⁾
							Production	% ⁽¹⁾	Processing and consumption	% ⁽¹⁾											Devaluation of stocks	Others						
(1)	(2) = (3) + (17) + (23) + (25) + (27)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17) = (5) + (7) + (9) + (11) + (13) + (15)	(18)	(19)	(20)	(21)	(22)	(23) = (19) + (20) + (21) + (22)	(24)	(25)	(26)	(27)	(28)	
Belgium	2,2	851,3	414,2	8,6	6,1	0,4	267,2	1,1	107,7	4,0	1,1	0,6	31,7	6,3	-6,2	2,9	407,6	1,4	1,3	0,4	6,8	-4,3	4,2	0,3	9,4	2,8	16,0	0,8
Denmark	3,0	1 154,0	334,1	7,0	59,5	3,4	656,2	2,6	52,4	2,0	0,0	0,0	12,5	2,5	-4,4	2,1	776,2	2,6	5,5	0,9	24,6	-2,9	28,1	1,9	4,2	1,3	11,4	0,6
Germany	14,3	5 553,0	645,2	13,5	309,6	17,9	3 433,5	13,6	322,0	12,0	6,4	3,6	78,2	15,6	-115,3	54,3	4 034,4	13,4	109,2	23,6	442,2	23,4	598,4	39,7	24,3	7,3	250,8	12,3
Greece	6,6	2 556,8	44,8	0,9	25,8	1,5	2 206,5	8,8	105,3	3,9	51,4	29,2	11,2	2,2	-0,9	0,4	2 399,3	8,0	2,9	1,1	12,5	-16,6	-0,1	0,0	19,1	5,7	93,7	4,6
Spain	13,7	5 293,5	158,6	3,3	372,3	21,6	3 842,4	15,3	379,7	14,2	37,4	21,3	39,4	7,9	-0,2	0,1	4 671,0	15,6	17,8	2,2	128,9	-25,4	123,5	8,2	57,5	17,2	282,9	13,9
France	23,3	9 007,2	1 152,4	24,1	465,7	27,0	6 047,7	24,0	608,7	22,8	40,3	22,9	105,3	21,0	-0,2	0,1	7 267,5	24,2	50,9	6,3	310,4	-14,7	352,9	23,4	67,2	20,1	167,3	8,2
Ireland	4,2	1 632,6	406,5	8,5	17,3	1,0	769,9	3,1	98,0	3,7	0,0	0,0	7,7	1,5	-13,6	6,4	879,3	2,9	26,1	5,0	82,5	-30,8	82,8	5,5	7,0	2,1	256,8	12,6
Italy	10,7	4 129,2	355,2	7,4	188,7	10,9	2 938,4	11,7	398,8	14,9	30,2	17,2	134,1	26,7	0,0	0,0	3 690,2	12,3	12,2	1,7	59,8	-42,1	31,6	2,1	72,9	21,8	-20,9	-1,0
Luxembourg	0,0	17,4	0,1	0,0	0,3	0,0	15,6	0,1	0,3	0,0	0,1	0,1	0,0	0,0	-1,2	0,6	15,1	0,1	0,0	0,0	0,3	0,0	0,3	0,0	0,1	0,0	1,9	0,1
Netherlands	3,5	1 372,7	624,5	13,0	3,8	0,2	224,1	0,9	333,3	12,5	2,8	1,6	25,8	5,1	-13,1	6,2	576,7	1,9	0,4	0,0	0,1	-0,6	-0,1	0,0	3,4	1,0	168,1	8,2
Austria	2,2	842,5	62,5	1,3	25,6	1,5	423,3	1,7	21,3	0,8	0,8	0,5	11,0	2,2	-12,7	6,0	469,3	1,6	6,7	0,9	21,8	1,8	31,2	2,1	1,6	0,5	277,9	13,6
Portugal	1,6	637,4	27,9	0,6	18,0	1,0	359,4	1,4	79,9	3,0	4,1	2,3	3,2	0,6	0,0	0,0	464,6	1,5	0,3	0,0	4,6	-14,4	-9,5	-0,6	18,3	5,5	136,1	6,7
Finland	1,5	575,7	114,9	2,4	29,4	1,7	232,1	0,9	19,7	0,7	0,0	0,0	3,7	0,7	0,0	0,0	284,9	0,9	2,1	0,4	12,5	-1,0	14,0	0,9	6,2	1,9	155,6	7,6
Sweden	2,0	770,1	62,7	1,3	62,2	3,6	439,4	1,7	14,5	0,5	0,2	0,1	8,7	1,7	0,0	0,0	525,0	1,7	6,9	0,6	35,3	2,3	45,1	3,0	9,7	2,9	127,6	6,3
United Kingdom	11,1	4 314,2	387,7	8,1	141,1	8,2	3 315,0	13,2	132,6	5,0	1,1	0,6	29,0	5,8	-44,7	21,0	3 574,1	11,9	44,2	8,1	181,1	-28,9	204,5	13,6	33,7	10,1	114,2	5,6
Subtotal	100,0	38 707,6	4 791,3	100,0	1 725,4	100,0	25 170,7	100,0	2 674,2	100,0	175,9	100,0	501,5	100,0	-212,5	100,0	30 035,2	100,0	286,5	51,2	1 323,4	-154,2	1 506,9	100,0	334,6	100,0	2 039,4	100,0
Commission ⁽²⁾		40,3	0,0	—	0,0	—	0,0	—	10,7	—	0,0	—	0,0	—	0,0	—	10,7	—	0,0	0,0	0,0	0,0	0,0	—	0,0	—	29,6	—
Total	—	38 747,9	4 791,3	—	1 725,4	—	25 170,7	—	2 684,9	—	175,9	—	501,5	—	-212,5	—	30 045,9	—	286,5	51,2	1 323,4	-154,2	1 506,9	—	334,6	—	2 069,0	—

⁽¹⁾ As % of total expenditure committed, excluding direct expenditure by the Commission.⁽²⁾ Direct expenditure by the Commission, which need not appear in the declaration of the Member State concerned (Table 104).

Source: Commission accounts.

Table 2.7 — EAGGF-Guarantee 1998: summary accounts

(Mio ECU)

Subsection/chapter	Available appropriations	Commitments	Payments	Carry-overs to 1999	Cancellations	
					Appropriations	Commitments
					End 1998	
Subsection B1						
1998 appropriations	40 237,0	38 748,1	38 732,5	15,5 ⁽¹⁾	1 088,9 ⁽³⁾	—
Automatic carry-overs from 1997	82,4	81,4	77,5	400,0 ⁽²⁾	4,9	—
Non-automatic carry-overs from 1997	0,0	0,0	0,0	—	—	—
Chapter B2-51						
1998 ⁽⁴⁾ appropriations	(E) 163,5	158,3	—	2,4	2,7	—
	(P) 141,3	—	138,3	1,2	1,8	—
Commitments from previous financial years still to be settled	—	283,5	81,7	158,6	—	43,1
Non-automatic carry-overs from 1997	0,0	0,0	0,0	—	—	—
Non-automatic carry-overs to 1999	0,0	—	—	—	—	—
Chapter B0-40						
1998 ⁽⁵⁾ appropriations	200,0	—	—	0,0	200,0	—

⁽¹⁾ Automatic carry-overs to 1999.⁽²⁾ Non-automatic carry-overs to 1999.⁽³⁾ Including the monetary reserve.⁽⁴⁾ Commitment of appropriations.⁽⁵⁾ Provisional appropriations concerning various budget headings under Subsection B1+A24.

Source: Commission accounts.

revenue and expenditure must be entered without any adjustment against each other. However, although they diminished considerably during the financial year 1998 (– 2 498,8 Mio ECU as against – 4 329,6 Mio ECU in 1997), a large number of negative amounts were entered in the EAGGF-Guarantee accounts (see **Table 2.8**). Of this sum of 2 498,8 Mio ECU, 1 290,1 Mio ECU corresponds to revenue (outside clearance) and 438,6 Mio ECU to corrections made by the Commission to the Member States' declarations. If any of these amounts are anything other than accounting adjustments, they must be treated as budget revenue. The Commission should, therefore, consider this matter in its entirety in relation to the redrafting of the Financial Regulation.

2.12. The Member States are also obliged to record on their monthly declarations any corrections they have made to a previous declaration. These corrections are not always clearly identifiable, in particular because of the off-settings made against the expenditure of the month. That makes it more difficult to check the declarations and therefore does not guarantee that the advances are paid correctly. The Commission should require the Member States to make their monthly declarations more transparent and should, if need be, propose that the regulation concerned be reformed.

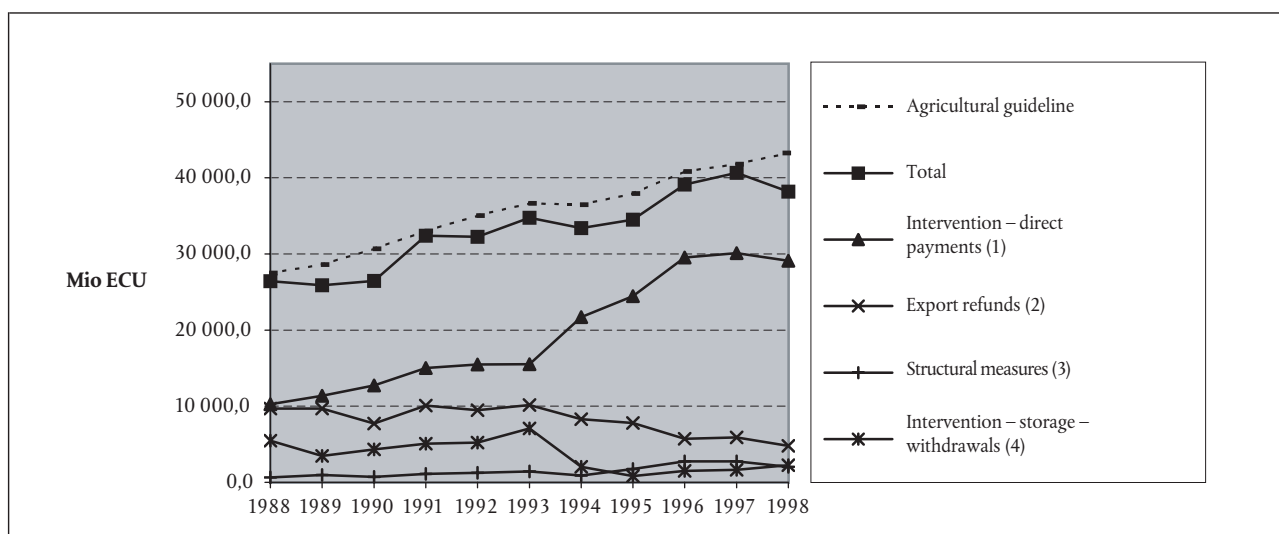
The principle of annuality

2.13. According to this principle, expenditure is authorised for one financial year only and all the expenditure for a given financial year must be booked to the corresponding budget. However, EAGGF-Guarantee expenditure is subject to a number of derogations from this principle.

2.14. Firstly, the agricultural financial year (from 16 October of the year n to 15 October of the year n+ 1) does not coincide with the general budget financial year (from 1 January to 31 December). Conversely, subsection B1 also contains expenditure, implemented directly by the Commission, that falls under the financial year lasting from 1 January to 31 December (40,3 Mio ECU in commitments and 24,8 Mio ECU in payments in 1998).

2.15. Furthermore, EAGGF-Guarantee expenditure is covered by non-differentiated appropriations, which are authorised for a period that may not exceed the duration of the financial year. These appropriations are therefore not suited to measures that are carried out over several financial years, such as accompanying measures, promotional measures and the (forthcoming) rural development measures. The effect of this practice is to underestimate the Community's long-term financial obligations.

Graph 2.1 — Evolution of EAGGF expenditure by type (1988-98)



Cross-checks with the columns in Table 2.5 are to be made as follows:

- (1) Intervention — direct payments: countervailing price aid (columns 5 and 6) plus the withdrawals for arable crops (line B1.10 of column 4).
- (2) Export refunds: column 3.
- (3) Structural measures: guidance premium (column 7) plus the accompanying measures (line B1.50 of column 17).
- (4) Intervention — storage — withdrawals: private storage (column 8) plus public storage (columns 11 to 14) plus withdrawals other than the arable crop withdrawals (column 4 minus line B1.10) and minus milk levies (column 9).

The other measures (food aid (column 16) and the expenditure minus accompanying measures (column 17 minus line B1.50 of the same column)), amounting to only 556.6 Mio ECU, are not shown in the above graph. Because of the scale chosen, they would not be legible.

Source: Commission accounts.

2.16. Lastly, the management of the appropriations itself has also involved derogations from the principle of annuality. Thus, Supplementary and Amending Budget No 1, adopted on 14 December 1998, included an increase of 400 Mio ECU in the appropriations under Chapter B1-31 for the supply of food aid to Russia. However, this could not be implemented during the financial year 1998 because:

- (a) the relevant legislation was not adopted by the Council until 17 December 1998;
- (b) the corresponding expenditure — which was subject to the declaration procedure — ought to have been carried out before 15 October 1998 and the stocks should have been mobilised before 31 August 1998.

2.17. As no amounts could be committed and, therefore, disbursed in 1998, the Budgetary Authority decided to carry these appropriations forward to the financial year 1999, thus transferring this expenditure from one financial year to another and taking advantage of the considerable room for manoeuvre offered by the under-utilisation of appropriations in 1998.

2.18. By contrast, in the case referred to further on (clearance of accounts relating to the financial years 1994 and 1997, paragraph 2.66), an item of expenditure that was executed and declared in 1994 was considered to be chargeable to 1995 owing to a lack of sufficient appropriations under the budget headings for the financial year concerned.

Deadlines for charging expenditure

2.19. The agricultural regulations do not always provide precise deadlines for the implementation of expenditure. In that case, the act of payment and declaration by the Member State determines the financial year under which the expenditure is to fall and not the event giving rise to the item (harvest, exportation, etc.). The charging of such expenditure thus depends to a large extent on how conscientious Member States are.

2.20. Among the expenditure declared in October 1997 (falling under the financial year 1997), one Member State included 47,1 Mio ECU in costs for the public storage of alcohol for the 1990-95 period. As the Commission did not have sufficient grounds for refusing this expenditure, but nevertheless wished to examine it, an advance was indeed granted during the financial year

Table 2.8 — EAGGF-Guarantee 1998: expenditure committed by chapter and item

(Mio ECU)

Chapter	Sector	Absolute values	Negative amounts	Positive amounts	Net amounts
B1		(1)	(2)	(3)	(4)
10	Arable crops	18 544,6	- 299,7	18 244,9	17 945,2
11	Sugar	1 856,0	- 39,7	1 816,3	1 776,6
12	Olive oil	2 331,5	- 32,4	2 299,1	2 266,7
13	Dried fodder and grain legumes	407,8	- 15,1	392,7	377,5
14	Fibre plants and silkworms	1 592,8	- 361,5	1 231,3	869,8
15	Fruit and vegetables	1 544,1	- 17,3	1 526,8	1 509,5
16	Products of the vine-growing sector	720,7	- 10,4	710,3	700,0
17	Tobacco	901,7	- 15,7	886,0	870,3
18	Other plant sectors or products	436,4	- 41,2	395,2	354,0
Total Title B1-1		28 335,5	- 833,0	27 502,6	26 669,6
20	Milk and milk products	3 334,4	- 368,9	2 965,6	2 596,7
21	Beef/veal	5 739,5	- 289,5	5 450,0	5 160,6
22	Sheepmeat and goatmeat	1 589,5	- 27,5	1 562,0	1 534,6
23	Pigmeat	264,0	- 13,2	250,8	237,7
24	Eggs and poultrymeat	128,2	- 19,0	109,2	90,2
25	Other animal product aid measures	99,6	- 2,2	97,4	95,1
26	Fisheries	23,0	- 0,9	22,1	21,2
Total Title B1-2		11 178,2	- 721,1	10 457,1	9 736,0
30	Refunds on process goods	767,7	- 107,3	660,4	553,1
33	Food aid	384,9	- 25,6	359,3	333,7
34	Interest to be paid to the Member States	0,0	0,0	0,0	0,0
35	Distribution to deprived persons	0,0	0,0	0,0	0,0
36	Monitoring and preventive measures	52,6	- 6,1	46,5	40,4
37	Clearance of previous years' accounts	697,5	- 676,2	21,3	- 654,8
38	Promotion measures	51,9	- 3,5	48,5	45,0
39	Other measures	406,5	- 114,5	292,0	177,4
Total Title B1-3		2 361,1	- 933,2	1 428,0	494,8
40	Income aid	0,7	0,0	0,7	0,6
50	Accompanying measures	1 870,1	- 11,5	1 858,5	1 847,0
70	Temporary BSE reserve	0,0	0,0	0,0	0,0
Subtotal		43 745,6	- 2 498,8	41 246,8	38 748,1
60	Monetary reserve	0,0	0,0	0,0	0,0
Total Subsection B1		43 745,6	- 2 498,8	41 246,8	38 748,1
70	Completion of the internal market	158,3	0,0	158,3	158,3
Total Subsection B1 + B2-51		43 903,9	- 2 498,8	41 405,1	38 906,4
60	Provisional appropriations ⁽¹⁾	0,0	0,0	0,0	0,0
Total Subsection B1 + B2-51 + B0-40		43 903,9	- 2 498,8	41 405,1	38 906,4

⁽¹⁾ Provisional appropriations concerning various budget headings under Subsection B1.

Source: Commission accounts.

1997. However, although the Commission has only two months to make the detailed booking, this was not done until the end of December 1998.

2.21. In 1997, the Member States implemented various control and prevention measures in the absence of an entire legal basis (absence of two implementing regulations ⁽⁹⁾ allowing Member States to declare expenditure

paid and permitting the Commission to refund it). The amounts (9,2 Mio ECU) were covered by a commitment during the financial year 1997, which was itself carried forward to the financial year 1998 and, unlike the previous case, the payment of the advance was carried over to February 1998 and the detailed payment booked in October 1998.

⁽⁹⁾ Commission Regulation (EC) No 1780/97 of 15 September 1997 (OJ L 252, 16.9.1997) and Commission Regulation (EC) No 2437/97 of 9 December 1997 (OJ L 339, 10.12.1997) adopted in application of Council Regulation (EC) No 723/97 of 22 April 1997 (OJ L 108, 25.4.1997).

2.22. All these practices led to entries of expenditure that were not consistent enough to guarantee the transparency and comparability of EAGGF-Guarantee expenditure over time.

Budgetary management

Advances and expenditure

2.23. EAGGF-Guarantee expenditure is executed by the paying agencies of the Member States. The following month, this expenditure is then included in a monthly declaration, on the basis of which the Commission refunds the Member States by means of advances. After the end of the financial year, the clearance of the accounts (see paragraphs 2.60-2.102 below) makes it possible to establish the definitive amount of expenditure to be charged to the Union.

2.24. The Member States can obtain an advance only if the expenditure has actually been disbursed (by cheque — payment is considered to have been made when the cheque is issued, which is favourable to the Member States — or by transfer) during the month of the declaration. At this stage, no checks are carried out as to whether the total for payments is justified. However, the Court sometimes found that the paying agencies were not able to produce an exact list of transactions in support of the amounts declared.

2.25. There were only limited checks on some aspects of the declarations (the reliability of estimates, quantities declared) which enable expenditure to be monitored to a certain extent. In practice, it was difficult to implement a partial or total rejection of the expenditure declared after the deadline by the Member States because of the complexity of the rules. In 1998, the Member States declared 38 744,2 Mio ECU in expenditure, of which financing was refused for 36,1 Mio ECU.

2.26. Moreover, for 35,7 % of the expenditure, there is no payment deadline. Delays were nevertheless found in implementing these measures (promotion activities or accompanying measures, for example). The Commission is also unable to ascertain that the Member State in question has answered a beneficiary's application within the deadline provided or has complied with the implementation timetable (food aid).

2.27. The Commission needs the Member States' estimates so as to be able to be ready for these financing requirements. But the estimates provided by certain Member States were not reliable enough, particularly at the end of the financial year, i.e. when the need for accuracy is greatest. The regulations currently make no provision for any penalty, however.

2.28. The positive effects of changes in dollar/ECU exchange rates (278 Mio ECU) helped to boost the monetary reserve by 78 Mio ECU (after deduction of the neutral margin of 200 Mio ECU). However, this amount of 78 Mio ECU was transferred from Chapter B1-15 (fruit and vegetables) and not from the budget headings actually affected by the changes in the exchange rate (cereals and sugar).

Management framework

Agricultural regulations

2.29. The agricultural regulations are complex and cover several hundred measures. The EAGGF-Guarantee managers therefore have to apply a large number of provisions that do not always belong to a clear or codified hierarchy and are sometimes even in contradiction with the general Financial Regulation. The consolidation of the agricultural regulations and the Commission's desire for simplification are a step in the right direction, but greater efforts still need to be made.

Budgetary nomenclature

2.30. Expenditure under sub-section B1 is organised in titles, chapters, articles and items in accordance with a nomenclature adopted in the context of the budgetary procedure⁽¹⁰⁾. Given the lack of synchrony between the financial year and the EAGGF-Guarantee financial year, expenditure between 16 October and 31 December is implemented and even declared before the actual adoption of the budget for the financial year under which it falls, which sometimes causes practical difficulties.

2.31. The 1998 budgetary nomenclature (191 items) has for the most part remained much the same as the 1997 version. It is very unbalanced because 93,8 % of the expenditure was booked to just 59 items, 40 % under five items and 0,3 % under 41 items of expenditure, whereas 29 items involve more revenue than expenditure.

2.32. The agricultural Financial Regulation provides for a more detailed sub-nomenclature for accounting

⁽¹⁰⁾ Article 19(2) and(3) of the Financial Regulation.

purposes. This sub-nomenclature (movements on 979 sub-items in 1998) should be improved in the following respects:

- (a) there is no systematic mention of the underlying legal basis;
- (b) it is not always possible to distinguish between the payment of an advance and a final payment or provide a breakdown according to the marketing year concerned. This renders comparisons between one financial year and another difficult.

Computer systems

2.33. In its report concerning the financial year 1997 ⁽¹¹⁾, the Court criticised the organisation of the AGREX and Sincom computer systems. Although the year 2000 problem has actually been studied, the shortcomings in the systems have nevertheless not been dealt with. This explains why incorrect information (dates or amounts) was once again found in AGREX. For example, according to the documents made available to the Court, the total for adjustments for payment deadline overruns amounted in some cases to 7,4 Mio ECU and in others to 13,9 Mio ECU. AGREX gives yet another amount for rejections and it is not possible to establish the reason for these rejections.

2.34. The Commission should therefore provide itself with a computer tool that is truly geared to analysing and checking agricultural expenditure.

Conclusion

2.35. Regarding the budgetary implementation of the EAGGF-Guarantee, the main features of the financial year 1998 were the numerous changes made to the initial budget allocations, the variable level of utilisation (but usually below the initial allocations) and various infringements of the budgetary rules. Because the accounts lack transparency and the possibilities for effectively checking Member States' monthly declarations are limited, the whole framework for the budgetary management of agricultural expenditure (computer systems, procedures, and even the regulations) needs to be improved. In view of the future enlargement of the Union and the transfer of structural measures to the EAGGF-Guarantee, the need for this improvement becomes all the more pressing.

⁽¹¹⁾ See paragraphs 2.24 and 2.25 of the Annual Report concerning the financial year 1997.

SPECIFIC ASSESSMENT OF THE FIELD IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

2.36. Almost all expenditure relating to the common agricultural policy is implemented by the Member States' paying agencies. The Commission pays them a monthly sum, the amount of which is determined on the basis of the total payments declared two months beforehand. These payments are entered in the accounts as expenditure, subject to possible adjustments when the accounts are cleared, after the end of the financial year.

2.37. Pursuant to Commission Regulation (EC) No 1663/95 of 7 July 1995, which lays down the implementing procedures for the clearance procedure, the Member States must send to the Commission, not later than 10 February of the following year, the annual accounts of each paying agency, together with a certificate as to their completeness, accuracy and truthfulness. This certificate must be issued before 31 January by a competent body that is independent of the paying agency on the basis of an examination of procedures and of a sample of transactions, implemented in line with internationally accepted auditing standards. On the basis of this certificate, the Commission clears, before 30 April, the accounts for the financial year that ended on 15 October the previous year. Notwithstanding this clearance, the Commission may subsequently exclude any expenditure that is not in line with Community rules. However, it may do so only within 24 months, except where there are irregularities or procedures related to Articles 88 (State aid) and 226 of the Treaty of Amsterdam (proceedings for failure to fulfil an obligation).

2.38. CAP expenditure essentially corresponds to appropriations under sub-section B1 of the Union's general budget. Payments totalled 38 810 Mio ECU for the financial year 1998 (see paragraphs 2.2-2.35).

Reliability of the accounts

2.39. An examination of the Commission's expenditure management systems did not uncover any information capable of calling into question the overall reliability of the accounts. However, identifying negative expenditure within the accounts is almost impossible as the latter is grouped together with movements that correspond to adjustments made by the Member States. Lastly, an examination of the items related to the EAGGF-

Guarantee did not reveal any major anomalies, except in the case of the revenue and expenditure account (concerning the depreciation of agricultural stocks) and off-balance sheet commitments reflected in the balance sheet. Thus:

(a) the depreciation of agricultural stocks, which was included in the revenue and expenditure account, was not calculated on the basis of the quantities actually held, but on that of an estimate. The Commission ought to base its calculations on the actual quantity of the stocks (for the same problem as for off-balance sheet commitments, see paragraph 2.39 (b) (iii));

(b) In the case of off-balance sheet commitments (assets):

(i) the amount entered under 'potential assets relating to fraud and irregularities observed in the field of EAGGF-Guarantee' (1 747 Mio ECU) has not been correctly evaluated, due to a delay by UCLAF in updating the information;

(ii) similarly, the amount of 862,5 Mio ECU listed under 'potential claims on EAGGF-Guarantee beneficiaries', which concerns sums to be recovered from the paying agencies, does not provide a reliable picture of the total amounts owed as those in Germany concerning 1998 were not registered (as the Member State had not submitted the data in good time). Furthermore, the amounts were valued using the conversion rate applicable on 10 November 1998, whereas the parity applicable on 31 December (which would have increased this heading by approximately 0,2 Mio ECU) ought to have been used. Conversely, a significant number of claims which have been listed under this heading for several years are clearly irrecoverable and should therefore be subtracted from this balance (see paragraph 2.94);

(iii) lastly, the 'net potential gain on disposal of agricultural stocks' (307,9 Mio ECU) was not estimated on the basis of the actual quantities held on 30 September but on the basis of information obtained in August and at the beginning of September (for a similar problem concerning the revenue and expenditure account, see paragraph 2.39 (a)).

(c) In the case of off-balance sheet commitments (liabilities):

(i) 'potential liabilities connected with the clearance of the EAGGF-Guarantee accounts, pending judgment by the Court of Justice' (350,4 Mio ECU) include 15,8 Mio ECU which should have been

subtracted from this balance (as the judgment was given before the close of the financial year), but not the potential liability relating to a disputed sum of 0,3 Mio ECU;

(ii) the amounts still awaiting a recommendation by the conciliation body or the adoption of a position by the Member States should be mentioned under a heading entitled 'potential liabilities relating to the clearance of the EAGGF-Guarantee accounts'.

2.40. The Court therefore reiterates its previous observation on the need to transfer to the balance sheet off-balance sheet commitments corresponding to debts or to definite amounts owed which can be recovered ⁽¹²⁾.

Legality and regularity of the transactions

Substantive errors

2.41. The rate of error likely to affect the value of all agricultural expenditure is once again too high. Half of the errors concern final beneficiaries. In most cases, the errors involve a slight over-declaration of surface area or of the number of heads of cattle. Over-declarations of this kind were detected in almost all the Member States.

2.42. The other substantive errors detected in respect of final beneficiaries concern cases of inconsistency or cases of insufficient evidence that the conditions for granting the aid had been observed, as the following cases demonstrate:

(a) differences between quantities paid for and volumes pressed for olive oil (Portugal);

(b) storage of alcohol (Italy);

(c) aid for the processing of concentrated butter (France);

(d) beef special premium (United Kingdom).

2.43. Certain substantive errors were also uncovered within the paying agencies. For the most part, these

⁽¹²⁾ See paragraphs 8.10 and 8.11 of the Annual Report concerning the financial year 1997 (OJ C 349, 17.11.1998, pp. 125 and 126).

errors concern the incorrect application of Community legislation, as the following cases demonstrate:

- (a) the failure to observe fixed percentages for the payment of an advance by way of aid for organisations of producers of fruit and vegetables (Italy);
- (b) failure to apply a penalty to an irregular declaration relating to the suckler-cow premium (Spain);
- (c) quantities of food aid distributed to the poor which differed from the amounts indicated (Portugal and Greece);
- (d) the rejection without an obvious reason of part of the declared surface area, even though the application is correct in terms of aid for the upkeep of vines, as part of the Poseican programme (Spain);
- (e) over-estimation of the value of an animal slaughtered under the programme to eradicate bovine spongiform encephalopathy (United Kingdom).

Systematic substantive errors

2.44. Systematic substantive errors are substantive errors which have a generalised effect on all or part of a category of expenditure.

2.45. As regards the 1997/98 marketing year, which comes under the 1998 budgetary year, Italy did not send to the Commission by the stipulated deadline the data where milk quotas are exceeded that would have enabled the additional levy due to be calculated. As a result, the Communities forwent negative expenditure totalling approximately 220,6 Mio ECU. This amount, which should have been charged as a reduction in the EAGGF advances paid to Italy in respect of milk production, will not be recovered until the following financial year, a delay which is prejudicial to the principle of the specification of each financial year's appropriations. Finally, the fact that some farmers are exempt from the obligation to pay the levy gives them a competitive advantage.

2.46. Two systematic errors stem from Community legislation being incorrectly transposed or misinterpreted. Thus, in France, the circular on aid for small

maize producers (in the maize base in separate areas) took as the average yield to be remunerated the regional average set-aside yield instead of the regional average cereals yield. Consequently, expenditure for the 1998 financial year was overestimated by 0,3 Mio ECU. In Greece, a law established a compulsory deduction to provision an insurance fund (2 %, rising to 3 % as from 1 January 1998) which is levied on Community aid disbursed by way of aid for the production of tobacco, olive oil and cotton. Although this levy is systematic in nature, no regulation applicable to these markets makes provision to this effect. Thus, 29,5 Mio ECU was deducted in error from Community aid for these three markets.

2.47. Similarly, as regards local management, a systematic error was uncovered in the region of Messinia (Greece). Deductions are made and then paid to the local cooperative, the local Union of Cooperatives and the Producers' Confederation⁽¹³⁾, even though the regulations make no provision to this effect.

Formal errors

2.48. Formal errors have no effect on the value of the transactions examined. They stem from a failure to observe the terms of the regulations and often lead to shortcomings in the management systems. More than one transaction in seven is affected by a formal error.

2.49. As regards the management of payments at the Commission, an analysis of the monthly payment orders showed that in half of the cases (accounting for a total of 278 000 Mio ECU) these payment orders had been approved outside the deadlines laid down in the regulations.

2.50. At Member State level:

- (a) compulsory registers were non-existent or non-compliant as regards the animal premium (Portugal and Ireland) or the storage of wine and grape must (Portugal) due to delays in implementing national application circulars;

⁽¹³⁾ These contributions are relatively significant: 1 % of the amount of Community aid for the Producers' Confederation plus 1 % for the Local Union of Cooperatives, and a flat-rate deduction of GRD 1 300 for the local cooperative.

- (b) checks were inadequate when compared with the required minimum level for export refunds (Belgium) or for cotton production (Greece);
- (c) the implementation of the rules governing the inspection and valuation of stocks was inadequate and the computerised accounting for alcohol stocks was not operational (Italy);

2.51. In terms of local management, these errors essentially concerned:

- (a) export documents which were non-compliant as regards refunds (Sweden);
- (b) vague identification of declared plots as regards aid for the production of olive oil (Spain);
- (c) payments made directly to farmers even though aid must be paid only to a producer organisation in the case of aid for the upkeep of vines in the Canary Islands (Spain);
- (d) the possibility of over-declaration in connection with aid for cotton production due to the use of outdated topographical surveys (some of which date from 1938) which take no account of recently established structures (Greece).

2.52. At the final beneficiary stage, errors are due to:

- (a) inadequate keeping of livestock records, especially as regards beef and veal (Spain, Ireland and the United Kingdom);
- (b) the late submission of production documents (Spain), inconsistency of pressing registers or the lack of output documents in the case of olive oil production (Portugal).

Other errors

2.53. In another category, there are some general errors of an accounting nature which were detected in Ireland and the United Kingdom. In the case of Ireland, two errors stem from poor accounting treatment of adjustment entries as a result of charging errors. At the same time the monthly declaration was not corrected, the balances on certain budget headings notified to the Commission are inaccurate and do not tally with the Member State's accounts, even if the overall amount of

expenditure is still correct. Furthermore, it was noted that the Irish authorities charged recoveries to be made under beef premiums to the nearest payments of this chapter of the budget, irrespective of the budget heading concerned. As a result, the balances of the budget headings are inaccurate even if overall expenditure regarding the chapter remains correct. Furthermore, in the United Kingdom, account entries which were not justified in respect of export refunds were generated automatically in the accounts due to computer problems, although the total amount of expenditure remains correct.

Clearance of 1998 accounts

2.54. Accounts in respect of five paying agencies (SOAEFD (United Kingdom), Ofival and ACCT (France), Bremen (Germany) and Denmark) were submitted after the 10 February deadline. Nevertheless, the Commission was able to take the financial clearance decision in respect of 1998 on the deadline of 30 April 1999. The value of the financial corrections applied was 1,5 Mio ECU. Deductions made from advances during the year and late payments totalling 37 Mio ECU will be subject to a subsequent compliance decision under Article 5 (2)(c) of Council Regulation 729/70⁽¹⁴⁾ as will further amounts found not to comply with Community regulations.

2.55. The Commission considered that the accounts of 13 paying agencies were initially subject to reserves or qualifications but later lifted them, except in the case of four paying agencies (Denmark, Lower Saxony (Germany), Cantabria (Spain) and Ofival (France) for which expenditure of 2 452 Mio ECU declared has been disjoined from the financial clearance decision. Denmark has been informed that the internal audit service will no longer be accepted as a certifying body. In Lower Saxony, the certifying body detected a high number of monetary errors, which are subject to further investigation. The expenditure for Cantabria has been disjoined for the second consecutive year partly because of the poor quality of the certifying body's report. The certifying body for Ofival found a large number of deficiencies in relation to export refunds, calf premium schemes and the beef special premium which will be followed up by the Commission.

⁽¹⁴⁾ Council Regulation (EEC) No 729/70 of 21 April 1970 (OJ L 94, 28.4.1970, p.13).

Conclusion

2.56. Except for the cases noted in paragraph 2.39, it is the Court's view that the EAGGF-Guarantee accounts are generally reliable. As regards the legality/regularity of the underlying transactions, the Court notes that the rate of error noted for the 1998 financial year is still significant and easily exceeds the acceptable maximum rate (see paragraphs 2.41-2.43) This excessively high rate of error shows once again that improvements are called for.

2.57. In order to improve the reliability of the accounts, the Commission should:

- (a) enter all probable debts and all claims (the principle of which is certain and which have become liquid and have fallen due) in the balance sheet (and not off-balance sheet);
- (b) make the necessary checks so as to ensure that income such as the additional milk levy is not omitted.

2.58. In order to reduce the number of errors which affect the legality/regularity of the underlying transactions, the Commission should ensure that the incorporation of Community regulations into national implementing circulars is correct and should see to it that the documents and reports which are required of the Member States are submitted to it in time for the necessary checks to be properly carried out.

2.59. Lastly, the number and nature of the substantive errors detected in respect of final beneficiaries should serve as an incentive for the Member States to step up inspection measures.

CLEARANCE OF THE ACCOUNTS FOR THE FINANCIAL YEARS 1994 AND 1997

Introduction

2.60. During the course of 1998 the Commission took clearance decisions in respect of 1994 and 1997. The former falls under the old system of annual clearance decisions including conformity, which has, with effect from 1996, been replaced by a new procedure whereby a financial clearance decision is taken each year and conformity decisions are taken on an ad hoc basis cov-

ering several years⁽¹⁵⁾. By the end of 1998, the Commission had not taken any conformity decisions under the new procedures. Details of the new procedure are set out in the Court's Special Report No 21/98 verifying the 1996 clearance⁽¹⁶⁾.

2.61. The Court has examined the decisions relating to the EAGGF years' 1994 and 1997. For 1994, clearance audit work was confined to the Commission. For the latter clearance, seven Member States were visited (Denmark, Germany, Greece, Spain, France, Portugal and the United Kingdom), in some cases together with the Commission services. The work of the certifying bodies was the primary focus of these visits but some paying agencies were also visited. The Court continues its programme of visits in the context of an appraisal of the new clearance procedures introduced under Council Regulation (EC) No 1287/95⁽¹⁷⁾.

2.62. The objective of the Court's audit was to determine whether these clearance decisions were soundly based and whether appropriate action had been taken to address the weaknesses identified by the certifying bodies and to recover any sums unduly paid.

Clearance of accounts 1994

Corrections and other adjustments

General

2.63. The Commission's clearance decision for 1994, under the old system, was taken on 6 May 1998⁽¹⁸⁾. Some 308 Mio ÉCU was disallowed (**Table 2.9**) relating primarily to public storage, arable crops, export refunds and meat sectors (**Table 2.10**). Three Member States (France, Italy and the United Kingdom) accounted for 75 % of the total disallowed.

⁽¹⁵⁾ Council Regulation (EC) No 1287/95 of 22 May 1995 (OJ L 125, 8.6.1995, p.1).

⁽¹⁶⁾ Special Report No 21/98 (OJ 389, 14.12.1998, p.1).

⁽¹⁷⁾ Council Regulation (EC) No 1287/95 (OJ L 125, 8.6.1995, p.1).

⁽¹⁸⁾ Commission Decision 98/358 (OJ L 163, 6.6.1998, p.28).

Table 2.9 — Summaries of the Commission's clearance decision for 1994 and 1997

Summary of the Commission's clearance decision for 1994

(Mio ECU)

	B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK	Total
Expenses declared in 1994	1 150,3	1 288,6	5 027,0	2 490,8	4 376,1	8 014,5	1 553,8	3 760,4	11,7	1 886,7		700,3			3 332,9	33 593,1
Expenses disjoined from previous decisions	0,9	34,8	304,3	0,0	439,9	470,6	0,6	169,7	0,4	0,5		17,7			126,5	1 565,9
Expenses disjoined in 1994	- 1,1	- 28,9	- 316,9	- 45,3	- 612,5	- 464,5	- 4,4	- 232,3	- 0,3	- 0,3		- 34,8			- 135,0	- 1 876,3
Amounts disallowed	- 10,2	- 4,6	- 21,8	- 14,7	- 9,7	- 78,5	- 4,5	- 99,3	- 0,3	- 9,0		- 5,1			- 50,0	- 307,7
Expenditure cleared	1 139,9	1 289,9	4 992,6	2 430,8	4 193,8	7 942,1	1 545,5	3 598,5	11,5	1 877,9		678,1			3 274,4	32 975,0
Expenditure charged in respect of the current year	1 150,3	1 285,5	5 026,7	2 490,9	4 373,0	7 987,4	1 550,2	3 734,9	11,7	1 882,0		692,1			3 333,1	33 517,8
Expenditure charged to following year						27,2		18,8								46,0
Amounts to be recovered by the EU (-) or paid to the Member State (+)	- 10,2	- 1,5	- 21,5	- 14,8	- 6,6	- 78,6	- 0,9	- 92,6	- 0,3	- 4,3		3,1			- 50,2	- 278,4

Source: Annex 20 to the 24th financial report.

Summary of the Commission's clearance decision for 1997

(Mio ECU)

	B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK	Total
Expenses declared in 1997	965,6	1 225,3	5 710,3	2 709,9	4 601,3	9 116,5	2 011,8	5 342,3	22,4	1 741,9	851,0	645,4	560,1	742,3	4 638,2	40 884,3
Reductions and suspensions	- 0,1	0,0	- 0,1	- 1,8	- 69,7	- 0,7	- 0,2	- 245,6	0,0	- 0,1	0,0	- 5,1	0,0	0,0	- 6,2	- 329,6
Amounts disallowed	0,0	0,0	- 0,1	0,0	0,1	0,0	0,0	0,0	0,0	0,0	0,0	- 4,5	0,0	0,0	5,6	1,1
Expenses cleared	965,5	1 225,3	5 710,1	2 708,1	4 531,7	9 115,8	2 011,6	5 096,7	22,4	1 741,8	851,0	635,8	560,1	742,3	4 637,6	40 555,8
Expenditure charged in respect of the current year	965,2	1 224,8	5 709,7	2 708,0	4 534,7	9 114,3	2 004,9	5 089,8	22,2	1 741,8	851,0	640,3	560,1	741,9	4 645,9	40 554,6
Expenditure charged in February 1998 but related to 1997	0,3	0,5	0,6		0,5	1,3	1,1	0,3	0,2	0,2				0,4	5,1	10,5
Total amount of expenditures charged for 1997	965,5	1 225,3	5 710,3	2 708,0	4 535,2	9 115,6	2 006,0	5 090,1	22,4	1 742,0	851,0	640,3	560,1	742,3	4 651,0	40 565,1
Amounts to be recovered by the EU (-) or paid to the Member State (+)	0,0	0,0	- 0,2	0,1	- 3,5	0,2	5,6	6,6	0,0	- 0,2	0,0	- 4,5	0,0	0,0	- 13,4	- 9,3

Table 2.10 — Corrections and disjunctions by category (1993 and 1994)

(Mio ECU)

	1993		1994		Trend	
	Corrections	Disjunctions	Corrections	Disjunctions	Corrections	Disjunctions
Regulation (EEC) No 4045/89			22,7		22,7	0,0
Public storage of cereals	42,4		40,7	9,2	- 1,7	9,2
Arable crops	5,9	1 369,4	37,9	1 384,4	32,1	15,0
Other	0,0		- 0,3		- 0,3	0,0
Fruit and vegetables	1,2		17,4		16,3	0,0
Milk and milk products	264,9	80,6	27,9	0,6	- 237,0	- 80,0
Olive oil etc.	112,0	99,3	2,2	431,3	- 109,8	332,0
Export refunds	216,3		68,3	0,6	- 148,1	0,6
Meat	78,3		66,0	45,1	- 12,3	45,1
Wine and tobacco	33,7	17,5	24,9	4,9	- 8,8	- 12,6
Total	754,6	1 566,8	307,7	1 876,1	- 447,0	309,3

2.64. The amount disallowed for 1994 was less than half of that disallowed in respect of each of the years 1992 and 1993 (788,2 Mio ECU and 754,7 Mio ECU respectively). This was due primarily to lower corrections in the milk sector. Because there were fewer breaches of milk quotas, corrections amounted to 27,9 Mio ECU in 1994 compared with 263,7 Mio ECU in the previous year⁽¹⁹⁾. Corrections in the olive oil sector were also significantly lower: 2,2 Mio ECU in 1994 compared with 112,7 Mio ECU in 1993 but 426,8 Mio ECU of expenditure was disjoined⁽²⁰⁾. Corrections for export refunds fell from 216,5 Mio ECU in 1993 to 68,2 Mio ECU in 1994 due to fewer large ad hoc corrections.

2.65. Some 6 % (1 876 Mio ECU) of the amounts declared by Member States were disjoined, most of which relates to oilseeds advances which are cleared when the final amount is paid in the following EAGGF year. In relation to this procedure, adopted by the Commission in respect of 1993, the Court maintains the view stated in its special report on the clearance of accounts for that year⁽²¹⁾, on the grounds that expenditure proper to a given year should be cleared in the decision that relates to it.

⁽¹⁹⁾ See Council Regulation (EC) No 1288/95 (OJ L 125, 8.6.1995).

⁽²⁰⁾ This procedure postpones the decision on the expenditure concerned until a later EAGGF year.

⁽²¹⁾ Special Report 2/98, paragraph 8.2 (OJ C 121, 20.4.1998).

2.66. In addition, due to insufficient appropriations on the budget lines for 1994 for various wine measures, the Commission deducted some 46 Mio ECU declared by France and Italy for the 1994 financial year and charged it to the 1995 EAGGF year thereby breaching the principle of annuality.

The use of flat rates

2.67. As the Court has noted in its previous reports⁽²²⁾ recourse to flat-rate corrections is only necessary in cases where the actual financial impact of systems weaknesses cannot be established. Flat rates of 2, 5, 10 or 25 % are used by the Commission to determine an amount of correction when systems weaknesses are detected during an audit. For example, the 2 % rate is applied when key controls are satisfactory but secondary controls are partly or totally ineffective and the 25 % rate is applied when there is no system of controls for a measure in the Member State, or one of its regions and there are signs of frequent irregularities and frauds (see **Table 2.11**). They can be applied to successive years until the situation improves. The determination of the rate to apply was inevitably somewhat subjective.⁽²³⁾ Flat-rate corrections are often referred by the Member States to the Conciliation Body. Of the 28 cases relating to 1994 expenditure submitted to the Conciliation

⁽²²⁾ Special Report No 1/97 (OJ C 52 21.2.1997) and Special Report No 2/98 (OJ C 121 20.4.1998).

⁽²³⁾ The guidelines regarding flat-rate corrections were revised in December 1997.

Table 2.11 — Corrections: use of flat rates

	EAGGF YEARS	
	1990 to 1993	From 1994 on
Document of the Commission	VI/216/93	VI/5330/97
Flat rates available	2 % 5 % 10 %	2 % 5 % 10 % 25 %
Criteria for a financial correction	Level of risk of financial loss to the Fund occurring because of the control weaknesses.	Significant weaknesses in the application of EC regulations which imply a real risk of financial loss for the Fund ⁽¹⁾ .
New notion since 1994		A distinction is made between key controls and secondary controls
Use of 2 % flat rate	The weakness is limited to a few less important elements of the control which are not essential to assess the regularity of the expenditure. The risk of loss for the Fund is limited.	Key controls are satisfactory but secondary controls are partly or totally ineffective.
Use of 5 % flat rate	The weakness relates to important elements of the control system. Therefore, the risk of loss for the Fund is significant.	Not all the key controls are executed in the number, frequency and with the rigour required by the regulations. Therefore, the risk of loss for the Fund is significant.
Use of 10 % flat rate	Fundamental controls are not operating effectively. Therefore, the risk of loss for the Fund is high.	One or more key controls do not operate and it is thus not possible to determine the eligibility of a claim and its regularity. Therefore, the risk of loss for the Fund is high.
Use of 25 % flat rate		There is no system of controls for a measure, in the MS or one of its regions, and there are signs of frequent irregularities and frauds. There is a risk of high losses to the Fund.
Use of higher flat rates		If the weaknesses are such that most of the payments are irregular.

⁽¹⁾ The Fund = EAGGF.

Body between February 1997 and March 1998, 18 dealt with flat-rate corrections amounting to 136,5 Mio ECU, six of which resulted in reductions amounting to 8,9 Mio ECU.

25 % rate was excessive but the Commission maintained its position.

2.68. For the 1994 EAGGF year, the 25 % rate was only applied in three instances for confined geographical areas (Corsica, Sicily and Calabria) or to small schemes such as production aid for fibre flax in the United Kingdom and the amounts involved did not exceed 10 Mio ECU. Italy and the United Kingdom submitted their cases to the Conciliation Body who concluded that the

2.69. The flat-rate corrections of 10 % for Spain and Greece in respect of production aid for olive oil, applied in 1993 and 1994 for campaigns up to 1992/93, were reduced by the Commission for later campaigns to 5 % on the basis that in its view there had been improvements in the work of the olive oil agencies. For Spain, the Commission accepted figures provided by the national authorities showing that the total quantity

milled exceeded that on which aid was paid to producers. The figures supplied by Greece for the 1993/94 and 1994/95 years were accepted by the Commission even though they regarded them as unreliable. They also accepted Spain's point of view that the primary control is that performed by the olive oil agency at the mills and that there was a lower risk to the Fund.

2.70. Moreover, the Commission's summary report for 1994 points out that serious weaknesses persist, such as:

- (a) failure by national authorities to apply sanctions;
- (b) significant discrepancies between the number of trees counted by the olive oil agency and the number of trees declared (on-the-spot controls of producers by the olive oil agencies are still limited, 0,37 and 0,23 % of the total number of producers for 1993/94 in Greece and Spain respectively);
- (c) the absence or ineffectiveness of the olive cultivation register and of a computerised data system. In the Court's opinion, the arguments accepted by the Commission, and presented in their reply, were not, in the light of the continuing weaknesses in the system, adequate justification for the application of a reduced flat rate.

Corrections made for delayed recoveries

2.71. Up to the year 1992/93 the amount of the milk super-levy paid over by Member States to the EAGGF did not include sums under litigation. With effect from the 1993/94 year, the Commission decided to make corrections for all the amounts not recovered as of April 1997 by Member States. A total of 20 Mio ECU was corrected in the 1994 decision, 86 % of which related to France for the years from 1988/89 to 1991/92.

Lack of or inadequate corrections

2.72. A correction was not made for weaknesses in the management of the olive oil production aid scheme in Portugal, whereas for comparable failings significant corrections were made for Spain and Greece (21,2 Mio ECU and 14,5 Mio ECU respectively).

2.73. In Italy, the authorities had used the wrong green rate in the calculation of the amounts to be paid for the permanent abandonment of wine production. Because the Commission had previously approved the application of this rate, it was unable to recover the estimated 8 to 10 Mio ECU at stake.

2.74. The amount disallowed by the Commission in response to the findings of the Court concerning exports of feta cheese from Denmark ⁽²⁴⁾ is inadequate. The Court's observations related to the decision of the Danish authorities not to take account of the results of laboratory tests on feta carried out under national procedures during the period 1990-94. Although these were designed for purposes other than export refunds, they relate to the same parameters of fat and water content used to determine eligibility for export refunds and failure to meet the parameters could and did result in the application of fines which were credited to the national budget. The Court considers that the determination of the characteristics of the product during checks before exportation should be taken into consideration when deciding whether the product satisfies the conditions for granting an export refund. The Commission agrees but has decided to disallow only on the basis of specific instances where the tests have revealed non-compliance (0,5 Mio ECU) and not to use the minimum error rate (3,3 % representing some 16 Mio ECU for the years 1990 to 1994), as described in the Annual Report 1995. The Commission contends that the individual results provide a more solid basis for a correction than an extrapolation. The 3,3 % error rate, however, was established from the results of a system which was designed to provide assurance to the customer that all of the feta supplied complied with the chemical and biological specifications. It has been corroborated by the results of tests carried out under two independent systems, both of which had higher error rates. The Commission's contention that this error rate is distorted because it includes samples which have failed the national minimum fat content parameter of 40 % but which would not have failed the EC minimum of 39 % is misleading because the overwhelming majority of failures relate to water content.

Notification of corrections

2.75. The determination of corrections was a long process involving several inspections per market and spanning two or three years. This was partly due to a

⁽²⁴⁾ Annual report concerning the financial year 1995, chapter 3, paragraphs 3.32-3.64 (OJ C 340, 12.11.1996).

lack of staff resources within the clearance unit and was the primary reason for the four-year delay between 1994 EAGGF year-end and the clearance decision. In April 1996 the lack of staff was one of the reasons why the European Parliament withheld the discharge for 1992. The Parliament demanded that the Commission increase its staff by 15 posts; 11 had been filled by the end of 1998. The remaining 4 posts should be allocated during 1999. Consistent staffing weaknesses are not acceptable and the Commission must put in place a workable strategy that will resolve the problem.

2.76. Given that the unit did not have sufficient staff to perform all the necessary work, private audit firms were contracted to perform audits, comprising evaluations of the systems and internal controls operating within the paying agencies. Of the 29 audits that took place in 1995, 20 were performed by private audit firms. Some of the audits relating to 1993 and 1994 were not performed until 1996. The Commission's legal service advised that the flat-rate corrections proposed in respect of the expenditure declared by three paying agencies ⁽²⁵⁾ (192 Mio ECU) for systematic weaknesses identified during the audit were without a legal basis.

2.77. For five cases (corresponding to 27,7 Mio ECU of corrections and 295,7 Mio ECU of disjunctions) out of a sample of 20 examined by the Court, there have been delays of up to 12 months between the date of the Commission's visit to a Member State and the issuing of the letter of observations and up to 17 months between the letter of observations and the notification of corrections. These situations are partly caused by delays in the responses from Member States.

Clearance of accounts 1997

Financial analysis

2.78. The 1997 clearance of accounts decision was taken within the 30 April 1998 deadline ⁽²⁶⁾, although expenditure for three small Spanish paying agencies (2 % of the total declared by Spain) was disjoined pending further work by the certifying bodies. These amounts were cleared by the Commission decision in February

⁽²⁵⁾ LASER (Netherlands) 2 %; AIMA (Italy) 2 %; Gedidagep (Greece) 5 %.

⁽²⁶⁾ Commission Decision 98/324/EC of 29 April 1998 (OJ L 141, 13.5.98, p.38).

1999 ⁽²⁷⁾. All the certifying bodies' met the deadline, except for the United Kingdom, which was a few weeks late.

2.79. Since 1996, corrections in the financial decisions distinguish between reductions/suspensions and amounts disallowed. Reductions and suspensions are adjustments to Member States' advances resulting from checks carried out by the Commission's accounting service. In 1997, these adjustments amounted to 329,6 Mio ECU, compared to 55,5 Mio ECU in 1996. This increase is primarily due to the inclusion of milk super-levies for Spain (65 Mio ECU) and Italy (232 Mio ECU).

2.80. The amounts actually disallowed as a result of the clearance unit's audit of the certifying bodies are minimal, indeed the net position is in favour of the Member States (**Table 2.9**). Under the new system the signs are that all significant disallowances will be made in the conformity decisions. No conformity decisions had been taken by the end of 1998.

Certification of accounts

Qualified certificates

2.81. The accounts for 17 paying agencies were qualified — seven small paying agencies (< 100 Mio ECU) and 10 large ones. A number of reasons for qualification were common to several paying agencies, regardless of their size, such as incomplete debtor ledgers or lack of supporting evidence. The accounts of eight of the paying agencies concerned were also qualified for the financial year 1996 ⁽²⁸⁾.

2.82. Concerning two of the larger paying agencies whose accounts were qualified in 1997, the Directorate-

⁽²⁷⁾ Commission Decision 1999/151/EC of 10 February 1999 (OJ L 49, 25.2.99, p.42).

⁽²⁸⁾ Azienda di Stato per gli Interventi nel Mercato Agricolo (AIMA) (Italy), Intervention Board Executive Agency (IBEA) (United Kingdom), Belgisch Interventie- en Restitutiebureau (BIRB) (Belgium), Dienst Landelijke Service Regelingen (LASER) (Netherlands), Instituto Nacional de Intervenção e Garantia Agrícola (INGA) (Portugal), Instituto do Financiamento e Apoio ao Desenvolvimento da Agricultura e Pescas (IFADAP) (Portugal), Fondo Español de Garantía Agraria (FEGA) (Spain), Productschap voor Groenten en Fruit (Pvis) (Netherlands).

General for the Administration of Purchases of Agricultural Produce (Gedidagep) (Greece) and the Intervention Board Executive Agency (IBEA) (United Kingdom), the accounts of the former were qualified primarily for lateness regarding its IACS controls and the latter for reconciliation problems. Although according to the certifying bodies neither met the accreditation criteria, no action was taken at that time by the authorities of the Member States concerned to call their status as paying agencies into question. The situation with regard to IBEA has since improved, key personnel have been replaced and much remedial work has been undertaken. As far as Gedidagep is concerned, despite a number of improvements the situation remains one of concern, since key accreditation criteria have still to be met. The Commission has no authority to rescind its accreditation and the Member State has not proposed a viable alternative. However, the Commission is empowered to open procedures under Article 13 of Council Decision No 729/94/EC⁽²⁹⁾ on budgetary discipline, under which it may reduce or provisionally suspend monthly advances to Member States where information supplied is deemed unsatisfactory or indicated manifest non-compliance, although no such action was taken during 1998 in the context of the new clearance procedures. In 1998, legal provisions have been adopted to restructure the organisation of the paying agency. It is too soon to say what impact this will have in Greece.

Internal audit

2.83. In the context of certification of accounts, Denmark and Germany continue to use internal audit departments of the paying agencies as the certifying body. The Court has already criticised this practice on the grounds that internal audit does not have the degree of independence necessary to fulfil this function.

2.84. Significant weaknesses raised in internal audit reports should be met with appropriate management action and any errors found by internal audit should be taken into account in the preparation of the opinion on the accounts. In some Member States, until these weaknesses are drawn to the attention of the paying agency in the certifying body's report, the problems persist. For example, in 1996, the Court informed Portugal about a systematic error concerning the calculation of bovine headage factors and in the certifying body's report reference was made to the same finding by internal audit in 1997; as at February 1999 no recoveries had taken

place. During 1997, in the United Kingdom the certifying body for MAFF found errors in the application of penalties for the late presentation of claims for the arable area payments scheme. Internal audit had reported on this in October 1996 and the paying agency had not taken any corrective action. The Commission should follow up these matters in the relevant conformity inspections.

Number of paying agencies

2.85. The number of active paying agencies has increased from 78 in 1996 to 91 in 1997 (Table 2.12). This is almost entirely due to the fact that paying agencies within the autonomous communities in Spain have become operational. On the other hand, the number of paying agencies was reduced in three Member States. One small paying agency transferred its operations to a larger one in the United Kingdom, one in Austria and one in Italy were closed in early 1998. The lowest amount declared by a paying agency was just 24 500 ECU (Austria — Vorarlberg) in 1997⁽³⁰⁾. As can be seen in Table 2.11, seven paying agencies declared less than 1 Mio ECU, 16 less than 5 Mio ECU. At the other end of the scale, nine paying agencies account for more than 21 000 Mio ECU, some 50 % of the total declared for 1997.

2.86. Given the size of the smaller paying agencies, there is scope for more rationalisation, particularly in Austria where four of six paying agencies declared less than 1 Mio ECU and in Germany where seven declared less than 10 Mio ECU and a single Land has four paying agencies (Table 2.12). There is a risk that the cost of accreditation compliance may be disproportionately high for such paying agencies⁽³¹⁾.

Accreditation criteria

2.87. Commission Regulation (EC) No 1663/95⁽³²⁾, and in particular the annex thereto, sets out a number

⁽³⁰⁾ The paying agencies Amt der Voralberger Landesregierung and Amt der Tiroler Landesregierung have been closed with effect from 15.10.1998.

⁽³¹⁾ Special Report No 21/98, paragraph 2.2 (OJ C 389, 14.12.1998).

⁽³²⁾ Commission Regulation (EC) No 1663/95 laying down detailed rules for the application of Council Regulation (EEC) No 729/70 regarding the procedure for the clearance of the accounts of the EAGGF-Guarantee Section (OJ L 158, 8.7.1995, p.6).

⁽²⁹⁾ OJ L 293, 12.11.1994, p.14.

Table 2.12 — Amounts declared by paying agencies (1997)

No	Member State	Paying agency	Amounts cleared (Mio ECU)	% of total
1	754,6	1 566,8	5 222,30	12,68
2	France	ONIC	3 915,49	9,50
3	Greece	GEDIDAGEP	2 409,09	5,85
4	United Kingdom	MAFF	2 286,49	5,55
5	Ireland	DAF	1 947,45	4,73
6	United Kingdom	IBEA	1 505,97	3,66
7	France	SIDO	1 408,71	3,42
8	Denmark	EU-Direktoratet	1 218,91	2,96
9	Spain	FEGA	1 052,45	2,55
			20 966,86	50,89
10	Spain	Andalucía	945,94	2,30
11	France	Ofival	924,39	2,24
12	France	Onilait	893,99	2,17
13	Germany	Hamburg-Jonas	860,61	2,09
14	Austria	AMA	783,88	1,90
15	Germany	BLE	761,60	1,85
16	Germany	Bayern StMELF	750,89	1,82
17	Sweden	SJV	749,31	1,82
18	Belgium	BIRB	666,10	1,62
19	Spain	Castilla-La Mancha	641,20	1,56
20	Netherlands	LASER	629,45	1,53
21	France	FIRS	625,96	1,52
22	Spain	Castilla y León	607,25	1,47
23	Germany	Niedersachsen MELF	564,43	1,37
24	Finland	MMM	554,09	1,34
25	Portugal	INGA	549,93	1,33
26	France	Services déconcentrés du Trésor	548,21	1,33
27	United Kingdom	SOAEFD	531,61	1,29
28	Netherlands	PZ	513,45	1,25
29	Spain	Extremadura	392,17	0,95
30	Netherlands	HPA	385,33	0,94
31	Germany	Mecklenburg-Vorpommern LM	385,20	0,93
32	Germany	Brandenburg MELF	341,03	0,83
33	Italy	DCCC	339,75	0,82
34	Spain	Aragón	339,63	0,82
35	Germany	Sachsen-Anhalt ML	335,78	0,82
36	Belgium	Ministerie van Landbouw (DG3)	295,59	0,72
37	Germany	Baden-Württemberg MLR	293,04	0,71
38	Germany	Sachsen	273,21	0,66
39	Germany	Nordrhein-Westfalen Westfalen	255,01	0,62
40	Germany	Schleswig-Holstein MELFF	250,32	0,61
41	United Kingdom	WOAD	248,86	0,60
42	Spain	Cataluña	245,05	0,59
43	Germany	Thüringen TLVwA	244,66	0,59
44	France	ONIFLHOR	242,77	0,59
45	France	CNASEA	230,37	0,56
46	United Kingdom	DANI	225,21	0,55
47	Netherlands	PVE	204,64	0,50
48	Germany	Hessen HMILFN	174,33	0,42
49	France	SAV	143,21	0,35
50	Spain	Canarias	120,39	0,29
51	Germany	Rheinland-Pfalz MWVLW	118,48	0,29
52	France	Odeadom	112,96	0,27
53	Spain	Valencia	103,67	0,25
54	Italy	IGFOR	97,15	0,24
55	Portugal	Ifadap	86,59	0,21
56	Germany	Nordrhein-Westfalen Rheinland	85,78	0,21
57	France	Onivins	82,73	0,20
58	Spain	Navarra	71,50	0,17
59	Austria	ZA Salzburg	61,81	0,15
60	Spain	Galicia	56,89	0,14
61	Spain	Asturias	36,27	0,09
62	Spain	Madrid	33,69	0,08
63	Spain	País Vasco	30,71	0,07
64	Spain	Murcia	27,90	0,07
65	Luxembourg	Ministère de l'agriculture	22,28	0,05
66	Spain	Rioja	19,84	0,05
67	Spain	Cantabria	13,71	0,03
68	Germany	Saarland MUEV	13,28	0,03
69	United Kingdom	FC	12,42	0,03
70	Spain	Baleares	11,93	0,03
71	Italy	ENR	10,98	0,03
72	France	FIOM	9,52	0,02
73	Germany	Nordrhein-Westfalen LfBJ	9,36	0,02
74	Spain	FROM	5,95	0,01
75	Netherlands	PT	5,87	0,01
76	Netherlands	DLG	4,67	0,01
77	Germany	WB Hamburg	3,50	0,01
78	Germany	Bayern StMLU	3,06	0,01
79	Germany	Berlin SenWiTech	2,24	0,01
80	United Kingdom	CCW	1,91	0,00
81	Netherlands	STOAS	1,61	0,00
82	Germany	Bremen	1,47	0,00
83	Germany	Nordrhein-Westfalen LfA	1,32	0,00
84	Germany	Schleswig-Holstein MNU	1,16	0,00
85	Austria	BMLF Abt. VI. B.8 (Wien)	0,94	0,00
86	Austria	Landesamt Tirol	0,51	0,00
87	Austria	Landesamt Salzburg	0,47	0,00
88	Belgium	Organisme payeur de la Région Wallonne	0,42	0,00
89	Netherlands	PVis	0,12	0,00
90	Netherlands	MVO	0,04	0,00
91	Austria	Landesamt Vorarlberg	0,02	0,00
		Total	41 199,40	100,00

of criteria that the paying agency should meet before it is accredited by the Member State. In addition, the Commission has provided the Member States with a series of guidelines. The certifying body, in its annual report, must comment upon the fulfilment of these criteria during the financial year but has no remit to recommend whether or not the paying agency should retain its accreditation status. It is clear from an examination of these reports and recent visits made by the Court that certain weaknesses persist in numerous paying agencies as illustrated in the following paragraphs.

Delegation of functions

2.88. Certain functions of the paying agency may be delegated to other bodies, provided that the conditions stipulated in the regulation are fulfilled. Delegation to some extent exists in all Member States and most paying agencies. As stipulated in the guidelines annexed to the regulation, under no circumstances must the payment function be delegated, which was the case for some measures in Denmark and Greece.

2.89. With regard to export refunds, the paying agencies are required to ensure that payments are in conformity with EU legislation. In general the customs authorities of the Member States are responsible for the physical checks⁽³³⁾ that provide evidence of compliance or otherwise. The customs authorities are independent of the paying agencies. It is therefore essential that procedures are put in place to ensure adequate cooperation between the two entities including ensuring that the required number of controls of the required quality has been carried out. The Commission's guideline issued in 1998 emphasises the need for a formal agreement (protocol) between both parties.

2.90. In some Member States (France, Italy, United Kingdom) the information obtained by the paying agencies was inadequate to ensure that the required controls had been carried out. For example, in the United Kingdom no attestation was provided by Customs and Excise before the certificate was signed by the certifying body. Similar problems exist with regard to other delegated functions.

2.91. At the request of the Commission, the certifying body (CCCOP) for France produced a specific report on

the role of the DDAF with particular regard to the main Integrated Administrative and Control System (IACS)⁽³⁴⁾ measures, all of which are managed at local level. The audit of the DDAF is the responsibility of Coperci (a control/audit service of the Ministry of Agriculture) but it only covers IACS schemes. Other EAGGF measures managed by DDAF, which for 1997 included more than 100 Mio ECU under direct support for beef producers to combat the effects of the BSE crisis, are not audited by the Coperci or any other independent body. In its report the certifying body stated that it was given only limited access to Coperci audit reports and was not able to comment on the quality of physical inspections (Coperci may perform such inspections but had not done so). Much of the expenditure that is dependent on checks performed at DDAF is thus not subject to adequate control either by Coperci or the certifying body yet none of the certificates for the paying agencies concerned were subject to a scope limitation.

2.92. More generally, the results of IACS inspections are not systematically covered in the relevant certifying body reports. Some certifying bodies only make oblique references to IACS or include limited data such as the number of inspections rather than the quality and financial consequences of the inspectors' reports. Given that the majority of EAGGF expenditure (excluding export refunds and storage) is now subject to IACS, certifying bodies should, where appropriate, be obliged to evaluate the system and assess the implications of the results of physical inspections. Such an analysis should make

⁽³³⁾ Council Regulation (EEC) No 386/90 (OJ L 42, 16.2.1990, p.6).

⁽³⁴⁾ Council Regulation (EEC) No 3508/92 of 27 November 1992 introduced an integrated administration and control system, the main elements of which are:

- (a) aid applications; in order to be eligible for area aid each farmer must submit every year an application indicating all agricultural parcels, including forage area and parcels covered by set-aside;
- (b) a computerised database which shall record for each agricultural holding the data provided by the aid applications;
- (c) an alphanumeric identification system for agricultural parcels, i.e. a system to allow areas declared to be located so they can be monitored over time and so that computerised cross-checks conducted;
- (d) an integrated control system for administrative control and field inspections.

an important contribution to the certifying bodies conclusions about the overall control environment and the likely level of error.

2.93. Article 19 of Commission Regulation 746/96⁽³⁵⁾ requires that all applications for agro-environmental aid be subject to exhaustive administrative checks and must include cross-checks with IACS data with effect from 1 January 1997. Clearly, in Greece, where IACS is still not operational, this is not possible. A few of the paying agencies in other Member States have performed 100 % checks but most of them have carried out a limited sample check. The certifying bodies have not qualified their opinions for failure to comply with this regulation.

Protection of the Community's financial interests

2.94. In 1996, Member States were requested to provide details of debtors in the form of a table to be annexed to the accounts (Table 105). Many were unable to identify or quantify debtors at this time. Some progress was made during 1997, at least as far as identification of debts was concerned, but the situation remains unsatisfactory in 1998. All Member States, except Germany, submitted the table and the total debts amount to 862,5 Mio ECU as at 15 October 1998. However, the table remains voluntary and is not, therefore, subject to certification although the certifying body is required to comment on whether the Community's financial interests are safeguarded. In most cases the debtors records are incomplete or inaccurate and many debts have been outstanding for several years. Some 60 % of the total debts relate to Italy (mainly olive oil measures and export refunds) and most of this is the subject of lengthy legal proceedings. A statement of balance should be made obligatory. This would include items in suspense, sundry debtors, creditors and cash. Procedures should also be agreed for the write-off of irrecoverable amounts in cases other than those of irregularity for which procedures already exist.

2.95. The use of suspense accounts and general accounts in which national and EAGGF monies are

mixed creates further difficulties (France, Portugal and United Kingdom). Furthermore, according to the certifying body in France, it does not have access to these accounts in order to determine if EAGGF funds are included.

2.96. In Portugal and the United Kingdom cheques issued but not cashed by the beneficiary after more than one year are not credited to the EAGGF (0,3 Mio ECU) although they are automatically cancelled after six months in the United Kingdom and 12 months in Portugal. The amounts to be recovered by offset (deduction from subsequent payments) are not included under debtors, neither are significant amounts in respect of overpayments for which invoices have not yet been raised. Although these are systematic weaknesses, the Commission has no information on the amounts involved.

2.97. In Portugal, as at 15 October 1998, advances of 15,5 Mio ECU in respect of olive oil consumption aid remained outstanding, in some cases after more than four years.

Conclusion

2.98. Although the amount disallowed for 1994 was significantly lower than that for the previous two years, this does not reflect a lower level of coverage by the Clearance Unit but rather the nature of the corrections in respect of the milk sector. Furthermore, various corrections were either not applied or should have been higher and 8 Mio ECU was irrecoverable because the Commission had previously approved an incorrect green rate (paragraphs 2.69 and 2.72-2.74).

2.99. The three and a half year delay between the end of the EAGGF year and the date of the clearance decision is not atypical of the 'old' system. This is clearly detrimental to the protection of the Community's financial interests in terms of the notional loss of interest.

2.100. The refusal of expenditure (46 Mio ECU) due to a lack of appropriations penalises the Member States and breaches the principle of annuality (see paragraph 2.66).

2.101. Conformity decisions must respect the 24-month rule under which timely notification of the

⁽³⁵⁾ Commission Regulation (EC) No 746/96 of 24 April 1996 laying down detailed rules for the application of Council Regulation No 2078/92 on agricultural production methods (OJ L 102, 25.4.96, p.19).

Commission's findings is paramount in order to minimise the risk that untoward delays will result in lost opportunities. No decision to disallow expenditure on conformity grounds had been taken by the end of 1998 (see paragraph 2.80).

2.102. Stronger action is needed by the Commission to enforce compliance with the accreditation criteria, particularly given that the Commission has no direct power to override accreditation decisions by the Member States (see paragraphs 2.81-2.82).

FOLLOW-UP OF PREVIOUS REPORTS: FRUIT AND VEGETABLES

Introduction

2.103. Fruit and vegetables account for about 4,5 % (1 662 Mio ECU in the 1999 budget) of annual expenditure under the EAGGF-Guarantee budget, but contribute 15 % to the value of the EU's final agricultural production, with shares up to 30 % in southern Member States.

2.104. The fruit and vegetables sector is governed by two common market organisations (COM), one for fresh and one for processed fruit and vegetables. The markets are characterised by strong variations in production volumes of the different products from one harvest season to another and of regular shortages of supply outside the EU harvest seasons. The main objective of the COMs is therefore to achieve a balance between supply and demand at prices that are fair both to producers and to consumers.

2.105. The Court's last audit of the COMs in fruit and vegetables dates back to 1993/94⁽³⁶⁾. It concentrated on certain aspects of the management of the market such as the fixing of prices and aid rates and the role of producer organisations. The audit covered the main market measures as well as the special schemes for dried grapes and nuts.

2.106. In view of the ever-growing imbalances for certain products and in response to the Court's observa-

tions in a special report of 1980⁽³⁷⁾, Special Report No 2/89⁽³⁸⁾ and in the Annual Report concerning the financial year 1994⁽³⁹⁾, following a common declaration by the Council and the Commission in September 1993 and an analysis of the market situation made in 1994 at the request of the European Parliament⁽⁴⁰⁾, the Commission made a proposal which addressed the main weaknesses of the previous market organisation. The Commission's reform proposal was tabled in October 1995⁽⁴¹⁾, the Council decided in November 1996. The reform entered into force on 1 January 1997⁽⁴²⁾.

2.107. In the following paragraphs an assessment is made of the extent to which the reform responded to the Court's main criticism.

Findings of the Court's previous audit and the reform of 1996

Producer organisations

2.108. Producer organisations (POs) are considered to be the basic elements in the COM. Their task is to group supply in order to strengthen the position of its members in the market, to market the produce and to organise, if necessary, withdrawals. Community aid for withdrawals is channelled through POs.

2.109. The Court's audit in 1993/94 had found that the system for the inspection and approval of producer organisations by the Member States was very weak and should be strengthened. After nearly 30 years of operation, encouragement and assistance, producers and their organisations still found it difficult to set up adequate intervention funds and to properly fulfil their duties of market management.

⁽³⁷⁾ OJ C 258, 6.10.1980, p. 1.

⁽³⁸⁾ OJ C 128, 24.5.1989, p. 44.

⁽³⁹⁾ OJ C 303, 14.11.1995, chapter 2.

⁽⁴⁰⁾ COM(94) 360 final, 27.7.1994.

⁽⁴¹⁾ COM(95) 434 final, 4.10.1995.

⁽⁴²⁾ Council Regulation (EC) No 2200/96 of 28 October 1996 (OJ L 97, 21.11.1996 p. 1)

Council Regulation (EC) No 2201/96 of 28 October 1996 (OJ L 97, 21.11.1996 p. 29).

Council Regulation (EC) No 2202/96 of 28 October 1996 (OJ L 97, 21.11.1996 p. 49).

⁽³⁶⁾ Annual Report concerning the financial year 1994 (OJ C 303, 14.11.1995).

2.110. Further reasons for the weakness of POs were:

- (a) their creation, beside traditional structures, of multi-product cooperatives without appropriate adaptation,
- (b) the unwillingness of farmers in certain regions of the Community to join any kind of association,
- (c) the lack of professionalism in marketing.

2.111. The reformed regime aims at improving market balance by creating a more market-orientated sector, in particular by strengthening the role of producer organisations. Aid should be channelled only through officially recognised producer organisations and the Community is co-financing a new operational fund for POs which would implement approved operational programmes.

2.112. However, it is not sufficient simply to improve the financial situation of the POs. The extent to which the national authorities and the Commission succeed in targeting funds towards the development of production and marketing skills within the POs is crucial for carrying out the key role assigned to them.

Withdrawals

2.113. The production of fruit and vegetables is greatly affected by weather conditions, their seasonal nature poses particular supply problems and their perishable nature makes them generally unsuitable for storage. If fresh produce needs to be withdrawn from the market in years of glut, it has to be disposed of in a way which avoids an adverse impact on the market and on the environment. One possibility is free distribution to charitable organisations, hospitals, old people's homes, schools, prisons etc., provided this does not adversely affect the market. All products can be subject to withdrawal at the decision of the producer organisation. However, Community financing differs, depending on the product: Community withdrawal compensation is only paid for products listed in Annex II of Regulation 2200/96 at rates fixed by the Council. Other products may receive withdrawal compensation financed out of the operations fund (i.e. co-financed by the producer organisation).

2.114. The Court had found that the control and management of withdrawal operations in Greece, France and Italy were poor, leading to unjustified payments. Produce was accepted for withdrawal which should have been rejected. Furthermore, the management of the market for perennial fruits by means of fixed institutional prices was ineffective. The costly system of withdrawal and destruction of surpluses relieved the market of excess production, but polluted the environment and had a negative impact on public opinion.

2.115. To counteract this, the reform aimed at restricting withdrawals by gradually decreasing the percentage of production permitted to be withdrawn and at the same time by decreasing the aid rates for the quantities withdrawn. However, POs are given the possibility to use the operational fund for topping up the payments on withdrawals received from the Community or to pay compensation for produce not eligible for Community withdrawal compensation. The reform further requires that physical destruction of produce withdrawn is done in a way that does not harm the environment. It also aims at promoting better marketing of the remaining products by the POs.

2.116. An inverse relationship between budgetary expenditure on withdrawals and on operational funds could be expected. The latter should permit better market management by the POs and thus a reduction of withdrawals. Indeed expenditure entered to the budget line for withdrawals oscillated in a two-year cycle around a downwards sloping trend since the Court's last report, but significant expenditure on operational funds (279 Mio ECU) was first incurred in 1998. In the 1999 budget the aggregate provision for the two elements is at an all-time high (479 Mio ECU).

Production aid

2.117. Production aid is paid to processors of a limited range of fresh fruit and vegetables, on condition that they pay producers a specified minimum price for the fresh product. The aim of the aid is to compensate them for the higher cost of raw materials from within the EU (i.e. to make processed products competitive on the world market and on the internal market in relation to imported produce).

2.118. In the three main producer Member States the frequency of raw material checks, stocktaking, sampling

and analysis of products manufactured from fruit and tomatoes needed to be improved. Due to weak controls the veracity of quantities declared for processing relied largely on trust. In effect, control was left in the hands of the most interested parties — processors claiming aid. Furthermore, the level of aid paid to processors was found to be high in comparison with the minimum prices which they had to pay to growers.

2.119. The reform tries to address these weaknesses by only paying production aid to processors who have entered into supply contracts with recognised producer organisations (which are considered to defend the interests of their members better than the latter can do individually). The creation of a special corps of inspectors comprising national and Commission staff aims at improving, *inter alia*, on the spot checks. The Council requires the Commission to report on the operation of the reform, including the special corps of inspectors. A full evaluation of the effectiveness of the reform and of the special corps is desirable in due course.

Citrus processing aid

2.120. This aid system is different from the normal processing scheme in so far as aid is paid to growers who have entered into contracts with processors. The aid system should provide, *inter alia*, an incentive for the disposal of certain citrus fruit with a view to processing them into juice and segments, *i.e.* to encourage producers to present their products for processing rather than for withdrawal.

2.121. Control problems in citrus processing had been found, particularly in Italy and Greece. Basic controls were not carried out, calling into question the reality of the quantities contracted and thus the validity of payments made. The policy for orange processing resulted in the Community granting high levels of aid for produce which is not competitive with imports.

2.122. The reform in this area abolished the minimum price system, as aid is now paid directly to the producer through the POs and no longer to the processors, and strengthened the control procedures by requiring a reconciliation between quantities delivered and processed and the production capacities of growers.

Dried grapes

2.123. Since the beginning of the 1994/95 marketing year, the EU provides support only in the form of area aid for grapes intended for dried fruit production (sultanas, currants and raisins). This aid replaced the former production aid per tonne. The management of the aid for dried grapes in Greece had been found ineffective: the proportion of claims checked on the spot by national inspectors was below the minimum required by the regulation; a high percentage of claims checked were found incorrect; and errors detected were not followed up by the Greek authorities. Aid for grape drying is only paid if a minimum yield per hectare fixed by the Commission is obtained at the vineyard assigned to the production of grapes for drying. However, the yield was fixed so low that it gave no encouragement to improvement in quality and engendered the risk of illicit sales of grapes on the fresh market, when the actual yield exceeded the computed one.

2.124. The large number of irregularities detected by the Court proved that the introduction of an aid per hectare for dried grapes did not take proper account of the inherent obstacles, *i.e.* the absence of a land register, and the large number of growers and vineyards. The 1996 reforms did not address all these problems.

Nuts and locust beans

2.125. Production methods and marketing of nuts and locust beans in the EU apparently lay behind other producer countries and so the Community co-finances 45 % of the cost of quality and marketing improvement plans of specialised POs. Aid is available for 10 years to producers presenting plans to stabilise supply through storage and improved packaging.

2.126. The Court's previous audit had found that the timing of payment of the national part of financing was irregular as it came only after the Community payment. Furthermore, the application of irrelevant inflation rates to payments during the execution period of the improvement plans led to overpayment of aid. Although the scheme is being phased out under the reform, the above-mentioned problems should be addressed by the Commission for payments still related to pre-reform approvals.

Marketing standards

2.127. EU marketing standards are set for fresh horticultural produce. They should facilitate trade under fair conditions, giving importers, exporters and wholesalers confidence in the quality of the produce they are trading. They should also guide production to meet consumer requirements, and keep unsatisfactory produce off the market.

2.128. The Court had found that quality standards were not in line with market requirements and should be updated. The reform addressed this problem by requiring the establishment of internationally recognised quality standards, which the Commission has been introducing since then.

Conclusion

2.129. By emphasising market orientation and competitiveness the reform went in the right direction. However, given that the implementation of the reform started only in 1997, it is premature to draw a conclusion at this stage as to the success of the reform

2.130. Stricter control provisions in Community regulations have to be put into effect. Real improvements can only be obtained when the control procedures are properly implemented in the Member States. The Court also recalls that the basic Council Regulation (EEC) No 729/70 of 21 April 1970⁽⁴³⁾ stipulates that Member States are responsible for establishing reliable control systems, whatever the content of specific market regulations may be.

⁽⁴³⁾ OJ L 94, 28.4.1970, p. 13.

COMMISSION REPLY

IMPLEMENTATION OF THE BUDGET FOR THE FINANCIAL YEAR 1998

Budgetary rules

The principle of universality

2.11. At present, negative amounts entered in the accounts are not regarded as revenue. In most cases they are amounts recovered on expenditure by Member States and charged to the Community budget. This question will be reviewed as part of the recasting of the Financial Regulation.

2.12. The transparency desired by the Court would at least double the number of budget headings in order to highlight amounts recovered on advances. However, this duplication would still not make it possible to identify the month when the expenditure was originally incurred.

Since the information is still provisional and would need to be entered in the Community budget accounts quickly, providing this additional information in the monthly declarations would increase the administrative workload.

The current survey of Member States concerning the transfer of data will reveal whether it is technically possible to resolve the problem in the manner desired by the Court.

The principle of annuality

2.13–2.14. The EAGGF-Guarantee financial year runs from 1 January to 31 December and refunds are paid to Member States during this period. The period from 16 October of the year *n* to 15 October of the following year covers the period of eligibility of the expenditure. The fact that Member States incurred the expenditure during a previous period does not affect budget annuality, as the Community budget only takes account of payments made by the Commission from 1 January.

Payments made in December are not notified to the Commission until 20 January of the following year. For them to be entered under the previous year it would be necessary to extend the accounting period to 31 March.

2.16–2.17. The Commission shares the Court's view that it would have been preferable to finance the Russian food supply operation on the basis of appropriations for the 1999 budget. Indeed, it was initially the intention of the Commission to proceed in this way. However, Council and Parliament preferred to make use of unused appropriations on the 1998 budget, carried forward to 1999. This was discussed and agreed by the budgetary authority in a triologue meeting on 24 November 1998, before the adoption of the supplementary and amending budget for 1998 and of the 1999 budget. The Commission had to take account of this agreement when it subsequently drew up the proposal for a Council regulation on the Russian food supply operation.

Deadlines for charging expenditure

2.19. The Commission is in the process of introducing into the agricultural regulations deadlines for payment for measures where it is possible to use fixed dates to make computerised control possible. The Member States then have no room for manoeuvre regarding payments to beneficiaries. It should be pointed out that in this financial year 62 % of payments made were subject to deadlines.

2.20. As regards the public storage of alcohol in one Member State, the Commission was uncertain as to the amount eligible, and therefore considered it advisable to wait until the completion of the controls before charging any expenditure which could later have been discovered to be ineligible and therefore not chargeable to the financial year when it had been declared.

2.21. In 1997, the Member States implemented and paid for control and prevention measures in accordance with Council Regulation (EC) No 723/97.

The implementing regulation was intended to establish the rules for entering the amounts in the Community budget. It was impossible to adopt the regulation in time for the Member States to declare the abovementioned expenditure.

As this involved expenditure incurred by the Member States in 1997, it was appropriate to commit the amounts and carry them over automatically, even if the absence of implementing regulations prevented payment from being made.

Budgetary management

Advances and expenditure

2.24. It is currently impossible to carry out the checks required on the justification of all payments carried out by the Member States on a monthly basis. They are carried out when the accounts are cleared.

2.26. As regards the measures for which there is no payment deadline, during the clearance of the accounts the Commission checks that the paying agencies make payments within a reasonable time as specified in Commission documents.

In connection with aid to promote agricultural produce, the Commission has introduced horizontal rules which make it possible to monitor the due dates in the various contracts to ensure that payment is made within a reasonable period of time.

2.27. The Commission has always been aware of the problem of the reliability of the Member States' agricultural and budgetary estimates and has made several unsuccessful attempts to make them more reliable. As part of the SEM 2000 programme, the Commission is currently conducting a feasibility study to examine methods of improving the reliability of paying agencies' estimates.

While the Commission agrees with the Court that the introduction of penalties could improve the situation, it is difficult to devise and implement a fair system.

2.28. Although the appreciation of the dollar compared to the budget parity led to expenditures for certain budget lines (notably, export refunds for cereals and sugar) which were lower than would otherwise have been the case, these savings were offset by additional expenditures for refunds resulting from other market factors (lower world prices in dollars than envisaged in the budget for cereals and sugar; higher export quantities for sugar). As a consequence, the appropriations available in these chapters were insufficient to cover the obligatory transfer of ECU 78 million to the monetary reserve. Instead, this transfer was made exclusively from Chapter B1-15 (Fruit and vegetables) where favourable developments in the market situation had left sufficient appropriations available.

If the Council adopts the Commission's proposal to abolish the monetary reserve, the problem will not arise in future.

Management framework

Budgetary nomenclature

2.31. The budgetary nomenclature is linked to the various measures and reflects the policies pursued by the legislative authority.

2.32. As regards the sub-nomenclature:

(a) the legal basis (which already appears in the budget remarks) needs to be mentioned only where it would otherwise be difficult to attribute the expenditure to the sub-item concerned;

(b) the distinction between advances and final payments is made only in cases where the breakdown is necessary for budgetary monitoring.

Computer systems

2.33. Last year the Commission already admitted that the AGREX computerised agricultural accounts system was extremely old and needed a complete rewrite. Work on this has just started. Such a complex tool cannot be developed overnight; the Commission notes that the accounts data in Sincom are correct. With reference to the discrepancies found by the Court, it should be pointed out that the amount of ECU 13.9 million refers to reductions resulting from failure to comply with payment deadlines and that the total reductions of ECU 36.1 million in the AGREX system include other reductions carried out by the Commission by way of application of Article 13 of the decision on budgetary discipline.

SPECIFIC ASSESSMENT OF THE FIELD IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

2.36–2.38. The Court's findings concerning expenditure under the Guarantee section of the EAGGF point to a level of substantive errors that is lower than that for the budget as a whole. Nevertheless, the error rate found by the Court lies above the level which it considers tolerable. The Commission considers it essential that its work and that of the Member States is reviewed by external auditors, and it appreciates the general principles and the methodology used by the Court from a technical and auditing point of view. Furthermore, the Commission is in agreement with the Court on most of the cases where the latter has found substantive errors.

At the same time it is worth noting that the Commission and the Member States have not had very much time to study in detail the substantive errors found by the Court. It is quite possible that the outcome of the clearance procedure for some of the cases will be that no financial correction should be applied. The Commission notes that the Member States have already initiated recovery action in a number of these cases.

The Court's sample is relatively small and the confidence band thus quite wide. As a result it is not easy to draw conclusions on the basis of the sample about the loss to the EAGGF, and it is equally difficult to make a comparison with amounts recovered. In this context it is also worth noting that the Commission and the certifying bodies perform a much larger number of inspections and checks, and so can narrow down the exact expenditure concerned by the Court's findings on each selected transaction.

It is still of interest to summarise the latest figures. For 1998, the latest financial year for which the accounts are closed, recoveries as a result of the clearance procedure amounted to ECU 655 million. This amount consists, as usual, of corrections relating to several different years, since the inquiries for different sectors are not all finalised at the same time. For 1999, recoveries are expected to amount to some EUR 606 million.

Furthermore, the inspection and sanctions systems in the Member States also lead to reductions of expenditure, particularly for arable crops. In this sector the sanctions applied by the Member States have the effect that for around 2% of the eligible area no aid is paid, reducing Community expenditure by some EUR 300 million.

Based on the latest figures, the clearance system and the inspection and sanctions systems thus boost the Community budget by around EUR 900-1000 million. This is an amount of the same order of magnitude as the most probable loss to the fund that can be extrapolated from the Court's DAS sample, still with the caveats expressed above.

Apart from auditing the Member States and applying financial corrections, the Commission also works on improving the inspection systems of the Member States. For example, the Commission is proposing that all Member States adopt graphical identification systems in order to reduce human error in claims submitted. Another example is the development and refining of the animal identification system.

A large number of the substantive errors found by the Court represent very small amounts of aid to individuals from the Community budget. This raises the policy issue of determining the appropriate number of checks from a cost-benefit point of view.

The regulations in force in most cases require a minimum of 5 or 10% checks by Member States' administrations. The payments to be checked are chosen randomly, based on a risk assessment. Since only a certain percentage of payments are checked, obviously there will be irregularities to be found in a random sample such as the DAS. Most of these irregularities should be small though, if the deterrent effect of the inspection system is sufficient and if the risk analysis performed by the Member States is of good quality.

To lower substantially the number of small errors which are currently not found by the Member States' inspection systems would require a very substantial increase in the resources allocated to these systems by Member States. It is an open question if it would be reasonable and cost-effective to do so, particularly in the light of the Commission's assessment that the financial corrections imposed on the Member States and the sanctions on the final beneficiaries applied by the Member States are of a similar magnitude as the most probable loss to the EAGGF based on the cases in the DAS sample.

Reliability of the accounts

2.39(a) and(b)(iii). The supplementary depreciation of public stocks carried out at the end of the financial year in accordance with Article 8(3) and (5) of Council Regulation (EEC) No 1883/78 is based on the forecasts of the quantities and values of stocks at 30 September, communicated by each Member State and for each product at the beginning of September. At that moment, and since the actual stock levels and values for the end of August will be known, the forecast is limited to physical stock movements and purchases for the month of September. The scale of the physical movements to take place in September should be known already to the intervention authorities in the Member States via the presentation of requests from operators for purchase into or sales out of stock, including the results of tenders. On this basis, the Member States' forecasts should be close to the actual stocks situation on 30 September and are therefore unlikely to give rise to major anomalies.

Given the legislative requirement that the depreciation costs for quantities bought in during a financial year must fall within that same financial year, the end-of-year depreciation costs have to be included in the Member State expenditure declarations for the period to 15 October. This would not be administratively feasible if the definitive stock situation on 30 September had to be used.

2.39(b)(i). In order to verify the figures concerning the 'potential debts' relating to fraud and irregularities, the Agriculture DG and OLAF have recently checked the actual recovery situation during missions on the spot in three Member

States that represent 80 % of the amounts to be recovered. From these missions it revealed that only minor differences exist between the figures published by the Commission and the actual debt recovery situation. In addition, OLAF has formally requested all Member States to define all irrecoverable debts from cases before 1995 in order to assess the 'potential debts' more accurately.

Since the reform of the clearance procedure, which became effective in the 1996 financial year, the paying agencies have been required to keep much improved records of debtors, and the certifying bodies were requested to pay particular attention to this aspect of the accounts during their audit of the 1998 accounts. The situation was found still to be unsatisfactory, and the Commission is currently undertaking an enquiry into the recording and management of debts due to the Guarantee Section of EAGGF, with the objective of ensuring reliable and complete records, and rapid recovery of the debts.

An element of duplication arises from the inclusion of both the irregularities reported to OLAF and the debts recorded by the paying agencies, as the authorities responsible for enquiring into irregularities hand over to the paying agencies the responsibility for recovering the amounts established as a result of each enquiry, and these amounts are included in their records of debts of all natures (administrative recoveries, uncleared advances, milk levies, etc.).

The Commission will examine whether it is feasible to establish links between the two information systems, but in the meantime only the figures presented by the paying agencies can be shown as concrete, verifiable debts. Even then, there will continue to be uncertainty about the amounts which may reasonably be considered as recoverable.

The conversion rate used to value potential debts was the accounting rate which applied to expenditure during the final month of the EAGGF-Guarantee year.

2.39(c)(ii). The Commission considers that it would be inappropriate to present information on clearance enquiries which are not yet concluded or to publish information concerning corrections which are still being considered. Indeed it would often be impossible to present meaningful figures when the Member States' replies are still awaited.

2.40. The Commission will follow the Court's request that information on debtors, and potential debts, be reported in its accounts, insofar as accurate, complete and audited information is supplied by the Member States. It is giving a high pri-

ority to the establishment of the legal bases necessary to this effect, and to verifying on the spot the information submitted and the timeliness of recoveries.

Legality and regularity of the transactions

Substantive errors

2.41. See replies to 2.36–2.38.

2.42. Irregular claims will be followed up within the clearance procedure, once the Member State's reply is examined.

(b) Different problems in the storage of alcohol in Italy have been the subject of investigation over the last two years, and financial consequences are being proposed.

(d) Concerning the special beef premium, the UK authorities stated that they considered the evidence of eligibility of the animals to be sufficient.

2.43. Because of their nature or value, not all of the errors identified will require correction in the clearance of accounts procedure. For example, the missing food aid in Portugal concerned 5 kg of hamburger beef, out of the 243 kg supplied, and the excessive advance paid to a producer organisation in Italy should normally be adjusted by a reduction in subsequent payments. As regards the overvaluation of an animal slaughtered as part of the programme to eradicate BSE in the United Kingdom, the UK authorities are of the opinion that the Court had insufficient grounds to doubt the valuation of an animal.

Systematic substantive errors

2.45. The Commission considers that there has been no significant or systematic loss through its charging uncollected milk quota levies to the subsequent budgetary year. Interest is chargeable on late paid levies, and will be collected from purchasers or through the clearance procedure. In the case of milk quotas, it is necessary to wait for the final figures which the Member States have to send in by 30 September following each marketing year and apply all the procedures for clearing the EAGGF-Guarantee accounts.

Italy returned the questionnaire concerning the milk levy within the stipulated deadline. The data it contained do not give rise to collection of any amounts relating to the milk levy at Community level. Consequently, the Commission had no valid basis for making a reduction pursuant to Article 13 of the decision on budgetary discipline.

Checks carried out by the Italian authorities revealed that production had been higher than previously notified. Once the Commission had been informed of this situation, the necessary reductions were made.

Infringement proceedings have already been started against both Italy and Spain concerning the exemption of some farmers from having to pay the levy.

2.46–2.47. The problems concerning small corn producers in France and deductions from cooperatives in Greece are dealt with each year during the clearance of accounts. However, deduction of insurance premiums from certain aids in Greece is not considered by the Commission to be irregular until 1 January 2000, when Regulation (EC) No 1259/1999 explicitly requires virtually all payments to be made in full to the beneficiaries.

Formal errors

2.49. The Commission will make every effort to reduce these delays.

2.50.

(a) The absence of compulsory livestock and vineyard registers is dealt with systematically in the clearance of accounts. However, allowance is made for the effectiveness of alternative control instruments for the various measures.

(b) Where checks are inadequate compared with the required minimum level, corrections are made on a flat-rate basis.

(c) As regards computerised accounts for alcohol stocks, a flat-rate correction is being made as part of the clearance of accounts.

2.51–2.52. Although the other observations are of a formal nature, they are dealt with in the clearance of accounts, where ad hoc corrections are made or flat-rate corrections are applied in a more general evaluation of the results of controls.

Other errors

2.53. With regard to the four general errors, the section 'Failure to comply with payment deadlines' in the 1997 and 1998 clearance of accounts contains very clear and firm recommendations to the Member States concerned.

Clearance of 1998 accounts

2.54. For the five paying agencies mentioned, a complete set of accounts and audit documents were received on: SOAEFD (United Kingdom) — 17 February; ACCT and Ofival (France) — 24 February, Bremen (Germany) and Denmark — 11 March. Fortunately, as there were very few paying agencies that were late in providing the necessary documents, this did not prevent the Commission from carrying out a full examination before the decision was taken.

The clearance of accounts decision 1998 does not prevent further corrections being made in the context of compliance audits.

2.55. The accounts and audit reports for all paying agencies are very carefully examined by the Commission. In many cases additional work or reports were required and a number of missions and other meetings took place to obtain clarifications of various issues. Where problems still remained which could not be solved in time for the decision, the accounts were disjoined. For the four paying agencies whose accounts were disjoined from the decision, further enquiries are ongoing and a second decision can be expected by the end of 1999.

Conclusion

2.56. See reply to paragraphs 2.36–38.

2.57(a). The Commission has initiated legal and control procedures with a view to obtaining from the Member States all the details needed to be able to present the data requested by the Court.

2.57(b). The Commission regularly verifies the Member States' compliance with the milk quota regulations, and recoveries are made from monthly advances when Member States fail to collect levies and/or interest within the regulatory deadlines.

2.58. The Commission regularly verifies the compliance of the Member States' systems and procedures with Community rules. This verification is undertaken in the course of 'preventive' audits regarding new measures and ex post audits of

existing measures. Present resources do not permit the Commission to vet every national instruction, and it is not considered advisable for the Commission to take on such a responsibility for the accuracy and sufficiency of all instructions, as this responsibility lies at present firmly and clearly with the Member States.

2.59. Inspection procedures in the Member States should be sufficient to comply with Community rules, and to detect and prevent significant levels of fraud and irregularity, and the clearance of accounts draws appropriate consequences when this is found not to be the case. It is not, however, realistic for these rules to require the Member States to detect every error, even those of lesser significance, in aid schemes which benefit many million producers, many of whom declare small parcels.

CLEARANCE OF THE ACCOUNTS FOR THE FINANCIAL YEARS 1994 AND 1997

Clearance of accounts 1994

Corrections and other adjustments

General

2.65. The advances disjoined from the 1994 decision were a minor part of the total expenditure on arable crops for the 1994 harvest year, the rest of the expenditure being declared in the 1995 financial year. If the Commission had awaited the completion of enquiries in this sector, including that expenditure declared in the 1995 financial year, the 1994 clearance decision would have delayed by a further nine months. In paragraph 2.99 of this report, the Court itself points out that the time required to adopt the clearance decision is already extremely long, and the Commission could not agree to extend this time further.

Since the reform of the clearance procedure came into effect in the 1996 financial year, the annual clearance decisions have covered all the expenditure declared (albeit in two decisions, the second regarding certain paying agencies which failed to submit the elements required to clear their accounts in time to meet the regulation deadline of 30 April of the following year).

2.66. In view of the unavailability of appropriations in the first half of October 1994, the last period of the 1994 financial year, ECU 46 million was paid to the Member States together with the expenditure of the second half of October 1994, which falls in the 1995 financial year. The Member States concerned received the ECU 46 million one month later than they were entitled to.

The use of flat rates

2.67. The guidelines regarding flat-rate corrections were revised on 8 December 1997 with the aim of linking them as far as possible to objective findings. Whilst subjective judgment inevitably influences the evaluation of the seriousness of a failure to comply with Community rules, and of the risk to the Fund (EAGGF), objective criteria are preponderant. The reduction of the rate of correction during, or as a result of, the conciliation procedure, was often the result of the presentation by the Member State of additional, objective, evidence that had not been made available during the bilateral exchanges.

2.68. It is fortunately unusual that a Member State, or one of its services, administers Community funds in such a way that there is a risk that 25 % of all claims paid were irregular. For this reason, a 25 % rate of correction is applied rather rarely.

2.69. Council Regulation (EEC) No 729/70 empowers the Commission to recover through the clearance procedure expenditure which does not comply with Community rules. The Commission has no power to sanction Member States, this power being reserved, under the Maastricht Treaty, to the Court of Justice. Before deciding on the amount of a correction, the Commission must, in accordance with Article 5(2)(c) of this regulation, examine the seriousness of any failure to comply with Community rules, and the risk to the fund. It must base the amount of the correction on this assessment.

In the case of the failures by Spain and Greece to fully apply the Community rules in respect of olive oil production aid, the Commission examined the above conditions particularly carefully. Neither of these Member States had yet put into place the required olive-tree register or computerised cross-checks of aid claims. Nor did they effect a number of on-the-spot checks on producers' cultivation declarations which was sufficient to compensate for these absences. For these reasons, a 10 % correction was decided for the marketing years up until the 1992/93 marketing year. However, aid (except for small producers) is paid on the basis of the oil produced by the mills, not on the basis of trees. Spain was able to demonstrate that

the volume of oil produced by its mills was of the same order of magnitude as the volume on which aid had been paid. Furthermore, the Spanish olive oil control agency had undertaken three times the number of checks on the mills as was required under the regulations. A mission comprising representatives of DG VI and of Financial Control examined carefully, in June 1997, the effectiveness of these compensating controls, and concluded that as from the 1993/94 marketing year, it was no longer reasonable to assume that 10 % of aid claims concerned fictitious, or irregular oil. There remained a number of weaknesses in the Spanish system in 1993/94 which justify a correction of 5 %, and the Commission considers this amply covers the real risk of loss to the fund.

Similar conclusions were drawn regarding Greece, where the effectiveness of the olive oil agency's inspection activities is highly regarded. The Greek authorities provided information on the quantity of oil pressed by the mills, which also showed that this total was of the same order of magnitude as the total on which aid was paid.

2.70. Given the long delays in implementing the olive oil register and the computer files in Spain and Italy, the Commission has, over the years from 1992, made particular efforts to reduce the risks of irregular claims by reinforcing the effectiveness of the agencies' inspection activities. As one means to this end, the oil mills were required to submit monthly returns on their milling activities. The Commission maintains its view that a correction must be reduced when a Member State can demonstrate that the risk of loss to the fund is limited. From 1993/94, Spain and Greece presented objective evidence, the accuracy of which has been tested by the control agencies.

Corrections made for delayed recoveries

2.71. Following an enquiry conducted in all the Member States, the Commission concluded that certain Member States, in particular France, had been unduly slow in recovering disputed milk levies, and made corrections except when amounts could be shown to be genuinely irrecoverable.

Lack of or inadequate corrections

2.72. The Commission considered that weaknesses in Portugal, a less significant beneficiary of olive oil production aid, were not of the same degree as those in Spain and Greece. Regarding the 1994 financial year, Portugal was corrected for unrecovered debts totalling EUR 1.4 million relating to production aid paid in previous years, and for a flat-rate correction of 5 % for significant weaknesses in checks on consumption aid.

2.73. The principle of legal certainty ⁽¹⁾ prevents the Commission from making corrections when the failure by a Member State to comply with Community rules is attributable to interpretations given by the Commission. In 1995, following remarks within the clearance procedure, the correct rate of exchange was applied.

2.74. Following the communication of the Court's findings, the Danish authorities undertook an exhaustive check of all the analyses of the composition of samples taken in 1992 and 1993. The Commission verified the results of this exhaustive check, which revealed 111 cases where the minimum fat content required for eligibility for an export refund was not attained. These cases include those found by the Court. The correction was based on the refunds paid for these 111 cases in 1992 and 1993, and on an extrapolation of this figure for the 1994 year. The resulting correction was lower than the Court's estimate, as:

- the Court's estimate of ECU 16 million includes the 1990 and 1991 years, which had already been cleared and hence closed: on the basis of the Court's calculation, the correction for 1992 to 1994 would have been limited to some ECU 8.2 million;
- the rate of error referred to by the Court includes cases which do not comply with Danish national rules, which require a minimum fat content in dry matter of 40 %, whereas the Community nomenclature permits a fat content of 39 %;
- the correction decided was based on the objective results of an exhaustive enquiry into all cases of non-compliance, which the Commission considers to be a more solid basis than an extrapolation.

The Commission considers that the correction decided was that which could be sustained after examining the evidence resulting from the enquiry undertaken by the Danish authorities.

Notification of corrections

2.75. All the posts requested by Parliament have been allocated to the Clearance Unit since 23 February 1999, and recruitment procedures have been completed.

⁽¹⁾ Ground 17 of the judgment in Case 1251/79, concerning clearance of accounts: wine storage.

2.76. A legal basis for requiring adequate inspection procedures in paying agencies and technical services was adopted as part of the reform of the clearance of accounts procedure, which came into effect in 1996. Annexed to Commission Regulation (EC) No 1663/95 are detailed criteria which paying agencies are required to comply with if they are to remain accredited to disburse Community funds. In the Commission's view, serious failures to comply with these criteria can now justify financial consequences in the clearance procedure.

2.77. The Court mentions five cases where there was an excessive period of time between a mission on the spot, and the notification of the Commission's findings and then its conclusions. It should be noted that 141 missions were undertaken in the course of the 1994 clearance procedure. The Clearance Unit endeavours to complete its reports on a mission within two months, and to communicate its findings soon after to the Member State. Taking into account the time required for the Member State to reply, for often a further exchange of letters, a bilateral meeting and a final reply by the Member State, together with the time required to have these communications translated, it is inevitable that some 12 to 15 months elapse between a mission and the communication of the final conclusions. To this period should be added four to five months to complete the conciliation procedure.

The Commission is aware of the need to avoid any further time elapsing, and it monitors closely the respect of the deadlines set for the Member States to reply.

Clearance of accounts 1997

Financial analysis

2.80. Adjustments to the Member States' monthly advances under Regulation (EC) No 296/96 are made when expenditure manifestly fails to comply with Community rules, such as payments made after the regulation deadlines, or above a fixed ceiling. These adjustments are also made when a Member State fails to collect receipts within the regulation deadline, in particular milk levies. It is very rare that the evidence contained in the report of the certifying body is sufficient to justify a disallowance in the accounting clearance.

The amount of these adjustments is taken over in the annual clearance decision, and is subject to confirmation in a subsequent compliance decision after the bilateral discussion and, very often, conciliation procedures are completed. Under Article 5(2)(c) of Regulation (EEC) No 729/70, disallowances can

only be decided after the completion of exhaustive bilateral exchanges and discussions, and, if the Member State makes the request, after a conciliation procedure. With the exception of provisional adjustments of obviously non-compliant expenditure, which can already be effected during the course of the year, no disallowances can be effected in the annual clearance decision, as Article 5(2)(b) of the same regulation requires this decision to be taken a very short time after the year end.

The annual clearance decision is based on the assurance given by the accredited paying agencies, and the certifying bodies, that only claims which comply with Community expenditure are paid, and that their accounts of these payments are accurate. The annual clearance decision accepts in this way some EUR 40 000 million each year. The compliance decisions concern the recovery of the much smaller amount which is subsequently found to have in fact not complied with Community rules.

Three compliance decisions have so far been taken, which resulted in the recovery of EUR 122.2 million, and the confirmation of EUR 102.3 million of adjustments made to advances in the 1996 and 1997 financial years. Compliance decisions will be proposed to the Commission approximately twice a year, and will comprise the consequences of all enquiries regarding which the bilateral and conciliation procedures have been completed since the previous decision.

Certification of accounts

Qualified certificates

2.81. The audit reports of all paying agencies are carefully examined. Where the accounts are qualified, additional information was demanded and, usually, missions were undertaken. In summary, of the 17 paying agencies whose accounts were qualified:

- 11 were subject to a Commission audit before clearance took place. Of these, 5 were subsequently revisited after clearance — 1 was subject to a later audit;
- 3 cases were considered by the Commission to be not material — in 1 case the necessary recovery action had already been launched;
- in 1 case compliance proceedings were launched and the correction was confirmed in July 1999.

In addition, in four of these cases a compliance enquiry is underway to examine further the findings of the certifying body.

2.82. The situation at IBEA and Gedidagep was closely followed by the Commission. For both paying agencies the concerns of the Commission were notified by Commissioner Fischler to the relevant Ministers of Agriculture.

For the IBEA, after a mission and exchange of letters appropriate action was taken, and this was verified by a further mission in October 1998. The EAGGF accounts for 1998 were not qualified by the certifying body and, although there are certain matters which still need to be improved, these were accepted by the Commission.

For Gedidagep, after various missions were carried out in 1998, a mission in November 1998 provided a definitive analysis of the remaining deficiencies, in particular concerning the failure of the paying agency to verify the work done by the bodies responsible for checking the claims submitted. The procedure for budgetary discipline has now been started and adjustments to monthly advances totalling EUR 234 million have been effected for the 1999 financial year for the budget headings most at risk. The proposed restructuring of the paying agency is not yet effective.

Internal audit

2.83. The Commission has accepted that the same service undertake both internal audit services and act as certifying body in the first years of the certification process. It now considers that the time has come to ensure that all certifying bodies enjoy full operational independence from the paying agencies that they audit. It has informed the Member States concerned and will insist that the necessary arrangements are made. The Member States concerned will nevertheless require some time to change their arrangements, especially as the implementation of Agenda 2000 will mean additional work for them in the immediate future.

2.84. The certifying bodies are required to follow up each year the action taken by the paying agency on their comments in the previous year's reports. If this action is insufficient to protect the Community's interests, a compliance correction is proposed.

Number of paying agencies

2.85–2.86. The Commission would agree that there is some scope for rationalisation of paying agencies, but this is a matter for the national authorities. The Commission will,

however, object to any increase in the number of paying agencies following the changes introduced by Agenda 2000 (notably the inclusion of rural development and veterinary expenditure in the EAGGF-Guarantee Section).

Accreditation criteria

Delegation of functions

2.88. The Commission, basing itself on a declaration to the Council during the adoption of amendments to Regulation (EEC) No 729/70, accepts that some small payments may exceptionally be made from advance funds held by bodies other than paying agencies, if the arrangements for inspection and supervision of this expenditure by the paying agency are sufficient. To date this mainly occurs for some accompanying measures. With the introduction of rural development measures in the EAGGF-Guarantee Section this practice can be expected to increase. The Commission will be proposing an amendment to the regulation in order to regularise this situation.

2.89–2.90. The Commission is still not satisfied with the coordination between the customs service and the paying agencies in some Member States. It will continue to require improvements.

2.91. The Commission will encourage the French authorities to permit its certifying body to verify all aspects of the inspection systems and to ensure that direct support for beef producers is not overlooked.

2.92. It is clear that certifying bodies must examine the operation of the IACS system. In 1997, this examination was inadequate. The Commission's guidelines on this aspect of the certification work were made more explicit, and reissued. However, Member States must report considerable amounts of information concerning IACS to the Commission and there are regular experts' groups and other meetings to discuss all this information. The Commission considers that the overall coverage of IACS is sufficient.

2.93. Certifying bodies will only qualify their opinion if they consider, based on an overall evaluation, that there are material errors in the accounts. They are not required to qualify the accounts for every weakness found, but are expected to mention all findings in their reports.

Protection of the Community's financial interests

2.94–2.97. Better protection of the financial interests of the Community was one of the major elements of the reform of the clearance of accounts process. Considerable progress has been made but the situation is still not satisfactory in many paying agencies. The Commission is continuing to work on this issue and has launched an enquiry into the management of debtors at several paying agencies, which together account for 95 % of the total recorded debts.

The Commission received figures for debtors from all paying agencies in 1998 (a total of EUR 1 038 million was reported), although in many cases the certifying bodies reported doubts about the completeness or accuracy of these figures.

The Commission has proposed an amendment to Regulation (EC) No 1663/95 to make the reporting and audit of debtors' accounts obligatory.

Conclusion

2.98. In the cases mentioned by the Court in paragraphs 2.71 and 2.76, the Commission has taken considerable pains, undertaking additional on-the-spot checks, to determine the real risk to the fund occasioned by the Member States concerned, and has based its corrections on this assessment. In the other cases mentioned, it had inadequate grounds to justify a correction.

2.99. The Commission is conscious of the need to reduce the time required to complete the clearance procedure to the minimum, compatible with a proper examination of the facts, and the necessary bilateral exchanges and, when relevant, conciliation procedures. The reform of the clearance procedure allows the Commission to rapidly gain reasonable assurance that the vast majority of expenditure complies with Community rules, and thus to concentrate its attention on the exceptions, when a recovery of non-compliant expenditure proves necessary.

2.100. In view of the unavailability of appropriations in the first half of October 1994, the last period of the 1994 financial year, ECU 46 million was paid to the two Member States concerned together with the expenditure of the second half of October 1994, which falls in the 1995 financial year. The Member States concerned received the ECU 46 million one month later than they were entitled to.

2.101. By 31 July 1999, the Commission had taken three compliance decisions refusing expenditure totalling EUR

224.5 million. It has the intention of taking such decisions every six months concerning the outcomes of enquiries for which bilateral, and, where relevant, conciliation procedures have been completed since the previous decision.

2.102. By the end of 1998, almost all paying agencies respect the accreditation criteria in all material aspects. Budgetary discipline procedures have been opened in respect of the only obvious exception, Gedidagep, in particular in view of its failure to verify the work of the technical departments charged with verifying the substance of most aid claims.

FOLLOW-UP OF PREVIOUS REPORTS: FRUIT AND VEGETABLES

Introduction

2.107. In the framework of the 1992 reform of the CAP, the Council and the Commission adopted a common declaration in September 1993, promising to take the necessary measures to maintain agricultural incomes and Community preference in all sectors for which the common market organisation had not been modified, including fruit and vegetables. In the process of adoption of the 1993/94 agricultural prices, the Commission accepted the request of Parliament and Council to present an in-depth analysis of the market situation, its foreseeable development, and the market organisation, in order to propose all necessary amendments. The analysis of the sector was published in 1994 in a communication of the Commission to the Council and the European Parliament, document COM(94) 360 final of 27 July 1994, and the Commission's proposal for reform was tabled in 1995, document COM(95) 434 final of 4 October 1995. The Commission report of July 1994 addressed the main weaknesses of the previous market organisation, and in particular the insufficiencies in the functioning of producer organisations and structural withdrawals in certain regions.

Findings of the Court's previous audit and the reform of 1996

Withdrawals

2.116. One objective of the reform was to reduce withdrawals in the fresh fruit sector and thereby also to reduce expenditure. Nevertheless, a temporary increase in expenditure was expected when the decision was taken on the reform. The maximum rate of withdrawal is gradually being reduced from an initial 50 % of production to reach 10 % in 2002. This gradual reduction was necessary as it would take time for the

reinforced POs to be fully operational. It has thus been necessary to accept that expenditure for withdrawals could remain substantial during a transitional period during which expenditure on the PO funds would also make its appearance.

In the event, however, overall expenditure for the years 1997 and 1998 did decrease in relation to previous years because withdrawals were limited due to climatic conditions, and because operational programmes were only implemented progressively.

Production aid

2.119. The special corps of inspectors (Article 40 of Regulation (EC) No 2200/96) comprises a small number of Commission staff supplemented by qualified and experienced staff of Member States. Their task is to carry out on-the-spot checks in Member States in order to ensure uniform application of Community rules in all the fields covered by the market organisation, whether they imply financial support or not. A non-exhaustive list of tasks is contained in Annex IV to that regulation.

The special corps of inspectors began their work in 1998. A full ex post evaluation will be made when further experience with the reform has been gained.

Citrus processing aid

2.120–2.122. The aim of the aid is not just to make processing an alternative to withdrawal. The Commission wishes to stress that the aim of the aid is to support the producer's

income and to maintain a competitive processing industry. The aid system has become much more market oriented.

Dried grapes

2.123. The reform maintains a hectare aid for dried grapes conditional on specialisation of the area for this type of production. In order to strengthen the condition of a specialised area for the production of dried grapes, minimum yields for sultanas have progressively been increased from 1 000 kg/ha in the marketing year 1994/95 to 3 000 kg/ha since 1998/99.

2.124. The 1996 reform did not include any changes to the aid scheme for dried grapes. However, the Commission has used the powers within its own competence to introduce new implementation rules, applying from the marketing year 1999/2000. These new rules reinforce the inspection provisions.

Nuts and locust beans

2.126. The Court's observations concern incorrect management and application of Community rules by Member States. The Commission will examine this in the clearance of accounts procedure and make any necessary financial corrections.

Conclusion

2.130. The Commission monitors the Member States' implementation of the inspection provisions through the clearance of accounts procedure, which has recently been further reinforced. Financial corrections will be imposed if significant shortcomings are established.

CHAPTER 3 (*)

Structural measures

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INTRODUCTION

3.1. This chapter concerns subsection B2 of the budget, 'Structural operations, structural and cohesion expenditure, financial mechanisms, other agricultural and regional operations, transport and fisheries'. It deals primarily with the implementation of the four Structural Funds (SFs): the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Guidance Section of the European Agricultural Guidance and Guarantee Fund (EAGGF-Guidance), and the Financial Instrument for Fisheries Guidance (FIFG). There are also some observations on the Cohesion Fund, since these five financial instruments taken together account for almost all of the appropriations entered under subsection B2.

3.2. The appropriations allocated to the SFs are differentiated appropriations. They are managed on the basis of multiannual programming, together with an indicative financing plan which sets out the Community aid. The financial contributions are committed in annual instalments and are disbursed in the form of advances and interim payments, according to the progress achieved with implementation, as evidenced by the expenditure declarations submitted by the national or regional authorities appointed by the Member States.

IMPLEMENTATION OF THE BUDGET

3.3. **Table 3.1** shows the implementation of the appropriations in subsection B2 of the budget (structural operations, financial mechanisms, other agricultural and regional operations, transport and fisheries). The commitment and payment appropriations available were 33 854 and 28 860 Mio ECU respectively, taking into account supplementary and amending budget No 1 ⁽¹⁾,

⁽¹⁾ Final adoption of supplementary and amending budget No 1 of the European Union for the financial year 1998. OJ L 81, 26.3.1999, p. 1.

which increased the payment appropriations for the Structural Funds by 117,8 Mio ECU. The overall implementation rate is over 99 % for both commitments and payments, while cancellations of appropriations amounted to approximately 200 and 80 Mio ECU respectively ⁽²⁾. However, there are significant variations between the various chapters of subsection B2. For example, an over-implementation of approximately 700 Mio ECU by the ESF in comparison with the initial payment appropriations compensated in part for the under-implementation of ERDF appropriations (270 Mio ECU) and those allocated to the Cohesion Fund (200 Mio ECU), the Community initiatives (277 Mio ECU) and the transitional measures and innovative measures (106 Mio ECU). In addition, for the second consecutive year, the payment appropriations were not sufficient to satisfy all the admissible requests for payment submitted by the Member States. Over 1 000 Mio ECU, mainly concerning the ESF, could not be disbursed in 1998 and had to be deferred to the financial year 1999. This situation is likely to be repeated in 1999, as the Commission has already emphasised in its decision on the carrying-over of appropriations for implementation in 1998 to implementation in 1999 ⁽³⁾.

3.4. There are considerable variations between the initial forecasts and implementation at the level of the budget headings. For example, the appropriations initially allocated to ERDF Objective 2 (O2) amounted to

⁽²⁾ A figure of 39 214 Mio ECU may be put on the total still to be committed as at 31 December 1998 in respect of the heading 2 resources in the financial perspectives. For the Structural Funds, out of a total overall amount allotted for the 1994/99 period of 159 406 Mio ECU (at 1999 prices), 123 324 Mio ECU (77,36 %) were committed during the financial years 1994/98. An amount of 36 082 Mio ECU (22,64 %) therefore is still to be committed in 1999. For the Cohesion Fund, the overall forecasts for the 1993/99 period amount to 16 622 Mio ECU, of which 13 490 Mio ECU (81,16 %) were committed during the 1993/98 financial years. Thus 3 132 Mio ECU (18,84 %) are still to be committed in 1999.

⁽³⁾ SEC(1999) 383 final document of 10 March 1999.

Table 3.1 — Implementation of the budget for measures and Structural Funds in 1998

(Mio ECU)

		Budget reference	Appropriations		Out-turn	Rate of implementation of initial budget	Rate of implementation of final budget	Appropriations cancelled at year-end		
			Initial budget ⁽¹⁾	Final budget after SAB and transfers				Amount ⁽²⁾	% (g)/(c)	
			(a)	(b)				(c)	(d)	(e)
Source: Revenue and expenditure accounts of the Commission	C	EAGGF-Guidance	B2-10	4 183,1	4 183,1	4 183,1	100,00	100,00	0,0	0,00
		FIFG (fisheries)	B2-11	464,2	464,2	451,4	97,24	97,24	12,8	2,76
		ERDF	B2-12	14 000,4	14 129,4	14 120,9	100,86	99,94	0,0	0,00
		ESF	B2-13	8 628,1	8 628,1	8 628,1	100,00	100,00		
		Community initiatives	B2-14	2 856,1	2 767,1	2 583,9	90,47	93,38	162,9 ⁽³⁾	5,89
		Anti-fraud measures	B2-15	0,8	0,8	0,7	99,88	99,88	0,0	0,12
		Implementation, monitoring and evaluation	B2-16	3,0	3,0	2,5	83,21	83,21	0,5	16,79
		Transitional measures, etc.	B2-18	346,4	306,4	281,4	81,24	91,84	25,0	8,16
		Subtotal Structural Funds	B2-1	30 482,0	30 482,0	30 251,9	99,25	99,25	201,2	0,66
		Cohesion Fund	B2-3	2 871,0	2 871,0	2 870,9	100,00	100,00	0,1	0,00
	Other measures	misc. ⁽²⁾	338,1	364,1	356,8	105,55	98,00	4,8 ⁽³⁾	1,33	
	Total	B2	33 691,1	33 717,1	33 479,6	99,37	99,30	206,1	0,61	
	P	EAGGF-Guidance	B2-10	3 521,5	3 521,5	3 521,5	100,00	100,00	0,0	0,00
		FIFG (fisheries)	B2-11	390,0	407,8	407,7	104,55	99,99	0,1	0,01
		ERDF	B2-12	12 045,3	11 796,9	11 776,4	97,77	99,83	0,0 ⁽³⁾	0,00
		ESF	B2-13	6 807,8	7 602,8	7 602,8	111,68	100,00	0,0	0,00
		Community initiatives	B2-14	2 558,8	2 451,1	2 271,6	88,77	92,68	49,3 ⁽³⁾	2,01
		Anti-fraud measures	B2-15	0,8	0,8	0,7	86,50	86,50	0,1	13,50
		Implementation, monitoring and evaluation	B2-16	3,0	1,5	1,4	47,67	95,34	0,1	4,66
		Transitional measures, etc.	B2-18	316,0	286,0	210,7	66,69	73,68	21,2 ⁽³⁾	7,41
Subtotal Structural Funds		B2-1	25 643,2	26 068,4	25 792,8	100,58	98,94	70,7	0,27	
Cohesion Fund		B2-3	2 648,8	2 448,8	2 448,8	92,45	100,00	0,0	0,00	
Other measures	misc. ⁽²⁾	302,7	322,4	315,3	104,15	97,79	5,9 ⁽³⁾	1,84		
Total	B2	28 594,7	28 839,6	28 556,9	99,87	99,02	76,7	0,27		
Carry-overs from previous year	C	Other measures	misc. ⁽²⁾	0,1	0,1	0,1	100,00			
	Total	B2	0,1	0,1	0,1	100,00	100,00			
P	Other measures	misc. ⁽²⁾	2,0	2,0	0,4	20,38	20,38	1,6	79,62	
	Total	B2	2,0	2,0	0,4	20,38	20,38	1,6	79,62	
again (after decommitments)	C	ESF	B2-13	105,4	105,4	105,4	100,00	100,00		
	Community initiatives	B2-14	13,5	13,5	13,5	100,00	100,00			
Total	B2	118,9	118,9	118,9	100,00	100,00				
again (after reuse of repayments of advances)	C	ERDF	B2-12	18,2	18,2	18,2	100,00	100,00		
	Subtotal Structural Funds	B2-1	18,2	18,2	18,2	100,00	100,00			
Total	B2	18,2	18,2	18,2	100,00	100,00				
P	ERDF	B2-12	18,2	18,2	18,2	100,00	100,00			
	Subtotal Structural Funds	B2-1	18,2	18,2	18,2	100,00	100,00			
Total	B2	18,2	18,2	18,2	100,00	100,00				
Total	C	EAGGF-Guidance	B2-10	4 183,1	4 183,1	4 183,1	100,00	100,00	0,0	0,00
		FIFG (fisheries)	B2-11	464,2	464,2	451,4	97,24	97,24	12,8	2,76
		ERDF	B2-12	14 018,6	14 147,6	14 139,1	100,86	99,94	0,0	0,00
		ESF	B2-13	8 733,5	8 733,5	8 733,5	100,00	100,00		
		Community initiatives	B2-14	2 869,6	2 780,6	2 597,4	90,51	93,41	162,9	5,86
		Anti-fraud measures	B2-15	0,8	0,8	0,7	99,88	99,88	0,0	0,12
		Implementation, monitoring and evaluation	B2-16	3,0	3,0	2,5	83,21	83,21	0,5	16,79
		Transitional measures, etc.	B2-18	346,4	306,4	281,4	81,24	91,84	25,0	8,16
		Subtotal Structural Funds	B2-1	30 619,1	30 619,1	30 389,0	99,25	99,25	201,2	0,66
		Cohesion Fund	B2-3	2 871,0	2 871,0	2 870,9	100,00	100,00	0,1	0,00
	Other measures	misc. ⁽²⁾	338,2	364,2	357,0	105,55	98,00	4,8	1,33	
	Total	B2	33 828,3	33 854,4	33 616,8	99,37	99,30	206,1	0,61	
	P	EAGGF-Guidance	B2-10	3 521,5	3 521,5	3 521,5	100,00	100,00	0,0	0,00
		FIFG (fisheries)	B2-11	390,0	407,8	407,7	104,55	99,99	0,1	0,01
		ERDF	B2-12	12 063,5	11 815,1	11 794,6	97,77	99,83	0,0	0,00
		ESF	B2-13	6 807,8	7 602,8	7 602,8	111,68	100,00	0,0	0,00
		Community initiatives	B2-14	2 558,8	2 451,1	2 271,6	88,77	92,68	49,3	2,01
		Anti-fraud measures	B2-15	0,8	0,8	0,7	86,50	86,50	0,1	13,50
		Implementation, monitoring and evaluation	B2-16	3,0	1,5	1,4	47,67	95,34	0,1	4,66
		Transitional measures, etc.	B2-18	316,0	286,0	210,7	66,69	73,68	21,2	7,41
Subtotal Structural Funds		B2-1	25 661,4	26 086,6	25 811,0	100,58	98,94	70,7	0,27	
Cohesion Fund		B2-3	2 648,8	2 448,8	2 448,8	92,45	100,00	0,0	0,00	
Other measures	misc. ⁽²⁾	304,7	324,4	315,7	103,60	97,31	7,5	2,32		
Total	B2	28 614,9	28 859,8	28 575,5	99,86	99,01	78,3	0,27		

⁽¹⁾ NB: In 1998, the B2 section was not affected by appropriations entered under the allocated reserve (Chapter B0-40), but was affected by the specific negative reserve (Art. B0-452).⁽²⁾ Figures for Titles B2-4, B2-5, B2-6, B2-7 and B2-9 are combined under 'misc.'⁽³⁾ After carry-overs to 1999, decided by the Commission (Article 7 of the financial regulation).

NB: C = commitments; P = payments.

Sources: Sincom (and revenue and expenditure account).

2 247 and 2 270 Mio ECU for commitments and payments respectively. However, only 1 610 and 1 095 Mio ECU respectively were disbursed (71,63 % and 48,25 %). On the other hand, the implementation rates based on the definitive appropriations amounted to 99,9 % and 100 %, following transfers to other headings, mainly in Objective 1 (O1). For Community initiatives, the appropriation implementation rates range from 60,6 % for Konver⁽⁴⁾ to 365,8 % for Resider⁽⁵⁾ as regards commitments, and from 45,9 % for REGIS⁽⁶⁾ to 158,3 % for Integra⁽⁷⁾ as regards payments. These examples confirm the situation already pointed out by the Court in its Special Report No 16/98⁽⁸⁾ and the considerable extent of the variations between budget forecasts and amounts actually disbursed. Moreover, the changes made in 1998 affect the forecasts on which the 1999 budget was based, which has, in the interim, become out of step with the actual circumstances and will also have to be amended in various ways.

3.5. The financial year 1998 was the fifth and penultimate year of the 1994/99 programming period for Community commitments. Payments may continue to be made until 2002, or later, if the financing plans are extended. In 1998 the Commission began the preparatory work necessary to amend the financing plans of the majority of the programmes in order to make it possible for all the amounts entered in the financial perspectives to be committed by the prescribed deadlines. This procedure was used at the end of the 1989/93 and 1994/96 periods, and consists of amending the financing plans so that the minimum implementation percentage required for the commitment of the last annual instalment is reached. Because of the unwieldiness of these procedures, the modifications in question involve a significant amount of administrative work for the Member States and the Commission, which is of no real benefit in terms of the sound management of the programmes. On the contrary, procedures of this kind are more likely to reduce interest in developing and implementing high-quality programming measures.

3.6. In 1998 the Commission approved a new table⁽⁹⁾ which gives an updated picture of the appropriations allocated to the Community initiatives, broken down by Member State and by type of initiative. Specifically, the additional financing granted for the PEACE initiative⁽¹⁰⁾ derives from a reduction in the allocations of other programmes which had been approved previously. There are a number of disadvantages to reducing the appropriations of programmes without using the procedures, conditions and methods previously agreed between the Commission and the Member States. Acting in this way results in objections which may have repercussions right down to the level of the final beneficiaries involved, especially at the end of the programming period. The Court has already highlighted in previous reports⁽¹¹⁾ other weaknesses in the procedures for allocating and programming appropriations for the initiatives.

3.7. As for previous financial years, it should be recalled that, according to the provisions in force⁽¹²⁾ governing measures lasting two years or more, the commitments which appear in the budget accounts are only the annual instalments which have already been implemented or are in the process of being implemented, for the various programmes approved. No commitment is therefore recorded for the annual instalments of those programmes which are not yet being implemented, even though these instalments represent legal obligations. According to an evaluation by the Court, the figure for these annual instalments totalled 32 536 Mio ECU on 31 December 1998 for all Structural Funds, including the Community initiatives. The sum of 3 546 Mio ECU still remained to be allocated to individual measures. These two situations cannot be seen from the revenue and expenditure account for the financial year. This account, taken together with the balance sheet on 31 December 1998⁽¹³⁾, gives an overview of potential debts which corresponds to the difference between the updated provisions set by the Edinburgh Summit of December 1992 and the amounts included in the commitments accounts. The Commission calculates these potential debts at 35 744 Mio ECU for all the Structural Funds and 3 118 Mio ECU for the Cohesion Fund (see also paragraph 3.22).

⁽⁴⁾ Community initiative concerning the conversion of the defence industry.

⁽⁵⁾ Community initiative concerning the economic conversion of steel areas.

⁽⁶⁾ Community initiative concerning the most remote regions.

⁽⁷⁾ 'Improving access to the labour market and employability of economically and socially vulnerable groups' section of the Community initiative entitled 'Employment'.

⁽⁸⁾ Special Report No 16/98 on the implementation of appropriations for structural operations for the programming period 1994/99 (OJ C 347, 16.11.1998).

⁽⁹⁾ Commission decision of 16 December 1998 (unpublished).

⁽¹⁰⁾ Special support programme for peace and reconciliation in Northern Ireland and the border counties of Ireland.

⁽¹¹⁾ See, for example, paragraph 3.1 of Special Report No 16/98.

⁽¹²⁾ Article 20 of Council Regulation (EEC) No 4253/88 of 19 December 1988, as amended by Regulation (EEC) No 2082/93 of 20 July 1993 (OJ L 193, 31.7.1993, p. 10).

⁽¹³⁾ Volume II of the revenue and expenditure account and the balance sheet concerning the transactions of the financial year 1998, p. 710.

3.8. The payments which appear in the Community accounts correspond to the various payments of instalments or refunds of final payments made by the Commission to the national or regional authorities responsible for implementing the programmes. By their very nature, these payments cannot reflect the actual state of implementation of the programmes and should not be thought to correspond to payments made to the final beneficiaries. Moreover, the accounting system in use does not yet enable a reliable distinction to be made between payments corresponding to advances and final payments. **Table 3.2** shows Community payments under the structural measures during the financial years 1987 to 1998 (see also paragraphs 3.28 to 3.30 of the Annual Report concerning the financial year 1997, and paragraph 3.22 of this chapter).

SPECIFIC EVALUATION OF THE FIELD IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Characteristics of the 'structural measures' field

3.9. The Structural Funds, and other structural operations, account for about 28 575 Mio ECU, or 35,7 %, of total payments from the general budget. During 1998, commitments amounted to 33 617 Mio ECU, of which 21 977 Mio ECU were unsettled at the end of the year. **Tables 3.1, 3.2 and 3.3** contain further details on the budgetary appropriations for structural operations.

Structural Funds

3.10. In the management process as described in paragraph 3.2, the amount of the Community payments is not equivalent to the volume of expenditure declared by the Member States at any given moment, since the effect of this expenditure is either to trigger payment of an advance to finance future expenditure, or to enable the payment of the balance to cover expenditure already made. The errors in the expenditure declarations do not necessarily have any effect on the Community payments concerned, since, even after ineligible expenditure has been deducted, the level of eligible expenditure may still justify the payment of the advance requested or of the maximum Community aid provided for in cases where the final balance has been requested. Nevertheless, even

in cases where declarations are overstated⁽¹⁴⁾, there is a risk that errors which affect the expenditure declarations may have an effect on the Community budget when the interventions come to be closed. The Court's audit findings show that this will continue to be a real possibility (see paragraph 3.29), until the new control and certification procedures have been effectively introduced (see paragraph 3.12).

3.11. The Structural Fund regulations do not lay down procedures for closing the interventions. In practice, the Commission applies at sub-programme level the requirements laid down by the financing plans relating to minimum eligible expenditure and public co-financing for the payment of Structural Fund assistance. Any underutilisation or overutilisation by the various measures may be offset without specific authorisation only within a sub-programme which sets a maximum amount for eligible expenditure. If declared expenditure is lower than this sum, the difference between the maximum aid provided for and the actual aid is decommitted. Only the ESF closes the various instalments annually, while the other Funds pay out successive commitments when cumulated declared expenditure reaches pre-set levels.

3.12. The Commission has taken three initiatives in the context of its Sound and Efficient Management 2000 Programme aimed at improving financial management and control of the Structural Funds. First, in consultation with the Member States, it has redefined the criteria which determine the eligibility of particular measures and expenditures for co-financing. Second, with the aid of consultants, it has carried out a study aimed at defining the audit trail required in each Member State to enable the funds to be properly managed, controlled and audited. Third, it has introduced a new Regulation (EC) No 2064/97⁽¹⁵⁾ which sets out in detail how the Member States are to discharge their responsibility for the proper management and control of the funds.

Cohesion Fund

3.13. Community contributions under the Cohesion Fund are paid in the form of advances which are based

⁽¹⁴⁾ 49 % of the ERDF interventions closed in 1998 show over-declarations averaging 15.5 % in the expenditure statements.

⁽¹⁵⁾ Commission Regulation (EC) No 2064/97 of 15 October 1997 (OJ L 290, 23.10.1997, p. 1).

Table 3.2 — Community payments for structural measures for the financial years 1987 to 1998

(Mio ECU)

Sectors	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
<i>Structural measures, of which:</i>	6 450,59	7 101,27	8 501,40	10 368,08	13 857,67	18 466,12	20 337,63	15 965,98	19 219,05	24 631,53	26 297,30	28 575,50
— EAGGF Guidance Section	863,19	1 142,26	1 348,97	1 825,34	1 881,00	2 661,76	2 747,08	2 553,67	2 572,67	3 404,55	3 580,00	3 521,50
— ERDF	2 535,03	3 092,81	3 920,00	4 554,11	5 180,85	7 656,87	8 292,93	6 599,16	8 455,94	10 713,19	11 521,40	11 794,60
— ESF	2 715,28	2 298,39	2 676,10	3 211,98	3 869,21	4 072,55	5 180,75	4 214,69	4 589,32	6 084,94	6 143,40	7 602,80
— Cohesion Fund							730,59	915,99	1 699,34	1 872,19	2 323,00	2 448,80
— Fisheries, subsequently FIFG	58,22	67,79	91,22	99,41	159,61	212,46	335,83	401,28	260,82	430,37	486,90	407,70
— Community initiatives					1 379,60	1 362,28	1 511,55	849,19	1 320,06	1 691,39	1 677,30	2 271,60
— Other structural measures	278,87	500,02	465,11	677,24	1 387,40	2 500,20	1 538,90	432,00	320,90	434,90	565,30	528,50

Sources: Revenue and expenditure accounts of the Commission.

Table 3.3 — Structural Funds: Community support frameworks: programming 1994-99 and implementation 1994-98

(Mio ECU)

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom	Total
Programming 1994-99	1 880,2	756,7	20 046,5	14 152,9	32 009,0	13 665,3	5 706,2	20 654,0	85,8	2 204,7	1 490,1	14 347,1	1 577,8	1 280,1	11 678,0	141 534,4
<i>By Objective:</i>																
Objective 1	760,6	0,0	13 987,3	14 152,9	26 516,7	2 245,3	5 706,2	15 219,8	0,0	153,8	173,6	14 347,1	0,0	0,0	2 450,7	95 714,0
Objective 2	349,7	122,3	1 605,5	0,0	2 475,0	3 876,7	0,0	1 457,2	15,2	666,2	101,0	0,0	189,4	165,4	4 693,2	15 716,8
Objectives 3 and 4	480,2	308,5	1 995,6	0,0	1 879,7	3 279,2	0,0	1 761,0	23,5	1 117,1	403,6	0,0	358,1	520,0	3 424,9	15 551,4
Objective 5a Agriculture	185,7	129,4	1 134,5	0,0	332,8	1 799,2	0,0	806,5	39,8	68,3	398,9	0,0	337,3	103,2	188,9	5 524,5
Objective 5a Fisheries	25,3	142,5	76,0	0,0	123,6	196,2	0,0	134,4	1,1	46,6	2,0	0,0	23,0	41,4	88,7	900,8
Objective 5b	78,7	54,0	1 247,6	0,0	681,2	2 268,7	0,0	1 275,1	6,2	152,7	411,0	0,0	194,0	150,0	831,6	7 350,8
Objective 6	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	476,0	300,1	0,0	776,1
<i>By Fund:</i>																
ERDF	861,4	118,1	8 581,2	9 566,7	18 070,9	5 460,6	2 614,6	11 572,8	15,4	602,1	289,4	8 949,2	423,3	363,9	5 495,6	72 985,2
ESF	733,9	345,1	6 922,4	2 634,1	8 697,3	4 737,0	2 000,8	4 981,8	26,9	1 406,2	578,8	3 225,4	539,6	654,5	5 472,9	42 956,8
EAGGF-Guidance	257,9	151,0	4 358,9	1 818,4	4 101,6	3 233,3	1 042,7	3 725,3	42,3	141,2	619,9	1 959,4	587,8	216,2	580,2	22 836,1
FIFG	27,0	142,5	183,9	133,8	1 139,1	234,4	48,1	374,2	1,1	55,3	2,0	213,2	27,1	45,5	129,1	2 756,4

Structural Funds — Implementation 1994-98

(Mio ECU)

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom	Total
Commitments 1994-98	1 377,1	566,5	16 442,2	11 630,5	25 714,9	9 925,5	5 134,2	14 660,2	67,5	1 486,2	1 092,2	13 704,2	1 118,5	895,5	9 309,9	113 125,2
ERDF	635,8	86,8	7 324,5	8 190,6	14 405,1	3 880,3	2 204,9	8 431,7	14,8	377,5	248,8	8 596,2	286,9	268,8	4 084,3	59 036,9
ESF	541,1	274,9	5 342,7	1 633,8	6 911,6	3 499,0	1 920,0	3 683,1	21,6	1 002,7	423,7	3 107,9	382,2	429,8	4 760,2	33 934,2
EAGGF	173,8	111,5	3 657,3	1 706,3	3 471,0	2 430,4	969,5	2 332,0	30,1	85,3	417,7	1 846,9	424,0	155,3	371,3	18 182,3
FIFG	26,5	93,4	117,8	99,8	927,2	115,8	39,7	213,5	1,1	20,8	2,0	153,1	25,4	41,7	94,1	1 971,8
Payments 1994-98	996,8	489,4	12 990,2	8 712,5	20 911,5	7 495,8	4 266,5	9 825,0	49,8	1 234,5	932,7	10 341,6	820,9	684,0	6 758,3	86 509,4
ERDF	391,4	75,1	5 694,5	6 015,1	11 542,4	2 603,6	1 782,1	6 169,6	8,9	279,2	193,8	6 603,0	236,3	190,5	2 699,8	44 485,0
ESF	443,4	248,3	4 296,6	1 257,0	5 823,4	2 825,3	1 541,3	2 196,8	18,7	872,0	375,7	2 241,8	266,6	325,5	3 677,1	26 409,3
EAGGF	142,1	89,0	2 913,8	1 366,0	2 727,4	1 974,8	909,4	1 338,2	22,1	66,1	361,7	1 383,3	297,6	134,8	303,5	14 029,6
FIFG	20,0	77,0	85,4	74,4	818,4	92,2	33,7	120,4	0,1	17,2	1,6	113,6	20,4	33,2	77,9	1 585,5

Programming: Commission; provisional figures. Amounts represent the SPD, CSF and OP programming adopted by the Commission as at 31 December 1998.

Implementation in commitments and payments: Sincom.

Source: Commission.

on the project's state of progress as certified in the reports submitted with payment requests. These show the progress made, especially with regard to the physical and financial indicators specified in the Commission decision approving the project. The final balance is equal to 20 % of the aid granted to the project (or 10 % in cases with special justification) and is paid when the Member States submit a report stating that the project has been completed in accordance with its objectives. Until 1998, neither the Commission nor the relevant Member State had checked the closure of Cohesion Fund projects systematically.

The new regulations on financial control

3.14. The mechanisms of control, audit and financial management through which the Commission co-finances Structural Fund programmes have been the subject of observations by the Court during the last decade, particularly in the context of the statement of assurance. Although the Member States have, since the inception of the Funds, had a duty to exercise effective financial control over co-financed operations (the current formulation is set out in Regulation (EEC) No 4253/88⁽¹⁶⁾), the Court has each year found many examples where eligibility criteria were not respected or essential information was lacking. Regulation (EC) No 2064/97 strengthened the relevant provisions in order to ensure efficient and proper implementation of the operations co-financed by the Structural Funds.

3.15. Article 2 of Regulation (EC) 2064/97 (and its annex) sets out the obligations of Member States as regards their management and control systems, defines the audit trail Member States are required to provide and describes the type of information which should be available for a sufficient audit trail. Articles 3 to 6 describe the tests of control and substantive checks that the Member States should carry out, and notably the requirement to carry out before closure controls on at least 5 % of total eligible expenditure for each form of assistance and a representative sample of the projects or actions approved. Improved arrangements for dealing with apparent irregularities are covered in Article 7.

⁽¹⁶⁾ Article 23 of Council Regulation (EEC) No 4253/88 of 19 December 1988, as amended by Regulation (EEC) No 2082/93 of 20 July 1993 (OJ L 193, 31.7.1993, p. 27).

3.16. The requirement to provide an independent audit statement with the final declaration of expenditure is set out in Article 8. Article 9 obliges Member States to report to the Commission by 30 June every year from 1998 on their application of the regulation. The regulation came into force in November 1997, except for Article 8, which Article 17 states was to apply from 1 January 1998.

3.17. During 1998 the Commission dealt mainly with queries from Member State authorities on how to interpret the new regulatory requirements and prepared a summary of the Member States' first reports on the implementation of Regulation (EC) No 2064/97. The information provided by the Member States in reply to Article 2 of Regulation (EC) No 2064/97 relating to the audit trails was intended to update that previously required by Article 23 of Regulation (EEC) No 4253/88. The quality of the information provided by some of the Member States in 1998 was not always adequate for complete information on audit trails to be compiled by the Commission. Some Member States referred to information provided to the Commission as part of Financial Control's audit trail study, which was completed at the end of 1998 but was not at this stage validated by the Commission through compliance tests.

3.18. With regard to the implementation of Articles 3 to 6 of Regulation (EC) No 2064/97, the organisational methods for controlling systems and the transactions relating to them vary from one Member State to another, from existing structures which have remained unchanged to new creations.

3.19. Member States pointed out difficulties with regard to the implementation of Article 8 of Regulation (EC) No 2064/97. The Commission then adopted Regulation (EC) No 2406/98⁽¹⁷⁾, according to which Article 8 need not be applied to forms of intervention for which the first decision granting assistance sets the final date for Community and national commitments up to 1 January 1997. The effect of this is that the independent audit statement required in Article 8 will neither be required for the 1989/93 period (all objectives) nor for Objective 2 operational programmes for the 1994/96 programming period.

⁽¹⁷⁾ Commission Regulation (EC) No 2406/98 of 6 November 1998 (OJ L 298, 7.11.1998, p. 15).

Nature of the audit

3.20. The objective of the financial audit of the structural operations policy area was to contribute to the statement of assurance on the general budget for 1998. The results of the audit of the accounts and of the legality and regularity of the underlying transactions in this area are summarised below.

3.21. For the structural operations as a whole, a sample of transactions was audited at the Commission and in the Member States. For the ERDF, part of the audit focused on interventions that were closed in 1998 and all of the payments received by these interventions during the relevant programming period were examined in depth. By means of a check on a representative sample of projects it was possible to draw conclusions on the level of eligible expenditure. With regard to the Cohesion Fund, a representative check was carried out on a sample of projects which had received a final balance payment in 1998.

*Findings***Reliability of the Community accounts**

3.22. The reliability of the information on the distinction between advances and final payments could still be greatly improved (see paragraph 3.8). The presentation of the Community accounts is affected by the lack of any differentiation, in the potential liabilities presented off-balance sheet, between legal commitments not entered in the accounts and Structural Fund resources regarding which decisions have not yet been taken (see paragraph 3.7).

3.23. When closure takes place, the unused appropriations are not systematically decommitted immediately, which leaves unjustified outstanding commitments in the accounts. Unjustified outstanding amounts were found in 27 % of a sample of outstanding commitments where no payment had been made during the last two financial years. The Court is of the opinion that at least 17 % of the cases audited no longer related to an obligation to make payments. A further 6 % of cases audited concerned operations that had been blocked for legal reasons, which oblige the Commission to maintain the commitments, although it is likely in many cases that they will require no further payments.

Legality and regularity of the underlying transactions

3.24. The majority of the substantive errors directly concerning the legality and regularity of the underlying transactions occurred at the level of the final beneficiaries, which also include public bodies managing programmes or measures ⁽¹⁸⁾.

3.25. As the Court made clear in its reports in support of the 1995, 1996 and 1997 statements of assurance, most of the substantive errors found in the expenditure declarations do not, in themselves, necessarily have an impact on the amounts of the Commission's payments. However, the Court considers that anomalies still occur too frequently in the declarations of expenditure co-financed by the Community.

3.26. A significant number of substantive errors was observed in the expenditure declarations. The most significant errors were:

- (a) expenditure or measures not covered by the programmes or regulations and expenditure outside eligible areas;
- (b) failure to observe the rules governing invitations to tender;
- (c) expenditure not backed up by supporting documents;
- (d) failure by the final beneficiaries to observe the rules on State aid;
- (e) expenditure on projects which were not carried out;
- (f) measures that had received undeclared revenue or sources of financing;
- (g) flat-rate expenditure which did not relate to actual costs.

⁽¹⁸⁾ Expenditure by these public authorities constitutes in these cases expenditure incurred.

3.27. Other errors were found on a more isolated basis: private expenditure taken into account in a case where only public expenditure was eligible, expenditure in connection with a project where criminal proceedings for alleged fraud had been brought, but not notified to the Commission, expenditure based on invoices unrelated to the project concerned and expenditure in connection with an agreement based on a completely outdated technical study.

3.28. Many of these errors are the consequences of inadequate systems, and provide evidence that the improvements sought in those systems had not yet taken effect. Thus difficulties remained, particularly in the case of the ESF, in apportioning costs where only part of a body's activities was eligible for co-financing, in avoiding the unjustified charging of overheads, and in reconciling the declarations of expenditure certified to the Commission with the individual expenditure records.

3.29. In the ERDF area, in-depth checks on expenditure declarations concerning final balance payments closing five sub-programmes revealed error rates ranging from 17 to 47 %, and in all five cases the errors had a direct effect on the amounts of the Commission's payments; out of a total of 182,1 Mio ECU paid for these five sub-programmes, the overpayment may be estimated at 47,5 Mio ECU.

3.30. In the case of the ERDF, the Commission's practice of applying to the closure the intervention rate set out in the programme, whatever the rates actually applied by the Member State to the various measures, is a source of error. For example, in one of the cases audited, the Commission calculated a sum which was 2 Mio ECU (or 30 % of the total for the sub-programme) higher than the amount stated by the Member State, although the final implementation report clearly showed the final amounts of aid disbursed to the various final beneficiaries.

3.31. The formal errors detected by the Court included a lack of adequate supporting documentation in order to justify fully the amounts declared, a lack of separate accounting, inadequate levels of inspection, unsatisfactory tendering procedures and excessive delays in payments to beneficiaries. Because of some of these formal errors, it is not possible to provide an adequate audit trail.

3.32. In two of the cases examined by the Court, the amount of eligible expenditure declared was insufficient

to justify the payment made by the Commission at the actual time of payment, and correct declarations would have led to Commission payments of 104,3 Mio ECU being postponed to a later date.

Audits by the Commission and the Member States

3.33. In general, the Member States and the Commission do not carry out sufficient on-the-spot audits of Structural Fund interventions, although Article 23 of Regulation (EEC) No 4253/88 makes provision for them (see paragraph 3.14). In particular, insufficient monitoring and checks are carried out by the Member States, in relation to Community provisions, on projects whose expenditure is entered under the heading of national counterparts in the expenditure declarations for the Community interventions which include these projects. With regard to programme closure, the Commission has not laid down systematic procedures in order to exercise the right to carry out, or to arrange for the carrying-out of, checks on the reliability of the documents on which closure was based. In this field, only 14 operations which were closed in 1998 within the framework of the ERDF for the 1989/93 programming period received on-the-spot checks from the Commission departments during the 1995/98 period (out of a total of 137 interventions closed).

Conclusion

3.34. Although the majority of the substantive errors found in the expenditure declarations have no direct effect on the Commission's payments of advances, the number of anomalies is still too high and there is still a real risk that these anomalies may have an effect when the interventions come to be closed.

3.35. The audit of Structural Fund interventions for the 1989/93 programming period which were closed in 1998 moreover revealed levels of anomaly with an impact on the Community payments made. The Commission needs to devote more effort to the effective supervision of the closure of programmes covering the 1994/99 period, and especially of the Objective 2 programmes for 1994/96. In addition to its own control and audit activities, the Commission should use the possibilities presented by its protocol arrangements with the Member States in order to reduce to the minimum the risk of error capable of affecting the final expenditure.

3.36. The introduction of Regulation (EC) No 2064/97 on financial control by the Member States of co-financed operations and the eligibility datasheets issued by the Commission on 23 April 1997 with the aim of dispelling uncertainties about types of eligible expenditure, make a useful contribution to the management of the programmes. However, these new arrangements cannot have had any significant impact on the expenditure declarations supporting the Commission's 1998 payments, and thus on this year's statement of assurance, because few of the expenditure items declared can have been affected by the eligibility criteria set out in the data sheets. The Commission is only now discussing with the Member States the arrangements for the establishment of clear audit trails, following the completion of the study at the end of 1998. And as noted in paragraph 19, the important requirement to provide an independent audit certificate will not in practice become effective until the programmes in operation for the current programming period reach the point of closure in 2000 and subsequent years.

3.37. Accordingly, while the Court recognises and supports the initiatives the Commission has taken to improve the financial management and control of the Structural Funds, it cannot take any assurance from them in the context of the 1998 DAS. The Commission should make every effort, together with the Member States, to ensure that the improvements take effect as soon as possible.

PROGRAMMING IMPLEMENTATION

3.38. In 1998 the administration of the Structural Funds was still concerned with measures from three programming periods: the current period (1994/99), the previous period (1989/93), and the period before the 1988 reform.

The 1994/99 period

3.39. For the current period, resources for the four Structural Funds were initially set at 149 818 Mio ECU, at 1994 prices⁽¹⁹⁾, and were increased by 4 747 Mio ECU, at 1995 prices⁽²⁰⁾, following the accession of three new Member States. At 1999 prices these resources amount to an overall figure of 159 000 Mio ECU. Of this amount, 90 % is earmarked for achieving the seven

objectives assigned to the Funds (primarily measures connected with the Community support frameworks — CSFs), while 9 % is for Community initiatives and 1 % is allocated for studies and pilot projects.

3.40. For the 1994/99 programming period, **Tables 3.3** and **3.4** give a summary of the state of implementation of Community support framework measures and Community initiatives respectively. For the period in question, a total of 1 133 measures has been approved for the four Structural Funds, including 265 operational programmes (OPs), 292 single programming documents (SPDs), 77 other measures (large projects, global subsidies, innovative measures) and 499 Community initiatives (CIs).

The 1989/93 period

3.41. On 31 December 1998, the programmes or other measures which had not yet been closed for the 1989/93 programming period amounted to 360 Mio ECU for the ESF, for 94 programmes, 113 Mio ECU and 64 programmes for the Guidance Section of the EAGGF and 1 355 Mio ECU for the ERDF. In the case of the ERDF, the corresponding amount on 31 December 1997 was 1 807 Mio ECU, and on 31 December 1996, 2 527 Mio ECU. The ERDF commitments still outstanding on 31 December 1998 for this period relate to 261 measures and represent 4,7 % of the total of 28 597 Mio ECU for commitments entered into. On 31 December 1997 the corresponding data were 432 measures and 6,3 %, and on 31 December 1996, 617 measures and 8,8 %, as against approximately 800 measures undertaken in total. For the Social Fund, closure procedures are more advanced and during the financial years 1997 and 1998 the commitments still outstanding were reduced by about three quarters. However, a considerable effort still needs to be made to enable the closure of the 1989/93 period to take place before the beginning of the new 2000/06 period.

3.42. Except in the event of an extension, for the majority of measures approved before 1994, commitments were supposed to be made in the Member States before 31 December 1993. As a general rule, the Member States then had two years within which to make the payments to the final beneficiaries and six additional months to send the Commission the documents necessary for closure. Provided these documents justified it, the Commission was, in general, supposed to make payments within two months, namely before 31 August 1996. The Commission granted some extensions of commitment and payment deadlines. These were for periods of no longer than one year, except for the O1 programmes in Italy, where the deadline for payments was, in most cases, extended to 31 December 1996 or 31 December 1997.

⁽¹⁹⁾ Commission SEC(93) 2113 document of 17 December 1993.

⁽²⁰⁾ OJ C 395, 31.12.1994, p. 1.

Table 3.4 — Expenditure on Community initiatives from 1994 to 1998

(Mio ECU)

Community initiative	Accounting period																	
	1994			1995			1996			1997			1998			Total		
	Provi-sions	Commit-ments	Payments	Provi-sions	Commit-ments	Payments	Provi-sions	Commit-ments	Payments	Provi-sions	Commit-ments	Payments	Provi-sions	Commit-ments	Payments	Provi-sions	Commit-ments	Payments
Interreg II	438,9	0,0	0,0	508,0	557,9	227,7	523,0	752,0	423,5	551,8	458,6	357,6	768,6	572,2	583,7	2 790,3	2 340,7	1 592,5
Leader II	217,0	0,3	0,0	244,9	468,5	132,7	257,9	251,7	133,6	273,9	157,8	104,1	390,0	270,4	242,1	1 383,7	1 148,7	612,5
ADAPT	207,9	0,0	0,0	231,7	307,7	152,6	244,9	222,4	87,0	260,9	125,4	147,9	349,4	374,7	249,7	1 294,8	1 030,2	637,2
SME	147,0	0,0	0,0	158,8	203,5	67,7	176,9	181,9	88,7	190,0	133,3	123,6	209,3	173,3	145,5	882,0	692,0	425,5
URBAN	107,1	0,0	0,0	121,7	157,4	58,1	124,2	215,0	108,1	129,5	118,1	75,6	205,1	182,0	140,0	687,6	672,5	381,8
PESCA	38,1	23,7	11,8	42,1	29,4	5,3	44,6	134,6	20,6	47,4	21,5	33,8	64,5	51,0	44,3	236,7	260,2	115,8
Rechar II	95,1	0,0	0,0	102,7	172,5	75,6	108,6	119,9	61,6	116,7	113,3	75,4	20,9	37,1	99,1	444,0	442,8	311,7
Resider II	120,9	4,3	1,3	131,5	172,8	77,0	139,1	134,4	79,6	179,6	105,1	62,1	19,9	73,2	52,7	591,0	489,8	272,7
RETEX	122,7	0,3	0,1	134,5	164,8	75,4	139,9	154,4	67,8	148,2	85,8	56,8	31,8	89,0	74,6	577,1	494,3	274,7
Employment	220,7	201,2	100,6	256,9	107,7	53,6	262,5	263,1	170,3	277,6	294,8	246,6	419,2	481,6	311,6	1 436,9	1 348,4	882,7
Konver	125,5	0,0	0,0	135,5	238,2	87,3	138,8	133,0	95,1	147,2	191,4	68,7	93,6	57,0	115,7	640,6	619,6	366,8
REGIS II	85,9	0,0	0,0	92,7	58,8	22,0	99,1	158,0	135,6	105,3	90,6	55,8	115,5	73,1	52,1	498,5	380,5	265,5
PEACE				66,0	27,4	13,7	118,0	95,6	41,7	119,0	53,3	81,2	100,0	162,9	61,0	403,0	339,2	197,6
Total	1 926,8	229,8	113,8	2 227,0	2 666,6	1 048,7	2 377,5	2 816,0	1 513,2	2 547,1	1 949,0	1 489,2	2 787,8	2 597,5	2 172,1	11 866,2	10 258,9	6 337,0

Source: Commission accounts.

The period prior to the reform

3.43. Payments for the ERDF measures decided on before the 1988 reform can be added to the management referred to above of the 1994/99 and 1989/93 periods. The total outstanding on 31 December 1998 was 519 Mio ECU (605 Mio ECU at the end of 1997 and 763 Mio ECU at the end of 1996), made up as follows:

- 243 Mio ECU (as against 282 at the end of 1997 and 386 at the end of 1996) for the non-quota measures, the integrated Mediterranean programmes, the integrated development operations, the national programmes of Community interest and the Community initiative programmes;
- 225 Mio ECU (as against 272 and 325 at the end of 1997 and 1996 respectively) for projects decided on before 1989 and subject to the automatic decommitment provisions (Article 12 of the amended ERDF Regulation) ⁽²¹⁾;
- 51 Mio ECU (as against 51 and 52 at the end of 1997 and 1996 respectively) for projects decided on in 1989 under the former Regulation (EEC) No 1787/84 and not subject to the automatic decommitment provisions.

3.44. Over 63 % of the outstanding aid referred to in the previous paragraph concerns ERDF measures in Italy, while approximately 29 % of the amounts relates to four other Member States (France, Greece, Spain and the United Kingdom). For many cases, it was noted that at the time of the final payment, the unused balanced was not immediately decommitted but was kept in reserve, sometimes for several financial years, in case of possible challenges ⁽²²⁾.

⁽²¹⁾ Sums committed under the granting of aid for projects decided on by the Commission before 1 January 1989 under the ERDF heading but for which no final payment request had been made to the Commission before 31 March 1995 were automatically decommitted by the latter by 30 September 1995 at the latest, without prejudice to projects pending for legal reasons.

⁽²²⁾ This is why, for four files closed in 1988 and 1989, a sum of 1 814 047 ECU still appeared in the accounts at 31 December 1998.

The closure of the Italian measures

3.45. With regard to the closure of the Italian measures, some special considerations should be borne in mind. In general, the programmes submitted by Italy tend to be based on measures intended for future financial years and do not include many projects which have already been decided on or are being implemented. The deadlines set in the programmes have proved unrealistic, in view of the fact that more time is needed for implementation. For the 1989/93 period, the Commission had approved aid under the ERDF for Italy totalling 6 484 Mio ECU ⁽²³⁾. The payment deadline was extended in most cases and closure was due to take place in 1998.

3.46. With regard to the ERDF, 215 measures were still open on 31 December 1998, 110 of which related to the 1989/93 period and the remainder to the preceding period. Except for four programmes relating to the region of Campania, all the measures for the 1989/93 period resulted in requests for final payments that were submitted within the six months following the payment deadline which had been extended. However, on 31 December 1998, the Commission had still not closed any of the programmes. Moreover, 15 programmes are still open as far as the ESF is concerned, following the extension of implementation deadlines or because of legal investigations.

The Cohesion Fund

3.47. Council Regulation (EEC) No 1164/94 of 16 May 1994 ⁽²⁴⁾, establishing the Cohesion Fund, allocated resources of 15 150 Mio ECU, at 1992 prices, for the 1993/99 period. According to the financial perspectives established by the regulation, the total for commitments at the end of the financial year 1998 was estimated to be 12 550 Mio ECU.

3.48. At 1999 prices, total resources may be estimated at 16 600 Mio ECU. On 31 December 1998, commitments amounted to 13 499 Mio ECU (7 374, 2 444, 1 224 and 2 448 Mio ECU respectively for Greece, Spain, Ireland and Portugal, and 9 Mio ECU for technical assistance) and payments amounted to 9 990 Mio ECU (5 141, 1 689, 928 and 2 225 Mio ECU respectively for Greece, Spain, Ireland and Portugal, and 7 Mio ECU for technical assistance).

⁽²³⁾ In fact, the sum also includes measures belonging to the former integrated Mediterranean programmes, national programmes of Community interest and others which had been transferred to the 1989/93 programming period.

⁽²⁴⁾ OJ L 130, 25.5.1994, p. 1.

Variations in the conception and management of the programmes

3.49. The concept of management by programmes was one of the chief innovations of the 1988 reform for the management of the Structural Funds. However, there are fundamental variations between Member States in the way the programming concept is implemented. Some Member States or regions primarily programme new measures, to be carried out while the programme is being implemented, while others incorporate into the programme investment which is already being made.

3.50. The two approaches have different consequences for the programmes' implementation deadlines. In the first case they are longer, while the second enables the Community financing to be used more quickly. The two approaches also have different effects as far as the impact of the Community financing is concerned; in the case of project incorporation, the impact is more indirect.

3.51. While differences in approach of this kind within programming may prove necessary in order to take account of differing circumstances, they should at the very least be monitored and assessed using appropriate methods. Under current circumstances, behind the same piece of terminology or document the situations may in fact be significantly different.

3.52. There are also variations in management between different Funds. Some have a more general approach and make more use of the concept of integration, while others focus on the annual instalments of the programmes, or even the projects. As a result, the extent of anyone's awareness of the implementation of the measures, and of the links between Community financing and the measures on the ground, varies from one Fund to another.

3.53. With regard to the financing of the projects, the principle is that, on the basis of the eligibility criteria set out in the programmes, each Member State is responsible for selecting and managing the projects. However, in order to implement a principle of this kind properly, it is necessary to have effective monitoring of the work carried out and data systems that make it possible to obtain less piecemeal knowledge of the measures, with the aim of verifying their impact in terms of structural development and the degree to which they conform to Community policies. At present it is difficult to obtain complete information on individual types of project, on their sustainability and viability, on the positive or nega-

tive impacts that they have on each other or on their overall effects. Data systems of this kind should be set up in partnership, since they are as necessary for the Community as for the Member States and, in the absence of any progress in compiling them, it will be difficult to improve and make more workable the evaluations prescribed by the provisions in force.

CONFORMITY WITH COMMUNITY POLICIES

3.54. Article 7 of the basic regulation on the Structural Funds stipulates that measures financed by the Structural Funds 'shall be in conformity with the provisions of the Treaties, with the instruments adopted pursuant thereto and with Community policies, including those concerning the rules on competition, the award of public contracts and environmental protection and the application of the principle of equal opportunities for men and women'.

3.55. Because of the decentralised way in which the Structural Funds are managed, Community bodies are often unaware of the precise circumstances under which the aid is used at the national and regional levels, or the characteristics of the individual projects financed. However, it is a basic principle that the Funds should make financial contributions towards measures and projects which observe and promote Community policies, and which aim, moreover, to make an essential contribution to the objective of sustainable development.

3.56. In its opinion on certain proposals for regulations within the Agenda 2000 framework ⁽²⁵⁾ the Court emphasised that more information and awareness was needed in this area in order for the national and regional departments involved in managing and monitoring the Funds to be better informed on Community directives and other measures.

3.57. The Court's audits revealed that a number of activities had been financed under circumstances which did not conform to the principles and procedures laid down by Community policies, particularly with regard to environmental protection, management of State aid

⁽²⁵⁾ OJ C 401, 22.12.1998, p. 29.

and the award of public contracts. The investigation carried out by the Court into expenditure on developing industrial sites also revealed some complex problems connected with the observance of the rules on competition, which are caused by the absence of a suitable, transparent system for setting prices.

3.58. In its Annual Report concerning the financial year 1996 (paragraphs 6.53-6.68), the Court had already noted contradictions between the objectives of regional policy and competition policy rules, the inadequacy of the verification procedures for these rules and the need to increase cooperation between the departments responsible for management in order to ensure that the rules on combination and overlapping of aid were observed. Few concrete steps have been taken to improve matters. Specifically, the Commission acknowledged in its reply to these observations (paragraph 6.60), the need to introduce computerised systems which automatically include data on all amounts of Community aid received by the measures and projects. There are still no such systems in place.

3.59. Although the regulations in force expressly emphasise that the activities financed must be in conformity with Community policies, the procedures put in place to ensure this have to date proved ineffective. At the very least, the regional plans, operational programmes and single programming documents should be more specific and should not simply state, in a general fashion, that the measures and activities financed should be in conformity with Community policies. For instance, they could include precise references to national or regional legislative provisions or other legal documents designed to ensure that the Community policies are applied properly, so as to make it easier for the participants to improve their implementation of the relevant rules and procedures.

IMPACT OF ONGOING ASSESSMENTS AND THE EXTENT TO WHICH THEY ARE TAKEN INTO ACCOUNT (OBJECTIVES 1 AND 2)

Introduction

3.60. The ongoing assessments of the CSFs and OPs/SPDs concerning the 1994/99 programming period

were carried out during the 1996/97 period for all the Objectives to which the SFs relate. The 1996/97 assessment statement drawn up within the scope of the implementation of SEM 2000 ⁽²⁶⁾ notes 144 evaluations for O1, 91 for O2, 42 for O3, 19 for O4, 8 for O5a, 83 for O5b and 2 for O6. Their main purpose was to provide the monitoring committees with information on the operation of the programmes and on the way in which the objectives were gradually being achieved, and to suggest possible reprogramming measures.

3.61. In the Court's Special Report No 15/98 ⁽²⁷⁾, as regards ongoing assessments, observations were made on the implementation procedures, on the various priorities given to evaluation objectives and on the approaches, methods and techniques used.

3.62. The following comments deal with the effects and the use made of the findings and recommendations of the ongoing assessments within the framework of O1 and O2. They are based on an analysis of replies to a questionnaire sent by the Court to 11 Member States, together with an audit at the Commission departments responsible for management, which included the examination of 30 files.

Quality and scope of the recommendations and results of the ongoing assessments

3.63. A detailed analysis of the ongoing assessments of the large O1 CSFs showed that the majority had attempted to evaluate the anticipated effects of the SFs in macroeconomic terms. As **Table 3.5** shows, the data for the 1994/99 period vary, in terms of additional growth, from 2 % in southern Italy to 5,1 % in Spain or, in terms of jobs created, from 1,5 % in east Germany to 3,2 % in Ireland. These estimated effects include both the effects of demand in the short term and the effects of supply in the medium or long term. As highlighted by the Court's Special Report No 15/98 ⁽²⁸⁾, since these results are based on calculation methods which cannot be compared directly and which vary from one country to another, they must be approached with caution. With regard to the reduction of regional imbalances, few results have been given at this stage. Those that have

⁽²⁶⁾ Implementation of SEM 2000 — Evaluation for 1996/1997, SEC(1998) 124 of 21 January 1998; see also Table 5 of the Court's Special Report No 15/98, (OJ C 347, 16.11.98, p. 25).

⁽²⁷⁾ OJ C 347, 16.11.1998.

⁽²⁸⁾ Part 7.

Table 3.5 — Macroeconomic effect of Objective 1 CSFs (1994-99)

	Germany (Obj. 1)	Greece	Spain	Ireland	Italy (Obj. 1)	Portugal
Additional growth (measured in terms of GNP)	3,2	4,8	5,1	3,8	2,0	4,4
Increase in the volume of employment	1,5	2,9	2,4	3,2	1,0	3,7 ⁽²⁾

(%)⁽¹⁾

⁽¹⁾ As compared with the reference period of 1999 (without CSFs).

⁽²⁾ The figure for employment in Portugal is equal to the fall in the rates of unemployment in percentage points.

Sources: IFO Institut (D), KEPE (EL), Quasar (E), ESRI (IRL), Ministero Tesoro (I), CISEP (P).

relate primarily to the programmes' physical achievements and stress the progress made in catching up with the European average. Only a few recommendations, based on the results produced by macroeconomic models such as the HELM model ⁽²⁹⁾ for the Hainaut (B) SPD or Hermin ⁽³⁰⁾ for Ireland and on the findings of tabular analyses of measures have resulted in redirecting priorities in reprogrammings and in justifying changes in strategy.

3.64. In many other programme assessments, the recommendations put forward by the evaluators are not always sufficiently quantifiable and workable within the framework of the existing programme to allow concrete and useful proposals to be drawn up for adjusting programmes, and in particular for changing the development strategy chosen.

3.65. In numerous cases the systems of indicators proved unsuitable or inadequate in terms of establishing the results and progress made in achieving the

objectives, or were non-existent. For this reason, instead of assessing the impact and effectiveness of the structural measures, the evaluators of some programmes have simply suggested that, with the agreement of the regional authorities, several indicators should be introduced which are essential for the next evaluation ⁽³¹⁾, since the conditions necessary for carrying out an assessment were not yet in place. In actual fact, the inputting of the data necessary, particularly for the employment and impact indicators, was not always done by the departments and the principals.

3.66. The evaluators did not carry out much analysis, during the ongoing assessments, of the evaluation systems used to select the projects co-financed by the ERDF. Few recommendations were found which were designed to improve these systems, where they exist, as in the Merseyside (UK) or the Hainaut (B) SPDs, or to create them where there were none. There is a lack of interest on the part of the evaluators and the partners in setting priorities, within the context of programming and monitoring. Operational instructions from the Commission might allow progress to be made in this area. Instructions of this kind, designed to constitute a coherent collection of priority criteria and the relevant weighting to be used when selecting projects, also ought to include the introduction of an analysis framework.

3.67. For this reason and because of the kind of analysis used or the inadequacy of the indicators, the findings and recommendations of the ongoing assessment do not in some cases enable the desired reprogramming to be carried out. The majority of OP managers who replied to the questionnaire mentioned in paragraph 3.62 considered that the recommendations put forward in the ongoing assessments were in fact intended for inclusion in the next programming period and that they were often premature in the current period.

⁽²⁹⁾ The HELM macroeconomic model, which was used for the ongoing assessment of the 1994/99 O1 SPD for the Province of Hainaut (Belgium), is one of the few to take the regional approach to development specifically into account by considering the effects of endogenous growth linked to long-term productivity, although improvements in productivity due to SF intervention are mainly limited to the industrial sector and only concern labour productivity.

⁽³⁰⁾ The Hermin econometric model seems to produce satisfactory results in terms of effects on demand. It takes into account the particular characteristics of each Member State and aggregates effects at a national level. It assumes that economies do not utilise their full production capacities and that the multiplier and accelerator effects related to increases in investment consequently cause an expansion in production and employment.

⁽³¹⁾ In general, the evaluators were not able to refer to these indicators or to ensure that they were consistent and operational.

Ongoing assessments and mid-term reviews

3.68. A report has just been published concerning the implementation of mid-term reviews with regard to Objectives 1 and 6 ⁽³²⁾. In fact, there is no provision for such a review, either in Article 6 of the basic regulation on the Structural Funds ⁽³³⁾, in Articles 25 and 26 of the regulation concerning the coordination of the Funds ⁽³⁴⁾ or in the CSFs and SPDs for the 1994/99 programming period.

3.69. However, at the request of the Member States ⁽³⁵⁾, in May 1997 the Commission decided to adopt guidelines on the adjustment priorities of the Structural Fund programmes up until 1999 (except for Objective 2, for which new programmes have been adopted). These guidelines, together with the ongoing assessments, were supposed to constitute the basis for adjustments to programmes within the framework of the mid-term review of the 1994/99 programming. This process was thus to include the ongoing assessment, the resulting changes in priorities and budgetary reallocations for the programmes. In many cases, these clarifications came too late to lead to a genuine linking of ongoing assessment and mid-term review as regards the 1994/99 programming period.

3.70. In general, a mid-term review in terms of budgetary reallocations of the SFs by Member State is thus still rare, particularly since reprogramming may take place, according to Article 6 of the coordination regulation for the SFs, either annually or when there are significant changes in the socioeconomic situation or the employment market. Thus, the new German *Länder*

continually reallocate their structural measures. At the time of the mid-term review, many financial reallocations had already been made. The amendments to the financing plan introduced during the mid-term review were, in fact, additional to the previous reallocations.

3.71. **Table 3.6** shows the reallocations made as part of the mid-term review. It demonstrates the limited extent of reprogramming in proportion to the SF resources within O1. The greatest change in terms of transfer of resources, that of the Italy O1 CSF (for a sum of approximately 700 Mio ECU), amounts to only 5 % of the total allocations. Greece, Spain and Portugal also made changes which were considerable in absolute terms but small in relative terms (400 Mio ECU, 610 Mio ECU and 364 Mio ECU respectively, representing 3, 2 and 3 %). In general, these changes consisted in redistributing appropriations to programmes with rapid expenditure rates. In relative terms, the greatest changes were in the O1 regional programmes of Hainaut, Belgium (19 %) and Flevoland (13 %). In the first case, the quality of the ongoing assessment enabled priorities to be realigned, and in the second case, the evaluator's recommendations for change confirmed the analyses of the provincial unit responsible for managing the ERDF aid.

3.72. The deadlines to be observed for considering proposals and recommendations for the reallocation of resources were not always taken into account. Thus, Community appropriations were redeployed at mid-term, although the ongoing assessments were not yet available, for reasons which were in some cases connected with the length and complexity of national administrative procedures. Other mid-term redeployments were unable to use the ongoing assessments, which were being completed at the same time ⁽³⁶⁾. In other cases, reprogramming that took into account the findings and recommendations of the ongoing assessments took place at the end of 1998, for certain O1 regions.

3.73. The conclusions and recommendations made by the evaluators are examined and taken into account in ways which vary according to whether or not an ad hoc assessment or management structure has been set up within the framework of the mid-term review. This is particularly true in relation to the findings on the impact made and progress achieved in realising the objectives and priorities of the programming in course.

⁽³²⁾ Report on the mid-term review of structural interventions — Objectives 1 and 6 (1994/99) (COM final document (1998) 782, 7 January 1999).

⁽³³⁾ Regulation (EEC) No 2052/88 (OJ L 185, 17.7.1988, p. 9), as amended by Regulation (EEC) No 2081/93 (OJ L 193, 31.7.1993, p. 5) on the tasks of the Structural Funds and their effectiveness and on coordination of their activities between themselves.

⁽³⁴⁾ Council Regulation (EEC) No 2082/93 of 20 July 1993 amending Regulation (EEC) No 4253/88 laying down provisions for implementing Regulation (EEC) No 2052/88 (OJ L 193, 31.7.1993).

⁽³⁵⁾ During the informal meeting of ministers responsible for regional policy and land development held in Ireland on 14 and 15 November 1996, the Commission was asked to formulate policy guidelines in accordance with the principle of subsidiarity, with a view to the adaptation of the current Objectives 1 and 6 programmes to make them more focused on measures in favour of employment until the end of 1999.

⁽³⁶⁾ However, the redeployments were not incompatible with the results of the ongoing assessments.

Table 3.6 — Reallocation of Structural Funds by Member State within the framework of the mid-term review (Objective 1)

(Mio ECU)

Country	SF aid at end 1997	Payments during 1994-97 period	Payments/Total SF aid 1994-97	Reprogramming	Reprogramming as % of SF aid
Belgium	748,50	267,60	36,00	140,00	19,00
Germany	13 831,60	6 754,60	49,00	0,00	0,00
Greece	13 902,30	6 095,20	44,00	400,00	3,00
Spain	25 705,60	13 597,30	53,00	610,00	2,00
France	2 222,70	821,30	37,00	95,40	4,00
Ireland	5 708,40	3 162,80	55,00	163,00	3,00
Italy	14 500,80	5 072,90	35,00	698,00	5,00
Netherlands	150,00	51,10	34,00	19,00	13,00
Portugal	14 106,80	7 952,50	56,00	364,00	3,00
United Kingdom	2 386,30	1 117,20	47,00	166,80	7,00
Total	93 263,00	44 928,50	48,00	2 656,20	2,80

3.74. For instance, when the mid-term review was implemented, some O1 programmes, such as the SPDs for Hainaut (B), Ireland and Portugal, benefited from the prior existence of a continuous process of evaluating the structural measures by means of ad hoc support structures together with the monitoring committee and the evaluators. In some cases the evaluators' recommendations were classified and assessed in detail by the steering group or the ad hoc body. These management structures were able to make the most of the analyses submitted and to take them further so as to put them into practice. Considerable changes to the contents of the programming were noted.

3.75. Although in 1995 and 1996 the Commission worked together with the Member States on defining and drawing up operational procedures to be followed when carrying out the mid-term review, it was in fact the monitoring committees that introduced this process in a flexible and pragmatic way, without organisational constraints. The diversity of responses from the monitoring committees involved highlights the need for this process to be managed and guided in a more homogeneous and formalised way.

Ongoing assessments and the suitability of management and assessment structures and tools

3.76. For the first period of ongoing assessment, considerable efforts had to be made with regard to organisation and the collection of data. This resulted in the introduction of management structures, referred to in paragraph 3.74, for Hainaut (B), Ireland and Portugal.

An assessment steering group for the Flevoland SPD (NL-O1) was set up by joint decision. In the case of the Valenciennes-Douai-Avesnes area (F-O1) an internal monitoring-assessment unit was linked to an external independent evaluator, while in the Franche-Comté region (F-O2) the active development of the task of evaluation is supported by an ad hoc body. In other cases, no organisational change has taken place, since the responsibilities and work connected with the monitoring process have been taken on at programme level by the relevant national and regional authorities and the information and management chain remains the same. This variety of systems is a reflection of whether or not national assessment organisations exist, as well as of variations in the structure of the programmes and the size, make-up and role of the monitoring committees.

3.77. On occasion the ongoing assessments have helped to introduce more appropriate management and monitoring tools. In the field of evaluation itself, new tools are gradually being introduced, such as a macroeconomic model for the German O1 regions, new terms of reference for evaluations in Flevoland and a framework for the final evaluations of the O1, O2 and O5b SPDs in France.

Objective 2 measures — specific aspects

3.78. The ongoing assessment of O2 measures was not directly linked to programming, either in the case of the review of the 1994/96 programming period

measures, or for the programming for the 1997/99 period ⁽³⁷⁾.

3.79. As pointed out in the Court's Special Report No 15/98 ⁽³⁸⁾, within O2 *ex ante* evaluation, ongoing assessment and *ex post* evaluation are out of step, given the relatively short length of the programming periods. It is also often difficult to separate the periods in order to identify their respective impacts on the region concerned, given also the lack of harmonisation of the indicators and data that are sometimes unreliable. It should also be noted that for some French regions, measuring the impact on employment and the environment will concern entire periods.

3.80. In this context, for some regions the O2 ongoing assessments have sometimes been taken as *ex post* evaluations or as preparations for *ex ante* evaluations. In general it has not been possible for them to make a contribution to the review of the 1994/96 measures, largely because of when they were carried out.

3.81. It is often at the level of management and monitoring (indicators, monitoring schedules, computer tools) that one can see the impact and the use made of the ongoing assessments concerning O2. For some regions, the findings of the ongoing assessments of the 1994/99 programming period have contributed to the programming of the 1997/99 period, particularly where the ongoing assessments supplied reliable observations on the programmes' added value and impact, and the findings have also been used in developing suitable databases (Limburg-B).

Conclusion

3.82. The Commission should ensure that monitoring, evaluations and (re)programming in general, and ongoing assessment and the mid-term review in particular, are properly linked in time.

3.83. As previously noted in Special Report No 15/98, there is still a need for a better methodological frame-

work, relevant indicators and suitable monitoring data and collection processes. The evaluation methods used should be those that are most appropriate for measuring the effects of the programmes and measures.

3.84. On occasion new evaluation and review structures have been introduced in an ad hoc manner, and the Commission should ensure that they are consolidated.

FOLLOW UP OF THE COURT'S AUDITS IN THE EAGGF-GUIDANCE FIELD

3.85. As mentioned in paragraph 3.1, the EAGGF-Guidance is a part of the Structural Funds. The Court has already examined the implementation of Council Regulation No 2328/91 of 15 July 1991 ⁽³⁹⁾, replaced by Council Regulation No 950/97 of 20 May 1997 ⁽⁴⁰⁾, in its Annual Report concerning the financial year 1996 ⁽⁴¹⁾. It provides aid for on-farm investments and for the setting-up of farmers through a system of part-financing for national aid schemes.

3.86. The various provisions of this regulation are aimed at individual farmers rather than agro-industrial companies and have, as an overall objective, improvements in the viability of individual farm holdings. The measures are aimed at both existing farmers and those setting up in agriculture for the first time.

3.87. With regard to agricultural matters (14th recital of EAGGF-Guidance Regulation No 950/97) the highest degree of consistency possible must be achieved between the EAGGF-Guidance measures and the measures taken to limit surplus production. Thus, Article 6 (2) of the above-mentioned regulation governing the implementation of the MIPs contains provisions for refusing or limiting investment aid whose effect would be to increase the holding's production of products for which no normal market outlets can be found. For this reason, the MIP must state the types of crops and products in which the subsidised investments will be made. However, the national authorities do not always apply these provisions strictly enough and the Court has noted various cases of aid granted to plans for production

⁽³⁷⁾ The 'guidance note concerning the measures in the industrial regions in decline (Objective 2) for the second programming period, 1997/99', (C(96) 952 final of 29 April 1996), could have developed principles to govern so-called ongoing assessments which were being planned at the same time.

⁽³⁸⁾ Paragraph 6.27.

⁽³⁹⁾ OJ L 218, 6.8.1991, p. 1.

⁽⁴⁰⁾ OJ L 142, 2.6.1997, p. 1.

⁽⁴¹⁾ OJ C 348, 18.11.1997, paragraphs 8.31-8.40.

where there are structural surpluses or problems in finding outlets and for which the EAGGF-Guarantee finances disposal or price support measures.

3.88. The promotion of organic farming and of non-polluting forms of agriculture is among the main elements of the reform of the CAP, and is mentioned in the fifth action programme and in Council Regulation No 2085/93⁽⁴²⁾. However, in a random selection of farmers across all Member States visited, only one had received set-up aid to create an organic farm. Furthermore, the system contains no specific incentives to encourage young farmers to take up organic farming.

3.89. In order to qualify for investment aid, the farmer has to fulfil certain conditions, such as practising farming as his main occupation, possessing adequate occupational skills and competence, and having had a material improvement plan approved. This is to ensure a structured development of the agricultural holding. The aim is the creation of new, or the improvement of already existing, agricultural economic activity, within the objectives and limitations of the common agricultural policy (CAP).

3.90. Checks by the Commission and by the national authorities of the Member States visited by the Court⁽⁴³⁾ are still inadequate⁽⁴⁴⁾. When on-the-spot checks are carried out, they are confined to a part of the planned investments and their costs, and do not examine their contribution to achieving the objectives of the material improvement plan (MIP) as a whole. The piecemeal nature of these inspections does not make it possible to check properly that consistency between the various investments set out in the MIP is being maintained. For this reason, it is almost impossible to be sure of either the long-term viability of the holdings receiving aid or of the aid's actual contribution to the structured development of agriculture.

Conclusion

3.91. The checks which have to be carried out should place more emphasis on verifying the effects of the MIPs on the viability of the holdings receiving aid and should not merely look at technical or financial aspects. More-

over, during the decision-taking process for granting EAGGF-Guidance aid, more consideration should be given to the kind of production to be aided, more especially where a product in structural surplus is concerned, since the progressive elimination of these products is in fact one of the chief aims of the CAP.

EFFECT ON EMPLOYMENT

3.92. One very important aspect of the results hoped for from structural measures is a direct and indirect effect on employment and on the job market. These measures constitute the main financing with which the Community encourages employment, whether in connection with vocational training, aid to productive investment and development of infrastructure and endogenous potential, or through more targeted measures in favour of more specific categories of recipient, such as programmes for the young or the long-term unemployed.

3.93. Forecasts dealing with this topic in the programmes receiving aid vary enormously, often even within the same Fund and Member State. Some only take gross direct impact into account, while others also analyse indirect impact. This diversity largely reflects the variations in the programmes' degree of preparation, and these variations have their repercussions on the later stages of monitoring and evaluation.

3.94. The value of the forecasts has not improved significantly during recent years. Some of them contain data obtained from traders on which no cross-checks or verifications have been carried out to confirm their accuracy. Not enough consideration is given to indirect effects, whether positive or negative, or to whether jobs have been created or safeguarded on a temporary or permanent basis. Even the concepts of creating or safeguarding jobs are often used in an ambiguous way. Where economic models are used, the measures are usually more comprehensive, but there is not always enough analysis or verification by the evaluators of the degree to which they are adapted to the actual situation.

3.95. National and regional employment aid schemes are numerous and complex. They may include tax or business benefits, site redevelopment or social measures. The departments responsible for managing the

⁽⁴²⁾ OJ L 193, 31.7.1993, p. 44.

⁽⁴³⁾ France, Germany, Ireland, Italy and Spain.

⁽⁴⁴⁾ See Special Report No 12/98, paragraphs 5.26-5.28 (OJ C 356, 20.11.98).

programmes at the national and regional levels usually only have a very partial knowledge of them and can do very little to bring about opportunities for synergy or to promote the most suitable schemes.

3.96. Little consideration is given to which type of financial benefit should be given priority: loans, subsidies, interest-rate subsidies or guarantees. Structural Fund finance is primarily based on granting assistance and even where global subsidies⁽⁴⁵⁾ are used and financial operations take the form of taking capital stakes, further monitoring of these activities by the Community is completely overlooked.

3.97. It is essential for the plans and programmes to specify the extent to which the activities receiving finance are capable of contributing to the development of economic activity. Actions or processes which turn out to destroy jobs, in particular in the context of relocations, should be examined more carefully, since projects receiving finance which create jobs in one region may destroy them in others. In many cases the programmes have become simply a kind of procedure for paying over aid, and the means employed are not really matched to the objective to be achieved. As far as employment is concerned, what is important is the net effect — in other words, the overall impact on unemployment — and this also requires the plans to be analysed carefully, in order for the measures financed by the Community to be put in place again in all the initiatives which contribute to structural development.

3.98. Coordination is designed to combine various instruments so that they act together in a way that will best ensure the objectives are achieved. It is one of the basic principles of the rules governing the Structural Funds and implies improved complementarity between the measures of the various Funds, such as aid for staff training, for investment and the production process, and for infrastructure facilities.

3.99. In actual fact, coordination between the Funds and other Community financial instruments has not advanced, either at the Community or the national level. Management objectives are not always transparent and

there is insufficient exchange of information. The programmes and other programming documents show very little integration between the measures. Ten years after the reform and contrary to its principles, some areas aided by the Community are still covered by two Structural Fund objectives, such as Objectives 2 and 3 or Objectives 3 and 5b.

3.100. An effort has been made to improve the quality of vocational training and to ensure that it satisfies the needs of the employment market to a greater extent. More attention is being paid to the opportunities offered by new technologies. Considerable progress still needs to be made, however, particularly as regards partnership with commercial operators, and the activities of the monitoring committees in this regard are still not worthy of note. Links with research sectors have not been developed sufficiently, whereas scientific innovation and the development of new technological inventions are the main areas which hold out prospects of employment.

3.101. Action in the field of employment is difficult and there is a risk that the short-term and longer-term results may diverge. The impetus that the Community structural measures may give largely depends, however, on laying down strict criteria for intervention and on adopting management practices which take more account of all the aspects to be taken into consideration.

GENERAL CONCLUSION

3.102. The basic principles of the rules governing the Structural Funds are ambitious and have as their overall goal a real improvement in the quality of administrative and financial management. The concepts of planning, coordination, partnership and evaluation are important innovations for increasing the measures' transparency and effectiveness.

3.103. Improvements have been seen from one programming period to another (see in particular paragraphs 3.74, 3.76 and 3.77). But progress in the application of the basic principles is still slow and their implementation at the national and also at the Community level is often deflected towards aspects which are primarily formal (see in particular paragraphs 3.41, 3.46, 3.57, 3.67, 3.72, 3.75, 3.87, 3.88, 3.90, 3.95, 3.96 and 3.97).

3.104. Reform is a long-term task. It is important to make sure first of all that it is fully and genuinely adopted at the Community level, and to ensure that its principles are integrated in an active and effective way at all levels of management of the Structural Funds.

⁽⁴⁵⁾ Under Article 5(2) (c) of Regulation (EEC) No 2052/88 and Article 6 of Regulation (EEC) No 2083/93 (OJ L 193, 31.7.1993, pp. 9 and 37).

COMMISSION REPLY

IMPLEMENTATION OF THE BUDGET

3.3. The inevitable forward nature of the programming of Structural Fund operations and the problems with estimating the amount of requests for payment from Member States, on top of a more restrictive budgetary policy, have, on several occasions, resulted in the volume of payment appropriations finally entered in the Community budget being reduced by comparison with Commission proposals, because of constraints relating to the financial perspective and the general balance of the Community budget. Moreover, this occurs even when cofinanced programmes are fully up and running.

However, the Commission's long experience allows it to estimate the need for appropriations by budget heading with a fair degree of precision.

3.4. To minimise the variations between initial forecasts and actual implementation of programmes, the Commission has asked Member States, within the framework of the SEM 2000 programme, to play a more active part in the forecasting process during the preparation of the preliminary draft and the management of the budget itself.

Furthermore, Article 31 of the new Structural Funds regulation (Regulation No 1260/99) provides that commitments are to be made automatically each year and will, as such, be wholly predictable. Article 32(7) further stipulates that each year the Member States must send the Commission their updated forecasts of applications for payment for the current year and the forecast for the following year. This provision should improve the participation of Member States and the quality of the forecasts they produce.

Regarding the forecasts for Objective 2 programmes, the implementation of these programmes was greatly affected by the change from the sub-period 1994-96 to the sub-period 1997-99. Commitments for many of the programmes of this second sub-period were made in a single instalment in 1997, which explains the sharp drop in the pace of Community commitments in 1998.

The high level of payments for the Integra strand of the employment Community initiative (158%) is due to the Commission's decision to divide the target groups of Horizon into two separate strands (Horizon for people with disabilities, Integra for other marginalised groups). The response to this

new action from Member States was very positive with a large number of Integra-specific projects proposed during the second launch of projects under the employment initiative in 1997. The large number of Integra projects and the fact that first payments were made to most of these in 1998 ensured a higher consumption rate than that originally provided for in the budget.

3.5. Although admittedly unwieldy in administrative terms, amendments to the financing plans of programmes have been made throughout the programming period to monitor the actual implementation of cofinanced projects as closely as possible. This is a practice which complies with the regulations and the standard terms annexed to all forms of assistance. However, the new regulations (for the next programming period) are in line with the Court's recommendations.

3.6. The Cardiff European Council called on the Commission to find the resources required to bolster the PEACE initiative. The Commission then proposed funding the Community initiative for peace and reconciliation in Northern Ireland in 1999 by reallocating EUR 100 million from other Community initiatives (CI).

The Commission therefore undertook a review of the CI financial execution. The methodology followed was agreed by the Management Committee of the CI on 22 September 1998. The Member States then proposed how this figure should be broken down per initiative. A formal decision of the Commission was finally taken on 31 May 1999.

3.7. The Commission acknowledges that the commitments which appear in the budget accounts are only the annual instalments which are being implemented, which means that decisions which are not yet implemented in terms of financial commitments cannot be seen from the financial statements. To remedy this, in accordance with the prudent accounting principle, the Commission publishes in the 'off-balance-sheet commitments' the difference between the updated provisions set by the Edinburgh summit in December 1992 and the amounts of commitments appearing in the budget accounts.

The Commission would nonetheless point out that the procedure followed with regard to Structural Fund commitments complies with Article 20 of Council Regulation No 2082/93, amending Regulation No 4253/88, which sets out the criteria to be fulfilled, particularly as regards degree of implementation, for Member States to take up all of the commitments for the period.

As already indicated in the reply to the Court's observations on the 1997 statement of assurance, the Commission has undertaken to review this situation in the recasting of the Financial Regulation.

3.8. The rules currently in force do not require the Commission to provide information in its financial statements on payments made to final beneficiaries. This is all the more valid in an area where the principle of additionality is applied and management is shared between the Member States and the Commission.

In these circumstances, the only information which the Commission is required to produce is the difference between the payment of advances and balances.

Moreover, in the case of the ESF, the system of annual closure of instalments, which involves Member State governments submitting a request for the balance each summer, makes it possible to monitor actual implementation more closely.

For the 2000-06 programming period, the new Structural Funds regulation provides for a different system of financial management, which makes a clearer distinction between pre-financing payments (initial advances) and actual expenditure (intermediate payments). It is designed to clarify and specify the legal framework for implementation in terms of commitments and payments.

The concepts of final beneficiaries, intermediate payments to reimburse actual expenditure and payment of balances are explicitly defined.

These new provisions will allow the Commission to provide the information requested by the Court in such a way as to make clear the distinction between the payment of advances, payments to final beneficiaries to cover expenditure and payment of balances.

SPECIFIC EVALUATION OF THE FIELD IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

The Structural Funds

3.10. In the case of ERDF payments, of the 25 substantive errors included in the 1998 statement of assurance, 18 concern payments of advances. As the erroneous amounts do not

affect the level of expenditure required to trigger the payment of such advances, the corresponding payments were correctly made.

The impact of anomalies in declarations of expenditure from Member States is difficult to estimate, but the Commission believes that it is reduced by the checks carried out at the time of closure, even if errors do remain. The results of checks can lead to corrections being made in final declarations.

Even if Member States overstate amounts of potentially eligible expenditure, which allows errors to be corrected, the Commission considers that they should improve the reliability of their certification systems with respect to the declaration of expenditure.

3.11. It is true that the Structural Fund regulations do not lay down detailed procedures for closure, apart from the provisions of Article 21 (4) of coordinating Regulation (EEC) No 4253/88 (as amended by Regulation (EEC) No 2082/93) which sets out the conditions for payment of a balance by the Commission.

However, the Commission has recently introduced detailed guidelines on the financial closure of operational measures from the 1994-99 programming period, which complement the regulations and the provisions governing financial implementation (Commission Decision, SEC(1999) 1316 final of 9 September 1999, sent to the Member States, the European Parliament and the European Court of Auditors for information). Moreover, the provisions governing financial implementation, which are annexed to each CSF and form of assistance, lay down procedures for the closure of instalments and operations (points 19, 20, 36 and 37).

Cohesion Fund

3.13. Projects financed from the Cohesion Fund are subject to checks by the Member States and the Commission in accordance with the procedures laid down by the Cohesion Fund regulation. The Commission coordinates these checks, under protocols signed with the national inspection authorities of the four Member States involved, through frequent contact with national control bodies.

The Commission may, in the future, take steps to resolve the problems identified by the Court.

The new regulations on financial control

3.14–3.19. Regulation (EC) No 2064/97 of 15 October 1997 entered into force in mid-November 1997, except for

Article 8. Article 17 provided that that article would not apply until 1 January 1998. However, frequent contact with the national authorities, including inspection coordination meetings with national authorities and reports submitted by the Member States in accordance with Article 9 of the regulation, shows that, in many Member States, the department or person responsible for independent control had serious difficulties in giving an opinion on the quality of control for these categories of programmes. They could not, obviously, apply the provisions of Regulation (EC) No 2064/97 before its entry into force. The national authorities were obliged, therefore, to ask that person or department to issue opinions on the basis of inspection reports which were drawn up before the detailed provisions set out in Regulation (EC) No 2064/97 were adopted.

To solve this problem, the Commission adopted Regulation (EC) 2406/98 amending the provision which governs the entry into force of Article 8 (1) of Regulation (EC) No 2064/97. Consequently, application of Article 8(1), from 1 January 1998, to forms of intervention for which the first decision granting assistance sets the final date for Community and national commitments up to 1 January 1997, is rendered optional.

Findings

Reliability of the Community accounts

3.22. In the Commission's view, the off-balance sheet obligations for the Structural Funds and the Cohesion Fund comprise the still uncommitted Edinburgh allocations for the programmed Community support frameworks (CSF) and Community initiatives (CI), as well as the still uncommitted allocations for the Cohesion Fund. With the above definition, the off-balance sheet obligations correspond to the ceiling of the remaining commitment obligations, which is in accordance with prudent accounting principles.

The programme allocations are subject to continuous adjustments through re-programming and reallocation, however, without exceeding the overall Edinburgh allocations. For the next programming period 2000-06, the Commission is preparing for an accounting of different levels of pre-commitments, thus enabling more detailed break-downs of the off-balance sheet obligations.

3.23. As Structural Fund grants are paid in staggered annual instalments, the Structural Funds will always have outstanding commitments from several financial years.

Legality and regularity of the underlying transactions

3.24. The only case concerning the Commission is the one mentioned at paragraph 3.30. The practice referred to by the Court concerned the previous programming period (1989-93); since then, the practice has been adjusted for the current programming period.

3.25. The Commission agrees with the Court that many substantive errors have no financial impact. However, it considers that they could often be avoided by more active monitoring on the part of the Member States.

3.26. Some anomalies arise from rules or situations which are peculiar to one or two Member States and which are only applicable in the cases in question.

The Commission undertakes to follow up the cases referred to by the Court and to make the necessary financial corrections. As a result of a decision of the Dublin European Council, the Commission is required to take into account the comments of the Member States in its reply to the Court. This year, the extremely short deadline did not allow it to examine these comments in detail. The Commission will take them into account in the follow-up of problems identified by the Court.

3.28. The question of charging indirect costs to projects cofinanced by the ESF is being examined by the Commission's control departments. The Commission decided to draw up an eligibility datasheet specifically for this matter.

3.29. When the Commission establishes the amount to be recovered, it will take account of the replies from the Member States concerned to the Court's observations sent in July 1999.

3.30. The provisions on the closure of interventions for the period 1989-93 (the case referred to by the Court relates to this period) lay down that the only items taken into account in calculating the amount of cofinancing are the total eligible expenditure and the rate of cofinancing in the financial plan, regardless of the actual rate of cofinancing applied at the national level. The situation referred to by the Court could only arise if the Member State applies a different rate of cofinancing from the one set out in the financial plan. However, this practice has since been adjusted for the current programming period.

3.31. The purpose of the provisions in Regulation (EC) No 2064/97 is precisely to ensure that an independent national authority certifies to the Commission, no later than at the time of the request for the final payment for the form of assistance concerned, that errors of the type detected by the Court have been eliminated and that an adequate audit trail can be provided.

The Commission undertakes to follow up the cases mentioned by the Court and, in particular, the cases concerning invitations to tender for technical assistance, measures for training and the treatment of contributions in kind.

Audits by the Commission and the Member States

3.33. The Court's observations are the main reasons for the Commission's adoption of Regulation (EC) No 2064/97 of 15 October 1997, establishing detailed arrangements for the implementation of Council Regulation (EEC) No 4253/88 as regards the financial control by Member States of operations cofinanced by the Structural Funds. At the time of closure of the 1994-99 operations, the Commission is required to obtain statements from the independent authorities, referred to in Article 8 of the regulation, which 'summarise the conclusions of the control examinations made in the previous years and provide an overall conclusion as to the validity of the request for the final payment and the legality and regularity of the operations underlying the final declaration of expenditure'.

Improving control activities is also a priority of the Commission.

Conclusion

3.34. While the checking of cofinanced measures is primarily the responsibility of the Member States under Article 23 of coordinating Regulation (EEC) No 4253/88 (as amended by Regulation (EEC) No 2082/93), the Commission recognises that Community checks must be stepped up and that it must make use of the opportunities offered by the protocols signed with the national control authorities to reduce the number of anomalies.

As it indicated in its reply to paragraph 3.10, the Commission considers that the Court's conclusion on the real impact of these findings at the time of closure should be qualified.

3.35. The Commission agrees with the Court and undertakes to continue its efforts in the area of monitoring projects cofinanced by the Structural Funds. It will be particularly

vigilant, with respect to the closure of 1994-99 operations, in ensuring that national authorities abide by the provisions of Regulation (EC) No 2064/97.

3.36-3.37. Regarding the expected effect of the initiatives taken by the Commission in 1997, particularly with respect to eligibility of expenditure and control arrangements, the consultation of Member States initiated by the Commission in 1999 on the implementation of the eligibility datasheets shows that the Member States consider them to have had a positive immediate effect on operators because of the clarification they provide, and are confident that a significant number of errors in the annual instalments for 1998 and 1999 have been avoided. The effects of these initiatives will be more obvious on final closure of the 1994-99 operations through the statements by the independent authority provided for by Regulation (EC) No 2064/97.

3.37. The Commission will continue its efforts to improve the financial management of the Structural Funds in partnership with the Member States.

PROGRAMMING IMPLEMENTATION

The 1989-93 period

3.41. The Commission is continuing its efforts to close programmes from the 1989-93 period.

As the Court states, closure of ERDF programmes in 1997 and 1998 progressed at a average rate of 180 a year; in 1999, up to the end of July, 23 programmes had been closed, and a further 30 or so are in the process of being closed.

However, there are factors preventing the closure of some programmes:

- incomplete supporting documents (missing payment request and/or final implementation report);
- inadequate information or inconsistency between the data contained in the programme's financial plan, the statement of expenditure and the implementation report;
- comments from the various national or Community monitoring services to be clarified (possible irregularities, shortcomings in the system of certification of expenses, etc.);
- cases in which projects have been suspended for legal reasons.

The Court's remark concerning the ESF confirms the efforts made by the Commission to close programmes from the 1989-93 period which are still open, except for those subject to judicial inquiries.

The period prior to the reform

3.43. In addition to the factors preventing closure of programmes indicated at paragraph 3.41, many of the measures mentioned in this paragraph were not subject to Article 12 of Regulation No 4254/88, which provides for the automatic decommitment of balances outstanding on 31 March 1995. The implementing rules do not stipulate any deadline for closure, and the Commission must examine the situation of each of these measures in detail with the Member States concerned before closing them.

3.44. The situation with regard to projects from before the 1989-93 period which still have to be closed is as follows:

Italy

Following the Commission's request at the end of 1998, the Italian authorities promised to supply any additional information so that the abovementioned projects could be closed. On the basis of the information received, it will be possible to close most of them during 1999. Some have been suspended for legal reasons.

Spain

There are only three projects which cannot yet be closed by joint agreement because of a difference of interpretation between the Spanish authorities and the Commission on the period of eligibility for payments.

France

The one programme for this period which was still open has now been closed.

United Kingdom

Up to July 1999, five projects from the period in question were closed.

The closure of the Italian measures

3.46. In the case of the ERDF, an internal structure and synergies with the national authorities were established from the fourth quarter of 1998 in order to speed up the closure of Italian programmes from the 1989-93 programming period.

The various dossiers have been examined with a view to adding all the information necessary for closure, and they are being carefully followed up by DG XVI, particularly at the level of national authorities, in order to find a solution to the problems preventing closure.

In the case of the ESF, the programmes in the region of Campania which are currently subject to judicial inquiry have been formally suspended (pursuant to Article 24 of Regulation 2082/93).

The other 11 programmes granted an extension were audited and placed under financial supervision. The final payment requests for these programmes were then forwarded by the national authorities to the Commission during the first half of 1999. They were analysed by the department responsible, which had to request additional information. Once the missing information has been received, and assuming that the abovementioned audits have a positive outcome, it will be possible to close these programmes.

Variations in the conception and management of the programmes

3.49–3.51. Article 4 of the framework regulation for the Structural Funds stipulates that 'Community operations shall be such as to complement or contribute to corresponding national operations.' It goes on to state that the conception and management of Fund programmes must be conducted 'in full compliance with the respective institutional, legal and financial powers of each of the partners', whether they be national or regional.

Consequently, differences in approach are inevitable and indeed normal. They are a natural reflection of the fact that circumstances and problems vary from one Member State to another and even from one region to another.

3.51. The Commission supports both the improvement of existing measures and the development of new measures as long as Community and national/regional priorities are met. The fact that some regions favour one or other approach depends on their individual situation, and both are perfectly consistent with the rules.

3.52. *The Structural Funds focus on the implementation of programmes rather than projects; this is entirely consistent with the conception and implementation of the rules governing them. One essential principle enshrined in those rules is precisely that of multiannual programming.*

Differences in management between the Funds result from the different nature of the measures and operations financed and from the varying practices of the respective partners in the Member States.

3.53. *The Commission agrees with the Court about the need for data systems which enable the measures to have the necessary impact in terms of structural development and the degree to which they conform to Community policies. The conception and operation of the Structural Funds are based on the concept of partnership, according to which responsibilities are divided between national and Community partners at each management level. Thus, the Member States and regions must ensure the transparency and existence of a sufficient audit trail (see also the requirements of Commission Regulation No 2064/97). For the period 2000-06, the new rules governing the Structural Funds (Article 34(1)(a)) explicitly confer responsibility for setting up a system to gather reliable financial and statistical information on the managing authority in the Member State, and provides for the creation of computer systems permitting the exchange of data with the Commission.*

CONFORMITY WITH COMMUNITY POLICIES

3.55. *The Commission shares the Court's concern concerning the need for the Funds to make financial contributions only to measures and projects which observe and promote Community policies, including that of sustainable development. The rules clearly confer responsibility for this on the managing authorities in the Member States.*

The Commission does not systematically have direct access to information concerning the implementation of projects, which, in view of their large numbers, are not in any case manageable by its departments. However, the audits carried out in the Member States allow it to analyse how the Structural Funds are managed at national and regional level and to monitor projects on the basis of sampling. If they find that Community law is being infringed, the Member States and the Commission will make the necessary adjustments.

3.56. *When preparing the new programming for 2000-06, the Commission distributed methodological working papers to all operators enabling them to take better account of this matter. Moreover, in its regular contacts, the Commission strives to make national and regional operators aware of the need for measures to be compatible with Community policies.*

3.57. *The Commission is aware of the danger that Structural Funds operations might in individual cases not be in full conformity with other Community policies, given the fact that the Structural Funds are implemented by the Member States, and that the Commission is not systematically informed about individual operations approved by national or regional authorities. In this context, the Commission gives regular evidence in its annual reports on monitoring the application of Community law. Where complaints are submitted or evidence is provided that a project might infringe Community rules, the Commission applies, where necessary, the infringement procedures as provided by the Structural Fund regulations or the Treaty.*

For the period 2000-06, the new Article 34 stipulates that the managing authority is responsible for ensuring compliance with Community law, and Articles 38 and 39 strengthen the provisions on financial control and corrections.

3.58. *There are very precise rules concerning the link between competition policy and the financial operations of the Structural Funds: no aid scheme may be cofinanced by the Structural Funds without first having been notified and approved by the Commission. In the case of large projects (involving over EUR 50 million), a new requirement to notify aid individually has been established. This will help to avoid any cumulation of unauthorised aid.*

In addition, in its reply to paragraph 6.60 of the Court's 1996 Annual Report, and out of a concern to avoid overlaps in the field, the Commission stressed the need for the Member States to set up computer systems for collecting data on the amounts of Community aid granted to measures and projects. The Commission has continued to encourage the use of such systems. The new rules governing the Structural Funds (Article 34(1)(a)) explicitly require the setting-up of computer data-collection systems within managing authorities.

3.59. *Managing authorities, which are generally public authorities, must comply with regional, national and Community law. Whenever the Commission finds that they have failed to do so, it will initiate the necessary infringement proceedings. The Commission will nevertheless consider the Court's proposal that precise references to legislative provisions should be specified.*

IMPACT OF ONGOING ASSESSMENTS AND THE EXTENT TO WHICH THEY ARE TAKEN INTO ACCOUNT (OBJECTIVES 1 AND 2)

Introduction

3.60. Neither the mid-term review nor the mid-term evaluation nor the guidelines were required by the rules, and tough negotiations with the Member States were necessary to gain acceptance for them.

Quality and scope of the recommendations and results of the ongoing assessments

3.63. All of the large OI CSFs have undergone a macro-economic impact assessment, the aim of which is to assess, using econometric or input-output procedures, the additional impact generated by the Structural Funds, primarily in terms of economic growth (measured in terms of the rate of variation of GDP as compared with the base scenario) and employment. However, whether or not regionalised models can be used depends on the availability of sufficiently long historical series, and they may not always be justified from an economic point of view. The link with the reduction of regional disparities cannot immediately be established and requires a special study; these data are presented in relatively complete form in the Sixth periodical report on the situation of the regions (1999).

3.64. Apart from the large OI CSFs (eastern Germany, Greece, southern Italy, Portugal, Spain and the SPD OI for Hainaut), for which a macroeconomic impact assessment has been carried out, most of the interim evaluations of programmes have focused on operational aspects linked to management and monitoring. They often produced specific recommendations on matters linked to programme structure and integration between the ESF and the ERDF, the formation of detailed 'instrument panels', and the use of monitoring indicators.

3.65. In its report on the mid-term review, the Commission points to the shortcomings which exist with regard to quantification of targets and indicators, although marked progress has been achieved during the current programming. In this context, most of the evaluations emphasised the need to improve indicator systems. Progress has been made in several countries (including Greece, Italy and the UK): the national and regional authorities have already take a number of measures to provide appropriate quantification of targets and corresponding indicators. In the context of the new programming, and in accordance with Article 36 of the new rules governing the Structural Funds, the Commission has drawn up a methodological document (Working document No 3) concerning the development and use of monitoring indicators.

3.66. In the light of experience with the mid-term review, it would appear that the evaluations have not generally attached enough importance to analysing Member States' systems of selecting projects. The existence of transparent and objective criteria is, however, an important condition for ensuring that the best projects have been chosen. The new rules governing the Structural Funds confer responsibility for this matter on the monitoring committees. The mid-term evaluations or, where appropriate, specific assessments carried out by the Member State and the Commission acting in partnership will therefore have to analyse the efficiency of the selection systems in place. In order to make this easier, the Commission could promote existing best practices, such as the rating systems used in the Merseyside region.

3.67. Despite the fact that the evaluations' findings and recommendations have not always been sufficiently taken into account, the mid-term review exercise is still very valuable. This is because several good practices (e.g. in Ireland) have been highlighted and might serve as examples to be followed in future programming. In addition, the effects of the evaluations sometimes go beyond the mere implications in terms of resource allocation. For example, the experiences of the ESF in Spain and Portugal show that the institutional and administrative changes suggested by the evaluators extend beyond the current programming framework and indeed the level of Community involvement (in this case, the breakdown of responsibilities between Member State and regions). Finally, in view of the dynamic launched by the latest reform of the Structural Funds, it has often been difficult to limit the assessment to the current programming period without drawing conclusions in terms of the strategy for the following period.

Ongoing assessments and mid-term reviews

3.68. The Court of Auditors is right to point out that the legal framework governing the mid-term review was incomplete. Nevertheless, the Commission, in agreement with the Member States, has established a reference framework for the mid-term evaluations carried out at the level of monitoring committees. In the light of the experience gained, the new rules governing the Structural Funds explicitly introduce mid-term evaluations while specifying their role in the current programming period.

3.69. In practice, strategic considerations have influenced reprogramming decisions, as demonstrated by the introduction of measures and indeed programmes involving specific employment initiatives in the field of the information society or equal opportunities.

3.70. The current rules allow some flexibility for carrying out budgetary reallocations within programmes. However, the

mid-term review is a different exercise in that it sets out to determine and assess the progress made so that, where necessary, corrective measures can be taken.

3.71–3.72. The Commission acknowledges that evaluation work varies in scope and quality. During the mid-term review, financial reallocations were not made solely according to budgetary criteria involving a redistribution of appropriations in favour of programmes or measures with rapid expenditure rates. In the case of the Belgian Hainaut programme, a link was observed between the quality of the evaluation and the scale of adjustments made, but this cannot be generally established.

Context-related factors, in particular political, economic and institutional changes, influenced the review of programmes. It should also be stressed that the Commission's report on the mid-term assessment does not take account of some cases of reprogramming carried out in 1998, the results of which were not available until the end of the year.

3.73. The aim of setting up partnership-based evaluation structures or 'ad hoc groups' is to coordinate evaluation activities in such a way as to take better account of the needs and concerns of the partners concerned. It is also to assess the results and make them available to the monitoring committees so that they can verify how they can be made operational.

However, it would appear that the constraints which influenced the quality of interim evaluations relate not only to the setting-up of steering committees but also to the availability of funds for evaluation work and public procurement procedures (amended following the entry into force of the European directives and the adjustments which followed the GATT-WTO agreement at the time the evaluations were launched). The mid-term evaluation required a learning process on the part of the national administrations.

3.74. The creation of support structures in conjunction with the monitoring committees and evaluators was relatively widespread. In general, they were useful because they enabled the results to be better exploited.

3.75. As the Court stresses, the Commission has played a role of defining and drawing up operational procedures to be followed when carrying out the mid-term review, in particular through its Common guide for monitoring and interim assessment. In this, the Commission proposed that steering committees be set up for each programme and indicated what the monitoring committee's role was in launching, monitor

ing and using the evaluation and what the monitoring instructions were. Partnership meetings between the Member States and the Commission have also made it possible to place the exercise within a better organisational framework.

Ongoing assessments and the suitability of management and assessment structures and tools

3.76. The Commission agrees with the Court when it observes that the organisational procedures for the mid-term review varied from one Member State to another. However, there are other significant experiences with regard to the organisation of the evaluation process apart from those cited by the Court. The list provided is not exhaustive.

3.77. Generally speaking, one of the main gains of the mid-term evaluation has been concrete recommendations for improving monitoring systems.

Objective 2 measures — specific aspects

3.78. Here it should be pointed out that, under the standard CSF and SPD clauses agreed with the Member States, 'assistance measures with a duration of more than three years shall be the subject of a mid-term assessment at the end of the third year following implementation, with a view to making any necessary changes' (point A.2).

3.79. The Commission agrees with the Court's comment concerning the lack of synchronisation in the Objective 2 context between the different evaluation stages resulting from the overlap between the 1994-96 and 1997-99 programming periods. However, the evaluations carried out relate to a single period and generally concentrate on providing a critical assessment of programme implementation and monitoring, in some cases including impact analyses, particularly with regard to employment.

3.80–3.81. The Objective 2 ongoing assessments have provided information and, in some cases, contributed towards the preparation of corresponding programmes for the following period. This is the case for the Aquitaine programme, for which it has been possible to make estimates of net effects on employment.

Conclusion

3.82. The new rules governing the Structural Funds go in the same direction as the Court's conclusions. For example, they lay down the content of monitoring and evaluation activities and the respective responsibilities of the Commission

and the Member States in these areas. In particular, it is clearly up to the Member State to organise — in partnership with the Commission — the mid-term evaluation, and the Commission is given observer status on the monitoring committee. To this end, the Commission will strive — as far as its powers allow — to ensure that the mid-term review exercise and, in support of this, the implementation of the performance reserve proceed smoothly.

3.83. As indicated in its reply to paragraph 3.37, the Commission has drawn up a methodological framework document on indicators for monitoring and evaluation, which sets out to improve the monitoring systems in the Member States and enable targets and the corresponding indicators to be better quantified (an initial list of relevant indicators by category of measure is also proposed). With regard to evaluation methods, the work produced under the MEANS programme has been published and will be made available to a wide audience.

3.84. The Commission will strive to ensure a more efficient framework and a better exploitation of the result of the evaluation, including through a generalisation of good practices, while complying with the rules in force.

FOLLOW UP OF COURT'S AUDITS IN THE EAGGF-GUIDANCE FIELD

3.87. The Commission shares the Court's desire to achieve the highest possible degree of consistency between EAGGF-Guidance measures and those taken to limit surplus production. It would point out, however, that this is a complex problem, and solutions need to be adapted to each sector and region, and must also meet changing circumstances over time.

These concerns are addressed by Council Regulation No 1257/1999 of 17 May 1999 (OJ L 160, 26.6.1999), in particular Article 6, which stipulates that 'support shall not be granted for investment which has as its objective an increase in production for which no normal market outlets can be found' and Article 37, which stipulates that '...measures shall be consistent with other Community policies and measures implemented thereunder.'

Concerning fruit and vegetables, it should be remembered that Council Regulation No 2200/96 imposes the principle of financial co-responsibility on producer organisations in this sector, which means that producers themselves have no interest in investing in the production of crops which are already in surplus.

Finally, it is not necessarily illogical to invest in a sector where surpluses exist, since aid may be used to convert to varieties which are not in surplus, or may be used to reduce surpluses by facilitating restructuring. Successful investments of this type have been made, for example, in the wine sector as well as in the fruit and vegetable sector.

3.88. Promoting organic farming is in keeping with the general objectives of Regulation No 950/97. Set-up aid for young farmers may be granted under this regulation, whether or not they choose this type of production. Furthermore, under Council Regulation No 2078/92 (agri-environmental measures), some Member States encourage organic farming by compensating farmers for loss of revenue in the first few years or for a lower yield due to the reduction of inputs.

Council Regulation No 2092/91 on organic production lays down specific conditions to be met by farmers wishing to use this production method. During the conversion period of two or three years, production falls and the costs of production rise, but the farmer is not permitted to use the term 'organic farming' or charge the higher prices which doing so would allow. These difficulties, together with the fact that there is not yet much demand for these products in some Member States, explain why this activity is slow in getting started. In its report on progress in implementing Regulation No 2078/92 sent to the STAR committee and to the Parliament (Document VI/7655/98 Evaluation of agri-environment programmes, point 15.2 Organic farming), the Commission takes stock of good practices and of the situation as regards organic farming in the various Member States.

3.90. The Commission agrees with the Court about the need to increase the number and quality of checks. It endeavours to do so whenever its limited resources permit. It also urges Member States to do the same, since they have prime responsibility for on-the-spot checking of measures under the rural development programmes.

However, the Commission continues to have prime responsibility for checking direct assistance, which it can still provide under Article 8 of the EAGGF-Guidance Section Regulation (No 4256/88), and it devoted much of its control capacity to this in 1998. As for the future, this type of measure will not continue under the new Council regulation on rural development.

In any event, checking consistency between the various investments set out in the material improvement plan is a matter for programme monitoring and evaluation rather than on-the-spot checks. The main purpose of such checks is to ensure that the recipient has complied with the conditions laid down when the assistance was granted. The Commission will inform the local authorities responsible in the areas where the Court has found incoherence in the implementation of the MIPs.

Conclusion

3.91. As indicated in the reply to paragraph 3.90, the Commission agrees that checks need to be more numerous and of a higher quality. With direct measures being discontinued under the new regulation and the number of staff assigned to checking activities increased, the Commission, in collaboration with the Member States, will better be able to cover the checking of measures part-financed under the rural development programmes.

As indicated in the reply to paragraph 3.87, the Commission shares the Court's view that consistency should continue to be ensured between development and market policies, both in legislation and in its implementation.

EFFECT ON EMPLOYMENT

3.93. Despite progress made during this programming period on assessing the effects on employment, the Commission is aware of the fact that the quality and findings of such assessments are very variable and often lack conceptual clarity and methodological soundness.

To overcome these inadequacies, the Commission has focused its efforts on developing tools, widely publicised in the form of booklets intended to harmonise concepts, definitions and methodological framework, such as those entitled: Mesurer

les effets sur l'emploi des interventions structurelles communautaires and Evaluer la contribution à l'emploi des Fonds structurels (Measuring the effects on employment of Community structural assistance and Evaluating the contribution to employment made by the Structural Funds) and the document Counting the jobs: how to evaluate the employment effects of Structural Fund interventions.

In addition, in order to harmonise measurement of the effects on employment in the new programming documents, the Commission is currently conducting a study with a view to collecting and analysing techniques used in each Member State for assessing employment impact. This will soon make it possible to measure and narrow, if necessary, the gap between national practices and an approach corresponding to quality standards. More generally, the recommendation that forecasts should be improved will also be taken into account by the efforts which will be made in the context of ex ante evaluation of the macroeconomic effects of programmes, in particular by means of econometric models for Objective 1 programmes.

In the case of the ESF, the impact on employment also refers to the concept of employability (increasing the chances of gaining employment). In this context, obtaining a post after a measure is not the only criterion, or always relevant for the measures financed by the ESF.

3.96. Of all the possible forms of financing, direct grants are the form most frequently used by Member States. This is a choice made by the Member State when it decides on the financial composition of projects, and most of the assistance part-financed by the Structural Funds lends itself to this form of financing.

The other forms of financing mentioned by the Court have not been ignored, however. They have been used in numerous global grants, a form of assistance which is particularly appropriate for facilitating the use and monitoring of these other forms of financing. The questions regarding eligibility of expenditure raised by these forms of financing are being looked at by the Commission in collaboration with the Member States in the context of SEM 2000. The new general regulation governing the Funds explicitly provides, in addition to repayable assistance, for the use of other forms of financing (Article 28(3)) and stresses the value of appropriately combining grants, loans and guarantees with a view to maximising the incentive effect provided by Community resources (Article 10(2)).

3.97. The Commission document Counting the jobs confirms that it is the net effect which gives a realistic picture of

the impact of the Structural Funds on employment. This is defined as the gross effect minus windfall effects and the effects of substitution and movement, the latter taking account of phenomena destructive to employment such as relocations.

The recent study conducted by the Commission on national practices in estimating effects on employment shows that modest but important progress has been made on this front. An examination of a sample of 60 recent evaluation studies reveals that in a third of the work, gross effects have been converted to net effects, even though measures continue to diverge, given the great complexity of such estimations.

3.99. The Commission is aware that coordination between the Funds and other financial instruments could still be improved. The fact that some areas are covered by Objectives 2 and 3 or 3 and 5b at the same time is not the result of a lack of coordination but arises from the nature of the Structural Fund Objectives themselves as defined in the Council regulations. Objectives 2 and 5b are geographical (they target regions) while Objective 3 is a horizontal objective (applying across Community territory) which also covers Objective 2 and Objective 5b areas.

The new regulation reiterates the importance of integrated strategic programming thanks to the reduction in the number of Objectives and Community initiatives (Article 1), proposes that assistance covered by a Community support framework be provided, as a general rule, in the form of an integrated operational programme by region (Article 18(1)) and insists on coordination between the various Funds, the EIB and other existing financial instruments (Article 10).

In any event, any integration achieved at the programming level must also be translated into operational integration on the ground and this decision is the responsibility of the managing authorities in the Member States.

3.100. Community structural measures constitute an important lever for the creation of sustainable jobs by means of increasing productive potential, including research and innovation and the improvement of human capital. In its communication on the Structural Funds and employment (COM(96) 109 of 20 June 1996), the Commission emphasised the need to extend partnership to include in particular the social partners and the private sector, which has resulted, in the context of structural policy, in the implementation of the territorial pacts for employment.

As regards links between economic operators and the research sector, the Commission recognises that more efforts are needed, as it pointed out in its communication Guidelines for programmes in the period 2000-06 (COM(1999) 344 final). It will bear this in mind when it negotiates the programmes with the Member States, although it should be pointed out that the latter have sole responsibility for preparing programming supplements.

3.101. The Commission agrees with the Court's general assessment of the difficulty of action in the employment field. This kind of action largely depends on the strategy, objectives and types of measure defined during programming. Tighter management and monitoring methods are essential if such assistance is to be effective.

Furthermore, implementation of the Title on employment in the Amsterdam Treaty has already been a turning point in the development of a European employment strategy. A key feature of this new process consists in setting European and national objectives which are clearly identifiable and measurable. This makes policies more transparent and management of them more responsible, while at the same time enhancing indicators and statistical monitoring tools. An integrated framework, based on the four pillars of the guidelines, has been set in place in the Member States. Its purpose is to encourage action on the part of all those involved to promote jobs and combat unemployment.

GENERAL CONCLUSION

3.103. The new regulation, which will apply during the period 2000-06, specifies that it is the responsibility of the managing authority to ensure that assistance is compatible with Community law.

As regards the effects on employment of the various forms of assistance, the new general regulation governing the Funds stresses the value of combining grants, loans and guarantees so as to maximise the stimulus provided by Community resources.

As regards the results of intermediate evaluation, several cases of good practice have been identified and could serve as examples for future programming.

Lastly, the Commission is continuing in its efforts to close the programmes from the 1989-93 period. In the case of the Italian measures, an internal structure and synergies with the national authorities have been set in place so as to speed up the closure of programmes.

3.104. In response to the Court's criticisms of the management of the Structural Funds, the Commission has taken a number of measures such as producing datasheets on the eligibility of expenditure, adopting a regulation implementing Article 24 of the Coordination Regulation (implementation of financial coordination) and signing agreements with the national authorities on tightening up checks. These instruments should, in the context of the new regulation, which

contains some new elements, help in the long term to resolve the problems mentioned by the Court of Auditors.

In order to ensure that the principles of the reform of the Structural Funds are applied in reality and in full, the Commission departments have produced a vade-mecum intended to analyse the new regulation so as to identify and order in a coherent manner the obligations of all those involved in the management of the Structural Funds. It specifies what type of information has to be provided to enable implementation arrangements to be defined and provides additional practical information on the new elements which have been introduced.

CHAPTER 4 (*)

Internal policies

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(*) The Commission's replies are on page 106.

INTRODUCTION

4.1. The European Union's internal policies, as defined in the financial perspectives, have as a common objective the development of the single market. They cover four subsections of the budget and several budget lines in one other subsection. The responsibility for implementing the internal policies and managing the corresponding budgets lies mainly with 13 directorates-general and the Secretariat-General of the European Commission.

4.2. The internal policy measures concern:

- (a) the completion of the internal market, other operations and controls in the agricultural sector, other regional policy operations, transport as well as other measures concerning fisheries and the sea (Titles B2-5 to B2-9 of subsection B2);

- (b) education, vocational training and youth, culture and audiovisual media, information and communication, and social dimension and employment (subsection B3);

- (c) energy policy, Euratom nuclear safeguards and the environment (subsection B4);

- (d) consumer protection, internal market, industry and trans-European networks (subsection B5); and

- (e) research and technological development (subsection B6).

IMPLEMENTATION OF THE BUDGET

4.3. **Table 4.1** below shows the utilisation of the available appropriations devoted to internal policies in 1998. In general, the budgetary provisions for commitments

increased by approximately 4 %. The largest increase, of more than 22 %, was for subsection B5, specifically for the benefit of technological innovation and trans-European networks. As far as payments are concerned, the volume of appropriations available in 1998 was approximately 1 % higher than in 1997.

4.4. With regard to commitment appropriations, the implementation rate increased to 97 % as against 95 % in 1997 and 86 % in 1996, while the utilisation of payment appropriations was stable at about 93 %, as compared with 1997. However, and without implying that a high rate of use of appropriations is necessarily an indication of sound financial management, some budget titles had an implementation rate in either commitments or payments or both of less than 85 %, when compared with the initial budget, final budget, or both. The use of commitment and/or payment appropriations for Titles B3-1, B3-2 and B6-1 to B6-5 was influenced by third country contributions, which are not subject to the annuality principle. Although this is not formally precluded by the Financial Regulation ⁽¹⁾, it does not correspond to sound financial management practice.

4.5. The use of appropriations available since 1993 for trans-European networks (Title B 5-7) is summarised in **Table 4.2**. While the funds available for transport networks increased considerably over the years and were practically fully used, the commitment appropriations for energy and for telecommunication networks have progressively decreased in recent years, and both the commitment and payment appropriations were only partially implemented and were particularly low in the first years of the programme.

4.6. The utilisation of both the commitment and payment appropriations in 1998 *by quarter* is shown in **Tables 4.3** and **4.4** and in **Graphs 4.1** and **4.2**. Both the commitments and payments were spread unevenly over the year and their utilisation varied considerably between budget lines:

- (a) for Titles B3-1 (Education, vocational training and youth) and B2-9 (Other measures concerning fisheries and the sea), more than half, and for Titles B2-6 (Other regional operations) and B5-5 (Labour market and technological innovation) more than two thirds of the total annual payments were made in the third quarter, with corresponding commitments in the same or the previous quarter, except

for Title B2-6, for which almost the total available commitments were made in the first quarter;

- (b) for Title B5-7 (Trans-European networks), almost two thirds, for Title B2-5 (Other agricultural operations) almost three quarters and for Title B5-4 (Industry) almost all (97 %) of the total annual payments were made in the last three months of the year. For Title B5-4, however, most of the corresponding commitments were made in the first quarter;
- (c) unusually, for Titles B6-1 to B6-4 (Joint Research Centre expenditure for staff and resources, direct operating appropriations for the EC and EAEC framework programmes and for the completion of previous joint and supplementary programmes), there were no commitments or payments in the first quarter of the year, while for Titles B6-5 and B6-8 (indirect action; completion of earlier projects and EAEC framework programme 1994-98, respectively) the bulk of the commitments were only made during the last quarter of 1998, although the payments were spread relatively evenly throughout the year; and
- (d) similarly, for Titles B4-1 (Energy; more than 90 % of available appropriations were committed in the last quarter) and B4-3 (Environment; almost three quarters of available appropriations were committed in the third quarter), the rhythm of commitments did not correspond to the spread of payments throughout the year.

SPECIFIC APPRAISAL OF THE AREA IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Nature of the expenditure

4.7. The implementation of the budget in the area of internal policies is mainly through direct expenditure, whereby the Commission services conclude contracts with public or private third parties (final beneficiaries) to support projects or activities by contributing a percentage of the eligible costs.

4.8. The contracts, which are standardised according to the type and the area of support, specify the costs that are eligible and set out a payment schedule. In most cases an advance is paid after the signature of the contract, followed by periodic intermediate payments which often depend on the submission of reports and/or cost

⁽¹⁾ Financial Regulation, Article 96(2).

Table 4.1 — Implementation of the budget in 1998

Title/ Subsection of the budget	Heading	Commitment appropriations						Payment appropriations					
		Initial budget (1)	Final budget after SAB (2) and transfers	Appropriations utilised	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)	Initial budget (1)	Final budget after SAB (2) and transfers	Appropriations utilised	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)		
												(1 000 ECU)	
B2-5	Other agricultural operations	145 900	163 450	158 261	108,5	96,8	121 300	141 300	138 316	114,0	97,9		
B2-6	Other regional operations	17 131	17 131	17 131	100,0	100,0	22 000	22 000	21 221	96,5	96,5		
B2-7	Transport	19 050	19 050	19 050	100,0	100,0	20 790	20 490	19 299	92,8	94,2		
B2-9	Other measures concerning fisheries and the sea	48 100	56 600	56 284	117,0	99,4	32 600	32 600	30 600	93,9	93,9		
	Total in B2	230 181	256 231	250 776	108,9	97,9	196 690	216 390	209 436	106,5	96,8		
B3-1	Education, vocational training and youth	422 450	452 448	438 211	103,7	96,9	381 527	413 164	301 734	79,1	73,0		
B3-2	Culture and audiovisual media	114 091	131 495	126 842	111,2	96,5	111 892	119 572	109 450	97,8	91,5		
B3-3	Information and communication	79 783	110 913	110 831	138,9	99,9	67 900	102 530	101 055	148,8	98,6		
B3-4	Social dimension and employment	155 085	155 343	149 406	96,3	96,2	155 852	151 852	136 888	88,3	90,1		
	Total B3	772 442	850 199	825 290	106,8	97,1	717 171	787 118	649 127	90,5	82,5		
B4-1	Energy	22 501	33 501	33 450	152,0	99,8	37 136	35 136	30 192	83,9	85,9		
B4-2	Euratom nuclear safeguards	16 000	16 000	15 390	96,2	96,2	17 000	14 196	14 196	83,5	83,5		
B4-3	Environment	140 831	141 031	140 384	99,7	99,5	129 773	126 273	121 487	93,6	96,2		
	Total B4	179 332	190 532	189 224	105,5	99,3	183 909	178 409	165 875	90,2	93,0		
B5-1	Consumer policy and consumer health protection	20 870	20 870	19 542	93,6	93,6	21 170	21 170	18 558	87,7	87,7		
B5-2	Aid for reconstruction	2 976	2 976	2 839	95,4	95,4	2 976	2 976	2 839	95,4	95,4		
B5-3	Internal market	161 295	156 489	146 572	90,9	93,7	152 290	143 990	133 066	87,4	92,4		
B5-4	Industry	84 100	84 100	84 100	100,0	100,0	77 000	42 500	42 199	54,8	99,3		
B5-5	Labour market and technological innovation	192 048	192 048	181 861	94,7	94,7	100 524	93 824	89 781	89,3	95,7		
B5-6	Statistical information	30 223	30 223	30 006	99,3	99,3	29 340	29 340	25 400	87,6	86,6		
B5-7	Trans-European networks	560 183	546 058	545 608	97,4	99,9	399 967	414 967	410 628	102,7	99,0		
B5-8	Cooperation in the fields of justice and home affairs	11 750	15 750	15 290	130,1	97,1	15 250	12 550	8 339	54,7	66,4		
B5-9	Measures to combat fraud and support expenditure for internal policies	5 400	4 400	4 385	81,2	99,7	10 900	10 900	7 017	64,4	64,4		
	Total B5	1 068 845	1 052 914	1 030 203	96,4	97,8	809 417	772 217	737 827	91,2	95,5		
B6-1	Joint Research Centre — staff and resources	210 038	248 484	248 212	118,2	99,9	206 057	239 952	230 656	111,9	96,1		
B6-2	Joint Research Centre — direct operating appropriations EC framework programme 1994 to 1998	41 614	92 497	48 549	116,7	52,5	35 483	60 870	37 724	106,3	62,0		
B6-3	Joint Research Centre — direct operating appropriations EAE framework programme 1994 to 1998	11 794	13 213	9 818	83,2	74,3	9 390	10 264	8 363	89,1	81,5		
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes... — completion of earlier projects...	p.m.	48 420	9 254	n.a.	19,1	p.m./1368	31 280	8 698	n.a.	27,8		
B6-5	Indirect action (shared-cost projects)... — completion of framework programme 1994 to 1998	40 983	78 958	70 878	172,9	89,8	290 799	299 439	196 167	67,5	65,5		
B6-7	Indirect action (shared-cost projects)... — EC framework programme 1994 to 1998	3 082 053	3 081 573	3 028 709	98,3	98,3	2 414 325	2 471 025	2 457 228	101,8	99,4		
B6-8	Indirect action (shared-cost projects)... — EAE framework programme 1994 to 1998	203 207	206 807	206 442	101,6	99,8	175 791	179 391	177 433	100,9	98,9		
B6-9	Fifth research, technological development and demonstration programme (1998 to 2002)	p.m.	p.m.	0	n.a.	n.a.	p.m.	p.m.	0	n.a.	n.a.		
	Total B6	3 589 689	3 769 952	3 621 862	100,9	96,1	3 133 213	3 292 221	3 116 269	99,5	94,7		
	Total	5 840 489	6 119 828	5 917 305	101,3	96,7	5 040 400	5 246 355	4 878 534	96,8	93,0		

(1) Initial 1998 — budget plus appropriations carried over.

(2) Supplementary and amending budget.

NB: p.m. = token entry; n.a. = not available.

Sources: Revenue and expenditure accounts and balance sheets [SEC(1999) 413-FR].

Table 4.2 — Utilisation of appropriations available for trans-European networks (Title B5-7) from 1993 to 1998

(1 000 ECU)

Chapter title	Trans-European networks (TENs)		Commitment appropriations			Payment appropriations		
			Final budget after SAB and transfers	Appropriations utilised	(%)	Final budget after SAB and transfers	Appropriations utilised	(%)
B5-70	Transport networks	1993	185 000	184 990	99,99	114 841	114 726	99,90
		1994	200 000	200 000	100,00	120 000	119 971	99,98
		1995	240 000	240 000	100,00	157 800	157 760	99,97
		1996	280 000	280 000	100,00	180 000	178 011	98,90
		1997	352 000	352 000	100,00	265 000	264 993	100,00
		1998	475 000	474 999	100,00	349 000	349 000	100,00
	Total	1 732 000	1 731 989	100,00	1 071 800	1 069 735	99,81	
B5-71	Energy networks	1993	—	—		—	—	
		1994	—	—		—	—	
		1995	16 000	12 166	76,04	5 300	3 555	67,08
		1996	19 834	8 907	44,91	7 045	4 404	62,51
		1997	25 000	24 199	96,80	10 000	7 064	70,64
		1998	18 620	18 600	99,89	11 000	10 737	97,61
	Total	79 454	63 872	80,39	33 345	25 760	77,25	
B5-72	Telecommunications networks	1993	24 000	20 977	87,40	18 867	12 411	65,78
		1994	62 380	61 909	99,24	46 533	32 206	69,21
		1995	95 159	76 315	80,20	68 400	47 395	69,29
		1996	105 361	97 434	92,48	70 529	58 796	83,36
		1997	79 902	73 332	91,78	76 892	61 370	79,81
		1998	52 438	52 009	99,18	54 967	50 891	92,58
	Total	419 240	381 976	91,11	336 188	263 069	78,25	
B5-73	European Investment Fund ⁽¹⁾	1993	—	—	—	—	—	—
		1994	30 000	30 000	100,00	30 000	30 000	100,00
		1995	30 000	30 000	100,00	30 000	30 000	100,00
		1996	30 000	30 000	100,00	30 000	30 000	100,00
		1997	30 000	30 000	100,00	30 000	30 000	100,00
		1998	—	—	—	—	—	—
	Total	120 000	120 000	100,00	120 000	120 000	100,00	
B5-7	TENs	Total	2 350 694	2 297 837	97,75	1 561 333	1 478 564	94,70

(¹) Annual Community contribution to the paid-up capital of the European Investment Fund.

Source: Revenue and expenditure accounts and balance sheets.

Table 4.3 — Utilisation of commitment appropriations in 1998 by quarter

(1 000 ECU)

Title	1st quarter	2nd quarter	3rd quarter	4th quarter	Total	
B2-5	Other agricultural operations	9 258	18 876	8 282	121 845	158 261
B2-6	Other regional operations	17 000	131	0	0	17 131
B2-7	Transport	1 428	3 170	1 636	12 816	19 050
B2-9	Other measures concerning fisheries and the sea	595	1 882	39 525	14 282	56 284
	Total in B2	28 281	24 059	49 443	148 943	250 726
B3-1	Education, vocational training and youth	17 273	210 766	93 108	117 064	438 211
B3-2	Culture and audiovisual media	56 390	20 034	25 792	24 626	126 842
B3-3	Information and communication	20 296	28 435	30 614	31 486	110 831
B3-4	Social dimension and employment	35 291	24 105	28 563	61 447	149 406
	Total B3	129 250	283 340	178 077	234 623	825 290
B4-1	Energy	252	1 756	1 051	30 391	33 450
B4-2	Euratom nuclear safeguards	6 477	1 863	840	6 210	15 390
B4-3	Environment	18 464	2 344	104 679	14 897	140 384
	Total B4	25 193	5 963	106 570	51 498	189 224
B5-1	Consumer policy and consumer health protection	516	5 440	7 799	5 787	19 542
B5-2	Aid for reconstruction	2 944	0	0	- 105	2 839
B5-3	Internal market	23 002	40 234	31 048	52 288	146 572
B5-4	Industry	49 224	945	0	33 931	84 100
B5-5	Labour market and technological innovation	6 412	9 546	104 286	61 617	181 861
B5-6	Statistical information	5 080	3 411	4 542	16 973	30 006
B5-7	Trans-European networks	505	6 921	436 489	101 693	545 608
B5-8	Cooperation in the fields of justice and home affairs	11	2 510	4 494	8 275	15 290
B5-9	Measures to combat fraud and support expenditure for internal policies	1 212	355	522	2 296	4 385
	Total B5	88 906	69 362	589 180	282 755	1 030 203
B6-1	Joint Research Centre — staff and resources	0	172 155	9 961	66 096	248 212
B6-2	Joint Research Centre — direct operating appropriations EC framework programme 1994 to 1998	0	20 064	6 875	21 610	48 549
B6-3	Joint Research Centre — direct operating appropriations EAEC framework programme 1994 to 1998	0	3 754	916	5 148	9 818
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes...	0	3 928	1 040	4 286	9 254
B6-5	Indirect action (shared-cost projects)... — completion of earlier projects...	461	1 851	2 716	65 850	70 878
B6-7	Indirect action (shared-cost projects)... — EC framework programme 1994 to 1998	669 517	676 734	800 839	881 619	3 028 709
B6-8	Indirect action (shared-cost projects)... — EAEC framework programme 1994 to 1998	63 828	16 444	13 771	112 399	206 442
B6-9	Fifth research, technological development and demonstration programme (1998 to 2002)	0	0	0	0	0
	Total B6	733 806	894 930	836 118	1 157 008	3 621 862
	Total	1 005 436	1 277 654	1 759 388	1 874 827	5 917 305

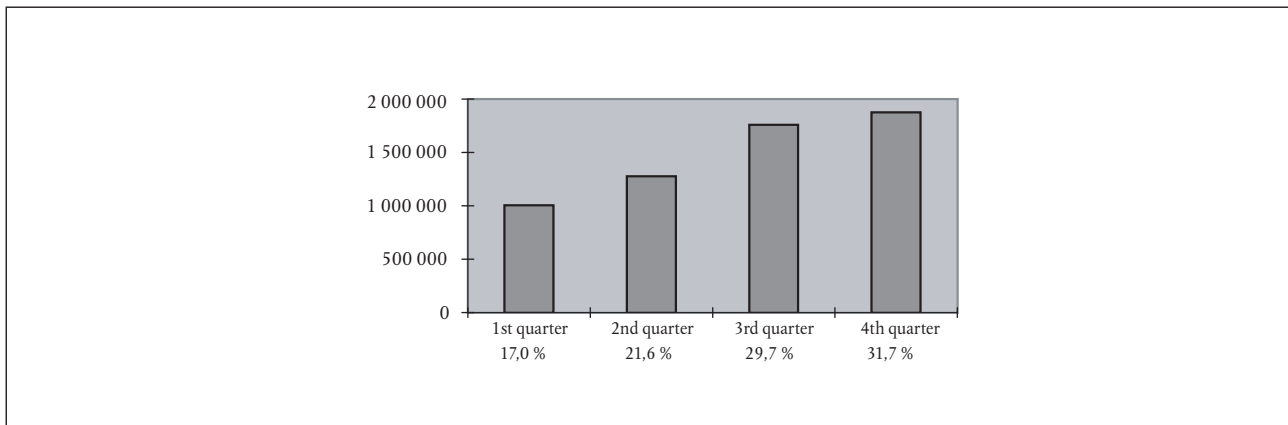
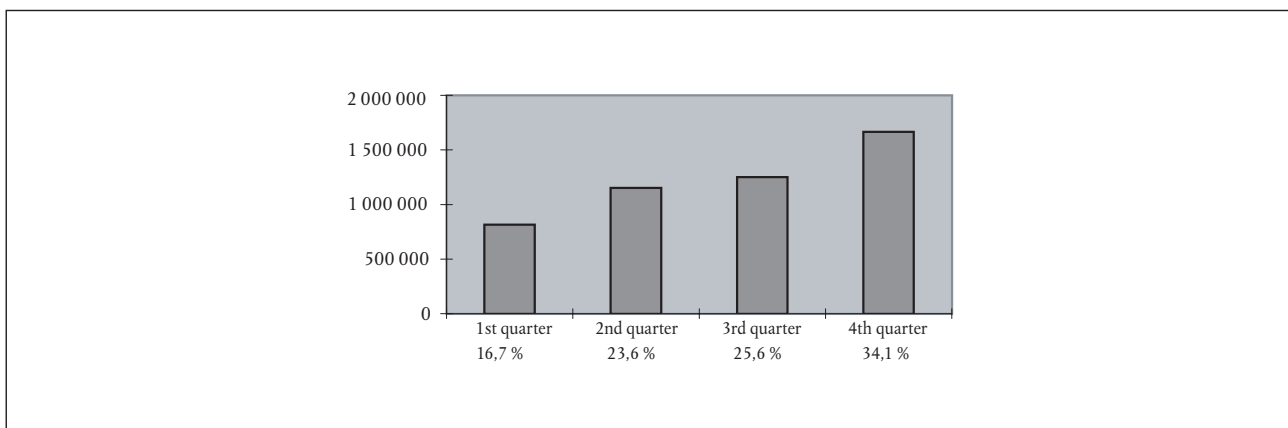
Sources: Quarterly reports on the implementation of the budget as well as revenue and expenditure accounts and balance sheets.

Table 4.4 — Utilisation of payment appropriations in 1998 by quarter

(1 000 ECU)

Title	1st quarter	2nd quarter	3rd quarter	4th quarter	Total	
B2-5	Other agricultural operations	6 457	16 606	14 656	100 597	138 316
B2-6	Other regional operations	248	4 773	14 649	1 551	21 221
B2-7	Transport	2 978	2 659	4 055	9 607	19 299
B2-9	Other measures concerning fisheries and the sea	914	2 048	17 734	9 904	30 600
	Total in B2	10 597	26 086	51 094	121 659	209 436
B3-1	Education, vocational training and youth	14 249	21 944	160 250	105 291	301 734
B3-2	Culture and audiovisual media	19 047	25 707	26 728	37 968	109 450
B3-3	Information and communication	12 843	19 278	34 818	34 116	101 055
B3-4	Social dimension and employment	35 708	37 667	26 092	37 421	136 888
	Total B3	81 847	104 596	247 888	214 796	649 127
B4-1	Energy	6 452	7 844	7 511	8 385	30 192
B4-2	Euratom nuclear safeguards	3 604	3 195	3 106	4 291	14 196
B4-3	Environment	19 545	18 662	36 228	47 052	121 487
	Total B4	29 601	29 701	46 845	59 728	165 875
B5-1	Consumer policy and consumer health protection	2 630	6 354	5 522	4 052	18 558
B5-2	Aid for reconstruction	0	1 289	1 091	459	2 839
B5-3	Internal market	26 950	35 248	31 593	39 275	133 066
B5-4	Industry	86	1 153	64	40 896	42 199
B5-5	Labour market and technological innovation	8 332	9 556	61 403	10 490	89 781
B5-6	Statistical information	5 814	6 281	9 032	4 273	25 400
B5-7	Trans-European networks	48 838	66 699	31 748	263 343	410 628
B5-8	Cooperation in the fields of justice and home affairs	2 465	1 541	1 829	2 504	8 339
B5-9	Measures to combat fraud and support expenditure for internal policies	1 041	1 534	1 676	2 766	7 017
	Total B5	96 156	129 655	143 958	368 058	737 827
B6-1	Joint Research Centre — staff and resources	0	98 619	50 941	81 096	230 656
B6-2	Joint Research Centre — direct operating appropriations EC framework programme 1994 to 1998	0	18 602	6 381	12 741	37 724
B6-3	Joint Research Centre — direct operating appropriations EAEC framework programme 1994 to 1998	0	4 252	1 489	2 622	8 363
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes...	0	4 130	1 368	3 200	8 698
B6-5	Indirect action (shared-cost projects)... — completion of earlier projects...	48 919	46 756	38 738	61 754	196 167
B6-7	Indirect action (shared-cost projects)... — EC framework programme 1994 to 1998	516 596	640 508	623 930	676 194	2 457 228
B6-8	Indirect action (shared-cost projects)... — EAEC framework programme 1994 to 1998	30 394	49 316	37 964	59 759	177 433
B6-9	Fifth research, technological development and demonstration programme (1998 to 2002)	0	0	0	0	0
	Total B6	595 909	862 183	760 811	897 366	3 116 269
	Total	814 110	1 152 221	1 250 596	1 661 607	4 878 534

Sources: Quarterly reports on the implementation of the budget as well as revenue and expenditure accounts and balance sheets.

Graph 4.1 — Utilisation of commitment appropriations in 1998 by quarter**Graph 4.2 — Utilisation of payment appropriations in 1998 by quarter**

claims. The final payment is made after submission and approval of the final deliverables and the financial report.

4.9. Certain other parts of the expenditure in this field consist of fixed price contracts for services or supplies, for which payment is made, against an invoice, upon receipt of the deliverables.

Scope of the audit

4.10. The objective of the financial audit of the internal policies area was to collect sufficient audit evidence to contribute to the statement of assurance on the general

budget for 1998. The results of the audit of the legality and regularity of underlying transactions in the internal policies area are summarised in this specific appraisal.

4.11. Commitments were audited at Commission level and their review included all formal aspects of the transactions as well as the legality and regularity of the selection of the contractor/beneficiary. Payments were audited at the appropriate level, payments based on cost claims being audited on the spot at the final beneficiary, with advances on contracts or payments based on invoices for fixed price contracts audited at the Commission. The audit of the old outstanding commitments

consisted of an evaluation of the explanations given by the Commission for the delays in their closure.

Main audit findings

Reliability of the accounts

4.12. In more than a quarter of the sample of transactions audited, the payment of an advance or payment on account had not been identified as such in the Commission's accounting system. As a result the information in the accounts of the Commission on provisional payments was understated. These errors were caused by systematic inaccurate coding in several DGs, where the internal rules dating from 1993 have not been followed.

4.13. The audit of outstanding commitments at 31 December 1998 revealed that the follow-up by the Commission services is not always sufficient. In almost one third of the cases no action had been taken for more than one year and in the worst case there had been no follow-up for more than three years. In one tenth of the cases decommitments or recovery orders should have been implemented in the course of 1998.

Legality and regularity of the underlying transactions

Commitments

4.14. According to paragraph 5 of Article 6 of the Financial Regulation, 'the commitments shall be entered in the accounts on the basis of the commitments contracted up to 31 December'. For some projects the negotiations were completed and the commitments were recorded, but the contract was not signed by all partners before 31 December. To ensure compliance with the abovementioned rule any such commitments should have been decommitted, and the carrying over of appropriations approved by the Commission. New commitments should subsequently have been recorded in the accounts for the following year. Some services have the practice of asking their contractors not to date their signature on the contract. This has enabled the Commission to backdate a number of contracts received shortly after the year-end. As a consequence the amount reported as committed in the accounts was overstated. The Court recommends that the Commission discontinue this practice.

Payments

4.15. Out of the payments audited half were affected by errors. Substantive errors were detected in approxi-

mately one third of the payments, in most cases of which the Commission had paid too much due to ineligible costs having been claimed by the beneficiaries. Formal problems were found in one fifth of the payments, the main type being a lack of a formal financing decision from the Commission.

4.16. The audit of payments based upon cost declarations confirmed the results of prior year audits, particularly in the research area. The Court discovered errors and inaccuracies, including deliberate overcharging, in almost two thirds of the cases. On average, in these incorrect declarations, the costs had been inflated by one third. The explanations for the high incidence of incorrect declarations, which have a direct impact on the legality and regularity of the payments, are on the one hand the incorrect interpretation of the contracts with regard to eligible overhead costs and on the other hand the insufficient control by the Commission services and the absence of contractually defined penalties in cases of overcharging.

Recommendations

4.17. Paragraph 5 of Article 6 of the Financial Regulation should be applied correctly and all signatories should sign and date all contractual documents as at the actual date of signature.

4.18. The problems with the interpretation of the rules regarding eligible costs, in particular where overhead costs are concerned, could be solved by a clarification and simplification of the standard contracts. Instead of giving vague and general descriptions of eligible costs, the definitions should be precise and unambiguous. During the establishment of the standard contracts, in the preparation phase of the programmes or measures, more emphasis should be placed on 'auditability'. In the case of smaller contracts in particular, the Commission should consider a drastic simplification, for example by introducing obligatory flat rates for overheads for all participants.

4.19. The Commission's control on cost claims, submitted by beneficiaries, has to be intensified and improved. This can be done by increasing the number of on-the-spot audits by the Commission's own services or by external auditors and by improving the follow-up of the audits. Another option is to introduce a policy whereby beneficiaries with cost claims exceeding a certain amount, have to provide a certificate from an external audit firm confirming the accuracy of the costs claimed and the eligibility of the expenditure under the

terms of the contract. The audit fees could then be accepted as eligible costs.

Conclusions

4.20. The audit of the legality and regularity of the underlying transactions for commitments and payments recorded during the year in the internal policies area again revealed a significant incidence of errors in payments as well as a lower incidence of errors in commitments. In addition to the difficulties in current transactions, the systems for the follow-up by Commission services of outstanding commitments proved in some cases to be inadequate.

INTERNAL AUDITS CARRIED OUT BY THE COMMISSION

4.21. **Table 4.5** summarises the information received from various directorates-general as well as the Secretariat-General on the number of audits they completed in 1998 in the field of internal policies. The internal audit procedures, however, varied from one directorate-general to another.

4.22. A comparison with the data provided by the Commission for the Court's 1997 annual report shows that most directorates-general had completed, in 1998, a similar or greater number of audits than in the previous year, with a significant increase in internal audits

and the number of contracts audited by DG VII and DG XVII. The significant reduction in the number of audits completed by DG XXII should be seen in relation to the high level of audit activity by this directorate-general.

FOLLOW-UP OF INTERNAL AUDIT BY DIRECTORATE-GENERAL XII (SCIENCE, RESEARCH AND DEVELOPMENT)

4.23. In total, 79 DG XII internal audit reports for the period 1995 to 1997 were examined and 33 of them concluded that amounts should be recovered. The precise determination of the recoverable amounts is pending, due to the fact that Commission services themselves still have to review a number of contracts. Twenty-two contract files relating to these were reviewed for evidence of recovery action. Several visits were made to DG XII to review, as requested, all relevant files.

4.24. Although follow-up of internal audit findings in DG XII was found to be generally satisfactory, in one instance, a recovery order had not been issued. Moreover, in 16 of the 22 cases, initial files either did not contain sufficient evidence relating to recovery action or were inadequate with regard to other administrative matters. DG XII services initially failed to provide complete documentation. Greater care needs to be taken to ensure that all the necessary information is properly filed.

Table 4.5 — Internal audits completed in 1998 ⁽¹⁾

Directorate-General		Number of audits completed		Number of contracts audited		Number of open contracts	Value of audited contracts (Mio ECU)	Value of open contracts (Mio ECU)	Amounts recoverable or reduced payments as a result of the internal audits (Mio ECU)
		1997 ⁽²⁾	1998	1997 ⁽²⁾	1998				
III	Industry	6	5	22	24	1 002	5,72	2 057,48	1,14
V	Employment, Industrial Relations and Social Affairs	2	11	3	41	4 704	7,13 ⁽³⁾	13,99 ⁽³⁾	0,43
VII	Transport	32	46	54	78	922	142,50	1 625,35	0,25
X	Information, Communication, Culture and Audiovisual Media	13	23	111	95	6 011	9,76	157,98	1,55
XI	Environment, Nuclear Safety and Civil Protection	n.a.	65	n.a.	65	2 540	28,39	296,18	0,40
XII	Science, Research and Development	59	69	117	132	11 099	55,20	5 668,00	2,80
XIII	Information Society: Telecommunications, Markets, Technologies — Innovation and Exploitation of Research	13	10	36	12	1 349	12,25	1 949,19	6,35
XV	Internal Market and Financial Services	n.a.	0	n.a.	0	124	0,00	4,85	0,00
XVII	Energy	25	37	33	58	3 322	74,37 ⁽³⁾	516,46	0,00 ⁽⁴⁾
XXI	Taxation and Customs Union	n.a.	3	n.a.	3	⁽⁵⁾	1,20	⁽⁵⁾	0,18
XXII	Education, Training and Youth	116	28	160	97	4 970	120,92	296,68	0,34
XXIII	Enterprise Policy, Distributive Trades, Tourism and Social Economy	5	3	5	3	390	0,64	36,00 ⁽³⁾	0,02
XXIV	Consumer Policy and Consumer Health Protection	3	5	5	15	143	1,11	25,40	0,00
Secretariat-General		n.a.	1	n.a.	1	1	39,00	39,00	0,00
Total		n.a.	306	n.a.	624	36 577	498,19	12 686,56	13,46

⁽¹⁾ Definitions used in generating this table:

— Number of audits completed: number of financial audits where a final audit report was issued during the year.

— Number of open contracts: number of contracts signed in the year that have not yet been completed, plus the total number of contracts that were open at the beginning of the year that were not completed during the year.

The word 'contract' denotes both contracts (either a shared-cost action or a contract awarded through the public procurement procedures) and subsidies (where a financial agreement has been reached).

A 'completed contract' is a contract where the terms of the contract have been fulfilled, all financial and technical reviews have been completed and the final payment has been made.

— Value of audited contracts: the value, of the audited contractor's share of the contracts audited on-the-spot.

— Amount recoverable: amounts calculated in the on-the-spot audits as recoverable and evidenced in the internal audit reports.

⁽²⁾ See 1997 Annual Report, Tables 4.3a and 4.3b, except for DG XVII. The 1997 figures are, however, not totally comparable with those of 1998, as the above definitions were only formally applied in 1998.

⁽³⁾ Commission's share only.

⁽⁴⁾ Audits normally prior to final payment, in case resulting in reduced final payments, total amounts of which not specified.

⁽⁵⁾ Not specified.

NB: n.a. = not available.

Source: Commission services

COMMISSION REPLY

IMPLEMENTATION OF THE BUDGET

4.4. The implementation of certain budget items under internal policies in 1998 was affected by the fact that the Commission was unable to undertake certain operations for want of legal bases.

4.5. For trans-European Telecommunications Networks, the patterns for the various items of Chapter B5-72 ⁽¹⁾ are different. For example, the evolution of appropriations (constantly increasing) and payments for the line TEN-Telecom is significantly different from the chapter as a whole.

4.6. The Commission is aware that the concentration of commitments and payments at the end of the year may have a negative impact on the quality of financial management. It is therefore one of the objectives of SEM 2000 to arrive at a more even execution over the budget year. However, when the execution of a programme depends on a decision by the legislative authority, Commission departments have to delay implementation until the legal basis exists, thus leading to late execution.

(a) — For Title B3-1 (Education, Vocational training and Youth), the rate of commitment of appropriations was relatively even in 1998: 52 % of appropriations were committed at 30 June, 21 % were committed in the third quarter and 27 % in the fourth quarter, which corresponds to the usual pattern of commitments under this chapter. As is the case each year, the implementation rate was low at 31 March (4 %), the utilisation of appropriations in the first six months being mainly concentrated on the second quarter. This situation improved in 1999: 11 % of appropriations were committed at 31 March (and 33 % by 30 April).

The utilisation rate of payment appropriations largely depends on the utilisation rate of commitment appropriations: in view of the large number of advances to be paid (especially, for mobility measures) after signature of agreements drawn up following the commitment of appropriations mainly in the second quarter, it is normal that the greater volume of payments

should be made in the third quarter. In 1999, however, the payment implementation rate was considerably higher at 30 June (30 % as against 12 % in 1998) due to the higher level of commitments in March and April.

— For Chapter B2-9 (Fisheries), payments implemented by the Commission in respect of B2-9 in the third quarter of 1998 mainly concerned B2-9010 (Financial contribution to inspection and surveillance operations carried out by the Member States).

The Community provisions on the subject provide that Member States must send in applications for reimbursement of expenditure relating to the above operations by 31 May. This is why most payments were not made in the third quarter of 1998, after the supporting documents had been checked.

Commitments cannot be made until the Commission has adopted the decision fixing the amounts allocated to each Member State. In 1998 the Commission adopted the decision in June.

— With respect to Chapter B5-50 (Labour market), the establishment of a Contracts and Grants sector in Directorate-General V prompted specific measures to avoid late commitments and payments in the year (maximum standardisation of documents, intensive staff training in operational units, institution of mechanisms for monitoring procedures).

(b) — In the case of Chapter B2-70 (Transport), the main reason why a large proportion of the appropriations were committed in the last quarter of the year was that 97 % of the ECU 6 million available under B2-706 (PACT) was not committed until November 1998. This was due partly to the length of the 3A selection procedure, which was not completed until July 1998, and partly to problems associated with the adoption of a legal basis needed for this heading. Following the adoption of the legal basis on 1 October 1998, in future it should be possible to implement this heading earlier in the year.

The concentration of payments in the third and fourth quarters was due partly to the late commitment of appropriations for B2-706, with a consequent delay in the payment of related advances, and secondly to the accumulated delays in the implementation of contracts mainly under B2-704; as a result of these delays a number of contracts had to be extended and consequently certain payments were deferred. The delay also accounts for the non-utilisation of part of the payment appropriations (ECU 1.2 million).

⁽¹⁾ The name of the chapter is the same as the name of one of its articles (B5-720, TEN-Telecom).

— In the case of Article B5-700 (Transport), a very strict timetable enabled the TEN Financial Assistance Committee — Transport Section to meet on 4-5 May 1998 to adopt the list of projects to be financed. The financing decisions were approved on 27 July 1998 and all available appropriations (ECU 475 million) were committed on 13 August 1998. In view of the type of budget heading and procedure laid down for adopting the list of projects to be financed it would be difficult for the Commission to commit the appropriations any earlier in the year.

Since the 1998 commitments were not made until August, the bulk of the payments were made in the last quarter. However, in the case of Article B5-700 the level of implementation was 80 % at the end of September (at authorising officer stage). Further, an additional ECU 20 million was allocated in the SAB and at year-end the implementation rate for payments was 100 %. Most of the appropriations in Chapter B2-5 concern veterinary expenditure, namely Item B2-5100 (Eradication programmes) and Article B2-5106 (Emergency funds).

B2-5100: the utilisation of appropriations (commitments and payments) at year-end derives from the precise timetable of operations provided for in Article 24 of Council Decision 90/424/EEC.

B2-5106: nearly all the appropriations (commitments and payments) were allocated to expenditure connected with the outbreak of classical swine fever in the Netherlands, Spain, Germany and Belgium. The ad hoc financing decisions were adopted from November 1998 onwards after the Member States concerned had submitted applications for refunds and the appropriations had been made available in sufficient quantity in response to the scale of the epidemic.

- (c) The amount of ECU 79 million in Title B6-5, referred to by the Court of Auditors in Table 4.1, covers the contribution from non-EEA countries to the fourth RTD framework programme. As the Court mentions (see paragraph 4.4.), these appropriations are not subject to annularity, and the unused part is automatically carried over to the following year. The Commission therefore gives a priority to the use of Community appropriations, for which the unused part is cancelled at the end of the year, and it considers this sound financial management practice.

For the Fusion programme, the largest part of Title B6-8, the late use of the commitment appropriations resulted from the lengthy procedures linked with an association agreement. The single large commitment could therefore only be made during the last quarter.

- (d) In Title B4-3 (Environment) the LIFE programme accounts for 70 % of the commitment appropriations allocated to the Environment DG. Following the adoption of the list of projects suitable for financing by the various management committees meeting in June 1998, the Commission adopted the financing decision in July 1998. The rate of implementation in payments is partly linked to adoption of the LIFE projects. A significant number of payments also stem from projects adopted before 1998 which must be settled. In 1998, the utilisation rate for payments in the first half of the year was higher than for commitments.

SPECIFIC APPRAISAL OF THE AREA IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Main audit findings

Reliability of the accounts

4.12. The Court of Auditors notes that certain payments were not identified as payments on account in the Commission's accounting system; as a result the information provided on these payments was understated.

It should be noted that owing to the particular features of research contracts, the payments in question cannot fully reflect the note referred to by the Court. However, in the light of the Court's observations, work has been undertaken to improve the information in the accounts.

In addition, the Commission would point out that the information is produced without any legal basis in the Financial Regulation and that the reliability of the accounts is not affected by this difference.

4.13. The Commission is pursuing its efforts to improve its procedures with regard to outstanding commitments.

Legality and regularity of the underlying transactions

Commitments

4.14 and 4.17. The Court of Auditors' observations give rise to the following comments regarding budget annularity and backdating of contracts:

- Principle of budget annuality (fifth paragraph of Article 6 of the Financial Regulation): the Court of Auditors points to financial commitments entered in the accounts at the end of the financial year in the absence of a contract signed by all parties.

For commitments to be entered in the accounts, the legal commitments must be contracted by 31 December. A legal commitment is established when the Commission enters into a financial obligation towards a third party which holds a claim on the Commission. Commitment is established in law as soon as the beneficiary receives a letter, accompanied where appropriate by the contract, informing him of a measure adopted to his benefit, and specifying the entitlements and a reasonable time limit for acceptance, which may be tacit, within the specified time limit. In conclusion, the Commission maintains that the commitment is contracted in accordance with Article 6 of the Financial Regulation and can therefore be entered in the accounts for that year, provided the above document has been sent by the Commission before 31 December and provided that the time limit for acceptance by the third party expires on 31 December.

- The Court of Auditors notes that several departments instructed the contractor not to date their signature on the contract. This practice is intended to make sure that only one date of signature appears on the contract to avoid any confusion regarding the date on which the contract comes into force; the last signature to be placed on the contract is that of the Commission representative. The Commission will review this practice.
- The backdating of contracts was discontinued in 1998.

Payments

4.15–4.16. On account of the limited time available, the Commission has not been able to consult certain contractors regarding the cases examined by the Court and adopt a position on them.

Accordingly, the Commission would recall that the procedure for the examination of files relating to contractors' proposals includes provision to examine other recent contracts in similar areas to identify any overcharging. In addition, the Commission carries out numerous ex-post audits of a significant sample of contracts. The Commission is very keen to step up audits and, starting in 1999, has adopted several measures in this area as the Court has been informed.

The Commission has undertaken and will pursue the task of clarifying the eligibility of costs to be reimbursed, with the objective of reducing the danger of overcharging.

Recommendations

4.18. For the fifth framework research programme the Commission adopted a standard contract spelling out the concepts relating to eligible costs. The contract is based on the arrangements for implementing the Treaty rules on participation and dissemination, which set out many of the concepts relating to costs. In addition, with the fifth framework research programme the Commission brought in the possibility of flat rates for overheads.

4.19. The Commission is interested in stepping up audits. In the case of research the Commission has concluded an audit contract with an outside firm following an invitation to tender. The firm is engaged in carrying out an initial group of 100 audits under the supervision of the Commission. The aim is to audit 10 % of contractors every year.

The Court of Auditors suggests that contractors should have to produce a certificate from an external audit firm confirming the accuracy of the costs claimed. The Commission will look into ways and means with the Court, bearing in mind in particular the diversity of contractors in the research area, especially any public agencies which are audited by a national audit body.

INTERNAL AUDITS CARRIED OUT BY THE COMMISSION

4.22. The Commission notes with satisfaction the Court's favourable comments on the completion of a similar or greater number of internal audits of departments. The decline between 1997 and 1998 in the number of internal audits of contracts carried out by Directorate-General XXII (Education, Vocational Training and Youth) is mainly accounted for by the greater involvement of the audit team in ex ante checks of payments of programme balances to final recipients by the Directorate-General's BATs; these checks entail validating the

BAT's analysis of a cost statement before the BAT makes payments and do not appear in the audits listed in the Court of Auditors' table.

factory manner. The Court is correct in stating that, in a single instance, the Commission issued a recovery order following the Court's audit.

FOLLOW-UP OF INTERNAL AUDIT BY
DIRECTORATE-GENERAL XII (SCIENCE,
RESEARCH AND DEVELOPMENT)

4.23–4.24. The Commission is satisfied that the Court noted that DG XII's audits are being followed up in a satis-

The Commission maintains extensive files on the research projects it funds. These files contain evidence of all the relevant information on the follow-up of contracts, including recovery orders if any. The Commission will, however, pay even greater attention to the organisation of these files and to the timeliness and quality of the information it provides to the Court of Auditors.

CHAPTER 5 (*)

External aid

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INTRODUCTION

5.1. External aid groups together the operations entered under Headings 4 and 6 of the financial perspectives. The aid that is provided through the European Development Funds appears only as a token entry, as it is financed separately from the general budget. The external action entered in Heading 4 of the financial perspectives comprises the traditional forms of aid and the operations adopted by the Council under the common foreign and security policy (CFSP). A significant event in the management of external aid in 1998 was the Commission's introduction of the RELEX Joint Service (SCR) which, beginning in the last quarter of the year, gradually took over responsibility for the implementation of the conventions and other financing agreements with aid beneficiaries.

ANALYSIS OF THE IMPLEMENTATION OF THE BUDGET

Change and use of appropriations in 1998

5.2. **Table 5.1** provides an overview of how appropriations were used in 1998.

Commitment appropriations

5.3. As **Table 5.2** shows, the year was marked by a very heavy concentration of commitments during the last quarter. In several cases, the bulk of the commit-

ments were in December ⁽¹⁾. The main reason for the concentration of the commitments was the timing of the presentation of programmes or financing proposals, often due to the overly heavy procedures followed in the EU institutions.

5.4. The Court has repeated on many occasions ⁽²⁾ that such a heavy bunching of commitments over such a short period is not conducive to sound financial management. For example, at the 141st meeting of the Asia and Latin America (ALA) Committee on 1 and 2 December 1998, 19 projects totalling 160,4 Mio ECU were examined, and at the 47th meeting of the MED Committee on 3 December, 11 projects totalling 380,8 Mio ECU were examined. This is too many for proper consideration.

5.5. In the case of the Phare programme the late commitments were for the national programmes. Such delays are a hindrance at the later stages of implementation where a decision taken within DG IA limits the duration of programmes to four years. In effect a year is lopped off the implementation period at the start, which very often means that management is under time pressure at the end of the period. On this point, one of the main conclusions of the Phare programme evaluation carried out on behalf of the Commission pointed out that insufficient time was devoted to defining measures in advance of programme implementation ⁽³⁾. Shortening the implementation period inevitably worsens the implementation problems resulting from

⁽¹⁾ B7-30 Cooperation with Asian countries 45 %, B7-31 Cooperation with Latin American countries 54 %, B7-410 MEDA 48 %, B7-50 Phare 57 %, during the last 45 days of 1998.

⁽²⁾ See, for example, paragraph 11.23, Annual Report concerning the financial year 1995 (OJ C 340, 12.11.1996).

⁽³⁾ *Fiche financière* B7-50 (p. B7/173).

Table 5.1 — 1998 external aid

(Mio ECU)

Budget nomenclature	Headings	Appropriations for commitments			Appropriations for payments		
		Available	Used	Rate of implementation (%)	Available	Used	Rate of implementation (%)
B7-2	Humanitarian and food aid	1 118,6	1 111,2	99,3	935,3	843,5	90,2
B7-3	Cooperation with developing countries in Asia, Latin America and southern Africa, including South Africa	808,2	771,0	95,4	492,6	463,4	94,1
B7-4	Cooperation with Mediterranean third countries and the Middle East	1 142,0	1 068,7	93,6	534,0	421,9	79,0
B7-5	Cooperation with countries of central and eastern Europe, the new independent States and Mongolia	1 972,5	1 926,2	97,7	1 726,0	1 628,6	94,4
B7-6	Other cooperation measures — Community measures to support NGOs	410,2	340,1	82,9	313,7	281,6	89,8
B7-7	European initiative for democracy and human rights	92,4	85,6	92,6	82,8	65,9	79,6
B7-8	External aspects of certain Community policies	380,8	330,0	86,7	395,5	332,2	84,0
B8	Common foreign and security policy	38,0	37,9	99,6	32,2	28,2	87,6
Total ⁽¹⁾		5 962,7	5 670,7	95,1	4 512,1	4 065,3	90,1
B7-91	Emergency aid reserve ⁽²⁾	188,0			238,0		

⁽¹⁾ Excludes 2,3 Mio ECU paid on B7-95 support expenditure for external policies over commitments of 1997.

⁽²⁾ Represents appropriations not required for transfer to B7-2.

NB: The commitment and the payment appropriations include the appropriations of the provisions (B0-40), the appropriations carried over, and reutilised appropriations.

Source: Commission (revenue and expenditure account).

Table 5.2 — 1998 external aid commitment by quarter

(Mio ECU)

Budget area		Commitments 1st quarter 1998		Commitments 2nd quarter 1998		Commitments 3rd quarter 1998		Commitments 4th quarter 1998		Total commitments 1998
		Amount	%	Amount	%	Amount	%	Amount	%	
B7-30	Cooperation with Asian developing countries	10,4	2,6	20,7	5,2	42,3	10,6	326,5	81,7	399,9
B7-31	Cooperation with Latin American developing countries	59,2	24,2	4,1	1,7	32,2	13,2	149,2	61,0	244,7
B7-41	MEDA	2,0	0,2	55,1	5,9	34,2	3,6	849,6	90,3	940,9
B7-50	Cooperation with countries of central and eastern Europe	26,1	2,3	242,9	21,7	11,0	1,0	838,9	75,0	1 118,9
B7-52	Cooperation with the new independent States and Mongolia	5,0	1,1	68,1	14,7	98,6	21,3	290,8	62,9	462,5
B7-54	Cooperation with the republics formerly part of Yugoslavia	67,9	28,0	22,8	9,4	48,6	20,0	103,4	42,6	242,7

NB: Gross commitments (i.e. excluding decommitments).

Source: Commission accounts (Sincom).

inadequate initial preparation. Under these circumstances, the commitments for actions whose preparation has been delayed should preferably not be entered into until the beginning of the following year, in order to restore the contractual implementation period to its proper dimensions.

5.6. Like those for the Phare countries, the commitments relating to the action programmes for Russia (112,2 Mio ECU) and Georgia (2 Mio ECU) were entered into towards the end of the financial year, with the same risk of curtailing the actual duration of the operations.

Payment appropriations

5.7. Payment appropriations were generally used more evenly through the year than commitment appropriations, although during the last quarter there was a decline, particularly in November, followed by a jump in December when, for the external actions as a whole, 17 % of the year's payments occurred. The case of MEDA (B7-41) stands out as noteworthy, with no less than 40 % of total payments being made in December.

5.8. While over 400 Mio ECU⁽⁴⁾ in payment appropriations were not used, on several budget headings payments were stopped or delayed because of shortages of appropriations⁽⁵⁾. These shortages caused serious disruption to some projects. The reasons for the shortages were:

- (a) insufficient appropriations initially provided in the budget: the most significant case was for Phare (B7-50) where the Commission's original request for 845 Mio ECU in payment appropriations was reduced by 115,4 Mio ECU in the initial budget;
- (b) considerable delays in reinforcing budget headings by means of transfers, notably the 'omnibus trans-

fer'⁽⁶⁾, or by supplementary and amending budget (SAB) No 1/98: the omnibus transfer and the SAB were not approved until 14 December.

5.9. The Commission, however, did not use all the possibilities open to it to deal with the shortages: for example, while waiting for 37 Mio ECU from the SAB 1/98 payments were stopped at the beginning of November on the mainstream financial and technical cooperation heading for Asian countries (B7-300) despite the fact that 21,8 Mio ECU remained unused on the adjacent economic cooperation heading for Asia (B7-301) until the end of the year.

5.10. In two important areas the utilisation of payment appropriations was less than planned. In the case of MEDA (B7-410), the Commission proposed 390 Mio ECU in the *fiche financière* for the preliminary draft budget. This was reduced by the budgetary authority to 285 Mio ECU, with 30 Mio ECU placed in the reserve (B0-40). The Commission only spent 230,7 Mio ECU (81 % of the adjusted appropriations). Although the *fiche financière* provided no support for the figure proposed, it is reasonable to conclude that the reduced level of disbursements reflects a slower than forecast implementation of MEDA actions. A similar situation was identified in 1997⁽⁷⁾.

5.11. In the case of the cross-border cooperation between the new independent States (B7-521), although the *fiche financière* made provision for a substantial increase in payments in 1998, 11,8 Mio ECU of the 15 Mio ECU initially entered under this heading were transferred in December 1998 to another heading and payments amounted to only 3,2 Mio ECU. In 1999 the appropriations (commitments and payments) entered under the heading decreased by 33 %. In fact, an inadequately prepared programme and the unsuitability of the Tacis procedures for implementing infrastructure work formed obstacles to transfrontier cooperation. Furthermore, the 30 Mio ECU of the 1998 programme was committed on 11 December 1998, even though the commitments outstanding from the 1996 and 1997 programmes remained at a very high level (56,7 Mio ECU) in comparison with the rate of payments.

⁽⁴⁾ Excluding unused amounts from the emergency aid reserve.

⁽⁵⁾ Notably B7-300 Financial and technical cooperation Asia; B7-500 Phare; B7-6200 Environment in developing countries; B7-6201 Tropical forests; B7-6211 Health programmes, AIDS; B7-6410 Rehabilitation and reconstruction; B7-700 Human rights and democracy.

⁽⁶⁾ The so-called 'Notenboom' transfer, No 36/98.

⁽⁷⁾ See paragraph 5.10, Annual Report concerning the financial year 1997 (OJ C 349, 17.11.1998).

5.12. The late approval by the budgetary authority of the omnibus transfer and the SAB 1/98 referred to in paragraph 5.8(b), together with delays in processing payments in 1998, and the consequent inadequacy of the budgetary provision in 1999 for payments, were given as the main reasons by the Commission justifying its decision to carry over 197,5 Mio ECU in payment appropriations from 1998 to 1999 on 28 budget headings ⁽⁸⁾.

5.13. In contrast to this, the timely transfers of funds in the humanitarian aid area ⁽⁹⁾ enabled ECHO to use almost fully its commitment and payment appropriations, and not carry over any payment appropriations. In this area, ECHO thus ceased in 1998 what had become in the period 1995-97 systematic large carry-overs of payment appropriations which were criticised by the Court ⁽¹⁰⁾.

Volume 1, Tome 2, of the revenue and expenditure account and financial balance sheet

5.14. Volume 1, Tome 2, of the revenue and expenditure account and financial balance sheet contains the analysis of financial management and is intended to provide the reader of the accounts with description and analysis of the management of budgetary appropriations during the year. The content of the section dealing with external actions in the volume for the 1998 accounts is very incomplete and unsatisfactory, most of the major areas (food aid, humanitarian aid, cooperation with Asian and Latin American developing countries, cooperation with countries of central and eastern Europe, the new independent States and Mongolia, and most of the other cooperation measures of B7-6) not

⁽⁸⁾ This is in addition to the 400 Mio ECU concerning food aid to Russia (B1-315) which were carried over.

⁽⁹⁾ B7-210 was reinforced by 140 Mio ECU in commitment appropriations in September and B7-214 by 35,3 Mio ECU. Payment appropriations were reinforced by 100 Mio ECU. These transfers enabled the Commission to withdraw its request for additional appropriations from SAB 1/98, which was not approved until 14 December by which time it would not have been possible to use the funds in 1998.

⁽¹⁰⁾ See, for example, paragraph 11.7, Annual Report concerning the financial year 1995 (OJ C 340, 12.11.1996).

being included at all. What information is published on the remaining areas is unbalanced and lacks any structure. The Commission should ensure that in future years it publishes useful and complete information in this volume.

MECHANISMS FOR MANAGEMENT OF AID BY THE COMMISSION: USE OF EXTERNAL STAFF, TAOs ⁽¹¹⁾, ETC. FINANCED FROM OPERATIONAL APPROPRIATIONS

Technical and administrative support for programmes (STAP)

5.15. The chronic lack of resources from Part A of the general budget allocated by the Commission to the RELEX directorates-general and ECHO has led to the use of various devices funded by operational appropriations to reinforce their management capacity. At various times mini-budgets, service contracts, study contracts and TAOs have been used. Since the 1996 financial year, specified percentages of the appropriations under the MEDA, Phare, Tacis and ex-Yugoslavia (1997) budget headings were authorised by the budgetary authority to be used by the Commission to conclude contracts 'for the duration of the programme, in order to supply technical support and cover relevant administrative expenditure for the mutual benefit of the Commission and the recipient countries' ⁽¹²⁾.

5.16. The difficulties that have been met with since 1996 in the implementation of the STAP facilities derive from the interpretation that should be given to the expression 'for the mutual benefit of the Commission and the partner countries'. Since the comment in the 1998 budget mentions 'contracts with experts responsible for preparing the terms of reference of the projects, for evaluating bids and for follow-up, monitoring and auditing', the Court considered that these activities, carried out in the context of projects, were for the mutual benefit of the Commission and the partner countries and should, for this reason, be covered by STAP. In fact, the responsibility for implementing the budget rests

⁽¹¹⁾ Technical Assistance Offices.

⁽¹²⁾ See the budgetary comments for the 1999 budget lines B7-410 (MEDA), B7-500 (Phare), B7-520 (Tacis). This is the so-called STAP (Support Technique et Administrative des Programmes) facility.

with the Commission alone and all these activities are part of the preparation or management of the implementation of the budget. Conversely, the Commission considers that, as far as projects are concerned, these actions are carried out for the sole benefit of the partner countries and that they should be excluded from STAP. Whatever the Commission may say on this matter, the 1999 budget comments do not in any way dispel the ambiguities to be found in the comments on previous budgets.

5.17. At the end of 1998, as part of the procedure for the establishment of the 1999 budget, the Commission carried out an internal enquiry to identify for the general budget as a whole the extent to which operational appropriations were being used to finance administrative and technical support for programmes. This identified for 1998 a total of over 875 man-years of TAOs and other technical assistance for DGs IA and IB and the SCR, at a total cost of 139,3 Mio ECU, entirely financed from operational appropriations⁽¹³⁾. This accounts for almost 60 % of the Commission's total use of TAOs and other technical assistance. As a result of this enquiry, the budgetary authority in the 1999 general budget generalised the STAP facility to the majority of budget headings in the external actions section of the budget, with fixed maximum amounts provided in the budget commentaries⁽¹⁴⁾. The budgetary authority, therefore, has endorsed in a general way the use of operational appropriations for technical support and administrative expenditure within defined limits, and so long as the tasks falling 'within the standing remit of public administration' are reserved to the statutory staff of the Commission.

5.18. The extent of the need for administrative support was confirmed by the level of totals entered for STAP for 1999. In fact, the increase in the 1999 ceilings rela-

tive to those for 1998 represents 190 % for Phare, 70 % for Tacis and 247 % for former Yugoslavia. The increase in the ceilings may facilitate management for the Commission, but it does not eliminate the risk that technical and administrative support expenditure may be charged outside the technical and administrative programmes support (STAP) system, as was the case in the last two years. For that reason it is clearly necessary for the Commission to adopt some guidelines and put in place a system of accounting that will be sufficiently transparent for the budgetary authority to be able to verify external management support. For the 1998 financial year the Commission has not filed a report on the implementation of STAP.

5.19. These developments in the use of operational appropriations for technical administration and support call for several observations. Firstly, in its Annual Report on the financial year 1997 the Court observed that in the area of external actions the increasing contracting of management and administrative functions to outside personnel and firms had not been done within a clearly thought out and coherent framework⁽¹⁵⁾. This was confirmed by the study of TAOs by the Inspection Générale des Services (IGS)⁽¹⁶⁾. Some of the most serious cases of irregularities⁽¹⁷⁾, poor financial management and weak control of actions and funds have occurred in such circumstances.

5.20. Secondly, a proliferation of TAOs is not a long-term solution to the problem of resources to administer and manage external aid actions. Expertise and experience is externalised, and with it the real capability of the Commission to take decisions. Management is rendered more complex rather than simplified. The need to avoid TAOs exercising powers which should be the preserve of public authorities leads to cumbersome procedures, with necessary restrictions on the power of technical assistants to act. When deciding to resort to a TAO for a particular set of functions, the Commission does not evaluate the costs of alternative solutions. The global data in paragraph 5.17 indicate that the cost per TAO man-year can be very high. Work needs to be done to evaluate more adequately the unit costs of TAOs against other solutions, as it is by no means clear that TAOs are always a cost-effective solution.

⁽¹³⁾ This concerns technical and administrative assistance for the benefit of the Commission, or for the mutual benefit of the Commission and its partners. See Communication 982 of 30 November, 1998, from Mr Liikanen to Mr Samland, President of the Budget Committee of the European Parliament.

⁽¹⁴⁾ The budget commentary is changed to provide that the specified maximum amounts may be used to 'fund technical and administrative assistance, to both the Commission and the beneficiaries of the measures, which does not fall within the standing remit of public administration, covering the identification, preparation, management, monitoring, audit and supervision of the programme or project. Such technical and administrative assistance may only continue as long as the programme or project itself.'

⁽¹⁵⁾ Paragraph 5.31 (OJ C 349, 17.11.1998).

⁽¹⁶⁾ Inspection of 'Le recours des services de la Commission aux Bureaux d'assistance technique (BAT)', IGS, 4.2.1998.

⁽¹⁷⁾ MED programmes and humanitarian aid.

5.21. Thirdly, there are problems with the way in which specifically the STAP facility is defined. In 1997 the Court observed⁽¹⁸⁾ that in order to ensure that the arrangement is kept under control the provision must be considered not only to be restrictive, but also to include all the support measures which the Commission delegates to other parties (TAO, special funds (see paragraph 5.29) and other individual consultants). The Court, however, reported that the system established by the Commission was neither transparent nor complete and that, for that reason, the limits imposed by the budgetary authority were being exceeded.

5.22. In 1998, as in 1997, the limits set by the budgetary authority were expressed as a proportion of the appropriations entered under each of the headings in question. No details were provided, however, as to the date at which the level of appropriations was to be assessed so that, in practice, the amount selected was usually the figure corresponding to the highest level of appropriations entered during the year. In the case of Phare, for example, the initial appropriations were taken, whereas the final appropriations were 4 % lower. For Tacis the figure used was taken at some point during the year and is higher than either the initial or the final appropriations. For former Yugoslavia the initial appropriations were taken for the 'rehabilitation' heading (B7-543), while an intermediate position was chosen for the 'reconstruction' heading (B7-541). For MEDA (B7-410) the Commission decided⁽¹⁹⁾ to allocate 70 Mio ECU from the overall MEDA envelope for the period 1997-99: the commitments cover the amounts contracted for the MEDA teams⁽²⁰⁾, and are not based on requirements by financial year. This lack of consistency in applying the system is contrary to the principle of discipline that is supposed to govern the management of appropriations.

5.23. In 1998, the procedures for implementation of the STAP continued to vary from programme to programme. Whereas in the case of Phare and former Yugoslavia the funds used are supposed to cover the operations relating to the programme committed during the year, for Tacis and MEDA the commitments cover the operations carried out during the financial year irrespective of the programme involved. Whatever the Commission may say in its replies to paragraph

5.40 of the Court's Annual Report concerning the financial year 1997, the second system is both simpler and more realistic, especially as regards auxiliary staff in the delegations, who are responsible for management of all the programmes carried out during the year, without any differentiation.

5.24. It has taken a long time to obtain functioning technical assistants in many areas, notably at delegations. Although budgetary commitments were made in 1996, the first contracts for additional ALAT⁽²¹⁾ personnel at the Phare were not signed until November 1997. At the end of 1998, 27 of the 70 ALAT posts authorised for 12 Phare delegations were filled, while for local staff, 9 out of 22 posts were filled. The position for Tacis, at the same date, was 10 out of 60 for the ALAT and 3 out of 28 for local staff. For the MEDA teams, at the delegations, eight out of nine teams (54 experts) were in place only in August 1998. In Brussels, most of the teams (36-39 experts) were in place at the beginning of 1998.

5.25. For there to be adequate control over the amount of operational appropriations used to fund technical support and administrative expenditure, the ceilings provided in the budgetary commentary need to cover *all* such expenditure. As in 1997, in 1998 this was not the case.

5.26. In fact, as in 1997, numerous Phare programmes contain expenditure of a technical and administrative support nature. One of them, to which the Court drew attention in 1997⁽²²⁾, was amended and the amount of support expenditure was cut from 9,5 to 4 Mio ECU. Of the new total funding of 4 Mio ECU, 0,77 Mio ECU was used for technical and administrative support expenditure in 1998. Given, on the one hand, the way in which STAP ceilings were established and, on the other hand, the inconsistencies observed in the way expenditure was charged to these various ceilings, the Commission is not entitled to say that the overall ceilings are still being respected.

5.27. For Tacis, in addition to the 15,9 Mio ECU committed by way of STAP in 1998, support and management expenses were committed in support of several programmes such as small-scale technical assistance,

⁽¹⁸⁾ Annual Report, paragraph 5.35-5.41 (OJ C 349, 17.11.1998).

⁽¹⁹⁾ Decision No E/524/97, 9.4.1997.

⁽²⁰⁾ 22 Mio ECU was committed in 1997, of which 11,5 Mio ECU remained unused at 31.12.1998. A further 20,2 Mio ECU was committed in December 1998 (which covers the extensions to the contracts for the MEDA teams in 1999).

⁽²¹⁾ Staff with European Union nationality recruited on the spot.

⁽²²⁾ Annual Report of the Court of Auditors concerning the financial year 1997, paragraph 5.38.

Table 5.3 — Examples of programmes involving ‘special funds’

(Mio ECU)

Programmes	Consultant	Fees	Special fund
Phare information	ECO	2,33	3,77
External information	IBF	0,53	4,67
Tacis information	Ogilvy	1,67	1,73
CREDO	Dangroup	2,70	9,00
Management Tacis Democ.	IBF	0,35	6,43
Baltic project facility	County West Zealand	0,36	5,64
TAIEX	EFG	4,88	6,15
Partnership	IBF	0,38	8,70
Regional quality assurance	CEN	1,75	25,30
Environment impl. strategies	ERM	2,99	7,00
TAIEX	IBF	3,66	20,46
LIEN	IBF	0,32	7,28
TAIEX	GTZ	8,45	12,50
Statistical TAs	CESD	5,38	5,12
Management Phare Democ.	IBF	0,35	7,00

Source: Commission.

the EBRD's 'Bangkok' facility and the small projects programme. The expenditure thus included in these programmes' costs has been estimated as at least 3,7 Mio ECU.

5.28. In the case of former Yugoslavia the contracts concluded with three consultants, one for management of the refugee-return programme, another for aid to Kosovo and Montenegro and a third for operations in Slavonia, correspond, in whole or in part, to the support costs for programme implementation. The Court estimates that these costs, which form part of STAP and were not charged to it, amount to 2,1 Mio ECU.

5.29. The 1998 financial year saw the emergence of a growing number of programmes implemented via 'special funds'. Under these arrangements a contractor is appointed to execute a programme, in return for a fee, and receives not only management fees, but also the programme's financial resources, to be administered in the form of 'special funds'. **Table 5.3** shows the programmes of this type which the Court was able to track down and which are not included in the STAP arrangements.

5.30. In the case of MEDA, in addition to the MEDA teams, technical support was provided to the programme through framework contracts, on which expenditure of 4,7 Mio ECU was incurred in 1998. The framework contracts existed long before the introduc-

tion of the STAP facility, but should be included in the STAP ceiling.

Conclusion

5.31. In summary, the above paragraphs show that although the principle of using operational appropriations to fund on a significant scale administrative and technical support expenditure in the area of external actions has been accepted by the budgetary authority, the arrangements to date are not satisfactory. They lack a coherent framework and are not transparent. The provision in the 1999 budget, at the level of individual budget headings, of fixed ceilings for such expenditure makes the management of the budget excessively complex. It would be preferable to consolidate these amounts by main programme area, for example, and enter them as specific lines in the budget, as the Court argued in paragraph 5.39 of its Annual Report concerning the 1997 financial year. Clear rules for their utilisation should then be fixed.

SPECIFIC APPRAISAL OF THE AREA IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction of the audit scope

5.32. Expenditure under Heading 4 of the financial perspectives, 'External actions', is directly managed by

the Commission. There are, however, two features which are de facto exceptions to the principle:

- (a) Programme management units (PMUs) in the Phare countries;
- (b) Technical assistance offices (TAOs) and special funds (see paragraph 5.29).

5.33. The audit examined the reliability of the accounts and the legality and regularity of the underlying transactions at the level of the Commission services for the 1998 financial year ⁽²³⁾. It did not cover payments made to final beneficiaries by PMUs in beneficiary countries in the context of the Phare decentralised implementation system (DIS), nor did it involve audit visits on the spot to check whether the expenditure incurred by the final beneficiary was legal and regular.

5.34. The Court wishes to emphasise that its observations in this specific appraisal concern matters that are the responsibility of all the services in all the RELEX directorates-general.

Reliability of the accounts

5.35. The following paragraphs set out matters concerning management procedures and accounting practices which had an impact on the Commission accounts.

Commitments

Understatement of potential liabilities

5.36. The Commission has entered into a series of multiannual commitments, mainly in the form of multiannual indicative programmes with individual Phare and Tacis beneficiary countries, which are not shown in the accounts as potential liabilities. The total value of such commitments identified by the Court amounted to

a total of 2 764 Mio ECU (Phare: 2 212 Mio ECU; Tacis: 495 Mio ECU; ex-Yugoslavia: 57 Mio ECU) at 31 December 1998.

5.37. In contrast to the Structural Funds, where the Commission includes as potential liabilities (Volume IV of the revenue and expenditure account and balance sheet) the uncommitted amounts of the budgetary envelope decided at the Edinburgh Summit in 1992, no information is given on the amounts decided at the Essen and Cannes Summits for MEDA and central and eastern Europe and the new independent States.

5.38. The potential liabilities concerning the Mediterranean protocols shown in Volume IV of the revenue and expenditure account are misstated by about 30 Mio ECU.

Overstatement of commitments still to be settled

5.39. As at 31 December 1998, the Commission's accounts showed for external actions a total of 13 985 Mio ECU in outstanding balances on commitments. However, not all of these commitments correspond to cases where payments will still be made. **Table 5.4** shows that the incidence of outstanding commitment balances on which there was no movement in the last two financial years is most acute in the development cooperation areas.

5.40. A review of the outstanding commitments in the development cooperation area found that a significant proportion should have been decommitted before the end of 1998 because they no longer corresponded to any liability of the Commission.

5.41. A review of a sample of Phare commitments raised before 1 January 1997 with no payment after that date, and with a total unpaid value of 21,8 Mio ECU showed that 15,7 Mio ECU should be decommitted. This included unspent commitment balances of 2,7 Mio ECU which the Court had recommended should be decommitted in 1997.

5.42. It should be a priority task of the Commission to bring outstanding commitment balances to a level which reflects the real position of the Commission's liabilities,

⁽²³⁾ The objective of the transaction testing was to determine whether the Commission services had sufficient information and supporting documentation to enable them to execute the transactions in accordance with the rules and regulations.

Table 5.4 — Outstanding commitment balances

Sleeping commitments: Balances on commitments prior to 1.1.1996 with no payments in 1997 and 1998

(Mio ECU)

Year of commitment	Development cooperation (B7 except B7-5)		PECO-NEI ⁽¹⁾ (B7-5)		Total	
	No	Amount	No	Amount	No	Amount
1978-1983	15	3,1	—	—	15	3,1
1984	15	10,3	—	—	15	10,3
1985	12	6,5	—	—	12	6,5
1986	12	2,3	—	—	12	2,3
1987	22	3,8	—	—	22	3,8
1988	35	4,4	—	—	35	4,4
1989	32	6,7	—	—	32	6,7
1990	62	7,6	17	1,2	79	8,8
1991	68	7,9	25	13,8	93	21,7
1992	177	26,2	22	4,4	199	30,6
1993	379	41,8	9	12,7	388	54,5
1994	422	117,3	21	30,9	443	148,2
1995	383	198,9	31	2,2	414	201,1
<i>Total 1978-90</i>	205	44,7	17	1,2	222	45,9
Total 1978-95	1 634	436,8	125	65,2	1 759	502

⁽¹⁾ The Phare programme was first decided upon late 1989 and the Tacis programme in 1990.

Source: Sincom.

and to keep the situation up to date ⁽²⁴⁾. Apart from the issues of regularity, and the need for the Commission to have accurate financial information as a basis for its future budgetary planning, it is difficult to accept that commitments should be kept open for as long as 20 years (see **Table 5.4**). There are few projects or programmes which, even allowing for start-up and closure periods should have commitments open for more than 10 years.

Advance payments

5.43. A large proportion of the payments made in the external actions area, both by value and by volume, are advance payments. They are not, however, always

recorded as such in the accounting records ⁽²⁵⁾. As a result the financial statements do not accurately reflect the distinction between advance payments and definitive payments (see paragraph 8.16).

5.44. For example, in respect of the Phare programme, up to the end of 1998, of total advance payments of 2 800,5 Mio ECU from the Commission to PMUs, about 600 Mio ECU was still on PMU bank accounts at that date (see paragraph 5.65(a)). Significant amounts of advances have also been paid by the Commission to TAOs special funds. For 1998, the Court identified payments to special funds amounting to at least 60 Mio ECU but the Commission services concerned were not able to provide a complete list of the special funds opened so that the outstanding amounts concerned cannot be ascertained.

⁽²⁴⁾ In 1999 the SCR highlighted from a management viewpoint the scale of the problem of outstanding commitment balances which it faces, in terms of the volumes of funds, number of commitments and number of contracts. This also requires the SCR to bring outstanding balances to a reasonable level (see 'service commun RELEX: situation au 31.12.1998', 10 February 1999).

⁽²⁵⁾ The coding of advances as such in the accounting records, as provided for in an internal circular from DG XIX included in the manual of procedures, is not properly done by some of the RELEX services, because they do not consider the provisions of the circular binding.

5.45. Article 111 in the title of the Financial Regulation dealing with external actions (Title IX) requires that advance payments should be shown in the Commission's balance sheet until they have been cleared. If applied, such a system would enable more efficient tracking of amounts to be recovered by the Commission. Even when charged as budgetary payments, as is the current practice, the amounts uncleared at year end should be disclosed. At 31 December 1998, the accounts provided no such information for external measures (see paragraph 8.16).

5.46. It is also to be noted in this context that the Commission's system for the closure of programmes under the Phare DIS was not functioning satisfactorily in 1998 because no final audits of Phare programmes were carried out (see paragraph 5.65(a)).

Other balance-sheet items

5.47. The imprest accounts opened in Croatia amounted to 842 768,05 ECU (1 659 269,72 DEM) at the end of 1998 although much of this was used for expenditure carried out over the period January to December 1998 to cover the running costs of ECHO's offices in Croatia. None of this expenditure was recorded as budgetary expenditure in 1998.

5.48. Furthermore, two of the three bank accounts used to finance running costs of ECHO were not allowed for in the official DG XIX decision to open an imprest account, which provided only for the account held with the Raiffeisenbank.

5.49. The regularisation of another imprest account and the recording of 1998 expenditure to the budgetary account concerning food aid to Angola was only done by the Commission when the Court raised an audit query. The lack of periodic regularisations and the long delays in recording transactions as budgetary expenditure is evidence of weakness in the control of extra-budgetary expenditure.

5.50. As in previous years, the outstanding bank balances for the Mediterranean protocols were not confirmed by the banks and reconciled by the Commission until June 1999, beyond the official deadlines. Little

progress has been made to improve performance in this area.

Legality and regularity of the underlying transactions

Absence of legal bases

5.51. As was pointed out in paragraph 8.27 of the 1997 statement of assurance, the Court of Justice, in its ruling of 12 May 1998 ⁽²⁶⁾, made it clear that the Commission is not empowered, except in a few limited situations, to commit expenditure where the legislative authority has not adopted a basic act authorising the expenditure.

5.52. Following this ruling, as part of the process which resulted in the interinstitutional agreement on legal bases of 13 October 1998, the Commission was enabled by the budgetary authority to unblock a series of budget headings on which it had previously stopped all operations ⁽²⁷⁾. In the light of the agreement between the Commission and the budgetary authority, the Court has not considered as errors for DAS purposes any of the items of expenditure incurred without a legal base on these headings.

International fisheries agreements: commitments made in excess of available appropriations

5.53. As in 1997 ⁽²⁸⁾, the Commission in 1998 entered into legal commitments under international fisheries agreements which exceeded the appropriations available by 352,7 Mio ECU. This amount is disclosed in the off-balance-sheet potential liabilities ⁽²⁹⁾.

Time limits for the execution of commitments

5.54. Article 1 paragraph 7 of the Financial Regulation provides that legal commitments entered into for measures extending over more than one financial year shall contain a time limit for implementation. Since 5 Decem-

⁽²⁶⁾ Case C-106/96.

⁽²⁷⁾ A few budget lines remained suspended throughout the rest of 1998, including that concerning the integration of gender issues in development.

⁽²⁸⁾ See paragraph 8.27 and Table 8.1 of the Annual Report concerning the financial year 1997, OJ C 349, 17.11.1998.

⁽²⁹⁾ Volume IV of the revenue and expenditure account and consolidated balance sheet, Chapter 4, page 81.

ber 1998 ⁽³⁰⁾, the regulation has also required the corresponding commitment proposals to contain this time limit, and for the parts of those commitments not used six months after this date to be cancelled ⁽³¹⁾. Following recommendations from the Court, the Commission has required for several years these time limits to be entered in the Sincom accounting system.

5.55. At 31 December 1998, the time limits for 3 847 (amounting to 812,8 Mio ECU) of the 10 716 commitments open in subsection B7 had expired. For 2 032 of these commitments (204 Mio ECU) the time limit expired between 1991 and 1997. Notwithstanding the expiry of the time limits on this last group of commitments, payments totalling 8,8 Mio ECU were still made against them in 1998. These payments constitute formal errors.

Tendering procedures

5.56. Tendering procedures present particular difficulties of assessment. Defects in tendering procedures carry with them a risk of excessive or unjustified expenditure. In some cases the circumstances are such that an actual loss to the EU is relatively unlikely, but, in others, the probability is that a lower tender could have been obtained. In some cases where the technically satisfactory tender with the lowest price is not selected, it is possible to calculate the additional cost wrongly incurred.

5.57. For the sample of payments examined, particular problems were noted in relation to the tendering procedures for awarding the relevant contracts and in the supporting documentation. In some cases, the problems concern the operation of the Commission's administrative procedures, but may not call into question the amounts of payments to final beneficiaries. In other cases, the problems are such as to call into question the substance of the payments.

⁽³⁰⁾ Council Regulation (EC, ECSC, Euratom) No 2548/98 of 23 November 1998, amending the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities. (OJ L 320, 28.11.1998).

⁽³¹⁾ Provision is made for the time limit to be extended in special circumstances, where appropriate reasons are given by the recipients.

Phare tendering procedures

5.58. For the Phare programme, the 'Instructions to tenderers' document, sent out by the Commission to firms bidding for contracts, states which criteria will be used for the financial evaluation of tenders. These criteria were not always followed by the evaluation committees, or, due to an absence of documentation, their application could not be verified during the audit.

(a) For about a quarter of the Phare payments sampled where tender procedures were used, the related contract had been awarded after other evaluation criteria than those communicated to the tenderers had been applied. In two cases, amounting to 15,7 Mio ECU, the correct application of the financial evaluation criteria indicated in the instructions would probably have resulted in the award of the contract to another tenderer. In these two cases, where the financial evaluation criteria were amended during the procedure, the control circuits mentioned by the Commission proved defective. In fact, the overall result of the technical and financial evaluations is what was affected.

(b) For four other Phare payments in the sample, the Commission was unable to provide adequate tender documentation and thus proper compliance with the tendering procedures could not be established.

Tacis tendering procedures

5.59. For Tacis, in contravention of Article 117 of the Financial Regulation relating to the procedures for the award of public service contracts, the financial evaluation criteria are not specified in the invitation to tender but are fixed by the Commission's tender evaluation committee. There was no justification of the criteria used on the files examined, nor is there any standard methodology for the evaluation. This situation undermines the transparency of the Tacis evaluation procedure.

5.60. For three quarters of the Tacis tenders examined, the Court could not obtain from the Commission all the offers made by tenderers, in particular, those excluded from the evaluation on the grounds of non-conformity with the tender conditions. As a result, the Court was unable to establish for these transactions whether there was proper compliance with tendering procedures. These constitute formal errors.

Tendering and other selection procedures for aid to former Yugoslavia

5.61. Among the five payments examined for operations in former Yugoslavia, two errors were found in the contract award procedure.

- (a) A contract to carry out a complete reconstruction programme in Croatia was concluded with an organisation for 6,6 Mio ECU without a tendering procedure. The Commission justified this under the provisions of Article 118(2) of the Financial Regulation, which permits private treaty contracts with NGOs. Although the organisation in question is an NGO, the functions which it was to carry out under the contract were not those of an NGO, but rather functions which should have been the subject of tendering procedures, with consultation of the Advisory Committee on Procurements and Contracts (ACPC).
- (b) In the context of the rehabilitation programme for Bosnia, a project of 2 Mio ECU, not selected by the evaluation committee, was nonetheless approved by the Commission without the justification required by Article 116 of the Financial Regulation being given. Furthermore, the Court considers that the award of this contract by derogation from the normal procedure provided for in Council Regulation (EC) No 1628/96 (OJ L 204, 14.8.1996), notably Articles 5 and 11, was irregular.

Tendering procedures related to ECHO operations

5.62. Several errors occurred in the tendering for an ECHO contract in East Africa. In particular, in contravention of Article 117 of the Financial Regulation, the criteria for the award of the contract were not set out in the tender notice or contract documents. Also, the method used to evaluate the technical and financial offers was flawed. This is a substantive error because the Court considers that if a more appropriate procedure had been applied, the contract could have been awarded to another contractor at an overall lower cost to the Community.

Documentary evidence

5.63. For a limited number of the underlying transactions examined, adequate supporting documentation could not be provided by the Commission.

5.64. For a number of budget headings (B7-6000) involving NGOs, there is no requirement for the beneficiaries to submit detailed supporting documentation with their expenditure declaration. They are, however, required to keep documents available for audit purposes for a period of five years. At the time of making payments, the Commission does not, therefore, check directly that the expenditure declared is correct. This weakness notwithstanding, for the 1998 financial year the Court has not classified this expenditure as being affected by error. In paragraph 5.71 the Court recommends that the Commission should improve its procedures in this area.

Funds to be recovered

5.65. In addition to its audit of a sample of underlying transactions across the whole financial perspective, the Court has looked specifically at the particular situations where unspent advances remain in the hands of intermediaries or beneficiaries. In such situations, the fact that these advances have been recorded in the Commission's accounts as final expenditure increases the risk that funds will remain in the hands of bodies no longer entitled to them. The Court reviewed a selection of Phare programmes in order to assess the arrangements for recovering these outstanding amounts. Insufficient priority is given to revenue collection by the Commission's operational services. Despite the fact that most of the funds to be recovered are located in beneficiary countries, Commission delegations have not been given clear responsibilities in this area. Moreover, the Commission lacks an adequate accounting system for monitoring the use of advances and managing the recovery of debts. These problems are illustrated by the following examples.

- (a) For Phare, depending on whether the contracting period for the programmes ended at 31 December 1996 or 31 December 1997, the Court estimates that between 50 Mio ECU and 120 Mio ECU respectively were in PMU bank accounts at the end of 1998 awaiting recovery.
- (b) Furthermore, out of a sample 24 programmes, the Court identified 17 cases where a recovery order should have been issued by the Commission by 31 December 1998. Recovery orders, however, were only established for six programmes. These six recovery orders were issued between 18 and 44 months after the end of the contracting period.

- (c) A total of 3,2 Mio ECU, which had been transferred by the Commission to special funds managed by two procurement agencies for the 1996 essential aid programme for Bosnia, had not been disbursed when the deadline for payments from the funds expired in January 1998, and had still not been recovered by the Commission at the end of 1998.
- (d) A payment of 3,4 Mio ECU made by the Commission in May 1998 to an NGO for rehabilitation work in Bosnia was withheld by an intermediary bank in Croatia. The Commission did not issue a recovery order until March 1999. As at 30 September 1999 this recovery order was still outstanding.
- (e) An amount of approximately 3 Mio ECU was owed to the Commission by the association européenne pour la coopération (AEC) concerning contracts dating back to before 1997. This situation arose from the former practice of ECHO of paying 100 % advances on AEC contracts, and the advance subsequently not being fully disbursed. While it would have been expected that a recovery order would have been raised by ECHO, it had not done so because of delays in agreeing with AEC the amount to be reimbursed.

5.66. As is the case for other fields of expenditure, the Commission does not account for interest received on advance payments in programme bank accounts. At the end of 1998, interest received on PMU bank accounts since the start of the Phare programme amounted to at least 62 Mio ECU. This is not disclosed in the Commission's accounts.

Conclusion

5.67. Important information about advance payments is missing from the accounts. The Commission should exercise greater control over funds transferred to third parties such as TAOs and PMUs, notably in relation to the recovery of advances and the monitoring and recording of interest earned on these funds.

5.68. Outstanding commitments are overstated in the accounts.

5.69. Overall, while the level of substantive errors was low there was a high number of formal errors which do not have a directly quantifiable effect on the amounts of Community funds disbursed.

5.70. Weaknesses were identified in the tendering procedures. In the light of the inherent risks involved, the Commission should give priority to improving its control over these procedures.

5.71. As NGOs are for many programmes no longer required to submit supporting documents with their expenditure declarations, the Commission services should ensure alternative control mechanisms, for example it should organise, preferably in conjunction with ECHO, audit visits so that, say, at least once every five years the NGO's accounts for the projects are checked.

FOLLOW-UP TO THE COURT'S PREVIOUS OBSERVATIONS

Special Report 2/97 on humanitarian aid ⁽³²⁾

5.72. The above special report, which covers the period 1992 to 1995, contains many observations resulting from a comprehensive audit of humanitarian aid financed both from the general budget and from the European Development Funds managed by the Commission. The follow-up work that has been carried out concerns two important matters covered in the report, the organisation and resources, notably staff, of the European Community Humanitarian Office (ECHO), and the Framework Partnership Agreement (FPA).

Organisation and staffing of ECHO

5.73. In the special report the Court observed in paragraphs 4.1-4.10 and 4.47 that too high a proportion of ECHO's staff were on temporary, auxiliary, service or consultant contracts, carrying out tasks which should have been performed by permanent officials. The lack of transparency in ECHO's recruitment procedures was also criticised, a point which was taken up in the European Parliament's resolution on the special report ⁽³³⁾.

⁽³²⁾ OJ C 143, 12.5.1997.

⁽³³⁾ Resolution of 16 January 1998 on Special Report No 2/97 of the Court of Auditors concerning the humanitarian aid of the European Union (1992-95) (C4-0219/97).

5.74. Despite a specific request to ECHO in November 1995 for confirmation that the personnel identified by the Court during its enquiry were all the staff available to ECHO between 1992 and 1995, financed from all budget headings, the Court was not informed of the existence of a significant number ⁽³⁴⁾ of additional persons employed irregularly on contracts financed from Part B of the budget ⁽³⁵⁾.

5.75. The subsequent enquiries by UCLAF into these irregular contracts found that they involved a complex group of companies — some of them operating through 'offshore trust' arrangements — whose business practices have been shown to be questionable. It is unsatisfactory that the Commission maintained contractual relations over many years, and involving many DGs, with such a group without having carried out basic due diligence tests. The enquiries of UCLAF are continuing, and the Court is monitoring the situation.

5.76. The Court notes that, in the light of the findings of the UCLAF enquiry, and of the report of an administrative enquiry set up to clarify the facts, the Commission referred the case to the Disciplinary Board to see whether any of the disciplinary sanctions provided for under the Staff Regulations should be applied to the ex-Director of ECHO. Following the unanimous reasoned opinion of the Disciplinary Board that the accusations against the ex-Director were not founded, the Commission decided to close the case. With regard to the Commission reply, the Court notes that the disciplinary procedure is now definitively closed, but it also notes that there are differences between the various reports and opinions within the Commission.

5.77. As far as the employment status of ECHO staff at the end of 1998 is concerned, there has been a major change since the Court's special report. There were 94 permanent staff, 10 temporary officials, seven auxilia-

ries, five interim employees and five seconded national experts. The operational units are now entirely staffed at Grades A and B by permanent officials, but there are still many temporary officials in policy and programming, and other important central functions. The Commission enquiry carried out during the 1999 budget procedure (see paragraph 5.17) found, that in 1997 and 1998 there were a few limited cases of 'submarines' ⁽³⁶⁾. The large scale use of submarines, however, ended in mid-1995.

5.78. At the beginning of 1999 there were 78 external technical assistance staff in the field. Many of these have been under contract to the Commission for many years. Following the closure of AEC ⁽³⁷⁾, the contract management of these persons was taken over by the service commun RELEX (SCR), which contracted out after open tender the day-to-day administrative tasks. In 1998, out of approximately 1 600 respondents to a call for expressions of interest, 1 400 names of persons suitable to be appointed as humanitarian aid field correspondents for ECHO were put into a database, which is now used when deciding who should be appointed. In principle, this is more transparent than the previous system based on personal intuition, although it will be necessary in the future to check that this is working out in practice.

5.79. To date, there has not been any progress in establishing a limited 'corps' of humanitarian aid experts as part of the external service of the Commission. The Court reiterates its recommendation in this regard ⁽³⁸⁾.

The Framework Partnership Agreement (FPA)

5.80. In Special Report No 2/97, the Court emphasised that it supported the principle of the FPA, which is at the centre of the relationship of partnership between ECHO and the multilateral, international, and non-governmental organisations (NGOs) which implement

⁽³⁴⁾ In 1994 16 persons within ECHO, and 11 in an 'external unit' preparing the financial closure of operational files to permit final payments. This compares with 90 posts for officials, auxiliaries and service personnel employed regularly.

⁽³⁵⁾ Also, when pointing, in its replies to the Court's Special Report, to what it considered to be the shortage of staff available to ECHO — 'less than 60 members of staff during a large part of the period over which the Court carried out its audit' —, the Commission made no mention of the 'submarines' employed.

⁽³⁶⁾ 'Submarines' are defined as persons employed on study or other contracts financed from operational appropriations who are supposed according to their contracts to perform their tasks outside the Commission, but who in fact work 'intra-muros' for the Commission services on administrative tasks.

⁽³⁷⁾ The European Association for Cooperation, known by its French acronym.

⁽³⁸⁾ Paragraph 4.10 of Special Report No 2/97 concerning European Union humanitarian aid between 1992 and 1995 (OJ C 143, 12.5.1997).

humanitarian aid operations. It made, however, a number of criticisms, particularly in paragraphs 4.11 to 4.21, of the first version of the FPA and the way it was implemented.

5.81. In its recommendation on the discharge concerning the 1996 financial year ⁽³⁹⁾, the Council noted the Court's proposals for improvement in the FPA. This made clear the need to differentiate the FPA, so as to take into account notably the special characteristics and mandates of the UN agencies and the international organisations such as the International Committee of the Red Cross (ICRC), the need for the FPA to have clear objectives and criteria and the need to combine strengthened effective control of funds and the results of operations, while allowing operational flexibility. The European Parliament made no explicit recommendation concerning the FPA in its resolution of 16 January 1998.

5.82. Following extended discussion during 1997 and 1998 with its partners, through a *Groupe Dialogue*, and a consultation of the Member States in the Humanitarian Aid Committee, the Commission adopted in March 1998 a revised FPA, which was introduced with effect from 1 January 1999. Although it will not be possible to draw conclusions about the new FPA and its implementation modalities until there has been more experience of applying it, it is appropriate to report on some of the key changes.

5.83. Under Article 7 of the Council regulation concerning humanitarian aid ⁽⁴⁰⁾ the Commission is required to take account of an organisation's administrative and financial management capacity ⁽⁴¹⁾. It was agreed in the Humanitarian Aid Committee that each Member State ⁽⁴²⁾ would certify the administrative and financial soundness of each NGO in their country which wanted to sign the FPA. The information supplied to ECHO in the process was general only. The Court recommends that during the missions of ECHO's internal audit staff to partner organisations' headquarters (see

paragraph 5.88), the assessments of administrative and financial management capacity should be updated.

5.84. The Commission has recognised the need to incorporate some modifications into the FPA for the ICRC and the UN agencies (UNHCR, WFP, Unicef, etc) to reflect the mandates given to them by the international community. However, as is shown by the differences of view between the UN and the Commission over standard contractual conditions that should apply to all contracts between them, there remain fundamental issues about their relationship to be resolved ⁽⁴³⁾. These are issues which could have been addressed in the humanitarian aid charter proposed by the Court (paragraphs 2.26 and 2.28 of Special Report No 2/97), and supported by the European Parliament ⁽⁴⁴⁾, but which has not been taken up by the Commission.

5.85. In revising the FPA the key objectives of ECHO were to simplify the general conditions, increase flexibility, while at the same time enhancing the accountability of partners. The modifications to the general conditions concerning, for example, the provisions for the use of the contingency reserve, budget modifications during implementation, the rules governing emergency operations, the duration of non-emergency contracts, the rules on flat-rates for staff, and the obligations on ECHO itself are clearer and more flexible than they were. They go a considerable way towards meeting the Court's recommendations in paragraph 4.15 and 4.22 of Special Report No 2/97.

5.86. The contract itself, and the approach of ECHO, also take much more account than in the past of the substance of the operation. It appears that this reflects a more results-oriented approach, rather than one

⁽³⁹⁾ Council recommendation of 9 March 1998 on the discharge to be given to the Commission in respect of the implementation of the general budget of the European Communities for the financial year 1996.

⁽⁴⁰⁾ Council Regulation (EC) No 1257/96 of 20 June 1996 (OJ L 163, 2.7.1996).

⁽⁴¹⁾ The need for this was stressed by the Court in paragraphs 3.15 and 4.15a) of Special Report No 2/97.

⁽⁴²⁾ And the United States, Norway and Switzerland, for partners with their headquarters in these countries.

⁽⁴³⁾ The UN considers that the approach of the Commission treats UN agencies as subcontractors of the Commission, executing Commission policies, whereas the UN agencies regard the Commission as a donor, financing the programmes that they adopt in furtherance of their international mandates. The UN organisations have decided not to sign the FPA until the standard contractual conditions have been agreed. The Commission, for its part, is concerned about the efficiency of the use of Community funds, and the loss of visibility when they pass through UN agencies.

⁽⁴⁴⁾ See paragraphs 5-7 of its resolution, *op. cit.*

focused excessively on inputs. This was the subject of a number of observations by the Court, in paragraphs 3.23, 4.14, 4.17 and 4.51 of Special Report No 2/97.

5.87. Both the special report on humanitarian aid and the chapter of the Annual Report concerning the financial year 1995 argued that in many instances ECHO, when financing an individual operational contract, was in reality contributing to a programme financed by several donors, and that its contractual and control arrangements should take this into account. The only advance in this area is that ECHO now requires more information on what other donors provide to the implementing partner, but it persists with an approach based on tight earmarking and defining all operations as separate projects. The Court reiterates its recommendations that the Commission, as a major humanitarian aid donor, and the Member States should take the lead in promoting, where appropriate, a programme approach, reporting, accountability and audit arrangements being agreed between the donors and implementing partner, at the level of the whole programme (see paragraphs 4.18-4.20 of the Special Report). These recommendations were supported by both the Parliament and the Council in their respective resolutions and recommendations for discharge concerning the 1996 accounts.

5.88. The general conditions specify stringent requirements on partner organisations to maintain adequate accounts of the operations financed by ECHO, and describe how the supporting documents are to be kept. As the supporting documents are not sent to the Commission with the detailed expenditure declarations made at the end of an operation, it is essential that ECHO has a sufficiently extensive programme of audit visits to the organisations to verify that their systems are adequate, that they are maintaining proper accounts and making correct declarations to ECHO. Since 1996 the internal audit unit of ECHO has undertaken 76 audit visits to organisations which have signed the FPA, covering 70-80 % of expenditure. The Court notes with serious concern that recovery orders for a total of 3,2 Mio ECU from 12 partner organisations have been issued as a direct result of these audit visits.

Conclusion

5.89. In summary, the Commission has done a great deal to simplify, clarify and make more flexible the

operational contracts under the FPA. However, the FPA remains predominantly a framework for contracting operations, rather than a real partnership agreement. The majority of the NGOs replying to the Court's questionnaire are positive about the improvements to the contractual terms and conditions. The UN agencies and international organisations such as the ICRC, however, remain concerned with what they perceive as the continuing deficiencies of the FPA as a partnership agreement, because it still does not take sufficient account of their specific roles and mandates in the area of humanitarian aid.

Special Report No 1/96 on the Mediterranean decentralised programmes ⁽⁴⁵⁾

5.90. The Court's special report on the Mediterranean decentralised programmes found serious irregularities and shortcomings in financial management in the way in which the programmes were organised and implemented by the Commission. When the Commission was first informed by the Court in October 1995 of the irregularities, the Commissioner responsible immediately stopped the MED-programmes and the renewal of the contracts of ARTM ⁽⁴⁶⁾ and the TAOs.

Audits carried out by the Commission services

5.91. Audits were carried out by DG XX between January and November 1996 into ARTM and 4 TAOs, which broadly confirmed the findings of the Court and identified amounts to be recovered totalling almost 2,2 Mio ECU. A total amount of 77 167 ECU had been recovered at 31 December 1998.

5.92. The Commission also engaged private auditors to carry out a financial review of the projects carried out by the networks, where the Court had identified a large number of weaknesses and irregularities ⁽⁴⁷⁾ in the

⁽⁴⁵⁾ OJ C 240, 19.8.1996.

⁽⁴⁶⁾ Agency for trans-Mediterranean networks.

⁽⁴⁷⁾ The Court pointed out in paragraph 104 of the special report '... payments have been made to the projects which were not justified and which should, therefore, in principle be recovered by the Commission. The total amounts to be recovered, however, can only be assessed after an exhaustive examination at the level of the networks. It is for the Commission to decide how to proceed in this matter.'

30 networks sampled. The auditors carried out detailed reviews of 233 projects, representing 70 % of funds disbursed and 71 % of total project costs. This financial review, still ongoing in May 1999, confirmed the earlier findings of the Court that there had been numerous irregularities and ineligible expenditure financed by the Commission. The review also confirmed the serious weaknesses in ARTM's control procedures identified by the Court in the special report ⁽⁴⁸⁾. The financial review identified potential recoveries of 4 Mio ECU, with further work required in respect of 22,7 Mio ECU. The Commission has carried out a detailed review of the findings of the auditors, and at the end of June 1999 had issued 69 recovery orders for a total of 2,4 Mio EUR. Further recoveries will be issued as the Commission completes its review.

The new general framework for decentralised programmes

5.93. In July 1996 following the conclusions of the Court, the Commission adopted a new general framework for the decentralised cooperation programmes in Asia, Latin America and the Mediterranean. This was followed in January 1997 by the approval of model contracts. The new framework defines and separates the technical and financial tasks which can be subcontracted to external organisations (TAOs), and those which must be carried out by the Commission services. Generally, it provides that the administrative tasks that can be entrusted to external organisations concern simple management only: powers of control, and the authority to exercise discretionary powers of decision may not be delegated.

5.94. The framework also defines a number of ethical obligations, which are set out explicitly in the contracts, to avoid incompatibilities of functions, confusions of interest, etc. and specifies sanctions in the event of infringements.

5.95. In its resolution of 18 July 1997 ⁽⁴⁹⁾ on the Court's special report, the European Parliament set out a number of conditions for the relaunching of the decentralised programmes ⁽⁵⁰⁾ in the Mediterranean region. The

Commission has sought to respect these conditions. However, although the Parliament resolved that the Commission should take on direct responsibility for either the technical or the financial management of the programmes, the Commission was not able to do so, and so put both tasks out to public tender. The tender for the financial management component was to find an organisation for the decentralised programmes in Asia, Latin America and the Mediterranean. The technical secretariat contract concerns the Mediterranean only (the 'MED-Secretariat'). Both contracts were signed on 19 May 1998.

5.96. The Commission has also designed a stronger management framework for the networks, giving the network coordinator real authority and clearly defined responsibilities.

5.97. The Commission has continued to allocate insufficient staff to these programmes. In the communication of 17 July 1996 to the Commission, by the Commissioner responsible, setting out the proposals for the new management framework, the *additional* staff requirements were set out. In practice, at the beginning of 1999, no additional staff had been provided.

5.98. The Commission has not yet entered into contacts with national authorities to ensure that the organisational structures and financial procedures of the networks are compatible with national rules and procedures. This was a serious weakness of the previous arrangements, particularly in respect of MED-Urbs, with national systems of financial control being bypassed ⁽⁵¹⁾.

5.99. On 22 April 1998, the Commissioner responsible announced that the conditions for the relaunch of the programmes had been met. In September 1998, letters were sent to 189 networks which had had their proposals for projects accepted under the 1995 programme to inform them of the new management arrangements, and to see whether they were still interested in carrying out the project, if necessary with modifications. The vast majority replied in the affirmative. The evaluation of the responses was completed early in 1999. The effective relaunch, however, had not taken place as of 15 July 1999. In the light of the prob-

⁽⁴⁸⁾ Special Report No 1/96, paragraph 86, *passim*.

⁽⁴⁹⁾ Resolution A4-0236/97 of 18.7.1997.

⁽⁵⁰⁾ MED-Urbs, MED-Campus and MED-Media (professional training only).

⁽⁵¹⁾ In its recommendation for the discharge concerning the implementation of the 1995 budget, the Council expressed concern at the difficulty in respecting contractual conditions if such provisions did not exist in national law.

lems incurred with the management of the first MED-programmes, the Commission is adopting a highly prudent approach.

Conclusion

5.100. It can be concluded, therefore, that the Commission has done a great deal to improve the management framework and the contractual provisions for the financial and technical management of the programmes. The dangers of incompatible functions and confusion of interest have been addressed. There remains, however, the important requirement to ensure that the

organisation structures and financial procedures of the networks do not bypass national rules.

5.101. The relaunch of the programmes has taken longer than expected, and considerable frustration is building up amongst prospective network participants. Although the technical and financial secretariats exist on a more satisfactory basis than before, the resources in the Commission allocated to the overall management and control of the programmes are inadequate. The Commission will need to ensure that the split of responsibilities, with the technical secretariat responsible to DG IB and the financial secretariat responsible to the SCR, does not complicate decision-making.

COMMISSION REPLY

ANALYSIS OF THE IMPLEMENTATION OF THE BUDGET

Change and use of appropriations in 1998

Commitment appropriations

5.3. The Court's comment makes no reference to the consequences of the late adoption of the amending budget (SAB — 14 December 1998) on the rate of implementation of commitment appropriations.

In the case of Chapter B7-50, for example, the appropriations available on 13 December 1998 were implemented in full. A further 21 % of the additional appropriations approved on 14 December 1998 (123 million) were still able to be used by the end of the financial year. A very large proportion of the remaining appropriations were carried over.

The Commission is willing to consider any possibility for simplifying operating procedures in order to solve the problem of the concentration of commitments at the end of the year.

5.4. Particularly in the case of the ALA and MED programmes, the Commission is aware of the problem caused by bunching of commitments during the year. It should nevertheless be noted that the annual cycle of programming at the beginning of the year, followed by identification of projects, deliberations by the various committees and drafting of financing agreements tends to concentrate commitments towards the end of the year. The situation will change with the gradual introduction of multiannual programming.

5.5. In the case of the Phare programmes, the Commission takes the view that the late commitments were linked to the refocusing of the programme. This refocusing is based on accession partnerships which were not adopted by the European Council until March and did not receive the backing of the Management Committee until July. As a result, finalisation of the new-style programmes was delayed. This refocusing now involves the entry in the accounts of programmes and projects which have reached maturity.

The fact that commitments are made late in the year does not necessarily mean that the duration of the programmes is curtailed and has no impact on the sound management of the programmes.

5.6. In the case of Tacis, certain commitments were entered into late in the year. The late commitments relating to the programme for Russia were the result of administrative problems, while those relating to Georgia can be explained by the wish to provide further support for the renewal of the process of reform in Georgia, which only emerged in July of this year.

Payment appropriations

5.7. Before the MEDA programme could be implemented a legal framework and technical assistance had to be set up — the framework financing agreement and the MEDA-Teams — a task which was not completed until 1997. It is therefore natural that, since these were complicated medium- or long-term projects, it was a relatively slow and gradual process for them to get up to full speed. Moreover, a shortage of manpower in the financial unit forced departments to give priority to commitments and held back the implementation of certain payments until November.

5.8. In addition to the reasons mentioned by the Court (reduction in the amount requested by the Commission and delays in reinforcing budget headings), the Commission's departments had to take account of the lack of flexibility in the management of the Relex payment appropriations. The reason for this lack of flexibility is that the major programmes are covered by a budget chapter and any transfer between chapters currently requires the approval of the budgetary authority.

Added to that is the fact that the departments do not have full control in administering payments, as they are dependent on the submission of invoices by outside contractors, whose number and diversity have grown steadily in recent years.

5.9. The Commission acknowledges the relevance of the Court's comment, which should be considered in a more general context.

The necessary priority could not be given to clearing invoices from Asia (B7-300), as the number of staff assigned to the financial department with particular responsibility for managing this budget heading was reduced in the second half of 1998.

The underlying cause of the problems highlighted by the Court is therefore a shortage of manpower.

5.10. The Commission regrets the fact that the MEDA programme took longer to get under way than expected; some of the reasons for this are given in paragraph 5.7.

It should be noted, moreover, that in the case of MEDA a number of payments relating to structural adjustments are subject to conditions which, if not respected, can lead to the postponement of the payment until the following year.

5.11. The cross-border cooperation programme is complex to implement. In particular, the largest single component, the improvement of border crossings, relates not only to the construction of infrastructure, but also to the operational methods employed by up to eight different institutions, in the case of Russia. This means that quite a long start-up phase was necessary before expenditure could commence. Furthermore, as this was the first major programme with a high percentage of investment in infrastructure in the NIS, additional hurdles had to be overcome in developing a contracting arrangement suitable to the Commission's standards, while at the same time ensuring compatibility with local legislation, relating, for example, to building standards.

5.12. Priority was given to the commitment of appropriations at the end of 1998. In the case of payments, the Commission tried to concentrate on solving the most urgent problems and took advantage of the option provided by the Financial Regulation of carrying over payment appropriations to 1999 to enable it to honour the invoices in its possession within the deadlines.

This carryover of appropriations was also judged necessary following the significant cuts made, once again, by the budgetary authority in the payment appropriations requested for the 1999 financial year.

Volume 1 Part 2 of the revenue and expenditure account and balance sheet

5.14. It is true that Volume 1 Part 2 of the revenue and expenditure account concerning the analysis of sound financial management did not include the information mentioned by the Court of Auditors. In drawing up the revenue and expenditure account, the Commission must keep to a strict schedule imposed by printing deadlines and it was not possible to finalise these contributions before the date set for consolidation.

In future, in addition to maintaining a basic framework bringing together the contributions from many different sources, the Directorate-General for Budgets undertakes to take the necessary steps to ensure that the information set out in Volume I Part 2 is relevant and complete.

MECHANISMS FOR MANAGEMENT OF AID BY THE COMMISSION: USE OF EXTERNAL STAFF, TAOs, ETC. FINANCED FROM OPERATIONAL APPROPRIATIONS

Technical and administrative support for programmes (STAP)

5.15–5.31. The experience gained since 1996 with the STAP Facility showed that clarifications and improvements were needed in order to make the system more efficient and more transparent. Contacts between the Commission and the European Parliament in connection with the preparation of the 1999 budget led to modifications to the system. Many of the comments made by the Court relate to differing interpretations of the remarks in earlier budgets (1996-98). The Commission expects that the new situation (the new remarks for 1999 and the internal implementing rules⁽¹⁾ and the rules governing the use of technical assistance offices (TAOs) — note of 15.7.1999 from Mr Liikanen to Mr Karlsson) will help make the interpretations of the budgetary authority, the Court of Auditors and the Commission more consistent.

⁽¹⁾ cf. joint memo from the Director-General for Budgets and the Director-General for Financial Control to Commission Directors-General and Heads of Service (No 32161 of 2.9.1999) concerning the internal implementing rules contained in the budget remarks relating to expenditure on technical and administrative assistance and for support expenditure charged to operating appropriations.

5.15. *The lack of resources in Part A of the budget is part and parcel of the policy of budgetary rigour pursued by the budgetary authority.*

In its proposal for recasting the Financial Regulation, the Commission will propose, as a permanent provision, an activity-based budgeting structure. As a transitional measure, however, the proposal will retain the present division of the Commission section of the budget into two parts (Parts A and B) and will strengthen the conditions on which administrative expenditure may be charged to Part B. These conditions are as follows: the basic instrument must provide for it, charging to Part B must be justified by the principle of sound management, the administrative tasks must not include any European public service task, and expenditure may be charged only within the limits laid down by the budgetary authority.

5.15–5.17. *To establish the ceilings for 1997, the Commission sent the budgetary authority a memorandum explaining the bases used for setting them.*

With the autumn 1998 inquiry into administrative and technical assistance and the outcome of the 1999 budgetary procedure, the Commission made a clear distinction between technical assistance of exclusive benefit to the recipient countries, technical assistance of mutual benefit to the Commission and the recipient countries, and administrative assistance to the Commission's departments with, as a decisive criterion, whether or not the amount had been entered in the accounts under the STAP allocation. This distinction was explained in the 1999 budget in a covering remark for Part B of the budget in conjunction with a specific remark for those budget headings for which technical and administrative assistance had been authorised by the budgetary authority with a specific limit.

5.18. *The rates of increase of the limits referred to by the Court are due to the fact that the ceiling for expenditure on technical and administrative assistance for 1999 includes forms of assistance which were not previously incorporated in the 1998 STAP ceiling, such as support structures for horizontal and multi-country programmes.*

As to the report on the implementation of the STAP, while the Commission had initially intended in early 1998 to pro-

vide quarterly information to Parliament on the use of the STAP appropriations, this was overtaken by developments in the Commission's approach to support expenditure. Therefore specific information about the STAP was provided to Parliament's Budgets Committee only in February 1998.

In July 1998 the Commission sent the Parliament an orientation document on technical assistance offices in which it proposed raising the issue of STAP expenditure in the context of the 1999 budget procedure. As a consequence of the discussions on the 1996 discharge, the provision of information to Parliament was widened to cover support expenditure under all Part B budget items.

In parallel, starting in 1999, a guide to technical assistance offices (TAOs) of 1 July 1999, and the internal implementing rules contained in the budget comments relating to expenditure on technical and administrative assistance and for support expenditure charged to operating appropriations (Part B of the budget), dated 2 September 1999, were drawn up in order to define the framework for the use of this type of expenditure; an analytical structure was also set up within the information system (Sincom) in order to monitor this expenditure in the light of the budget remarks.

5.20–5.31. *As the Commission and the Court interpret the budget remarks on the STAP differently because of a lack of clarity, the budgetary authority has taken the initiative of revising the wording with effect from the 1999 budget.*

The introduction of the new formulation is an attempt to reduce any problems to a minimum, since the Commission intends to comply strictly with the instructions of the Committee on Budgets as reflected in the internal implementing rules (cf. reply to paragraphs 5.15 to 5.31 above) and in the guide to TAOs published at the beginning of July 1999. The SCR, for its part, has published the list of TAOs/Relex on the Internet.

5.20. *In most cases, the reason for the use of outside assistance is a shortage of manpower.*

Between 1989 and 1998, while commitments under the EDF and Heading No 4 of the financial perspective increased by

170 %, staffing in the External Relations DGs rose by just 86 %. Thus, in order to commit ECU 10 million, the Relex DGs had 5 permanent or temporary staff available in 1989 but just 3.4 in 1998 (cf. page 9 of 'Service Commun Relex: situation at 31.12.98' cited in footnote 24 of the Court's observations).

In view of the scale of the phenomenon and experience with outside assistance, in 1998 the Commission adopted a number of initiatives aimed at clarifying the legal framework governing the use of outside assistance. This initiative has already led to a new budget remark. Before this can be fully operational and transparent, the operational definitions on which the Commission's departments have been working, the Guide to TAOs and the internal implementing rules referred to earlier, will have to be further refined.

It should be noted, however, that when the Commission makes use of a TAO it is very often because it does not have enough staff.

5.21. The limits imposed by the budgetary authority for the expenditure referred to in the budget remark have been respected and the Commission considers, as it has explained in earlier annual reports, that a number of cases (e.g., TAOs and consultants providing administrative assistance to beneficiaries, contractors' management costs and of course the technical assistance which is the purpose of the programme itself) do not form part of the structures referred to by the budget remarks and are consequently not subject to the limits imposed. The Commission clarified its position to the budgetary authority and provided documents supporting its point of view, with all due transparency, when revising the remark for the 1999 budget.

5.22. In theory, the STAP amount is calculated on the basis of the initial budget approved by the management committees. The Commission's approach has not been designed to keep appropriations at their highest level. In the case of the former Yugoslavia, it could have mobilised an additional amount of EUR 1 million for the STAP facility in question.

The problem raised in this paragraph has been solved. The budgetary authority altered the comment with effect from the 1999 budget, expressing the ceiling as an absolute amount rather than a percentage.

5.23. The Commission agrees that the system whereby technical and administrative assistance covers all programmes implemented in the course of the financial year regardless of the year in which they began is the simplest to apply. The ambiguity which existed previously has been removed by the new remark and the problem has therefore been solved.

5.24. The Commission acknowledges that the recruitment of ALAT personnel got off to a slow start. The system was new and some time was needed to make it successfully operational, particularly as regards what conditions could be offered to ALAT personnel compared with those prevailing on the expatriate market.

As regards Phare, the situation improved during the first half of 1999, with an increase of 55 % in the number of staff concerned from 36 to 56.

As regards the MEDA programmes, the selection of experts began in 1997, both in Brussels and in the delegations, and continued into the spring of 1998; all the teams were operational by autumn 1998.

5.25. See reply to 5.15–5.17

5.26. The contracts making up the amount of ECU 0.77 million include expenditure on technical and administrative assistance to authorities receiving aid and, in some cases, to the Commission too. These latter expenses fall within the STAP ceiling, even though the expenditure was not entered in the accounts under the STAP programme. The *de facto* situation is that the overall ceilings remain unaffected.

5.27. The bulk of the support and management expenses to which the Court of Auditors refers, namely small-scale technical assistance to beneficiaries under the EBRD's 'Bangkok' facility and the small projects programme, are not, according to the Commission's interpretation, covered by the ceiling referred to by the budget remark.

5.28. *The situation on the ground in Bosnia and Herzegovina, Montenegro, Kosovo and Slavonia bore little resemblance to the customary situation regarding Commission relations with the authorities of non-member countries with which it is embarking on a cooperation programme. In addition, the measures continued to be urgent. The Commission takes the view, in this particular case, that the content of the contracts included for the most part measures that would normally fall outside the scope of STAP, but which had to be described in the contracts in question as support for the Commission. When the contracts were concluded, the Commission did not enter them under the STAP ceiling.*

The budgetary authority, aware of the special circumstances in Bosnia and Herzegovina, in any case raised the ceilings for technical and administrative assistance substantially in the 1999 budget.

5.29. *The supply contract formula of a 'special fund' is useful when it is necessary to make a series of purchases of supplies or to organise the provision of a series of services.*

5.30. *The discussion on the budget remark for 1999 came to the conclusion that the cost of 'framework contracts' for technical assistance should not be included in the STAP allocation.*

In the specific context of MEDA, following the creation of the MEDA-Teams, use of framework contracts is and will remain limited and their financial impact will be negligible.

Conclusion

5.31. *The Commission agrees with the Court of Auditors that the provision of an amount for technical and administrative assistance by main programme area would constitute a further considerable improvement over the present system whereby ceilings are identified by budget heading.*

Other improvements might also be envisaged; these should be examined in the context of the work on 'activity-based budgeting' and the recasting of the Financial Regulation.

The Commission has already stated above that its proposal for the recasting of the Financial Regulation will include the presentation of the integrated budget on the basis of 'activity-based budgeting'.

SPECIFIC APPRAISAL OF THE AREA IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Reliability of the accounts

5.35. *The Commission considers that the financial statements it produces provide a true picture of financial operations.*

Commitments

Understatement of potential liabilities

5.36. *The Commission reiterates that these programmes are binding neither on the Commission nor on the beneficiaries and that they are simply indicative programmes which serve as the basis for detailed planning and discussion between the Commission and the beneficiary countries. It would therefore not be correct to show them in the accounts as potential liabilities*

5.36 and 5.37. *The financial allocations decided at the Cannes European Council for cooperation with the countries of central and eastern Europe and for cooperation with Mediterranean non-member countries, of which MEDA forms a part, are not expenditure targets with the same status as for the Structural Funds.*

The annual financial statements attached to the preliminary draft budget set out the multiannual programming.

5.38. *It would indeed appear that there was an error in the revenue and expenditure account regarding the Mediterranean protocols.*

Overstatement of commitments still to be settled

5.39–5.42. *The Commission is making determined efforts to deal with the backlog of outstanding commitments, on the initiative of the Common Service for External Relations. The scale of the task and the demands it places on experienced staff mean that it is likely to take some three years to resolve the problem. None the less, progress has already been made, particularly in the Phare programme mentioned by the Court where EUR 38 million was decommitted during 1997 and 1998 and EUR 117 million in 1999 as at 30 September 1999.*

Advance payments

5.43–5.45. *The Commission considers that these operations do not fall within the scope of Article 111 of the*

Financial Regulation, the provisions of which are to be reviewed during the recasting of the Regulation to take account of the specific implementing mechanisms for the programmes of financial assistance to central and eastern Europe.

The Commission is of the opinion that these payments have been properly charged to the budget ⁽²⁾. This question will be examined during the recasting of the Financial Regulation. Meanwhile, the Commission promises to examine ways to improve the information value of the accounts.

5.44. *Special Funds:* The Commission has provided information to the Court of Auditors about contracts containing Special Funds. However, such contracts fall into the category either of service contracts or of supply contracts. They are not listed as a specific 'special funds' category, which is why the Commission has to conduct a lengthy and laborious search in order to produce a survey of this type of contract.

5.46. *Programme audits:* in 1998 priority was given, on the basis of the manpower available, to accounting operations relating to commitments and payments of appropriations for that year and to recovery orders.

In the case of the Phare audits, an effort was made to follow up reports on audits carried out in the previous year. The year 1998 was mainly devoted to the introduction of a new framework contract covering all geographical areas, based on a more clearly defined methodology and designed to distinguish more clearly between audit tasks and monitoring and evaluation tasks.

Other balance sheet items

5.47. In 1999 the Commission regularised Echo operations in Croatia; imprest accounts of indefinite duration do not require year-end closure.

5.48. This situation was regularised at the beginning of 1999 with the closure of the two additional accounts.

⁽²⁾ Charging payments via non-budget accounts would introduce a lack of transparency for the budgetary authority and would lead to non-implementation of appropriations with the result that there would no longer be any justification for calling in funds from the Member States.

5.49. Specific measures to absorb the burden of the past have already been taken (cf.: 5.39—5.42) and the Commission is anticipating that the situation will improve within a reasonable period of time.

5.50. The Commission will endeavour to keep to the timetable in future.

Legality and regularity of underlying transactions

Absence of legal bases

5.51—5.52. Differences in interpretation on the part of the two arms of the budgetary authority on the notion of 'legal basis' were ironed out in the interinstitutional agreement of 13 October 1998, as the Court points out.

International fisheries agreements: commitments made in excess of available appropriations

5.53. The specific feature of the international fisheries agreements is that they constitute legal frameworks which, although extending over a number of financial years, set annual obligations for each of the parties (Community — third countries). The Community's financial obligations are thus clearly divided into annual tranches in the basic text (the financial protocol). That is why the Commission merely commits the annual tranche in the course of the year in question.

Nevertheless, since January 1998 the Commission has improved the wording of protocols falling due for renewal since that time, as well as that of new agreements, in such a way as to indicate clearly the amount to be committed each year in financial compensation.

Time limits for the execution of commitments

5.54. After the amendment to the Financial Regulation came into force, in 1999 the Commission took the necessary action to ensure that the Sincom 2 accounting system requires the commitment execution time-limit to be entered and prevents any payments being made after expiry of the time limit.

5.55. The Commission is fully aware of the problems referred to by the Court regarding payments being made after expiry of the time limit. It was for this reason that the Commission had the Common Service for External Relations carry out a stock-take of the state of play with external relations appropriations, which was then written up into a report. The report was sent to the budgetary authority for concerted action to be taken on priorities, methodology and the additional resources to be enlisted for the purpose of eventually clearing outstanding commitments (ECU 13 000 million at the end of 1998 for Heading No 4).

Tendering procedures

5.56–5.57. In 1999 the Commission endeavoured to harmonise contract procedures to make them simpler and more transparent.

For service contracts the criterion for selecting the successful tender is not whether it is the cheapest of the technically acceptable tenders, but whether it offers the best value for money.

The Commission notes that the Court's observations refer to procurement procedures and in no way challenge the fact that the payments are in accordance with the Financial Regulation, that they are legally due and that they are made on the basis of checks on the required supporting documents. Under the contracts it has signed, the Commission is obliged to pay the contractors on the basis of the supporting documents required by the Financial Regulation. Given the terms of the contracts these payments could be challenged only at the cost of creating an area of legal uncertainty which would then undermine the smooth running of the programmes.

Phare tendering procedures

5.58. The procedure for awarding the contracts was as follows:

(a) The evaluation committees are required to select the tender that is economically the most advantageous taking account of such things as the cost of performance, technical merit, the tenderers' qualifications and the nature of the work (Article 117 of the Financial Regulation). Any evaluation of tenders is therefore the outcome of a considered judgement based on both qualitative and quantitative criteria.

In the two cases referred to by the Court, the evaluation committees carried out their selection duties impeccably. The soundness of their final selection was borne out by the series

of checks carried out by Commission departments: the tender selected was the economically most advantageous one, when all the data in the files were taken into account.

Tacis tendering procedures

5.59. In the vast majority of Tacis invitations to tender, the financial evaluation criterion is the total price of the tender. The evaluation method involves giving the lowest tender maximum marks and then scoring the other tenders in proportion to this. The criteria are weighted so that the technical ones account for 70 % and the financial one for 30 %.

The Court's observations refer to contracts concluded between 1995 and 1997. It is true that before the setting-up of the Common Service for External Relations, the evaluation method was not explained in the invitation to tender. However, the structure of the technical evaluation criteria was always the same and in practice tenderers were familiar with it. The evaluation criteria were always adopted by the evaluation committee before opening the sealed tenders. Furthermore, the terms of reference indicated what people would be needed to see the project through, including the people who would be called to the interview, and the most important work to be carried out, which gave the tenderers an idea of the main criteria used for evaluating the tender. The Common Service for External Relations has subsequently rectified this formal shortcoming. Since the beginning of 1999, Tacis procedures have been aligned with the practices of other external aid programmes where the invitations to tender contain a complete table of the evaluation criteria, including their weighting ratios.

5.60. It is true that some of the tenders were not able to be located in the Tacis files. This is why a rigorous system for filing contracts has been introduced for all external relations files.

Tendering and other selection procedures for aid to former Yugoslavia

5.61.

(a) The Commission granted assistance to an NGO operating in the region to implement a refugee return programme, including reconstruction work involving local workers as well as identifying and providing support for prospective returners and organising mine clearance. Given the urgency and the political constraints, an NGO was judged to be the most suitable way of putting the programme into effect.

(b) With its 1998 return programme the Commission was committed to supporting the return plan set up by the OHR-RRTF (Office of the High Representative — Refugee Return Task Force) and endorsed by the international community. The Commission's programme was set up against the background of considerable time constraints and a complex situation on the ground: activities to promote minority return in destroyed areas of a country in post-war shock.

The process of identifying the projects to be funded contained several steps, which were defined from the very beginning. On the basis of the technical evaluation and an impact assessment the projects were ranked according to geographical areas and sub-areas and the impact assessment team made a recommendation of projects for funding. On the basis of this recommendation the Commission produced a final political evaluation and selected the projects. These were submitted to the Obnova committee for its opinion and, after unanimous approval, to the Commission for decision.

Given the political objectives of the programme set by the international community and the OHR-RRTF, the Commission needed to have at least some flexibility to fine-tune the recommendations from the first evaluation stage. This was the only way of ensuring that the projects submitted to the Obnova committee would correspond to the changing circumstances on the ground and produce an effective balance of projects across the regions and sub-regions based on an appropriate mix of political and technical considerations. The Commission does not consider the selection process applied to be irregular.

Tendering procedures related to ECHO operations

5.62. In the Commission's view, the criteria for the award of the contract were properly set out and were similar to those generally used in procedures of this type. The purpose of an evaluation committee is to select the tender offering the best value for money in terms of the various considerations set out in points 5.58 and 5.59. There was nothing secretive about the procedure for evaluating the technical and financial tenders, which was carried out in the presence of officials from several Commission departments. The selection procedure was checked and certified by Commission internal auditing. The selection needs to be based on clear and definite criteria, whereas the calculation method for arriving at a lower price

proposed by the Court is based on a series of hypothetical assumptions.

Documentary evidence

5.63. The Commission considers that the Court was provided with adequate documentary evidence for the underlying transactions concerned. In all the cases examined the payments were made correctly and were substantiated by the required supporting documentation.

5.64. Payments to NGOs under budget heading B7-6000 are made on the basis of the implementation reports submitted by the beneficiaries together with the expenditure statement. Beneficiaries hold on to the supporting documentation themselves and keep it available for random inspection purposes for a period of five years.

In a memo of 22 July 1999 the Commissioners responsible for external relations notified the Commission that an audit would be required of all beneficiaries receiving subsidies of EUR 100 000 or over. This audit would cover either the beneficiaries' organisational set-up, if the beneficiary was able to produce it before signing the subsidy agreement or a post-project audit of the operations would be carried out by the beneficiary. As regards large-scale operations, the memo also states that the payment of advances of EUR 1 million or over requires a bank guarantee or other form of financial security to be lodged, so that the Commission can be sure of recovering any claims it may have in respect of payments the audit shows to be unsubstantiated or incorrect.

Funds to be recovered

5.65. The Commission acknowledges that the procedures followed previously led to delays in issuing recovery orders, which is why it has adopted in-house measures to resolve the problem. Amounts to be recovered are now to be checked more regularly, which means at least at the end of the contracting period and then again at the end of the disbursement period. This has already started to produce results.

It is regrettable that other action taken by the Commission in the meantime was not mentioned:

(a) amounts to be recovered from PMU bank accounts: up to the end of September 1999 the Commission had issued

recovery orders totalling EUR 86.4 million in respect of Phare programmes.

(b) excessive delays in recovery (18 to 44 months): in line with its approach to recovery, the Commission is of the view that recovery orders needed to be issued only for programmes where the disbursement period ended before 31 December 1998. The recovery orders which had not been issued by the end of 1998 for the programmes referred to by the Court have now been issued or will be issued by the Commission in the course of 1999.

(c) recovery order for amounts not used: no recovery action has been taken for the amounts transferred to the special funds for the two contracts referred to by the Court since no expenditure statement or final invoice has been submitted.

Following devolution of programme implementation to Sarajevo, the local European Commission Representation Office (ECRO) is finalising the closure of these two contracts and preparing to issue the recovery orders for them, which is likely to be some time in October 1999.

(d) recovery order concerning an intermediate bank: the Commission took action as soon as it learnt that the funds were being withheld, first trying to solve the problem amicably with the bank and through other channels.

(e) recovery order concerning the AEC: while it is true that there has been a certain delay in winding up the ECHO files over the last three years, it should be noted that the Commission and the AEC have been working hard on resolving this for about a year now.

The Commission has recovered ECU 2.8 million from the AEC by means of offsetting. The amounts offset now have to be reconciled with the recovery orders issued by ECHO. Otherwise, the winding-up of the AEC accounts is proceeding.

5.66. The issue of posting interest is a general problem and not specific to external aid.

As regards the particular remark concerning PMU bank accounts, the Commission would stress the fact that it does not receive any interest to account for, because the legal basis provides for the interest accrued to be allocated to the programmes.

Conclusion

5.67. The Commission reiterates its position on advance payments (cf. 5.43–5.45). The Commission agrees that appropriate control should be exercised over funds transferred to third parties by all departments involved, which, therefore, also means recovering funds not used.

5.68. The Commission is fully aware of this state of affairs, which was brought about in the 1980s and 1990s and could not be kept under control as a result of the qualitative and quantitative increase in external relations appropriations during the 1990s.

The Commission instructed the new Common Service for External relations, which was set up on 1 July 1998, to produce a list of commitments pending. The list, as it stood at 31 December 1998 for the whole of Heading No 4 and the EDF, was sent to the Council, Parliament and the Court during the first half of 1999.

In this way, the Commission wanted to draw the budgetary authority's attention to the growing imbalance in recent years between budget appropriations and the human resources supposed to deal with them. The extent of the work would require additional human resources for a limited period to carry out a systematic audit-based examination and to decide whether to cancel the commitments or to issue recovery orders.

Given the staff available, in 1999 priority was given to implementing that year's budget and settling late payments as well as making some inroads with outstanding commitments for certain programmes like Phare and Tacis.

5.69. The Commission notes that the Court's observations refer to the tendering procedures and do not deny that the payments are in accordance with the Financial Regulation, that they are legally due and that they are made on the basis of checks on the required supporting documents.

5.70. The Commission is fully aware of the importance of managing invitations to tender properly. It is endeavouring and will continue to endeavour to improve the quality of the management of invitations to tender by making the procedures less complicated and more transparent, by improving the instructions given and through proper training of operators and inspectors. Initial work on harmonising external relations procedures is under way (see paragraph 5.69 above).

5.71. Pending the revision of the Financial Regulation, the Commission is required to check that the contracts it concludes with NGOs are lawful and in conformity with the rules. It agrees with the Court that checks in the future should focus more on results and that the Financial Regulation should be amended accordingly.

The Commission does not have the staff it would need to be able to systematically audit NGO contracts. It has duly noted Parliament's call for it to discontinue its current policy of requiring bank guarantees from NGOs.

FOLLOW-UP TO THE COURT'S PREVIOUS OBSERVATIONS

Special Report 2/97 on humanitarian aid

Organisation and staffing of ECHO

5.74. This matter was discussed in correspondence between the President of the Court of Auditors and the President of the Commission between July and September 1998.

5.76. Following the administrative enquiry report, disciplinary action was initiated against the former director of ECHO concerning alleged responsibility for certain irregular contracts. All the stages of the procedure have been completed: examination of witnesses and inquiry, referral to the Disciplinary Board, delivery of opinion by the Disciplinary Board, hearing the official concerned and final decision.

The Disciplinary Board, which is the body provided for in the Staff Regulations to conduct inquiries to establish whether any disciplinable misconduct has occurred and the level of penalty warranted by the circumstances, were of the unanimous opinion that the complaints against the former director of ECHO were unfounded and that he had not failed to comply with his obligations under the Staff Regulations. As a result, the Commission, in its capacity as appointing authority, closed the procedure, respecting the powers duly delegated to the Disciplinary Board.

5.79. The Commission notes the Court's recommendation regarding the setting-up of a permanent corps of experts as part of the unified external service. As things stand, the system applicable to humanitarian aid experts is the same as the one that applies to technical assistance experts on the ground in non-member countries, which was introduced when the AEC was wound up and is managed by the new Common Service for External Relations on behalf of all external relations departments.

The Framework Partnership Agreement (FPA)

5.80–5.89. The Commission welcomes the Court's assessment of the new Framework Partnership Agreement (FPA). Point III of the preamble to the FPA provides for an annual meeting between the Commission and its partners to assess the monitoring of FPA implementation and procedures.

This meeting will provide the opportunity to draw conclusions and, on the basis of this, make any changes that may still be needed.

5.84. An agreement between the United Nations (UN) and the EC on the principles applying to the financing or co-financing by the Community of programmes and projects administered by the UN was signed by the representatives of the two parties on 9 July 1999. It will be signed as soon as the two institutions have completed their internal approval procedures.

The conclusion of this agreement, which provides reasonable solutions to the outstanding issues, should allow the UN to sign the FPA.

Special report 1/96 on the Mediterranean decentralised programmes

Audits carried out by the Commission services

5.91–5.92. As the Court noted, the audit work is constantly progressing.

The new general framework for decentralised programmes

5.93. The most important prerequisite for managing both the technical and financial aspects of the programmes, i.e. making sufficient staff available, was not met. This is why the Commission has to sub-contract out the technical and financial parts of the programmes.

5.97. The Commission is aware that it did not assign extra staff to these programmes. The lack of general resources, the zero growth in new posts and the redeployment of staff to the delegations called for by Parliament are among the reasons which prevented more staff from being allocated and which weighed in favour of putting in place a technical assistance office to do the administrative and technical work and a financial secretariat.

5.98. Despite the complexity of the question, the Commission is all for compatibility between national and Community rules. It none the less thinks that it is up to the Member States who have not yet done so to take the necessary measures so that the main actors in their civil society can participate in European Union decentralised cooperation programmes without breaking national rules.

In the case in question, when entering into contractual relations with the project coordinators, the Commission will be reminding them that they absolutely must comply with the procedures and rules applicable to them, for example as regards national systems of accounting.

5.99. The Commission is aware of the situation brought about by the time lag it considers necessary for the proper relaunch of the Mediterranean decentralised cooperation programmes. This operational phase is subject to a certain number of objective constraints that are being sorted out:

- the wait for the complete results of the audit referred to in paragraphs 5.90 and 5.91;
- the approaches made to the selected project coordinators for a thematic regrouping of certain networks;

- the practical implementation of a new management system approved by the Commission and taking account of the recommendations of the Court of Auditors and of the relevant European Parliament resolution;

- the need for coordination between the two technical assistance bodies and the Commission to avoid clogging up the decision-making procedure, as pointed out by the Court of Auditors;

- the lack of extra human resources in the Directorate-General responsible for putting this type of cooperation into effect.

Conclusion

5.100. The Commission notes the Court's acknowledgment of the efforts made to improve the management arrangements and the contractual provisions as regards the financial and technical management of the programmes. When the programmes are relaunched, if any incompatibilities come to the Commission's attention, it will notify the relevant national authorities accordingly and encourage them to amend their rules to allow decentralised cooperation under the Euro-Mediterranean partnership to operate freely.

5.101. All steps have been taken to ensure operational communication between the various technical assistance offices, as is already the case for other programmes, such as Al-Invest and Alpha. The work done by technical assistance offices is of a purely technical nature and the decisions are taken at Commission department level.

The Commission made a start on reorganising its external relations administration structures by setting up the Common Service for External Relations, which started operating on 1 July 1998. The Commission is continuing discussions with a view to possible further arrangements, for example, in the light of the observations of the Court of Auditors, without prejudice to the reshaping of the project cycle.

CHAPTER 6 (*)

Administrative expenditure

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AUDIT OF THE INSTITUTIONS' ADMINISTRATIVE EXPENDITURE

Introduction

6.1. The out-turn for Heading 5 of the financial perspective 'Administrative expenditure', which groups together the institutions' administrative appropriations (Part A of the budget in the case of the Commission), is shown in **Table 6.1**. These appropriations are managed directly by the institutions and are essentially used to pay the salaries, allowances and pensions of persons working for the Community institutions, as well as rent, acquisitions of immovable property and miscellaneous administrative expenditure. The breakdown between the institutions of the staff receiving these payments is given in **Tables 6.2** and **6.3**. In the Commission's case, these appropriations also enable the Commission to subsidise the associations and organisations that assist in the implementation of the various aspects of the European Union's activities. Globally, the rate of utilisation (payments and carry-overs to the following financial year) of the appropriations available in 1998 (1998 appropriations and carry-overs from 1997) is relatively satisfactory (97,1 %). The rate of cancellations of appropriations is reasonable (2,9 %), given that in the end it is better to cancel unused appropriations rather than to put them to unsuitable use.

Specific appraisal within the framework of the statement of assurance

6.2. The Court's review concerned all the accounts and transactions covered by Heading 5, with particular emphasis on the payment of staff and rents and acquisitions of immovable property, the largest of these items of expenditure, as well as on the accounts of the Community Ombudsman, the management of which had not previously been examined in depth.

6.3. In the Court's opinion, the budgetary accounts and the financial statements in support of the consolidated balance sheet are, in this area, generally satisfactory, as are the legality and regularity of the underlying transactions.

Reliability of the accounts

6.4. The **revenue and expenditure accounts of the committees (ESC, COR, JOS) and the Parliament** are affected by the failure to book, as budgetary expenditure, the costs which are caused by the application of weightings ⁽¹⁾ to the portion of the salaries that the

⁽¹⁾ Taking into account the difference in the cost of living between Brussels and the country of destination of the transfer.

Table 6.1 — Administrative expenditure 1998 ⁽¹⁾ (summarised by section)

(Mio ECU)

Institutions		Available appropriations (1998 appropriations and 1997 carry-overs) ⁽²⁾	Commitments for the financial year	Payments (1998 appropriations and 1997 carry-overs)	Carry-overs to 1999	Cancellations
Parliament (I) (including the Ombudsman)	Staff	535,3	513,1	498,4	30,8	6,1
	Admin.	620,7	393,9	363,6	236,4	20,7
	Total	1 156,0	906,9	862,0	267,2	26,8
Council (II)	Staff	197,5	193,0	192,2	2,3	3,0
	Admin.	161,5	124,2	110,7	45,6	5,2
	Total	359,0	317,2	302,9	47,9	8,3
Commission (III) Part A (including the Publications Office)	Staff	2 139,0	2 009,6	1 991,9	91,4	55,7 ⁽³⁾
	Admin.	986,3	765,0	798,9	152,2	35,2
	Total	3 125,3	2 774,6	2 790,8	243,6	90,9
Court of Justice (IV)	Staff	96,8	93,1	93,5	1,9	1,4
	Admin.	28,5	25,9	24,4	3,9	0,2
	Total	125,3	119,0	118,0	5,8	1,6
Court of Auditors (V)	Staff	53,6	51,4	51,1	0,9	1,6
	Admin.	7,6	6,1	6,0	1,4	0,1
	Total	61,2	57,5	57,1	2,3	1,8
Economic and Social Committee Committee of the Regions (VI)	Staff	55,9	52,6	52,4	0,6	2,9
	Admin.	53,1	38,0	35,5	9,0	8,7
	Total	109,1	90,6	87,9	9,6	11,5
Administrative budgets total	Staff	3 078,0	2 912,7	2 879,6	127,8	70,7
	Admin.	1 857,8	1 353,1	1 339,1	448,5	70,2
	Total	4 935,8	4 265,8	4 218,6	576,3	140,9

⁽¹⁾ Under the financial perspective.⁽²⁾ Not including the transactions where revenue from the financial year was reused or that carried over from the previous financial year, or the various amounts of earmarked revenue which in 1998 gave rise to payments amounting to approximately 82,4 Mio ECU.⁽³⁾ Of which 10,3 Mio ECU of appropriations relating to salaries and allowances that had been committed but had not given rise to any payments (Article 7(1) of the Financial Regulation).

Source: Accounting tables, Volume III.

staff of these institutions transfer to their country of origin. These amounts (0,5 Mio ECU for the committees and 2,5 Mio ECU for the Parliament) ought to have been charged to the budget of these institutions, under Heading 1190. They were in fact booked, outside the budget, as exchange rate differences and have direct repercussions on the consolidated out-turn of the financial year, without ever having been charged to the general budget.

6.5. There are some booking problems affecting **the Commission's revenue and expenditure account** (Volume II) (cases of confusion between rents and acquisitions of immovable property, which are not entered in the accounts in a consistent manner), but they are not such as to undermine the reliability of the consolidated

revenue and expenditure account, which has only two expenditure headings ('Staff' and 'Administration') for each institution.

6.6. Furthermore, the Commission has forgotten to show, under cancelled appropriations, around 10 Mio ECU corresponding to appropriations relating to the salaries and allowances of members and staff. These appropriations, having been committed but not having given rise to any payment during the financial year, had not been carried forward, pursuant to Article 7(1) of the Financial Regulation, to the following financial year. They should therefore have been formally cancelled in order to avoid any ambiguity arising when the rates of budgetary implementation for this area were analysed.

Table 6.2 — Staff numbers by institution and by category of staff as at 31 December 1998

Institutions	Officials	Temporary staff	Auxiliaries	Local employees	DYE	SNO	Advisors	Total
European Parliament and the Ombudsman ⁽¹⁾	3 231	673	168	34	—	—	1	4 107
Council	2 441	18	—	—	—	—	—	2 459
Commission ⁽²⁾								
— Administration (Brussels, Luxembourg ⁽³⁾ , Strasbourg)	15 234	1 862	1 088	—	—	—	47	18 231
— Joint Research Centre ⁽⁴⁾	824	1 207	224	—	—	—	—	2 255
— Representations in the EU	257	13	3	187	—	—	—	460
— External delegations, representations and offices	605	6	—	1 699	79	9	—	2 398
Court of Justice	715	246	24	—	—	—	1	986
Court of Auditors	390	141	13	—	—	—	1	545
ESC/COR ⁽⁵⁾	633	107	51	1	—	—	1	793
Total	24 330	4 273	1 571	1 921	79	9	51	32 234

⁽¹⁾ Ombudsman: 14 temporary and 3 auxiliary staff.

⁽²⁾ Commission total: 23 344 (16 920 officials, 3 088 temporary staff, 1 315 auxiliary staff, 1 886 local employees, 79 young experts in the delegations (DYE), 9 seconded national officials (SNO) and 47 special advisers).

⁽³⁾ Including EUR-OP.

⁽⁴⁾ JRC staff and Commission staff at the JRC.

⁽⁵⁾ Economic and Social Committee/Committee of the Regions (including the joint organisational structure).

Source: The relevant institutions.

Table 6.3 — Staff numbers by institution and by place of employment as at 31 December 1998

Place of employment	European Parliament and Ombudsman ⁽¹⁾	Council	European Commission				Court of Justice	Court of Auditors	ESC/COR ⁽⁵⁾	Total
			Administration ⁽²⁾	Representations in the EU	Delegations ⁽³⁾	Research Centre ⁽⁴⁾				
Member States (headquarters)										
— Brussels	1 576	2 432	15 333	—	—	53	—	1	793	20 188
— Luxembourg	2 317	—	2 896	—	—	—	986	544	—	6 743
— Strasbourg	60	—	2	—	—	—	—	—	—	62
Member States (outside headquarters)	154	—	—	460	—	2 175	—	—	—	2 789
Total for Member States ⁽⁶⁾	4 107	2 432	18 231	460	—	2 228	986	545	793	29 782
Outside the Member States	—	27 ⁽⁷⁾	—	—	2 398	27	—	—	—	2 452
Grand total	4 107	2 459	18 231	460	2 398	2 255	986	545	793	32 234

⁽¹⁾ Ombudsman: Brussels 4, Strasbourg 13.

⁽²⁾ Including EUR-OP.

⁽³⁾ External delegations, representations and offices.

⁽⁴⁾ Brussels: 53, Ispra: 1 497, Karlsruhe: 204, Geel: 204, Petten: 170, Seville: 52, San Diego: 12, Naka: 15, Garching: 35, Culham: 5, Frascati: 8.

⁽⁵⁾ Economic and Social Committee, Committee of the Regions and joint organisational structure.

⁽⁶⁾ Member States: Belgium: 20 392, Denmark: 37, Germany: 301, Greece: 29, Spain: 107, France: 130, Ireland: 106, Italy: 1 559, Luxembourg 6 743, Netherlands: 199, Austria: 28, Portugal: 29, Finland: 26, Sweden: 26, United Kingdom: 70.

⁽⁷⁾ Outside the European Union: Geneva: 17 and New York: 10.

Source: The relevant institutions.

6.7. The **consolidated balance sheet** is suffering from the problems that are being faced by certain institutions because of the slow and still incomplete transition to a comprehensive, harmonised presentation of data on

depreciation (completed only at the Commission and the Court of Auditors), operations to acquire immovable property financed in the form of leasing (entered in the accounts as off-balance-sheet commitments at

the Parliament and the Court of Justice) and intangible assets (software). Specific problems concern the presentation of the financing of preliminary fitting-out work done in certain Commission buildings (see paragraph 6.17).

6.8. Furthermore, the **Commission's balance sheet** shows some rather questionable data as regards goods in the Commission's delegations and tangible fixed assets. The sum involved is a little more than 100 Mio ECU. This is due to the system whereby the balance sheet is drawn up outside the accounts and to variations in the know-how of the staff responsible for collating and processing the data sent to the accounting departments. Under the supervision of the Directorate-General for the Budget, which is responsible for drawing up the balance sheet, these departments need to draw up instructions and set up the monitoring procedures and checks required to safeguard the reliability of the data.

6.9. For the first time, the **off-balance-sheet commitments** include an actuarial forecast ⁽²⁾ of future costs for the pensions that will have to be paid in the years to come to staff currently employed or already in retirement. These costs are estimated at around 15 000 Mio ECU. Bearing in mind the various hypotheses on which the actuarial calculation is based, this figure realistically reflects the order of size of the commitments relating to pensions. However, given that this expenditure is going to increase sharply in the years to come, it would be useful to specify, in the explanatory note relating to this type of off-balance-sheet commitment, the foreseeable amount of the budgetary expenditure for the next five years, for example.

6.10. The off-balance-sheet commitments also give rise to certain problems as to the consistency and comparability of the data in respect of the future rents for the institutions.

Legality and regularity of the underlying transactions

6.11. The way in which the institutions organise their system of internal control for the payment of **salaries** needs to be commented on. Some of the allowances and entitlements for staff are a function of their family

circumstances and are based on information declared by the people concerned. A system that is based on declarations can only be reliable if the information that is declared is regularly updated by means of a system of unequivocal annual declarations. The system that is in force at the Commission is not adequate in this respect because it is based on a simple annual note sent to the staff concerned to remind them of their obligations, whereas in the other institutions the staff are periodically asked to confirm or declare their personal situation explicitly. The ESC and the COR should be more rigorous in applying this procedure.

6.12. In cases where persons whom officials are legally obliged to support are regarded as being equivalent to dependent children and where their maintenance entails heavy costs (just over 200 beneficiaries for all the institutions), the common rules laid down by the institutions do not always make it possible to ensure that the condition of a legal obligation to provide support is met. This condition presupposes an analysis on a case-by-case basis of the implementation of the conditions provided for in Article 2, paragraph 4, of Annex VII to the Staff Regulations. For these decisions, for which the appointing authority must provide reasons, the documents in the files give evidence of an automatic analysis according to the Community criteria, without any in-depth examination of the legal and economic situations prevailing in the countries of residence of those benefiting from this 'dependent child' equivalence.

6.13. The financial management of the institutions' **rents and acquisitions of immovable property** gives rise to many problems associated with the unsuitability of the regulatory framework, as pointed out by the Court in its Opinion No 4/97 ⁽³⁾ on the Financial Regulation. In the interests of improved economic efficiency, the institutions have developed a policy governing their acquisitions of immovable property. In the absence of any differentiated appropriations and since the rules do not offer any possibility of having recourse to borrowing, those institutions which wish to follow a policy of acquisitions of immovable property have to resort to practices that are not authorised by the current financial rules.

6.14. Thus, the European Parliament, having taken up the option to buy that it held on the building that it occupies in Brussels, has been obliged to enter on its balance sheet all the debts which it still has to repay in respect of this acquisition (530,7 Mio ECU). The Parliament is therefore in the position of being a borrower, despite the fact that borrowing is not specifically authorised by the financial regulations.

6.15. Similarly, the financing, reimbursement for and execution of fitting-out work on the premises rented by the Commission give rise to questions of

⁽²⁾ In 1997 the Commission had supplied an initial actuarial forecast, but stated that it was only provisional.

⁽³⁾ OJ C 57, 23.2.1998, paragraph 2.13.

legality/regularity and to management problems. Between 1993 and 1995, the Commission often called on its landlords to finance the fitting-out work, for a sum of about 24 Mio ECU. The corresponding costs, plus interest, are charged to the rents for one or more years. Mechanisms of this kind are analogous to borrowing operations and as such there is no authorisation for them in this field in the current financial regulations.

6.16. In effect the Commission also placed its landlords in the position of general contractor with delegated responsibility for the execution of the work and payments for it, but it did not define their assignment and did not set down the responsibilities, rights and obligations of both parties. The tendering and payment procedures employed by the landlords were unevenly supervised by the Commission and were outside the framework of the regulations that apply to budgetary expenditure. In general terms, the absence of a formalised decision-taking procedure on the question of rentals, work associated with the premises rented and the invoking of any early repayment or purchase options makes it difficult to identify clearly the responsibilities in this area.

6.17. This approach may also lead to management shortcomings. In 1998, the Commission had unused appropriations available and, as it had done in 1997 for more than 13 Mio ECU, made an early repayment of a portion of the financing referred to in paragraph 6.15 (2,3 Mio ECU). In the absence of an early repayment clause, the Commission often had to pay indemnities that were negotiated with individual landlords on terms that were sometimes unfavourable for the Community (an extreme example: one indemnity was equivalent to two and a half years' worth of interest). Outstanding commitments in this respect amounted to 5,3 Mio ECU at the end of 1998 and are not entered in the balance sheet, but are shown solely under the potential debts as off-balance-sheet commitments.

6.18. For **other expenditure** than that relating to the remuneration of staff or to rents and acquisitions of immovable property, the main observation concerns an anomaly that has already been pointed out in the past and to which the institution concerned has not yet reacted satisfactorily. Thus, the mission expenses for Parliament staff are still higher than those provided for in the regulations (general scales not suited to all the categories of staff and granting to C and D staff of expenses stipulated for A and B staff).

Other audit work concerning the administrative expenditure entered in the budget

6.19. The main audit of the institutions' administrative expenditure was carried out within the DAS framework (see paragraphs 6.1-6.18).

6.20. However, there was also an in-depth audit of the Council's expenditure on formal and other meetings. Overall, the management system for this type of expenditure is effective. It has nevertheless permitted some anomalies and departures from the rules which must be corrected or, if there is in fact justification, must lead to modification of the current rules. The Council has been informed of these observations in detail, in a letter from the President of the Court calling on it to take appropriate action.

6.21. The appraisal carried out during a similar audit of the expenditure on formal and other meetings for groups of experts at the Commission found it to be generally satisfactory. The remarks and suggestions resulting from this audit have been drawn to the attention of the Commission departments in question.

6.22. In 1998 the Court also continued with its audit of Commission delegations in non-member countries; it pointed out to the departments concerned that the wording of the framework regulations on local staff was giving rise to certain inconsistencies concerning grading, and that the level of remuneration was in some cases still over-generous in relation to local practice. It also pointed out that improvements needed to be made to the management of the sickness insurance scheme. Lastly, it also noted inadequate control over private telephone expenditure and, in some delegations, a lack of compliance with the administrative procedures relating to mission expenses or the conclusion of contracts for security and caretaking services.

6.23. The Court also followed up an earlier audit of the mission expenses, travel and other incidental expenses of Members of the Commission. The follow-up shows that the Commission has taken account of the Court's remarks by improving its internal control in this field.

6.24. At the President of the Parliament's request, the Court issued an opinion on the management of the additional pension scheme and the fund for Members of the European Parliament. This gave reasonable assurance that the accounts of the scheme are reliable. Nevertheless, the opinion draws the Parliament's attention to the need to define clearly the Parliament's role vis-à-vis the scheme, to examine the scheme's legal frame-

Table 6.4 — The Community satellite bodies: budget and staff for 1998

Name	Headquarters	Year of creation	Total expenditure (Mio ECU)	Total number of permanent posts
I. First-generation satellite bodies				
European Centre for the Development of Vocational Training (Cedefop)	Thessaloniki	1975	12,6	81
European Foundation for the Improvement of Living and Working Conditions	Dublin	1975	13,6	83
II. Second-generation satellite bodies which are not self-financing				
European Environment Agency (EEA)	Copenhagen	1990	16,9	62
European Training Foundation (ETF)	Turin	1990	15,2	130
European Monitoring Centre for Drugs and Drug Addiction (EMCDDA)	Lisbon	1993	7,3	40
European Agency for Safety and Health at Work (EASHW)	Bilbao	1995	5,0	24
European Monitoring Centre for Racism and Xenophobia	Vienna	1997	0,5	11
III. Second-generation satellite bodies which are wholly or partially self-financing				
European Agency for the Evaluation of Medicinal Products (EMA)	London	1993	27,2	184
Office for Harmonisation in the Internal Market (OHIM)	Alicante	1994	52,6	407
Community Plant Variety Office (CPVO)	Angers	1994	5,8	22
Translation Centre for Bodies of the European Union (TCBEU)	Luxembourg	1994	12,8	112
Total			169,5	1 156

work and to agree on the respective relationships and responsibilities of the Parliament's administration and the manager of the fund. This clarification should be made without delay, especially in view of the possible adoption of the proposed new statute for MEPs. Furthermore, the Court repeats its recommendation to define and quantify expenditure that may be covered and reimbursed under the general expenditure allowance ⁽⁴⁾.

AUDIT OF THE COMMUNITY SATELLITE BODIES

6.25. The annual audits of the Community satellite bodies (satellite bodies, agencies) have been the subject

⁽⁴⁾ Special Report No 10/98 concerning the expenses and allowances of the Members of the European Parliament (OJ C 243, 3.8.1998, pp. 1-15).

of separate annual reports ⁽⁵⁾, containing some comments, which will be published in the *Official Journal of the European Communities*. One of the objectives of the reports is to allow discharge to be given for the implementation of the budget.

6.26. The satellite bodies may be divided into three categories (see **Table 6.4**):

- (a) the 'first generation' of satellite bodies, whose management boards are granted discharge by the Council and the European Parliament;
- (b) the 'second generation' satellite bodies which are not self-financing and which receive a discharge from their own board of directors or management board;
- (c) the 'second generation' satellite bodies which are wholly or partly self-financing and which receive a discharge from their own management board.

⁽⁵⁾ To be published in the Official Journal.

General findings

6.27. The setting-up, organisation and effectiveness of an Advisory Committee on Procurements and Contracts (ACPC) is causing problems. In the case of the small satellite bodies in particular, it might be desirable to take more advantage of the Commission's know-how in this area. A similar form of collaboration is already in operation for some administrative expenditure which is usually managed by the Commission.

6.28. The charges for use of the services of the European Agency for the Evaluation of Medicinal Products (EMA, London), the Office for Harmonisation in the Internal Market (OHIM, Alicante) and the Community Plant Variety Office (CPVO, Angers) are set by the Council. It might be necessary to set up an analytical accounting system in these agencies in order to identify the

costs of the services provided and, if appropriate, to adjust the charges accordingly.

AUDIT OF THE EUROPEAN SCHOOLS

6.29. The audit of the European Schools is the subject of a separate annual report which is sent to the Board of Governors of the European Schools. The management for the financial year 1998 does not call for particular comment.

REPLIES OF THE EUROPEAN PARLIAMENT

6.5. In the 2000 budgetary procedure, Parliament has taken action on the Court's observation by requesting the appropriations required to enable the expenditure relating to weights under Article 17 of Annex VII to the Staff Regulations to be charged to the budget.

6.7. This observation should be answered by the Commission, which draws up the consolidated balance sheet pursuant to Article 81(1) of the Financial Regulation.

6.10. The Commission is the competent body to reply to this point.

6.12. Under Article 2(4) of Annex VII to the Staff Regulations, the dependent child allowance may be granted in respect of persons treated as dependent children, provided that:

- the official or other servant of Parliament applying for the allowance has a legal responsibility to maintain the person to be treated as a dependent child for the purposes of the application; and
- maintenance of that person involves 'heavy expenditure' for the official or other servant.

As regards the second condition set out above, the relevant general implementing provisions require the expenditure to be calculated in detail.

Regarding the 'legal responsibility to maintain' a person in the category in question, each case is considered according to its individual merits. The applicable law is determined on the basis of the following criteria:

- nationality of the official and/or other servant;
- nationality of the person to be treated as a dependent child;
- country of residence of the official and/or other servant;
- country of residence of the person to be treated as a dependent child.

Depending on the law applicable, the maintenance obligation either arises automatically when the legal conditions are satisfied or is subject to a court ruling.

Since its experience dates back over a number of years, the Administration is naturally familiar with the law applicable to these matters in most European countries where legal responsibility for maintenance could extend to persons other than those expressly referred to in Article 2(2) of Annex VII to the Staff Regulations. Should there be so much as the slightest doubt on that point, the appropriate department consults a legal expert sufficiently well versed in the law of the country in question.

Having determined what law applies in the light of the criteria listed above, the administration then ascertains either that the mandatory conditions have been met in accordance with that law or that the necessary court ruling has been handed down.

In this way, whenever an application is made for a person to be treated as a dependent child, Parliament's departments thoroughly investigate the legal and economic circumstances submitted for their consideration. They will continue to employ the method advocated by the Court.

6.13. Given that the rules are inappropriate for their purpose, as the Court has repeatedly pointed out, the institutions may make use of indirect financing.

Following the guidelines given by the Council and the Commission departments concerned, Parliament has taken care not to enter into any direct contractual relationship with banks.

Now that Parliament has exercised its option to purchase the buildings in the Espace Léopold complex, its creditor, Société Forum Léopold, observing the law applicable to the contract, has disposed of its claim as regards the payments owed by Parliament by assigning it to a bank syndicate and informed Parliament that it has taken this action. That being the case, Parliament cannot be viewed as a direct borrower.

6.18. The arrangements applied by Parliament to pay travel expenses and allowances are in line with the Bureau decision of 15 May 1992 based on Annex VII to the Staff Regulations.

Most of the disparities noted by the Court have now been eliminated. Parliament is implementing Council Regulation (EC, ECSC, Euratom) No 620/1999 of 22 March 1999 (OJ L 78, 24.3.1999) adjusting the rates provided for in Article 13 of Annex VII to the Staff Regulations of officials. The new rates correspond to the rates already in force in Parliament.

Furthermore, the Commission has set up a working party to conduct an in-depth study of the method for calculating mission expenses.

At Parliament, as has already been pointed out in the past, officials in categories C and D are treated in the same way as those in the A4 to B range on account of the special difficulties with which Parliament has to contend because its departments are scattered over three main working places and a great many meetings are held outside those three working places.

Parliament's Bureau has set in train a discussion process on administrative practice with regard to staff missions which ought to culminate in reforms before the end of the current financial year.

6.24. The College of Quaestors has been considering the recommendations put forward by the Court in its opinion on the pension fund. It has instructed one of its members to submit proposals with a view to complying with the Court's observations. The Bureau will later be called upon to take a decision on the Quaestors' recommendations.

6.24. To comply with the observations put forward by the Court in its Special Report No 10/98 concerning the expenses and allowances of the Members of the European Parliament ⁽¹⁾, the Bureau decision of 3 May 1999 has specified the expenditure incurred in Member States that may be covered by the allowance referred to above.

The amended Article 13 of the Rules governing the payment of expenses and allowances to Members also states that the allowance 'may not be used to cover personal expenses or to finance subsidies or gifts of a political nature'.

⁽¹⁾ OJ C 243, 3.8.1998, p. 1.

REPLIES OF THE COUNCIL*Fixed assets*

6.7. *The General Secretariat of the Council is currently making every effort to find a rapid solution to the problem of fixed assets, and in particular calculation of the amount of depreciation, by means of the new ELS software developed by the Commission; the essential training in its use will be completed shortly.*

country of residence of the person for whom such treatment is sought. The economic situation of that person is also checked on the basis of supporting documents. The Administration informs the Appointing Authority of its findings by means of a note in the file. In future, the factors considered will be specifically mentioned in the decisions adopted by the Appointing Authority.

Persons treated as dependent children

6.12. *With regard to the comments on staff expenditure and, in particular, on the treatment as a dependent child of any person whom an official has a legal responsibility to maintain, the General Secretariat would point out that it applies the provisions of Article 2(4) of Annex VII to the Staff Regulations with due regard, in each case, for the laws on legal responsibility for maintenance which obtain in the*

Expenditure on holding and convening meetings

6.20. *The comments in the letter from the President of the Court of Auditors have been brought to the Council's attention by the Budget Committee. The Committee instructed the Secretariat to draft the reply sent under cover of a letter dated 17 September 1999. The letter identifies a number of measures taken in 1996 and 1997 which began to bear fruit in the 1998 financial year and should substantially reduce the anomalies noted.*

COMMISSION REPLY

AUDIT OF THE INSTITUTIONS' ADMINISTRATIVE EXPENDITURE

Specific appraisal within the framework of the Statement of Assurance

Reliability of the accounts

6.5. The Commission books the ground rents to which the Court's observation refers as rents as long as the option to purchase is still open. To eliminate any confusion, this has been spelled out in the title of the budgetary article concerned in the 1999 budget (A-200 — Rent and ground rent).

6.6. The Court is correct in its observation as regards the cancelling of unused appropriations relating to the salaries and allowances of members and staff. The Commission undertakes to consider the best procedure to follow to make sure that the figures concerned are properly entered in the revenue and expenditure account.

6.7. The Commission shares the Court's view and will urge the other institutions, as it has already done at the close of the last two years, to make sure that the data are presented in a comprehensive, harmonised manner in the consolidated balance sheet.

6.8. The Commission acknowledges that the financial data in the balance sheet concerning the tangible assets in its delegations ought to be more detailed. When the balance sheet is drawn up on 31 December 1999, the figures for land and buildings and current fixed assets will be reviewed. As regards the movables in the delegations, the Commission has drawn up a work programme designed to ensure that, after a test period in a number of pilot delegations, new rules for the making of inventories in the external delegations can be introduced in all of them by the end of 2000.

To guarantee that the data on tangible and intangible assets in the balance sheet are reliable and harmonised, the Directorates-General for the Budget and for Administration and Personnel are drafting a proposal for amendments to the rules on making inventories. The rules will be split into two parts, with all the accounting rules in part one and the management rules in part two.

6.10. The Commission will give the other institutions clear and precise instructions to ensure that the data in off-balance-sheet commitments relating to future rents are comprehensive and harmonised with the Commission's data.

Legality and regularity of the underlying transactions

6.11. The Commission agrees with the Court that a system for checking staff entitlements based on a mechanism involving annual declarations would in principle be more reliable than the present system.

In practice, however, thought will have to be given to how this could be done and how long it would take to set up.

6.12. Article 2(4) of Annex VII to the Staff Regulations provides that any person whom an official has a legal responsibility to maintain and whose maintenance involves heavy expenditure may, exceptionally, be treated as if he were a dependent child by special reasoned decision of the appointing authority, based on supporting documents.

Article 2 of the General Implementing Provisions says that legal responsibility for maintenance means the obligation between relatives by blood or marriage expressly laid down by the law, to the exclusion of any obligation of a contractual, moral or compensatory nature.

When the Commission's headquarters departments receive an application, they first check whether the national law applicable in the case concerned imposes on the official legal responsibility for maintaining the family member whom the official is applying to have treated as if he or she were a dependent child. They then look at the economic and financial situation, on the basis of the documents which the General Implementing Provisions require the official to submit with the application.

6.13, 6.15–6.17. The Commission refunds to the owner, in the form of rents or annual charges, the cost of any fitting-out which he has carried out in a building rented (or rented with an option to purchase) by the Commission before the Commission moves into the premises. In proceeding in this way, the Commission is acting under the following operational constraints:

- before they are occupied, buildings have to be fitted out to suit the Commission's particular requirements (partitioning, cabling, telecommunications facilities) to short deadlines (three to six months at the most);
- the Commission has to keep down the number of its own staff involved in fitting out buildings;
- the budgetary impact of the fitting-out work (roughly one year of rent) has to be absorbed.

This practice is a cross between the two possible approaches to financing such work, which are as follows:

- (a) either the Commission rents (or rents with the option to purchase) a building fitted out to its requirements at the most advantageous rent available, in which case the work is done by the owner (or vendor) in his own name and on his own account and the VAT is payable by him and therefore reflected in the amount charged in rent;
- (b) or the Commission rents (or rents with the option to purchase) a building which is not fitted out and then does the fitting-out work, or has it done, itself, in which case the Commission is directly or indirectly the developer and is therefore exempt from VAT; the work is paid for out of the appropriations for the year in which the contract is signed.

In its current practice, which as regards the principle goes for option (a), i.e. renting fitted-out buildings, the Commission has sought to maximise the advantages available under option (b), in particular:

- carrying out the operation concerned at the lowest possible cost compared with the alternatives referred to above;
- retaining a degree of control over the carrying out of the work and its cost;
- enjoying exemption from VAT on the cost of the work as reflected in the rent charged;
- spreading out the cost of the work over a number of years.

The Commission has in any case made some early repayments; these repayments either had a lower budget cost than payment by instalments or served to reduce future expenditure, and they were made by means of transfers granted by the budgetary authority in 1997 and by internal transfer in 1998.

Opting for (b) would mean having to wait much longer between signing a lease and actually moving into the building when all the work was satisfactorily completed. While the time it takes under the present practice is from three to six months (during which time no rent is payable), this would go up to 12 to 15 months if the Commission, as the developer, put the work out to tender itself or had it done by its authorised representative.

This would be impractical in operational terms and would also entail substantial extra costs to the budget (payment of rent for an unoccupied building, consultancy and advisory fees and the cost of the human resources assigned to the development functions) which would greatly exceed the savings in VAT on the cost of the work which would be achieved using option (b).

The Commission would point out that making single payments for the fitting-out of a building prior to occupation — about a year's rent in each case, for a useful life of between 10 and 30 years — would make for considerable fluctuations in the demand for appropriations from year to year. It would be impossible to justify such fluctuations to the budgetary authority in the present financial circumstances.

For these reasons, and relying on the exemption provisions in the Financial Regulation (Article 58(1) of the Financial Regulation of 21 December 1977) and Article 1(a)(iii) of Title I of Council Directive 92/50/EEC of 18 June 1992, the Commission has opted for the approach described above.

In response to the Court's observations, the Commission undertakes, when implementing the 2000 budget, to adopt an unambiguously worded form of contract which provides that fitting-out must from now on be done by the owner or lessor in his own name and on his own account. The contract will take particular care to avoid using tables of repayments for fitting-out work of which the form in itself suggests a borrowing operation, when such tables are merely a method of calculating how much of the rent is intended to recoup the cost of the fitting out.

By wording its contracts in this way, the Commission will commit itself contractually only to an overall price for a fitted-out building.

The Commission regrets that, in view of the constraints referred to above and having regard to the Court's observations, it finds itself compelled to adopt a less transparent cost structure — because all the financial components of the contract (rent and fitting out) are aggregated into a single figure for the rent — and to bear an additional cost to the budget because, among other things, of having to pay VAT.

Lastly, the Commission shares the Court's feeling that the existing regulatory framework (non-differentiated appropriations and the inability to borrow) is not the ideal context in which to develop capital transactions which a proper policy on immovable property would entail.

Other audit work concerning the administrative expenditure entered in the budget

6.21. Cost of meetings

The Commission notes the Court's observations and will take its suggestions into account, notably when it is overhauling the rules.

6.22. Delegations in non-member countries

Concerning the wording of the framework regulations on local staff, the Commission, as frequently happens in administrative law, has been concerned to ensure that local staff in service retain the rights they held under their previous contractual arrangements.

Concerning keeping the level of local staff remuneration within reasonable limits, the Commission is still trying to establish a more detailed methodology and introduce further standardisation of the criteria for comparison.

Those aspects of the supplementary sickness insurance scheme for local staff which need to be improved and made clearer have been noted and changes will be made as appropriate.

Concerning control over private telephone expenditure, the Commission, as budgetary resources permit, is pushing ahead

with installing computerised telephone number identification software in all the delegations, provided the switchboards can be adapted and the system can be maintained locally.

Staff have been reminded that they must comply with the administrative procedures relating to mission expenses — responsibility for this has now been devolved to the heads of delegation — and thorough checks for compliance are made when the imprest accounts are analysed ex post.

Delegations will be reminded that they must comply with the rules for the conclusion of contracts for security and caretaking services, except in cases of force majeure such as a state of war or civil commotion.

AUDIT OF THE COMMUNITY SATELLITE BODIES

General findings

6.27. Advisory Committee on Procurements and Contracts

As the Court of Auditors points out, authorising departments sometimes consult the chair of the Commission ACPC and its secretariat on their draft calls for bids. Such consultations often take place, on a voluntary basis, with certain agencies which wish to draw on the Commission's experience and know-how in the areas concerned. The Commission would be prepared in future to consider ways and means of stepping up cooperation with such agencies.

6.28. Partly self-financing satellite bodies

Two of the agencies (the EMEA in London and the OHIM in Alicante) have already started working on setting up an analytical accounting system. The Commission agrees with the Court that such a system needs to be set up in the agencies. Discussions are continuing between the Commission and the Community satellite bodies concerned.

AUDIT OF THE EUROPEAN SCHOOLS

6.29. Management of the European Schools

The Court of Auditors' observations do not call for comment by the Commission.

REPLIES OF THE COURT OF JUSTICE

RELIABILITY OF THE ACCOUNTS

6.7. Consolidated balance sheet

Data on depreciation

The Court notes, first of all, that the rules relating to inventories of the assets of the institutions of the European Communities have not yet been drawn up.

Moreover, Article 70a of Council Regulation No 2548/98 of 23 November 1998 amending the Financial Regulation gives no further details in that regard, since it provides as follows: 'The rules for the entry in the accounts of the depreciation of assets and the rules for writing down the value of assets and for constituting provisions shall be determined by the implementing rules provided for in Article 139'. As it is, those rules have not themselves since been adapted.

Nevertheless, depreciation forms an integral part of the computerisation of the management of the inventory of the Court of Justice.

Two factors have delayed the installation of such an application in the Court. The first has been the need to evacuate the main Court building on account of its contamination by asbestos, which has necessitated a large-scale move. That move has prevented the stable inventory situation which such an operation demands.

The second factor which has prevented the implementation of that project is the straitened budgetary circumstances facing the Court this year. The application will become operational during the course of the first quarter of 2000.

Acquisitions of immovable property financed in the form of leasing

The Court of Justice has signed an Agreement with the Luxembourg Government, Article 8.4 of which provides that ownership of the buildings is not to be transferred to the European Communities until the entire purchase price has been paid. Until then, the Court is to be regarded as the lessee of the buildings (see Articles 1 and 11 to 14 of the Agreement).

The Court is naturally conscious of the fact that the subject-matter of the Agreement is the future purchase of the buildings, and that the rents paid are to be regarded as advance payments (Article 8.1). The Court is willing to revise the presentation of the capitalised value of its buildings in order to bring it into line with that of the other institutions.

LEGALITY AND REGULARITY OF THE UNDERLYING TRANSACTIONS

6.12. Persons regarded as equivalent to dependent children

Articles 2 to 4 of the General Implementing Rules adopted by the Court of Justice for the application of Article 2(4) of Annex VII to the Staff Regulations lay down the rules for establishing the existence of a legal responsibility on the part of an official to maintain a person who is to be regarded as equivalent to a dependent child; if the conditions prescribed are not fulfilled, the person in question cannot be regarded as dependent.

Thus, whenever a request is made in that regard to the Court of Justice, it carries out an in-depth investigation of the matter on a case-by-case basis, in the light of the law applicable to the applicant, to the person to be treated as dependent and to any other persons who may be involved in the maintenance of the latter, in order to ensure that the applicable conditions are fulfilled.

If they are, the request is then examined in the light of the very comprehensive documentation to be provided by the official with regard to the financial situation of all persons concerned, with a view to establishing whether the maintenance of the person to be treated as a dependent involves heavy expenditure by the official concerned, as defined by Article 9 of the General Implementing Rules. A decision is taken by the appointing authority, and subsequently approved by the Financial Controller, on the basis of a complete file and in accordance with the various calculation criteria establishing the existence of the heavy expenditure commitment. The file note drawn up sets out in express terms the reasons for the decision of the appointing authority.

As to the final observation by the Court of Auditors, Article 8 of the General Implementing Rules provides that the economic situation prevailing in the country of residence of the person to be treated as equivalent to a dependent child is to be taken into consideration. The weighting fixed for the country of employment of the official concerned, or the country of residence of any other persons involved, is applicable to all amounts considered in the context of the examination described in the preceding paragraph.

REPLIES OF THE COURT OF AUDITORS

6.12. *On 22 May 1997 the Court of Auditors adopted its general implementing provisions (GIP) in respect of Article 2(4) of Annex VII to the Staff Regulations. These GIP have*

been agreed by the institutions, which have all adopted the same legislation.

REPLIES OF THE ECONOMIC AND SOCIAL COMMITTEE AND
OF THE COMMITTEE OF THE REGIONS

Weighting

6.5. *The ESC and COR recognise the erroneous treatment in the accounts of costs arising from application of the weighting in the past.*

Immediately after this irregularity was noted by the departments of the ESC and COR at the beginning of 1999 (and before the Court's checks on 1998), the ESC and COR took the following steps:

(a) *since there has been no exchange difference for transactions within the euro zone since 1 January 1999, expenditure on transfers to the country of origin within the euro zone in 1999 will have to be covered by budget line 1190. The necessary appropriations will be transferred from other budget lines on which economies are possible.*

Transfers to 'pre-in' countries in 1999 will be recorded, as in the past, in the off-budget 462 account (exchange difference);

(b) *for 2000, the overall sum for the funding of all transfers to the country of origin is included in the draft budget.*

Depreciation

6.7. *The method to be used for the exhaustive and harmonised presentation of depreciation data will be discussed at interinstitutional level by the accountants. The conclusions drawn from this discussion will be implemented by the ESC and COR.*

Staff allowances and rights

6.11. *The Court's conclusion refers to the procedure followed in 1998 concerning verification of individual rights to a household allowance in cases where there is no dependent child (25 cases recorded).*

Normally, the administration sends out a memo each year to staff claiming this right asking them for an explicit declaration of their personal circumstances. So, this is a case of annual declaration machinery. However, due to an omission, such a check was not carried out in 1998. Nevertheless, the annual check for 1999, which was carried out by the administration of the two committees before the investigation of the Court of Auditors under the SOA did not reveal any irregular payments in 1998.

It should be emphasised that the internal monitoring system of the ESC and COR is comparable with the systems used in most of the other institutions, but through an omission it was not applied correctly in 1998. The ESC and COR will apply this procedure scrupulously from now on.

Treatment as a dependent child

6.12. *The ESC and COR share the Court's point of view: the general implementing provision of Article 2(4) of Annex VII to the Staff Regulations (treatment as a dependent child) can be improved. Since these rules are harmonised for application by all the institutions, this matter will be raised at the next meeting of the heads of administration.*

CHAPTER 7 (*)

Financial instruments and banking activities

7.0. CONTENTS	Paragraph reference
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(*) The Commission's replies are on page 165.

GUARANTEE FUND

Introduction

7.1. Following the Edinburgh European Council's decision to set up the fund in December 1992, the Guarantee Fund for External Actions was established on 31 October 1994 by Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 ⁽¹⁾. The Fund reimburses the Community's creditors if the beneficiary of a loan granted or guaranteed by the Community to or in a third country defaults. If the beneficiary is still in default three months after the date on which payment was due, resources from the Fund take over from the Community cash resources that have been used to service the loan in the meantime.

Situation and development of the Fund

7.2. Since the Guarantee Fund was set up, it has received budget payments totalling 1 338,3 Mio ECU as at 31 December 1998. Calls on the resources of the Fund in its role as guarantor amounted to 425,3 Mio ECU (including 13,6 Mio ECU of default interest) and late recoveries from defaulting debtors accounted for 321,7 Mio ECU (including 38,8 Mio ECU of default interest) (see **Table 7.1**).

⁽¹⁾ OJ L 293, 12.11.1994, p.1.

7.3. As of 31 December 1998 the balance of defaults was 162 Mio ECU, broken down as follows (see **Table 7.2**):

- (a) 72,4 Mio ECU (including 9,2 Mio ECU of default interest) for the 1 250 Mio ECU loan granted in December 1991 to finance the importation of food-stuffs and agricultural products, as well as medicines, by the republics of the former Soviet Union;
- (b) the remainder, 89,6 Mio ECU (including 24 Mio ECU of default interest), for the loans to an authorised total of 760 Mio ECU granted between 1976 and 1987 by the EIB, with a Community guarantee, to the countries of former Yugoslavia.

7.4. The ratio of the Fund's liquid assets to its outstanding capital liabilities for loans and loan guarantees for third countries, plus unpaid interest due, has continued to rise year on year and reached 13 % at the end of 1998. The ratio had already exceeded the target

Table 7.1 — Operations and situation of the Guarantee Fund

(Mio ECU)

Financial year	Payments ⁽¹⁾	Activation of guarantees ⁽²⁾	Late repayments	Result ⁽³⁾	Repayments to budget	Total Fund resources at 31 December	Total guarantee outstanding ⁽⁷⁾	Coverage (%)
1994	293,72	—	—	0,47	—	294,19	6 017	4,9
1995	250,75	(303,07)	35,63	23,35	—	300,85	5 882	5,1
1996	235,39	(52,54)	55,72	17,99	—	557,41 ⁽⁴⁾	6 715	8,3
1997	286,10	(54,29)	45,03	27,54	—	861,79 ⁽⁵⁾	7 960	10,8
1998	272,38	(15,41)	185,3	42,60	66,00	1 280,66 ⁽⁶⁾	9 834	13,0
Total	1 338,34	(425,31)	321,68	111,95	66,00			

⁽¹⁾ Payments to the Guarantee Fund pursuant to Regulation No 2728/94 of 31.10.1994.⁽²⁾ The Guarantee Fund has been activated since January 1995 to reimburse defaults.⁽³⁾ The result is the difference between the interest on the Fund's deposits and the management fees levied by the EIB.⁽⁴⁾ After deduction of EIB fees not paid at 31.12.1996, namely 0,10 Mio ECU.⁽⁵⁾ After deduction of EIB fees not paid at 31.12.1997, namely 0,32 Mio ECU.⁽⁶⁾ After deduction of EIB fees not paid at 31.12.1998, namely 0,51 Mio ECU.⁽⁷⁾ Including default interest incurred but not paid at 31 December.

Source: Commission.

Table 7.2 — Cumulative total of operations since the creation of the Guarantee Fund and default situation as at 31.12.1998

(Mio ECU)

Country	Calls on Fund			Recovered by Fund			Balance of defaults		
	Capital	Interest	Default interest	Capital	Interest	Default interest	Capital	Interest	Default interest ⁽¹⁾
	(1)	(2)		(3)	(4)		(5) = (1) - (3)	(6) = (2) - (4)	
Armenia	57,6		0,9	57,6		9,3			
Georgia	113,3	14,9	2,1	113,3	14,9	17,0			
Kazakhstan		1,6			1,6				
Kyrgyzstan		0,7			0,7				
Tajikistan	54,5	8,7	1,3			3,0	54,5	8,7	9,2
Turkmenistan	44,9	1,0	0,8	44,9	1,0	2,7			
Ukraine	31,9		1,0	31,9		1,5			
Subtotal I	302,2	26,9	6,1	247,7	18,2	33,5	54,5	8,7	9,2
Former Yugoslavia	30,1	52,5	7,5	4,7	12,3	5,3	25,4	40,2	24,0
Subtotal II	332,3	79,4	13,6	252,4	30,5	38,8	79,9	48,9	33,2
Total		425,3			321,7			162,0	

⁽¹⁾ This column includes interest accrued between the date of the call on the Fund and the close of the financial year; comparison of the three 'default interest' columns is thus not possible.

Source: Commission.

amount ⁽²⁾ of 10 % last year, reaching 10,8 % at 31 December 1997, with the result that 66 Mio ECU was returned to the budget in March 1998.

7.5. The amount returned was shown under costs on the profit and loss account. It was thus charged against the net result for the year ⁽³⁾. The 66 Mio ECU returned to the budget should, however, have been debited to Guarantee Fund — Payments from the budget, under liabilities on the Fund's balance sheet, without affecting the profit and loss account. The net result for the year should have been a profit of 55,4 Mio ECU ⁽⁴⁾ instead of a deficit of 10,6 Mio ECU. Entering the amount returned to the budget against costs is contrary to the true and fair principle and also generates a loss artificially, without any real foundation. The effect of this is likely to be even more substantial in 1999, because for the 1998 financial year the amount returned to the budget is around 297,8 Mio ECU.

7.6. As regards the operation of the Fund, the Commission has proposed reviewing some provisions of the Fund Regulation within the Agenda 2000 framework:

- (a) amending Article 3 to reduce the target amount for the Fund from 10 to 8 % of the total outstanding capital liabilities;
- (b) amending Article 4 so that the payments to the Fund are equivalent to not more than 6 % of the capital value of the new operations underwritten and covered by the Fund, instead of the present 14 % ⁽⁵⁾. This rate could, however, be increased to

⁽²⁾ Article 3 of the regulation states, 'The Fund shall rise to an appropriate level, hereinafter referred to as "the target amount". The target amount shall be 10 % of the Community's total outstanding capital liabilities arising from each operation, increased by unpaid interest due. If, at the end of a year, the target amount is exceeded, the surplus shall be paid back to a special heading in the statement of revenue in the general budget of the European Communities'.

⁽³⁾ The result is the difference between the interest earned on the Fund's deposits and the management charges levied by the EIB.

⁽⁴⁾ This profit of ECU 55,4 Mio represents the sum of the result for the year (ECU 42,6 Mio) plus the default interest charged on late recoveries (ECU 12,8 Mio).

⁽⁵⁾ Article 4 of the regulation states, 'The payments ... shall be equivalent to 14 % of the capital value of the operations until the Fund reaches the target amount'.

7 %, instead of 15 % ⁽⁶⁾, if resources in the Fund fall below 75 % of the target amount as the result of defaults.

7.7. The Court has set out its observations and comments on this proposal in Opinion No 10/98 ⁽⁷⁾ concerning certain Agenda 2000 proposals. In the Court's view, the Commission's assumption, that the sum total of defaults will remain at 315 Mio ECU throughout the period 1999–2006, is rather unrealistic, since that total had already been reached by 31 December 1997 and, according to the Commission's forecasts, total outstanding capital liabilities were expected to rise from 7 960 Mio ECU at the end of 1997 to 25 298 Mio ECU at the end of 2006.

7.8. Finally, the political agreement reached in the Council on 1 December 1998 ⁽⁸⁾ set at 9 % the target amount for total outstanding capital liabilities and payments to the Fund, but with the possibility of increasing the provisioning rate to 10 % for new operations when the Fund's resources are below 75 % of the target amount.

Audit of the Fund

7.9. The Court audited the Fund for the financial year ended 31 December 1998, at the Commission as regards the administrative management and at the EIB for the financial management delegated to the latter by the Commission ⁽⁹⁾, which pays it an annual commission of 0,05 % ⁽¹⁰⁾ of the Fund's average monthly assets. With the exception of the observation set out in paragraph 7.5, the audit did not reveal any matter that required particular comment.

⁽⁶⁾ Article 5 of the regulation states, 'If, as a result of the activation of guarantees following default, resources in the Fund stand below 75 % of the target amount, the rate of provisioning on new operations shall be raised to 15 % until the target amount has once more been reached or, if the default occurs before the target amount is reached, until the amount drawn under the activation of the guarantee has been fully restored'.

⁽⁷⁾ OJ C 401, 22.12.1998, p.44.

⁽⁸⁾ Doc. Council 8155/99, 11 May 1999.

⁽⁹⁾ Article 6 of the regulation states, 'The Commission shall entrust the financial management of the Fund to the EIB under a brief on the Community's behalf'.

⁽¹⁰⁾ The rate of remuneration to the EIB was reduced from 0,125 to 0,05 % in September 1996 with retrospective effect to 31 December 1994.

EUROPEAN INVESTMENT FUND

7.10. The Community subscribed 600 Mio ECU, corresponding to 30 %, of the authorised capital of the European Investment Fund (EIF) and 120 Mio ECU, or 20 %, of the capital subscribed by the Community was paid in instalments of 30 Mio ECU from 1994 to 1997. Other payments to the EIF totalling 75 Mio ECU were made between 1995 and 1998 with a view to their management under a mandate from and for the account of the Commission.

*Management of budgetary resources***Measures managed by the EIF under a mandate from and for the account of the Commission**

7.11. The Commission has so far delegated the management of three Community measures to the EIF, namely, the pilot project growth and environment, the European technology facility start-up and the SME guarantee facility, the latter two being part of the technological facility for SMEs. A total of 25 Mio ECU was transferred to the EIF in years 1995 to 1997 for the growth and environment pilot project. In 1998 50 Mio ECU was transferred by way of the technological facility for SMEs. For the years 1999 to 2001 an additional amount of 168 Mio ECU is being provided under the heading of the technological facility for SMEs, bringing the total budgetary resources under management to 243 Mio ECU (see **Table 7.3**).

Pilot project 'growth and environment'*Introduction*

7.12. The growth and environment pilot project was created in 1995 as an initiative of the European Parliament⁽¹¹⁾, acting on the basis of a proposal from the Committee for Economic and Monetary Affairs. The initiative took the form of a pilot project not representing a 'significant action', meaning that under Article 22(1) of the Financial Regulation it did not require a legal basis other than the budget.

7.13. The objective of the project is to facilitate access for small and medium-sized enterprises (SMEs) to bank financing for new environmental investments. The

⁽¹¹⁾ Parliament amendment No 0233 to the draft Community budget for 1995 (OJ C 18, 23.1.1995, p. 317).

scheme provides for guarantees on financing granted by financial institutions (mainly banks) in the Member States, up to 50 % of such finance. Under this scheme, the Commission provides subsidies designated primarily to cover premiums for guarantees and costs to promote the scheme.

7.14. In accordance with the Commission decision of 19 June 1995, the implementation of the scheme was delegated to EIF⁽¹²⁾. Their mandate includes, *inter alia*, the following tasks:

- (a) providing EIF guarantees;
- (b) concluding guarantee agreements with financial intermediaries⁽¹³⁾;
- (c) verifying the eligibility criteria of the financing;
- (d) administering the budgetary contributions made by the Community on a trust account held by EIF.

7.15. The communication related to the aforementioned Commission decision of June 1995 says that 'the growth and environment initiative constitutes an opportunity for the EIF to demonstrate its potential as a source of loan guarantees for small firms. This would contribute to the positioning of the Fund as a powerful instrument of Community support in favour of small firms.' Thus, the scheme was also meant to enable EIF to obtain experience in setting up guarantee operations for SMEs.

*Execution of the 'growth and environment' pilot project**Budgetary management*

7.16. Initially, the budget for this project, as it was introduced by a Parliamentary amendment to the 1995 draft budget, amounted to 5 Mio ECU of commitment appropriations, with payment appropriations of 4 Mio ECU for 1995 and 1 Mio ECU for 1996. As is shown in **Table 7.4**, the amount of appropriations was increased during the years 1995-97 to become 25 Mio ECU.

⁽¹²⁾ Agreement between the Commission and EIF signed on 6 December 1995.

⁽¹³⁾ The financial intermediaries were selected on the basis of a call for expression of interest (OJ C 177, 12.7.1995), and on the basis of a second call for expression of interest in 1997.

Table 7.3 — Measures managed by the EIF under a mandate from and for the account of the Community

(1 000 ECU)

Heading	Budget item	1995 ⁽¹⁾			1996 ⁽¹⁾			1997 ⁽¹⁾			1998 ⁽¹⁾			Total payments end 1998	1999 ⁽¹⁾		2000 ⁽²⁾		2001 ⁽²⁾		Following years ⁽²⁾		Total budget 1995–2001	
		Appr. com.	Appr. pay.	Pay.	Appr. com.	Appr. pay.	Pay.	Appr. com.	Appr. pay.	Pay.	Appr. com.	Appr. pay.	Pay.		Appr. com.	Appr. pay.	Appr. com.	Appr. pay.	Appr. com.	Appr. pay.	Appr. com.	Appr. pay.	Appr. com.	Appr. pay.
1. Growth and environment	B5-323	9 000	6 000	6 000	12 500	11 500	11 500	5 000	7 500	7 500	-1 500	—	—	25 000	—	—	—	—	—	—	—	—	25 000	25 000
2. Technological facility — start-up	B5-510	—	—	—	—	—	—	—	—	—	—	—	25 000	25 000	118 000	70 000	118 000	35 000	—	73 000	—	108 000	336 000	336 000
3. SME guarantee facility		—	—	—	—	—	—	—	—	—	—	—	25 000	25 000										
Total													75 000										361 000	361 000

⁽¹⁾ Source: Commission, budgets and revenue and expenditure accounts.⁽²⁾ Source: Commission, draft budget for 2000.

Table 7.4 — Budgetary progress of 'Growth and environment' pilot project

(1 000 ECU)

Heading	1995		1996		1997		1998		Total	
	Commitments	Payments	Commitments	Payments	Commitments	Payments	Commitments	Payments	Commitments	Payments
Initial budget	5 000	4 000	5 000	4 000	5 000	9 000	—	—	15 000	17 000
Suppl./Amend. budget	4 000	2 000	—	—	—	—	—	—	4 000	2 000
Transfers	—	—	7 500 ⁽¹⁾	7 500	—	-1 500	—	—	7 500	6 000
Cancellations	—	—	—	—	—	—	-1 500	—	-1 500	—
Total available appropriations	9 000	6 000	12 500	11 500	5 000	7 500	-1 500	—	25 000	25 000
Budget out-turn	9 000	6 000	12 500	11 500	5 000	7 500	-1 500	—	25 000	25 000
Implementation rate (%)	100	100	100	100	100	100	100	—	100	100
Use of Funds by EIF		—		—		32		895		928
(%)		0		0		0,43		—		3,71

(¹) From item B5-222, 'Growth and employment', i.e. the temporary mechanism for SMEs also known as the Copenhagen facility, managed by the EIB under mandate from and for the account of the Commission.

Source: Commission.

7.17. As shown in **Chart 7.1**, the absorption of the scheme developed very slowly. By the end of 1998 the allocated guarantee premiums totalled 1.2 Mio ECU, which is 4,8 % of the total envelope of 25 Mio ECU. The cumulative payments made up till 31 December 1998 totalled 928 000 ECU, which corresponds to 3,7 %.

7.18. Transfers were made from 1995 to 1997 into an account held by EIF on behalf of the Community. These payments were treated as instalments and were therefore recorded as final expenditure in the Commission's budget accounts. Even though most of these sums were still unused as at 31 December 1998, the budget accounts show full utilisation.

7.19. The time lag between the budget transfers and the actual use of the funds disrupts the annuality and the transparency of the budget accounts. At the same time, although the balance of the account held by EIF on behalf of the Community represents a financial claim for the Community and a liability for EIF, it does not appear on the Community's balance sheet. It does, however, appear on EIF's balance sheet. Furthermore, the interest accrued to this account, in total ECU 2 Mio up to the end of 1998, was not recorded as revenue in the Community accounts.

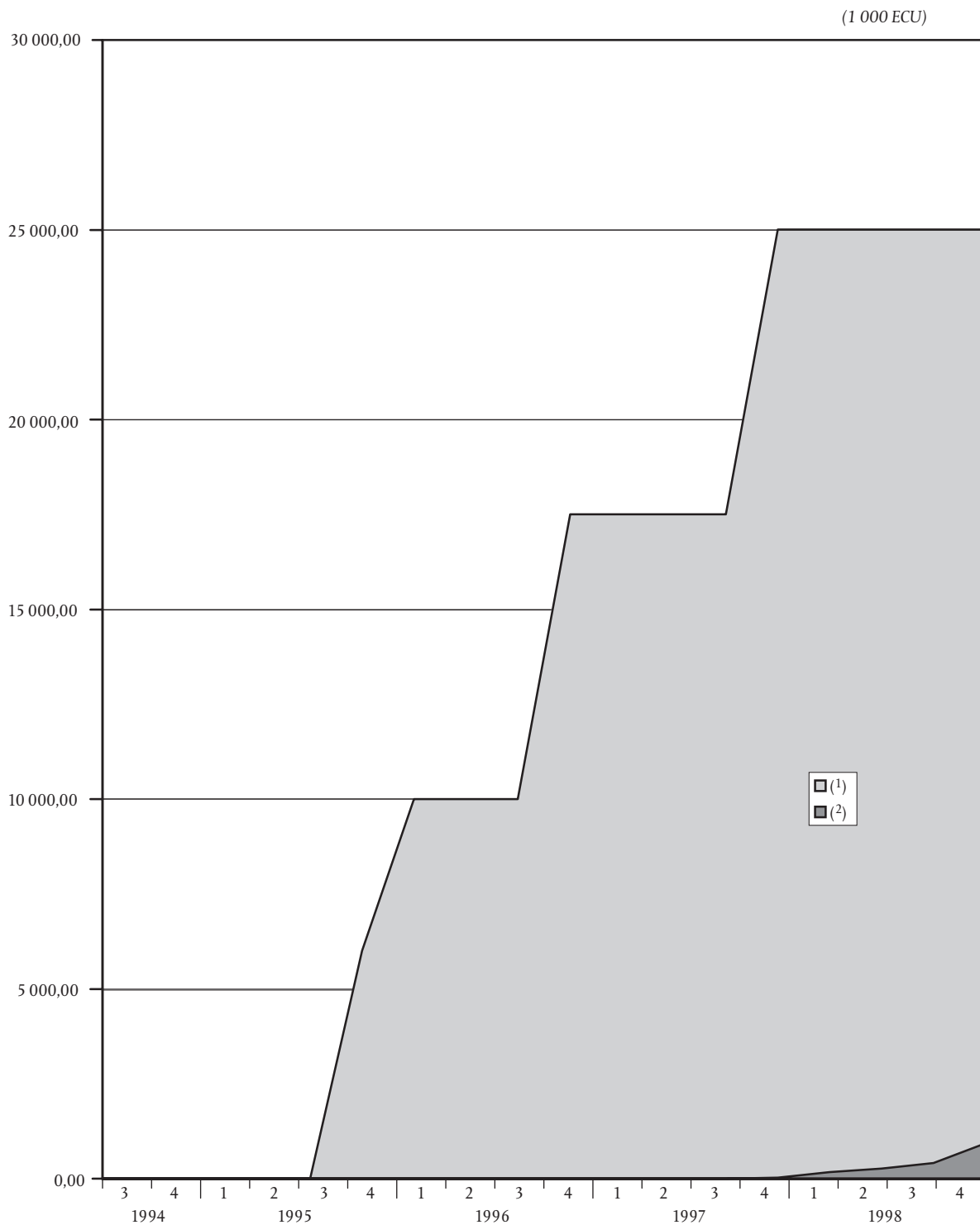
Implementation of the scheme

7.20. Although the scheme was launched in mid-1995, the first payments in relation to effective operations were not made until late 1997. **Table 7.5** shows a chronology of the main events in connection with the implementation of the scheme. As it became obvious in 1998 that absorption was not developing satisfactorily, the Commission and EIF carried out an analysis, by which they identified in particular the following obstacles:

- the financial criteria (¹⁴) imposed by EIF, on top of the normal credit procedures of the financial intermediaries, turned out to be too restrictive. Moreover, complying with these additional criteria increased the administrative burden for the financial intermediaries;
- the definition of the environmental eligibility criteria was unclear for the financial intermediaries;
- some technical details of the first contract between EIF and the financial intermediaries turned out to complicate the absorption. Such technicalities included, for example, exclusion of start-ups, non-incorporated enterprises and leasing contracts.

(¹⁴) The financial criteria imposed by EIF set minimum requirements for the solvency ratio, for the capacity to repay long-term debt and for the net profit of the final beneficiaries.

Chart 7.1 — Comparison between the budget transfers to the EIF and their utilisation



(¹) Transfers to the EIF (cumulative).

(²) Payments of guarantee premiums and expenses (cumulative).

Source: Commission.

Table 7.5 — Chronology of main stages of the 'Growth and environment' scheme

19.6.1995	Commission decision
12.7.1995	Call for expression of interest (deadline 30.9.1995) for the financial intermediaries
6.12.1995	Agreement signed between the EIF and the Commission
11.12.1995	The Commission transmits a list of preselected banks to the EIF
4.11.1996	First contract signed between the EIF and a financial intermediary
15.5.1997	Second call for expression of interest (deadline 30.6.1997, extension 31.12.1997)
14.7.1997	Conclusions of the evaluation committee on the call for expression of interest with deadline 30.6.1997
10.2.1998	Conclusions of the evaluation committee on the call for expression of interest with deadline 31.12.1997
20.5.1998	Amendment to the agreement between the EIF and the Commission
29.6.1998	Revised fee agreement between the EIF and the Commission
3.8.1998	Changes in the statement of the environmental characteristics

Source: Commission.

7.21. Following this analysis, the Commission and EIF made, *inter alia*, the following changes:

- (a) the premium agreed between the Commission and EIF was increased by approximately 40 % in order to enable the latter to relax its financial criteria on the beneficiaries and to consider a wider circle of interested enterprises;
- (b) the Commission accepted that no guarantees would be retroactively cancelled if environmental eligibility criteria turned out not to have been met, unless they were obtained by intentionally supplying false information;
- (c) the range of potential final beneficiaries was extended to include starting and non-incorporated enterprises and leasing contracts.

Control

7.22. At the moment that the audit was conducted, i.e. 11 May 1999, the Commission had not yet established the key controls to ensure regularity and sound financial management of the funds. The missing control procedures are in particular those intended to:

- (a) verify the correct application of the agreed guarantee premium by EIF;
- (b) check the marketing costs paid by EIF to financial intermediaries;

- (c) check the correctness of the information provided by the final beneficiaries regarding the eligibility criteria.

No *ex post* verifications⁽¹⁵⁾ of compliance with the objectives of the scheme have as yet been performed.

Technological facility for SMEs⁽¹⁶⁾

7.23. An amount of 100 Mio ECU was entered as commitment appropriations and 50 Mio ECU as payment appropriations in the 1998 Commission budget. In 1998 the Commission actually committed 100 Mio ECU and in September of the same year paid 50 Mio ECU, which gives a budget out-turn of 100 %, even though, as of 31 December 1998, the EIF had still not used the funds that it received, except for the management fee of 1 Mio ECU which it levied in October 1998.

⁽¹⁵⁾ Article 20 of the agreement between the Commission and EIF: 'In order to ascertain that the financial institutions comply with objectives of the scheme (...), the Commission shall carry out regular *ex post* verifications of compliance (...).'

⁽¹⁶⁾ Conclusions of the Special Luxembourg European Council on employment of 20 and 21 November 1997 and Council decision of 19 May 1998 on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs) (OJ L 155, 29.5.1998, pp. 43–52).

Management of own funds

7.24. In addition to the Community participations (see paragraph 7.10), the EIF's capital was subscribed by the European Investment Bank (EIB), which holds 40 %, whilst only part of the remaining 30 %, which was intended for commercial banks, was subscribed. Up to 31 December 1997 the Court relied on documents provided by the Commission, which is an EIF shareholder, and on the Fund's annual report in order to be able to express a general opinion. However, the Commission has not forwarded any documents for more than a year now, despite the Court's repeated requests, and the EIF's 1998 annual report had not been published at the time when the Court drafted this report.

7.25. Without access to the requisite information it is not possible for the Court as the Community audit institution to provide the discharge authority with an opinion on the management of the Fund and the lack of information mentioned in the preceding paragraph makes it impossible for the Court to formulate general comments such as those published in its annual reports between 1994 and 1997 ⁽¹⁷⁾.

⁽¹⁷⁾ Annual reports of the Court concerning financial years 1994 (OJ C 303, 14.11.1995, paragraphs 8.24–8.31), 1995 (OJ C 340, 12.11.1996, paragraphs 8.29–8.36), 1996 (OJ C 348, 18.11.1997, paragraphs 18.40–18.47, 18.52), 1997 (OJ C 349, 17.11.1998, paragraphs 7.11–7.16).

COMMISSION REPLY

GUARANTEE FUND

Situation and development of the Fund

7.5. The Commission had included the repayment of the Fund's surplus in the profit and loss account, to add to the transparency of the consolidated financial balance sheet. However, the Court correctly points out that this transfer has no influence on the Fund's profitability. Accordingly, for future years, the Commission will follow the Court's suggestion to include it only in the balance sheet.

7.7. The Commission still believes that the assumption that the sum total of defaults would remain at ECU 315 million was realistic.

EUROPEAN INVESTMENT FUND

Management of budgetary resources

Pilot project 'Growth and environment'

Introduction

7.15. By the time the first operation for the growth and environment scheme was concluded at the end of 1996, the EIF had already signed five SME guarantee operations amounting to ECU 137 million and encompassing credit enhancement, credit insurance, as well as structured finance features.

Execution of the 'Growth and environment' pilot project

Budgetary management

7.17. When the project was launched, the combination of environmental issues and SMEs in a guarantee scheme was a novelty; its innovative character is also reflected in the fact that it was conceived as a pilot scheme. As such, it is, by definition, subject to revision in the light of the experience gained.

From the start, the Commission and the EIF have followed the scheme very actively and used their best efforts to implement it on the basis originally agreed. As soon as it became clear that absorption was slower than foreseen, a thorough internal review was undertaken to identify the underlying reasons. This

review resulted in a number of technical adjustments, described by the Court in paragraphs 7.20 and 7.21, which led to a considerable increase in the absorption rate.

7.18–7.19. The Commission shares the view of the Court and recognises that the amounts transferred to the European Investment Fund should have appeared as a financial claim on the assets side of the Commission's balance sheet. Steps will be taken to ensure that this does not occur again. However, it is important to note that the Community budget did not suffer any financial disadvantage: the amounts held on a trust account earn interest which is earmarked for the programme.

Implementation of the scheme

7.20–7.21. The level of the guarantee premium determines directly how restrictive financial selection criteria have to be.

Control

7.22.

- (a) The Commission subsequently verified the correct calculation of the premium by the EIF for a sample of loans.
- (b) The Commission also subsequently checked all marketing expenses claimed by the EIF, as well as a sample of the marketing costs claimed by financial intermediaries and paid via the EIF.
- (c) The Commission intends to organise control visits on a sampling basis, in order to verify compliance with the eligibility criteria.

Now that the absorption of the scheme is picking up, the Commission will also start ex post verifications of compliance with the objectives of the scheme.

Technological facility for SMEs

7.23. Once the management agreement with the EIF had been signed, the selection procedure moved rapidly: the agree-

ment was signed in July 1998, i.e. soon after the Council decision of 19 May. The EIF then published the selection criteria for the risk capital funds in the Official Journal in October 1998 and the first funds were selected in November 1998.

Even if no transaction could be finalised by the end of 1998, the premium paid for the management of the programmes has a counterpart in actions taken by the EIF, including advice, marketing initiatives and missions to the authorities of the Member States, to the venture capital funds and to the financial institutions.

The amounts paid were transferred to interest-producing trust accounts. According to the relevant Council decision, earned interest is earmarked for the programmes.

Management of own funds

7.24–7.25. The Commission is prepared to allow the Court to check all EIF operations, including those on its own funds, since these are, at least in part, raised from public Community funds.

The President of the EIF was informed of the Commission's position by the two Members of the Commission concerned in April 1999.

Since then, the Commission has taken steps to try to bring the parties concerned to an agreement on the practical aspects of such checks.

Moreover, the Commission regrets that EIF documents were not forwarded to the Court more efficiently; it will ensure that in future documents are dispatched in a satisfactory manner.

CHAPTER 8 (*)

The Statement of Assurance and supporting information

8.0. CONTENTS	Paragraph reference
Statement of Assurance concerning activities financed from the general budget for the financial year ended 31 December 1998	I — VII
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Errors affecting fixed assets	8.12 — 8.13
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Presentation of information on advances and payments on account	8.17 — 8.18
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(*) The Commission's replies are on page 176.

Statement of Assurance concerning activities financed from the general budget for the financial year ended 31 December 1998

I. The European Court of Auditors ('the Court') has examined the consolidated accounts of the European Community for the financial year ended 31 December 1998. The accounts consist of the consolidated revenue and expenditure account and balance sheet and explanatory notes ⁽¹⁾, and are the responsibility of the Commission. Pursuant to the Treaties ⁽²⁾, the Court is required to provide the Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions which underlie these accounts.

II. The Court carried out the audit in accordance with its audit policies and standards. These adapt generally accepted international auditing standards to the Community context. The audit comprised an appropriate range of procedures designed to examine, on a test basis, evidence relating both to the amounts and disclosures in the consolidated accounts and the legality and regularity of the transactions underlying the accounts. It also included an assessment of the accounting principles used and of significant estimates made by management, as well as of the presentation of the accounts. Through the audit the Court obtained a reasonable basis for the opinion expressed below.

*
* *

Reliability of the accounts

III. The figures presented in the consolidated revenue and expenditure account and balance sheet and explanatory notes are affected by the following errors and weaknesses. These concern primarily the balance sheet and the presentation of advances and commitments for future expenditure.

Balance sheet

- (a) the understatement of fixed assets, essentially buildings, by around 540 Mio ECU;
(see paragraphs 8.12–8.13)

- (b) a net overstatement of debtors in the region of 1 000 Mio ECU principally resulting from the overstatement of sums likely to be recovered for unpaid customs duties and agricultural duties;
(see paragraphs 8.14–8.15)

- (c) an understatement of cash and debtors amounting to at least 600 Mio ECU because some amounts held on bank accounts, or paid as advances to third parties which act as agents for the Commission, have been omitted from the balance sheet.
(see paragraph 8.16)

⁽¹⁾ Volume IV of the documents submitted by the Commission to the European Parliament and Council and to the Court, and published in the Official Journal (OJ C 350, 3.12.1999) (see paragraph 8.40).

⁽²⁾ Article 248 CE, Article 160c and Article 45c with regard to the ECSC's former administrative budget, which was incorporated into the general budget by the Merger Treaty of 8 April 1965.

Expenditure

(d) the inaccurate and inadequate presentation of information on advances and payments on account at 31 December 1998;

(see paragraphs 8.17–8.18)

(e) the overstatement of commitments still to be settled by some 660 Mio ECU;

(see paragraphs 8.19–8.21)

(f) the omission of certain commitments (352,7 Mio ECU) and potential liabilities (at least 2 794 Mio ECU).

(see paragraph 8.22)

Legality and regularity of commitment transactions

IV. During 1998 the Commission entered into commitments to a value of 352,7 Mio ECU without having legal authorisation in the form of sufficient budgetary appropriations.

(see paragraph 8.23)

Legality and regularity of transactions underlying payments

V. The audit revealed an unacceptable incidence of error which affected the amount of the payments made, or the eligibility of the transactions financed by the Community budget ('substantive' errors).

(see paragraphs 8.25–8.31)

VI. The audit showed numerous other failures to comply with regulations, which often indicated a failure to properly apply control procedures, but where no direct effect on payments or on transactions financed by the Community budget was identified ('formal' errors).

(see paragraphs 8.32–8.36)

Opinion of the Court

VII.

- Except for the effects of the matters summarised in paragraph III above, the Court is of the opinion that the accounts for the financial year 1998 reflect reliably the Community's revenue and expenditure for the year and financial situation at the end of the year;
- Within the limits described in paragraphs 1.4–1.5 the Court is of the opinion that the transactions underlying the revenue entered in the accounts for the financial year are, taken as a whole, legal and regular;
- Except for the effect of the matters discussed in paragraph IV above, the Court is of the opinion that the commitment transactions for the financial year are, taken as a whole, legal and regular;
- Because of the effect of the matters described in paragraphs V and VI above, the Court declines to provide assurance that the transactions underlying the payments for the financial year are, taken as a whole, legal and regular.

15 October 1999

Jan O. KARLSSON

President

European Court of Auditors
12, rue Alcide De Gasperi, L-1615 Luxembourg

INFORMATION SUPPORTING THE STATEMENT OF ASSURANCE

Introduction

8.1. The following text should be read in conjunction with the preceding statement of assurance on the reliability of the accounts of the European Community and the legality and regularity of the underlying transactions for the financial year 1998. It provides further explanation of the observations in the statement of assurance on the reliability of the accounts. It also summarises the main conclusions leading to the Court's opinions on the legality and regularity of transactions underlying the accounts.

8.2. The statement of assurance itself, and this chapter of the Annual Report, follows the structure of the Treaties in concluding first on the reliability of the accounts and second on the legality and regularity of the underlying transactions. Within this chapter:

- (a) the basis for the qualified opinion ⁽¹⁾ on the reliability of the accounts is explained in paragraphs 8.10–8.22;
- (b) the basis for the single qualification ⁽¹⁾ in the opinion on the legality and regularity of commitments is described in paragraph 8.23;
- (c) the basis for the adverse opinion ⁽¹⁾ on the legality and regularity of transactions underlying payments is explained in paragraphs 8.25–8.36.

The basis for the unqualified opinion on the legality and regularity of revenue is explained in the specific appraisal for own resources at paragraphs 1.3–1.15.

8.3. Further information, in particular on the legality and regularity of underlying transactions, is provided in specific appraisals in the appropriate chapters of this

⁽¹⁾ The opinions expressed and the terminology used in this statement of assurance are identical in nature to those given in 1997 and previous years.

Annual Report for each of the following areas of expenditure:

- Common agricultural policy (paragraphs 2.36–2.59)
- Structural operations (paragraphs 3.9–3.37)
- Internal policies (paragraphs 4.7–4.20)
- External action (paragraphs 5.32–5.71)
- Administrative expenditure (paragraphs 6.2–6.18).

Scope of the audit

8.4. The statement of assurance is expressed on the consolidated financial statements of the European Community for the financial year ended 31 December 1998, as presented in the 'consolidated revenue and expenditure account and balance sheet' and on the transactions which underlie these accounts. Because the financial statements given to the Court on 30 April 1999 contained some errors which could be readily corrected, the Commission presented amended financial statements in September 1999 for publication in the Official Journal. The statement of assurance covers the amended version of these financial statements, sent to the Court by the Commission on 30 September 1999 ⁽²⁾ (see paragraph 8.40).

8.5. The audit was planned and performed so as to obtain sufficient, relevant and reliable audit evidence to determine whether, taken as a whole, the financial statements are reliable and the underlying transactions legal and regular. Many irregularities are not intentional, or do not have a detrimental effect on Community finances. Errors detected in the course of the statement of assurance audit, and reported here, should not be taken as generally representing fraud.

8.6. Amongst the errors detected, a certain number result from the presentation of inaccurate information by recipients of Community funds. Where this is deliberate, fraud is likely to have occurred. The Commission and the Member States are responsible for the investigation and prosecution of such cases, in addition to their more general responsibilities for the prevention and detection of fraud.

⁽²⁾ SEC(1999) 1473, Volume IV 'Consolidated revenue and expenditure account and balance sheet'.

Accounting framework

8.7. The Court has repeatedly drawn attention to the need for an adequate and complete accounting framework to be established and consistently applied⁽³⁾. The continuing absence of a clear and comprehensive accounting framework, governing the accounting treatment of budgetary transactions as well as assets and liabilities, lies behind many of the issues dealt with in this report concerning the reliability of the accounts. In addition, the Commission does not always apply its accounting policies and procedures consistently. Although DG XIX is responsible for the preparation and presentation of the consolidated financial statements, it has difficulty in obtaining the cooperation of the other institutions and other directorates-general. As a result, approaches are followed which breach the fundamental requirement for consistency in accounting treatment. For example, the Commission and other institutions do not always apply the same bases for the identification, valuation and disclosure of assets and liabilities.

8.8. The Court notes that, although the Commission has made some effort, little progress has been made in improving the presentation and content of the financial statements since 1997. For example, Table 11 relating to advance payments remains affected by the same errors noted in previous years, because staff in the operating DGs concerned continue to record incorrect information (see paragraph 8.17). No steps have been taken to simplify the presentation of data in Table 10.

8.9. An illustration of the difficulties faced by DG XIX in making improvements to the financial statements is provided by the treatment of imprests held by third parties (see paragraph 8.16). In response to the criticism of the Court, DG XIX sought to include in the balance sheet the total of such advances at the year end. Several DGs provided the information required, but the units responsible for the largest amounts did not.

The reliability of the accounts

8.10. The Court's opinion on the accounts is qualified essentially for the same reasons as in previous years, which are described in paragraphs 8.12–8.22. In other respects the Court found that the consolidated revenue and expenditure account and balance sheet reflect reli-

ably the Community's revenue and expenditure for the year and financial situation at the end of the year.

8.11. The matters which give rise to the qualification of the accounts are:

- (a) the inaccurate valuation and presentation of fixed assets (see paragraphs 8.12–8.13) resulting in an understatement of some 540 Mio ECU;
- (b) the overstatement of the value of outstanding debtors, particularly for own resources payable to the Communities (see paragraphs 8.14–8.15);
- (c) the understatement of cash and debtors due to the omission of certain transfers of funds treated as budgetary payments amounting to at least 600 Mio ECU (see paragraph 8.16);
- (d) the inaccurate and inadequate presentation of information on budgetary payments which represent advances or payments on account (see paragraphs 8.17–8.18);
- (e) the overstatement of commitments still to be settled by some 660 Mio ECU; (see paragraphs 8.19–8.21);
- (f) the omission of certain commitments with a value of 352,7 Mio ECU and potential liabilities with a value of at least 2 794 Mio ECU (see paragraph 8.22).

Errors affecting fixed assets (paragraph III (a) of the Statement of Assurance)

8.12. The balance sheet presents the total value of tangible fixed assets as 3 310 Mio ECU. This figure is not accurate as:

- (a) it does not include buildings being purchased through leases by the European Parliament and European Court of Justice with a value of approximately 540 Mio ECU (see paragraph 6.7);
- (b) the value of equipment held by the Joint Research Centre (280 Mio ECU) is not supported by adequate physical verification procedures.

8.13. In addition, as the institutions have failed to implement a common approach to the presentation of the balance sheet, assets are inconsistently identified, valued and classified. Only the Commission and the

⁽³⁾ 1997 Annual Report, paragraphs 8.5–8.7 (OJ C 349, 17.11.1998).

Court of Justice have capitalised intangible assets, although the accounting officer of the Commission issued instructions to do so to all the institutions. Only the Commission and the Court of Auditors have calculated depreciation, but this is not reflected in the balance sheet and is only disclosed in the notes to the accounts. See paragraph 6.7.

Errors affecting debtors (paragraph III (b) of the Statement of Assurance)

8.14. The balance sheet presents the total amount of sums due to the Community from third parties as 3 398 Mio ECU. This figure is uncertain and likely to overstate the total amount recoverable. The principal reason for this is that the Commission takes no account of potential bad debts in presenting the total of own resources receivable from the Member States in the balance sheet (1 739 Mio ECU). At the same time the underlying accounts maintained by the Member States are not, in certain cases, complete. On the basis of the experience of recent years, the Court estimates that the overall net overstatement of the sum recoverable may exceed 1 000 Mio ECU. See paragraph 1.10.

8.15. On the other hand, the Commission has not included in the balance sheet those amounts due to be recovered from farmers, other agricultural enterprises and exporters which have received EAGGF payments to which they were not entitled. An amount of 862,5 Mio ECU, declared by paying agencies as due at the end of the EAGGF-Guarantee financial year on 15 October 1998, is included in the notes to the accounts as a potential asset (Volume IV, Chapter 4, Potential assets, item 13.1, p. 85). A significant part of this total is made up of debts on which recovery is doubtful. However, the net value, after provision for bad debts, should be included in the balance sheet (see paragraphs 2.39 (b) (ii) and 2.94).

Understatement of cash and debtors (paragraph III (c) of the Statement of Assurance)

8.16. In the field of external action, the Commission continues to record certain transfers to bank accounts, or advances to third parties which act as agent for the Commission, as definitive payments charged to the budget. In the view of the Court, Article 111 of the Financial Regulation requires that such transfers be recorded as imprest accounts in the balance sheet until the relevant expenditure has been realised. Meanwhile, in the current situation, reported expenditure for a given year is overstated and the assets in the balance sheet (Volume

IV, Chapter 3, Consolidated balance sheet) are understated. For the Phare programmes, the difference between the Commission's transfers for 1998 and the subsequent payment made to final beneficiaries by the end of the year was approximately 600 Mio ECU (see paragraphs 5.43–5.44). For the other measures, it is likely that the outstanding amounts concerned are of the order of several hundred million ecu. A further 35,8 Mio ECU was held by the European Training Foundation (based in Turin) at the end of the year.

Presentation of information on advances and payments on account (paragraph III (d) of the Statement of Assurance)

8.17. Table 11 of the financial statements (Volume IV, page 44) seeks to distinguish intermediate payments (payments on account and advances) from payments of a definitive character. As in previous years, this table continues to contain significant errors. The failure to properly record intermediate payments as such means that their total is understated by at least 2 000 Mio ECU (see paragraphs 3.22, 4.12 and 5.44). In addition, in some areas, notably Structural Funds, the services of the Commission systematically record intermediate payments against the outstanding commitment representing the oldest annual 'tranche', and so often records intermediate payments as if they were payments of a final balance. As a result, the information presented in Table 11 does not accurately reflect the nature of the payments made.

8.18. The financial statements of the Communities continue to provide no indication of the extent to which advances and payments on account have been utilised. Most of these represent Structural Fund advances to Member States where the extent to which the Commission's payments have been absorbed by expenditure reported in certified declarations from the Member States is not shown. The specific case of external action is described at paragraph 8.16 above. In the field of internal policies advances are also paid to intermediaries, which are subsequently paid, sometimes only years later, to the final beneficiaries. Some of these amounts are held by Community bodies such as the European Investment Bank and the European Investment Fund. Information on the utilisation of advances would be relevant to all users of the financial statements who require information about the real degree of implementation of Community policies at the level of final beneficiaries. The logic of the Commission's own reflections on the future format of the financial statements points to such payments being charged to the budget, but accounted for as an asset in the balance sheet until Member States or other intermediaries have accounted for the final use of funds.

Overstatement of commitments still to be settled (paragraph III (e) of the Statement of Assurance)

8.19. At 31 December 1998, commitments against differentiated appropriations totalling 58 848,4 Mio ECU remained to be settled, 571,2 Mio ECU of which were covered by payment appropriations carried over from 1998 to 1999.

8.20. The Commission was unable to provide evidence that some 4 % of the sums relating to the commitments outstanding from 1997 and previous years, estimated at about 1 100 Mio ECU at year end, still related to an obligation to make further payments. On the basis of its audit of a sample of such balances, the Court estimates that, of this amount, some 660 Mio ECU no longer represented such an obligation (see paragraphs 3.23, 4.13 and 5.39–5.42 for further details). In addition, an estimated 270 Mio ECU of outstanding commitments for Structural Funds expenditure were retained because legal proceedings had been initiated. Such amounts cannot therefore be cancelled by the Commission although previous experience suggests that much of them will not result in further payments.

8.21. Despite the efforts made to improve the monitoring of outstanding commitments, the overall situation remains variable between different Commission departments. An estimated 1 800 Mio ECU of outstanding commitments, for which no payment had been recorded in 1997 and 1998, appears not to have been the subject of follow up.

Understatement of certain commitments and potential liabilities (paragraph III (f) of the Statement of Assurance)

8.22. Different Commission directorates-general apply different definitions of a commitment. This leads to inconsistency and inaccuracy in figures provided on budgetary execution for the year. In the area of the Structural Funds, the Commission's legal commitments (multi-annual obligations) extend to the whole amount outstanding in each successive programming period, but, in accordance with the sectoral regulations, the annual budgetary accounts only reflect the accounting commitments of annual tranches up to the financial year in question. The amounts not yet recorded as commitments are, however, disclosed as potential liabilities (see paragraph 3.7). For other areas of expenditure, the applicable regulations do not foresee any distinction

between legal commitments and the commitments recorded in the accounts. However, for budget headings relating to international fisheries agreements, the Commission has entered into legal obligations which exceed available appropriations. As a result, the commitments for the year are understated by 352,7 Mio ECU, this amount only being disclosed as a potential liability (see paragraph 5.53). Furthermore, total potential liabilities in the field of external action are understated by at least 2 794 Mio ECU (see paragraphs 5.36–5.38).

*Legality and regularity of underlying transactions***Errors affecting the legality and regularity of commitment transactions (paragraph IV of the Statement of Assurance)**

8.23. During 1998 the Commission entered into commitments to a value of 352,7 Mio ECU without having legal authorisation in the form of sufficient budgetary appropriations (see paragraph 8.22).

8.24. Furthermore, during 1998 the Commission entered into commitments amounting to at least 170 Mio ECU in the absence of a relevant regulation adopted by the Council⁽⁴⁾. However, the Court accepts that the interinstitutional agreement of 13 October 1998 and Council regulations adopted by the end of 1998 provide a sufficient basis for the expenditure concerned (see paragraphs 5.51–5.52). Total recorded commitments for 1998 amounted to 88 300 Mio ECU.

Errors affecting the legality and regularity of transactions underlying payments*Substantive legality and regularity errors concerning transactions underlying payments (paragraph V of the Statement of Assurance)*

8.25. The Court's audit again showed an unacceptably high incidence of error affecting the amount of payments made or the eligibility of transactions financed by the Community budget. The errors did not differ significantly in amount and nature from those found in previous years. As in previous years, the majority of the errors occurred in the areas of Community expenditure, which are essentially managed by authorities in the Member States, and which represent more than 80 % of

⁽⁴⁾ 1997 Annual Report, paragraphs 8.27–8.28. (OJ C 349, 17.11.1998).

the general budget. But there was also a significant incidence of error in the Commission's directly managed expenditure on internal policies, which represents about 5 % of the budget.

Common agricultural policy

8.26. The errors detected generally resulted from inaccuracies in the information provided by farmers, other agricultural enterprises and exporters. They can be categorised as follows:

- (a) for arable crops covered by the integrated administration and control system, the errors found, typically had a relatively small impact on the payments made;
- (b) for other products (most of which are not covered by the integrated administration and control system), a similar number of errors were noted, but these tended to have a relatively larger impact on the value of payments made.

See paragraphs 2.41–2.47 for further detail.

Structural operations

8.27. For the structural operations field a high incidence of error was found in Member States' declarations of expenditure, chiefly relating to the eligibility of the transactions financed by the Community budget. The declarations continue to contain a significant number of items for which:

- (a) essential conditions for Community financing have not been complied with;
- (b) costs have been incorrectly calculated or are expressly excluded by the relevant legislation.

See paragraphs 3.24–3.30 for further detail.

8.28. The audit provided evidence that control procedures at the closure of European Regional Development Fund programmes, whether by the Member State or the Commission, continue to be ineffective as a means of identifying and correcting such errors (see paragraphs 3.29 and 3.33 for further detail).

Internal policies

8.29. For the internal policies field, payments continued to be affected by a particularly high incidence of error. This often resulted from the presentation of inaccurate cost statements for research projects. In particular, many of the contractors involved had overcharged for overheads. See paragraphs 4.15–4.16 for further detail.

External action

8.30. The audit of external action indicated a low incidence of substantive error affecting payments.

Administrative expenditure

8.31. The audit of administrative expenditure did not reveal a material incidence of substantive error affecting payments.

Formal legality and regularity errors concerning transactions underlying payments (paragraph VI of the Statement of Assurance)

8.32. Formal errors were noted across most areas of the budget. These errors do not have a directly quantifiable effect on amounts of the transactions underlying Community funds disbursed, but often increase the risk of substantive errors occurring. The majority of these errors reflect failures to administer Community programmes in accordance with the systems of control established by Community regulations.

Common agricultural policy

8.33. Most of the formal errors found in the area of agricultural expenditure related to failures to implement properly the control requirements of the integrated administration and control system, such as maintaining registers of animals. For products not covered by this system, the most frequently noted error was a failure by olive mills to notify paying agencies of the start of milling. Errors of this type increase the risk that incorrect payments are made. Control weaknesses noted in the area of export refunds could lead to mispayment, which would not be detectable once the goods in question had left the customs area of the Community. See paragraphs 2.48–2.52 for further detail.

Structural operations

8.34. The formal errors in this field include an absence of separate identification of the use of EU funds and a failure to retain all the documentation required by Community rules (see paragraphs 3.31–3.32 for further detail).

External action

8.35. There were numerous formal errors in the field of external action. The main category consisted of failures to respect tendering procedures (see paragraphs 5.56–5.62).

Administrative expenditure

8.36. The Court's audit revealed formal errors in payments for work fitting out certain buildings rented by the Commission prior to their occupation (see paragraphs 6.13–6.17 for further detail).

Recommendations

Reliability of the accounts

8.37. The Court of Auditors has issued a qualified audit opinion on the reliability of the accounts in each statement of assurance issued since its introduction in 1994. A key reason for this is the fact that the Commission does not yet have an adequate and complete accounting framework, which would ensure that all transactions of the same kind are treated in a consistent and appropriate manner in the consolidated financial statements. The Court of Auditors recommends that the Commission ensure that such a framework is adopted, based on generally accepted accounting principles, and applied consistently to all transactions by all institutions.

8.38. Such a framework is particularly required to regulate the treatment of intermediate payments (advances and payments on account) and of debtors, for which the Community's financial statements are incomplete and hard to understand. The Court of Auditors recommends that the Commission take urgent steps to develop the accounting treatment of these items with a view to providing accurate summary information to the users of the Community's financial statements.

8.39. The Commission should address the whole question of an appropriate accounting framework, including the scope of the consolidated financial statements of the Community, in its proposals for a new general Financial Regulation.

8.40. It is important that the situation in which the Commission had to present amended financial statements at the end of September 1999 does not recur (see

paragraph 8.4). The Court of Auditors considers that the eventual aim of the Commission should be to submit fully checked financial statements to the Court of Auditors no later than 31 March well in advance of formal publication. In order to improve the production of the financial statements, the Commission should reinforce the authority and resources of its accounting officer and evaluate the possibility of employing external professional expertise to help to prepare financial statements to acceptable standards within a reasonable timescale.

Legality and regularity of transactions underlying payments

8.41. In most areas of the operational budget the Court found a material incidence of error which affected either the amount of payments made, or the eligibility of activities for Community financing. Action is required both of directorates-general responsible for spending programmes, and of the Member States, who implement many of these programmes, to prevent or detect and correct errors. The Commission should ensure that it has appropriate management and organisational structures in place before new spending is authorised.

8.42. The necessary improvements in financial management will require a continuing effort to improve and simplify the relevant legislation. The unnecessary proliferation of different rules and procedures should be avoided, and the responsibility for each element in financial management and control must be clearly defined and enforced. Where programmes are financed by advance payments from the Commission, reliable systems must be established to ensure proper management of the funds.

8.43. A commitment to simplification and proper accountability should underpin the Commission's forthcoming proposals for a new general Financial Regulation, as well as the specific regulations to be adopted in the future for particular programmes.

COMMISSION REPLY

INFORMATION SUPPORTING THE STATEMENT OF ASSURANCE

Introduction

8.2. The Commission notes that the 1998 statement of assurance is similar to the 1997 statement and that there has been no deterioration from one year to the next.

As regards the qualified opinion on the accounts, the Commission would point out that the Court's observations relate more to shortcomings in connection with general accounting principles than with the rules in force.

Accounting framework

8.7. The Court states that the Commission does not have an adequate framework of standards and principles for drawing up the institutions' account in a harmonised and consistent manner.

Without denying the substance of the Court's observations, the Commission would point out that the errors noted by the Court relate more to the accounting principles which it would like to see applied than shortcomings as regards the financial legislation. The Commission has stated on various occasions that it would accede to the Court's requests when recasting the Financial Regulation.

Every year the accounting officer's departments send a circular to the accounting officers of the other institutions setting out harmonised information on assets. Unfortunately, only some of the institutions have so far made any improvements.

8.8. As regards Table 11 (advance payments), it is true that the reliability of the information is linked to the coding of operations and the heterogeneous nature of these operations. The Commission undertakes to conduct an exhaustive analysis to improve the reliability of the figures in this table.

8.9. The Court criticises the information in the 1998 accounts concerning funds held by financial intermediaries (e.g. the technical assistance offices), claiming that it is incomplete. The Commission admits that this information, which was first supplied in 1998, is incomplete, but it will endeavour

to improve the information value in 1999. Specific provisions will be contained in the proposals for the recasting of the Financial Regulation to take account of this issue.

The reliability of the accounts

Errors affecting fixed assets (paragraph III (a) of the statements of assurance)

8.12 and 8.13. The Commission acknowledges that this information was missing from the 1998 accounts even despite the requests the Commission accounting officer made to the accounting officers of the other institutions.

The consolidation manual and the regulation now being drawn up for the accounting management of the Commission's assets are organisational measures which will contribute to a harmonised presentation of the accounts.

The Joint Research Centre's inventory will be completed in 1999 and that year's accounts will contain information backed by figures from the inventory.

Errors affecting debtors (paragraph III(b) of the statement of assurance)

8.14. The Commission admits that the balance of the separate account for own resources overestimates real amounts receivable as the accounts also include long-standing entries which are unlikely to be recovered. The amendment to Regulation (EEC, Euratom) No 1552/89 now being examined by the Council aims to strengthen the procedure for writing off irrecoverable entitlements and should provide the appropriate remedies.

However, while upholding its claim to its entitlements by entering this information in the balance sheet, the Commission will now endeavour to increase the transparency of the accounts by incorporating a note in the balance sheet referring to this overestimate.

8.15. Since the reform of the clearance procedure became effective in the 1996 financial year, the paying agencies have

been required to keep much improved records of debtors and the certifying bodies were requested to pay particular attention to this aspect of the accounts during their audit of the 1998 accounts. The situation was still found to be unsatisfactory and the Commission is currently undertaking an enquiry into the recording and management of debts due to the EAGGF-Guarantee Section, with the objective of ensuring reliable and complete records and rapid recovery of the debts. In the meantime, the figures presented by the paying agencies could be shown as certain and verifiable debts.

Understatement of cash and debtors (paragraph III (c) of the statement of assurance)

8.16. The Court considers that the payments made to financial intermediaries (PMU — Programme Management Unit and TAO — Technical Assistance Office) under Phare should be treated in accordance with Article 111 of the Financial Regulation.

The Commission considers that these operations do not fall within the scope of Article 111 of the regulation, the provisions of which are to be reviewed during the recasting of the regulation to take account of the specific implementing mechanisms for the programmes of financial assistance to central and eastern Europe.

The Commission maintains that these payments have been properly charged to the budget ⁽¹⁾. This question will be examined during the recasting of the Financial Regulation. Meanwhile, the Commission promises to examine ways to improve the information value of the accounts.

Presentation of information on advances and payments on account (paragraph III (d) of the statement of assurance)

8.17. The Court criticises the reliability of the information provided by the Commission in Table 11 (payment of advances) of the revenue and expenditure account with regard to the distinction between payments on account and payment of the balance.

The Commission would point out that in future the new rules applicable to the Structural Funds will contribute to the provi-

⁽¹⁾ Charging payments via non-budget accounts would introduce a lack of transparency for the budgetary authority and would lead to non-implementation of appropriations with the result that there would no longer be any justification for calling in funds from the Member States.

sion of more reliable information as they will clarify the meaning of payments on account and institute a mechanism for the repayment of expenditure incurred instead of advance funding. This should lead to better presentation in the new programming period.

8.18. The Court considers that the accounts should show the extent to which payments on account have been absorbed by the expenditure declared by the Member States. The Commission will do what it can to include in the 1999 financial statements the funds (advances) which have not been formally transferred to the recipients even though it is not yet under any legal obligation to do this.

As far as the Structural Funds are concerned, the Commission will examine the extent to which the financial statements can indicate the payments on account which have been absorbed by the Member States' declarations of expenditure.

Overstatement of commitments still to be settled (paragraph III (e) of the statement of assurance)

8.19, 8.20 and 8.21. As regards the monitoring of dormant commitments, the Commission would point out that the measures taken have led to a reduction of ECU 900 million compared with 1997, a fall of about one third (see paragraph 8.21 in the 1997 report).

Understatement of certain commitments and potential liabilities (paragraph III (f) of the statement of assurance)

8.22. As regards the Structural Funds, the Court is correct in saying that only the budgetary commitments corresponding to the annual tranches being implemented are reflected in the accounts. The Commission would also point out that the budgetary authority does not allocate commitment appropriations covering all Commission decisions. It is, however, aware of the problem of transparency, in terms of information published in the financial statements, when its decisions have not led to financial commitments. In accordance with the prudent accounting principle, the Commission records in the off-balance-sheet commitments the difference between the updated allocations provided at the Edinburgh summit in December 1992 and the amounts of commitments appearing in the budget accounts.

The Commission would none the less point out that the budgetary commitment procedure for the Structural Funds

complies with Article 20 of Council Regulation No 2082/93 amending Regulation No 4253/88, which sets out a number of criteria which Member States must fulfil, particularly as regards the degree of implementation, in order to take up all the commitments for the period. By the end of 1999, the final year of the current programming period, there should no longer be any difference between the decisions adopted and the budgetary commitments.

As regards the international fisheries agreements, the Court notes that budget commitments are understated by ECU 352.7 million. The specific feature of the international fisheries agreements is that they constitute legal frameworks which, although extending over a number of financial years, set annual obligations for each of the parties (Community — third countries). The Community's financial obligations are thus clearly divided into annual tranches in the basic text (the financial protocol). That is why the Commission commits only the annual tranche during the year in question.

As for the understatement of potential liabilities in the field of external relations by ECU 2 798 million, the Commission would point out that the multiannual indicative programmes for Phare and Tacis are not binding on either the Commission or the recipients; instead, they are indicative programmes which serve as a basis for discussion between the Commission and the recipient countries. It would not therefore be correct to enter them as potential debts.

The financial allocations decided at the Cannes European Council for cooperation with the countries of central and eastern Europe and for cooperation with Mediterranean non-member countries, of which MEDA forms a part, are not expenditure targets with the same status as for the Structural Funds.

Legality and regularity of underlying transactions

Errors affecting the legality and regularity of transactions underlying payments

Substantive legality and regularity errors concerning transactions underlying payments (paragraph V of the statement of assurance)

Common agricultural policy

8.26. The Commission is proposing that all Member States adopt graphical identification systems in order to reduce human

error in claims submitted in the arable crop sector. However, many errors concern small plots of land and Member States cannot realistically extend their on-the-spot checks to cover all plots of land and to detect minor discrepancies. Current rules require Member States to examine a minimum of 5 % of claims and to direct their checks towards the higher risks and higher value claims. In many cases the Member States have undertaken to recover irregular claims. Others will be followed up within the clearance procedure. However, certain of the Court's findings do not concern irregularities as defined by the Commission.

The ECU 655 million recovered under the clearance of accounts procedure in 1998, together with the inspection and sanction systems in the Member States which lead to reductions of expenditure of the order of ECU 300 million, compensate for a large part of the level of irregularities found for that year.

Structural operations

8.27-8.28. It is the Member States which have prime responsibility for controlling co-financed operations, but the Commission agrees that Community controls must be intensified and that full use must be made of the possibilities provided by the protocols signed with the national control agencies. The Commission is confident that the initiatives which it has taken since 1997 in connection with the eligibility of expenditure (Decision of 23 April 1997), the strengthening of national systems of control (Regulation (EC) No 2064/97), financial corrections (guidelines resulting from application of Article 24 of Regulation (EEC) No 4253/88 of 15 October 1997) and the procedure for the closure of operations (Commission decision of 9 September 1999) will have an effect in reducing the volume of error, which will be seen when the final balances are presented and which will be confirmed by the independent authorities provided for in Regulation (EC) No 2064/97.

Moreover, the Dublin European Council decided that the Commission must take account of the Member States' comments in its reply to the Court; this year it was unable to examine these comments in detail because of the very short time limits.

Internal policies

8.29. The Commission would point out that it first carries out an ex ante examination of contractors' proposals and

analyses them in the light of other recent contracts in similar fields to check for any overcharging. The Commission also conducts a number of ex post audits of a significant sample of contracts. The Commission is very keen to step up its audits and has taken a number of measures in this field since the 1999 financial year, as the Court has been informed. In addition the Commission will continue to improve the cost reimbursement system with the objective of reducing the danger of overcharging.

Formal legality and regularity errors concerning transactions underlying payments (paragraph VI of the statement of assurance)

Common agricultural policy

8.33. The formal errors found by the Court indicate risks of control weaknesses. These will be considered by the Commission when establishing the work programme for the clearance of accounts and when conducting individual enquiries.

Structural operations

8.34. Regulation No 2064/97 phases in the rule, from 1999 onwards, that an independent national authority must certify to the Commission, no later than at the time of the request for the final payment, that errors of the type detected by the Court have been eliminated and that an adequate audit trail can be provided.

External action

8.35. In 1999 the Commission attempted to harmonise contractual procedures in order to simplify them and make them more transparent.

Under the contracts it signs and sends to the contractors, the Commission is obliged to make payments on presentation of the supporting documents demanded by the Financial Regulation. In accordance with the contractual conditions, there can be no question in these circumstances of casting doubts on these payments without creating a legal uncertainty which would be incompatible with the smooth operation of the programmes.

Administrative expenditure

8.36. The Commission's detailed reply to the Court of Auditors' observation is set out at points 6.13 to 6.17 of this report.

Recommendations

Reliability of the accounts

8.37. The Court recognises that the Commission has every year tried to improve the presentation of the accounts. The Commission has also undertaken to review the whole accounting framework when recasting the Financial Regulation.

8.38, 8.39 and 8.40. The legal framework wanted by the Court will be introduced with the recasting of the Financial Regulation. However, this revision procedure will be a lengthy process and the outcome will not affect the accounts for 1999 (or even 2000).

As regards entitlements relating to the separate accounts and debts owed to the EAGGF-Guarantee Section, the Commission has already set out in the replies to paragraphs 8.14 and 8.16 of this report the measures it will be taking to improve the reliability of accounts.

The date for the adoption of the accounts proposed by the Court (31 March) is something that can only be considered in the context of the recasting of the Financial Regulation.

The Commission welcomes the Court's proposal that outside assistance should be used to ensure that the financial statements are consistent with the accounting standards and principles generally accepted by the public sector. This will be investigated in the fourth quarter of 1999.

Legality and regularity of transactions underlying payments

8.41. In the case of the Structural Funds, there have been a number of initiatives which have yet to produce their full effect. Greater commitment is required from the Member States. Thought is currently being given to the appropriate management and organisational structures.

8.42. The Agenda 2000 reforms have provided the opportunity to simplify the Structural Fund rules relating to indirect management shared with the Member States. New procedures have been drawn up for making use of the Technical Assistance Office.

8.43. As regards simplification and proper accountability, the Commission believes that it should put forward appropriate proposals in the context of the reform of the Financial Regulation and the specific regulations.

