

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, ECSC, Euratom) No 2673/1999 of 13 December 1999, as well as the corresponding provisions relating to the European Development Funds, the Court of Auditors of the European Communities, at a meeting on 11 and 12 October 2000, adopted its

ANNUAL REPORT

concerning the financial year 1999

(2000/C 342/01)

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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GENERAL INTRODUCTION

0.1. This Annual Report follows the format used for the past two years with chapters dealing with revenue and each of the expenditure areas that fall under the headings of the financial perspectives. There is a separate chapter containing and explaining the Statement of Assurance. The Court's observations concerning the activities of the sixth, seventh and eighth European Development Funds are presented separately.

0.2. Since the last discharge procedure the Court has adopted 24 special reports, containing the results of audits which focus attention on a wide range of specific areas in which the Community's financial management can be improved. The findings in these reports are taken into account along with those in this Annual Report by the discharge authority. A full list of the reports and opinions adopted by the Court in each of the last five years appears in Annex II to this report.

0.3. 1999 was an important year for financial management in the Community. A crisis of confidence in the Commission's management which had developed over previous years came to a head with the two reports of the Committee of Independent Experts, after the first of which the Commission resigned. The new Commission which began work in September 1999 immediately set about a new reform programme. There are three related themes in the programme: reform of the way political priorities are set and resources allocated, important changes to personnel policy, and a radical overhaul of financial management and control. During 2000 the Commission has been developing the details of its proposals and starting the process of implementation.

0.4. Many of the important weaknesses which the reform programme is seeking to address are points which the Court in its reports over the years has emphasised on many occasions: the inadequacy of the Community's contractual arrangements, fundamental and structural weaknesses in internal control which diminish the responsibility of authorising officers, persistent shortages in resources for the management of some programmes, which led to a proliferation of sometimes

irregular devices such as the so-called BATs ⁽¹⁾ to try to fill the gaps. Insufficient priority was given in the past to taking the steps necessary to deal with the weaknesses quickly and effectively.

0.5. As highlighted by the Court on several occasions, a fundamental improvement in internal control will require 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 the commitments and payments. In this context, the internal audit function should also be strengthened, as proposed by the Commission. The Commission's proposals in its White Paper take into account the observations of the Court in its Opinion No 4/97 ⁽²⁾ on the Commission's proposed revision of the Financial Regulation. The priority which the Commission has attached to the reform, including the necessary modification to Article 24 of the Financial Regulation, and the creation and staffing of the internal audit service, is to be welcomed.

0.6. Another element of the reform that corresponds closely to a key priority identified by the Court is the increased focus to be placed on results and performance measurement, within a framework of resource allocation that is consistent with predetermined priorities and objectives that are clearly defined and measurable. In the general introduction to the Annual Report for 1998 the Court argued that the measure of success for the Commission should be the extent to which policy goals are attained with the minimum of cost, and stressed that the change of culture and practice that this would entail should be placed at the heart of the financial reform process. Again, the introduction of activity-based management (ABM) should assist the Commission to improve its setting of priorities in line with available financial and administrative resources, and avoid situations in which relatively small programmes absorb disproportionate amounts of effort from its staff.

⁽¹⁾ The acronym for the French title of Technical Assistance Offices.

⁽²⁾ Opinion No 4/97 of the Court of Auditors on the proposal for a Council Regulation (Euratom, ECSC, EC) amending the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities (OJ C 57, 23.2.1998), paragraphs 5.1 to 5.17.

0.7. In addition to adopting the general programme of administrative and financial reform, the Commission has announced reform programmes for certain budgetary areas, which also address concerns expressed over a number of years by the Court. The Commission's May 2000 proposals for improving the management of external aid programmes are based on an analysis of the weaknesses of the Commission's programmes which is very similar to that of the Court, as set out in various special and annual reports, notably chapter 5 of the Annual Report for 1997.

0.8. The wholesale revision of the Financial Regulation currently underway is necessary to provide an appropriate regulatory framework for the reform of financial management. In its Opinion No 4/97⁽³⁾ and subsequently, the Court has made, among others, recommendations concerning the authorising officer's responsibilities, the introduction of the independent internal auditor⁽⁴⁾, the requirement for accounts to be presented in accordance with international standards, and the introduction of borrowing for the purpose of investing in buildings for the use of the institutions. It has also recommended simplification of the provisions concerning the definition of commitments and the carry-over of appropriations, and a reduction in the exceptions to the basic principles of the Financial Regulation. The Court will continue to insist strongly on these recommendations, and will follow up carefully on all aspects of the revision of the Financial Regulation, while reserving its position on further possible improvements.

0.9. The Court encourages the Commission to proceed with the implementation of its proposals for reform as quickly as is feasible, bearing in mind that some of the reforms require changes in the Financial and Staff Regulations. At this stage, while the first steps are being taken, the reform programme has, for the most part, still to be implemented. It is only when structures and procedures are in place and actually functioning that it will be possible to assess whether the intended improvements in financial management are being obtained. Changing the management culture of an organisation such as the Commission is difficult, and will take time, but it is only with such changes that the reform proposals will work.

⁽³⁾ OJ C 57, 23.2.1998.

⁽⁴⁾ Opinion No 1/2000 of the Court of Auditors on the proposal for a Council Regulation amending the Financial Regulation of 21 December 1977 and separating the internal audit function from the *ex ante* financial control function (fifth paragraph of Article 24 of the Financial Regulation) — adopted by the Court on 5 October 2000.

0.10. As the Court has said on many occasions, improvements in financial management by the Commission constitute but a part of what is needed to improve the overall management of Community funds. Member States are responsible for the day-to-day management of the bulk of the funds from the Community budget, in the areas of the common agricultural policy and the Structural Funds. This Annual Report and the special reports published since the last discharge continue to draw attention to serious and persistent weaknesses in Member States' management and control systems. Important initiatives have been taken to improve matters by strengthening the financial controls that the Member States themselves are required to maintain over Community-financed (or co-financed) operations⁽⁵⁾. This Annual Report, however, shows that implementation of the new systems remains incomplete (see paragraph 2.41, paragraphs 3.69 to 3.74 and 3.78), and that the Commission needs to increase its pressure on the Member States to implement them fully.

0.11. By placing more emphasis in the Annual Report on following up the action taken in response to its previous audit observations, the Court is responding to the concerns of the discharge authority. Separately from any consideration of the Commission's reform proposals, this Annual Report shows that some progress has been made in some specific areas. Action has been taken by the Commission to remedy specific weaknesses in some projects and programmes (for example the programme of assistance to South Africa, reforms to the measures for the subsidised use of skimmed milk and skimmed-milk powder for animal feed, action on some own resources matters). In other areas, however, such as the reform of the wine market organisation and the taking of corrective action following the detection of errors or irregularities in the ERDF field, the response has been slow, or partial.

0.12. In its Statement of Assurance on the 1999 accounts, the Court again draws attention to problems with the Community's financial statements similar to those found in previous years. Weaknesses in accounting systems and procedures mean that the information presented is in some cases incorrect or incomplete. The problems in management and control systems covering operational expenditure, both at the Commission and

⁽⁵⁾ The integrated administrative and control system (IACS) concerning agricultural expenditure, and Council Regulation (EC) No 2064/97 on financial control of the Structural Funds.

in Member States, continue to give rise to a significant incidence of errors, mainly at the level of final beneficiaries. In view of the findings set out above the Court declines to provide assurance that the transactions underlying the financial statements are legal and regular, except in the case of own resources, the commitments and the institutions' staff expenditure. The Court, therefore, endorses the intentions of the Commission's plan for improving financial management, presented to the discharge authority in the context of the discharge for 1998. As pointed out in paragraph 8.59 of this report, if there is an effective and constant improvement in management and control procedures of the Commission and the authorities in the Member States, there should be an effect on the Court's audit findings and conclusions. However, no one can determine in advance the opinion of the independent external auditor, which has to be based on the facts established in the course of the audit.

0.13. Finally, attention is drawn to the danger of misinterpreting or misrepresenting the errors found by the Court as an indication of the level of fraud affecting the Community budget. The references in the Court's reports to payments whose amounts are wrong because of error and irregularity primarily concern problems of inadequate financial management and control. The bulk of the errors occur in the main expenditure programmes managed by the public authorities in the Member States and particularly concern such things as small overpayments to farmers and payments for expenditure by public authorities which is not eligible for EU co-financing.

Only a small proportion of the breaches of the regulations found by the Court have justified further investigation by OLAF or the authorities with criminal jurisdiction in the Member States. The extent of fraud is the subject of an annual report of the Commission, collating data provided by the Commission and the Member States, on the protection of the Communities' financial interests.

0.14. Nevertheless, if the Court finds indications of deliberate fraud, it continues to work closely with OLAF in the protection of the Community's financial interests, in accordance with the agreements between the two bodies. In this context, the Court notes that the 1995 Convention on the protection of the Community's financial interests has still not been ratified by all the Member States, and that the parallel Convention dealing with corruption in connection with the EU budget has been ratified by only one Member State. This shows that, although Article 280 of the Treaty provides that the Member States have important responsibilities for combating fraud against the Community budget, they are not yet discharging these responsibilities in a fully satisfactory way. It is therefore necessary to explore all possible instruments, either within the existing Community legal framework or through appropriate amendments to the Treaty, to protect the Community's financial interest. Further, as the OLAF Supervisory Committee has recently emphasised, much remains to be done to improve cooperation between OLAF and the Member States in the investigation and prosecution of fraud and corruption involving the EU budget.

REPORT ON THE ACTIVITIES FINANCED
FROM THE GENERAL BUDGET

CHAPTER 1 (*)

Own resources

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(*) The Commission's replies are on page 25.

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INTRODUCTION

1.1. The Court's examination of the Community's traditional own resources concentrated on the establishment and recovery by the Commission and Member States of amounts due to the Community, as well as the implementation of Community regulations, particularly in the field of outward-processing customs arrangements.

1.2. With regard to the resources that derive from VAT and GNP, the Court's work dealt mainly with comparing tax and statistical data for the purposes of fighting fraud. Furthermore, the Court reviewed the actions taken in response to the criticisms it had previously made of the fact that a dual system of national accounting standards has been retained (ESA 79 and ESA 95).

1.3. Moreover, the Court submitted its observation on the Commission's control of the reliability and comparability of GNP in its Special Report No 17/2000 ⁽¹⁾.

IMPLEMENTATION OF THE BUDGET

1.4. **Table 1.1** summarises Community revenue for the financial year 1999 and **Graph 1.1** shows the following:

- (a) revenue for the financial year 1999 increased by 2,8 % compared with financial year 1998 (84 529,7 million euro), amounting to 86 908,1 million euro, or 101,5 % of the revenue provided for in the final budget;

⁽¹⁾ Shortly to be published in the Official Journal. Available now on the Court's Internet site.

- (b) net traditional own resources (that is, minus 1 539,7 million euro of collection expenses) amounted to 13 857,6 million euro, which represents 15,9 % of total actual revenue; these resources fell by 1,8 % compared with the financial year 1998, and can be broken down as follows:

— customs duties amounting to 13 006,5 million euro (gross), making up 84,5 % of gross traditional own resources (15 397,3 million euro) ⁽²⁾,

— agricultural duties amounting to 1 187,3 million euro (gross), making up 7,7 % of gross traditional own resources,

— sugar and isoglucose levies amounting to 1 203,5 million euro (gross), making up 7,8 % of gross traditional own resources;

- (c) own resources from VAT amounted to 31 332,3 million euro ⁽³⁾, or 36,1 % of total actual revenue; actual revenue fell by 5,3 % compared with the financial year 1998 (33 086,5 million euro);

- (d) the GNP resource amounted to 37 512,0 million euro ⁽⁴⁾ (of which 305,4 million euro of reserves),

⁽²⁾ Net traditional own resources (13 857,6 million euro) + collection costs (1 539,7 million euro) = gross traditional own resources (15 397,3 million euro).

⁽³⁾ Own resources from VAT (31 332,3 million euro) = own resources from VAT of the financial year (31 381,6 million euro) + balances and adjustments from previous financial years (- 49,3 million euro).

⁽⁴⁾ The GNP resource (37 512,0 million euro) = the GNP resource of the financial year (37 011,7 million euro) + balances and adjustments from previous financial years (500,3 million euro).

Table 1.1 — Revenue for the financial years 1998 and 1999 - Analysis of budgetary implementation 1999

(Mio EUR)

Type of revenue and corresponding budget heading	Actual revenue in 1998	Development of the 1999 budget		Actual revenue in 1999	Rate of implementation of the final budget (%)
		Initial budget	Final budget		
	(a)	(b)	(c)	(d)	(e) = (d)/(c) x 100
1. Traditional own resources (totals)	14 110,7	13 814,9	13 355,0	13 857,6	103,8
— Agricultural duties (Chapter 10)	1 102,2	1 054,5	1 054,5	1 187,3	112,6
— Sugar and isoglucose levies (Chapter 11)	1 070,1	1 080,0	1 080,0	1 203,5	111,4
— Customs duties (Chapter 12)	13 506,2	13 215,4	12 704,4	13 006,5	102,4
— Collection expenses (Chapter 19)	-1 567,8	-1 535,0	-1 483,9	-1 539,7	103,8
2. VAT resources (total)	33 086,4	30 374,2	31 041,8	31 332,3	100,9
— VAT resource from the current financial year (Chapter 13)	32 684,9	30 374,2	31 041,8	31 381,6	101,1
— Balances and adjustments to balances in respect of previous financial years (Chapter 31)	401,5	p.m.	p.m.	-49,3	
3. GNP resource (total)	35 026,1	39 260,0	37 534,9	37 512,0	100,0
— GNP resource from the current financial year (Chapter 14) (of which reserves)	34 428,4 (271,7)	39 260,0 (1 192,0)	37 534,9 (1 192,0)	37 011,7 (305,4)	98,6 (25,6)
— Balances and adjustments to balances in respect of previous financial years (Chapter 32)	597,7	p.m.	p.m.	500,3	
4. Budgetary imbalances (totals)	55,4	0,0	0,0	-169,2	
— Financing of the UK correction (Chapter 15)	60,9	0,0	0,0	-167,8	
— Final calculation of the financing of the UK correction (Chapter 35)	-5,5	0,0	0,0	-1,4	
5. Surpluses available from the previous financial year (Chapter 30)	960,0	1 478,0	3 022,2	3 022,2	100,0
6. Refunds to Member States (Chapter 33)	-29,4	p.m.	p.m.	0,0	
7. Miscellaneous revenue (Titles 4 to 9) (of which contributions from EEA States, Article 630)	1 320,5 (61,5)	630,6 (p.m.)	630,6 (p.m.)	1 353,2 (65,1)	
Grand total	84 529,7	85 557,7	85 584,5	86 908,1	101,5

Source: 1999 budget and 1998 and 1999 revenue and expenditure accounts.

or 43,2 % of total actual revenue; this resource increased by 7,1 % compared with the previous financial year (35 026,1 million euro);

- (e) the surplus available from the previous financial year (3 022,2 million euro) and miscellaneous revenue (1 288,1 million euro) represent 5,0 % of total actual revenue, or an increase of 94,2 % compared with the financial year 1998.

1.5. The Court has reviewed the information presented by the Commission in Volume I of the revenue

and expenditure account. This volume provides a commentary on the year's revenue. In particular, it explains the variations between the amounts in the approved budgets and actual revenue. This review did not seek to provide assurance as to the reliability of these explanations. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading. In one case, the commentary does not give an explanation for a difference in Title 9 'Miscellaneous revenue', between the budget amount of 5,2 million euro and actual revenue of 31,4 million euro.

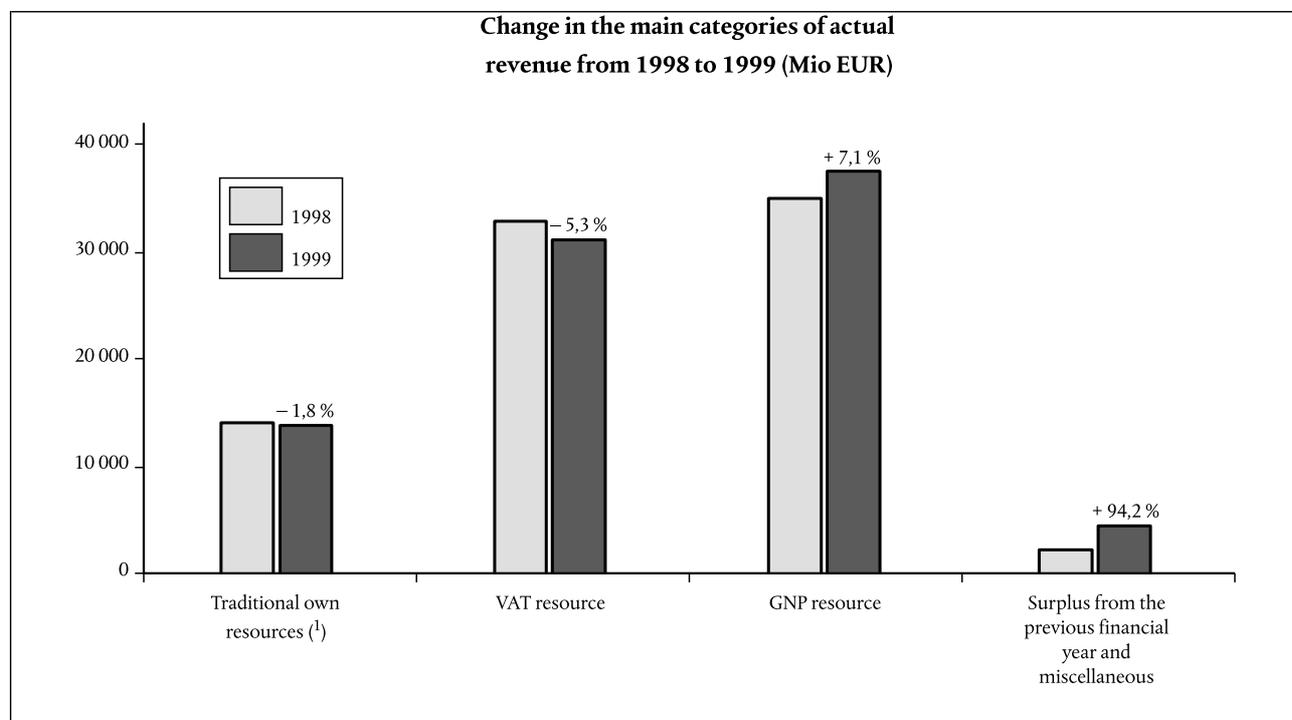
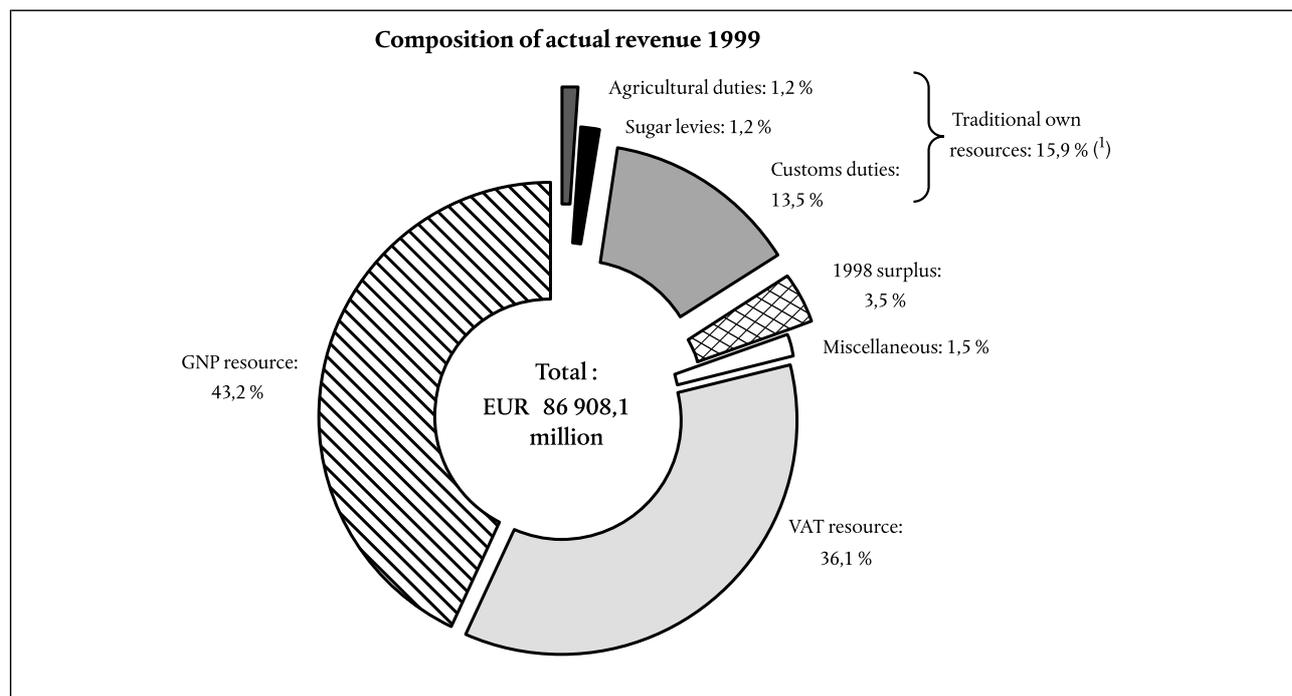
Table 1.2 — Estimated and actual own resources in 1999, by Member State

(Mio EUR)

Type of resource		B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK	EU-15
Chapter 10 — Agricultural duties	estimated	106,1	3,6	191,3	8,0	33,2	77,5	7,7	141,9	0,3	168,5	26,0	40,0	7,0	31,3	212,1	1 054,5
	actual	38,1	8,5	167,8	10,9	57,4	60,5	2,0	81,0	0,6	192,9	13,8	43,4	7,1	19,8	483,5	1 187,3
Chapter 11 — Sugar and isoglucose levies	estimated	64,9	36,3	301,7	17,3	42,6	295,0	10,8	110,5	0,0	71,5	29,8	2,4	8,1	21,0	68,1	1 080,0
	actual	72,3	42,0	347,9	11,9	47,3	334,9	12,1	126,5	—	67,5	34,3	3,2	8,5	22,4	72,7	1 203,5
Chapter 12 — Customs duties	estimated	1 094,5	265,3	2 967,5	151,5	697,2	1 229,9	194,9	1 153,0	22,4	1 533,5	210,2	141,4	129,9	358,1	2 555,1	12 704,4
	actual	1 115,1	278,9	3 026,6	185,9	805,1	1 256,1	180,1	1 213,0	22,0	1 530,8	223,7	158,6	126,9	352,9	2 530,8	13 006,5
Chapter 19 — Costs incurred in collecting own resources	estimated	- 126,6	- 30,5	- 346,0	- 17,7	- 77,3	- 160,2	- 21,3	- 140,5	- 2,3	- 177,4	- 26,7	- 18,4	- 14,5	- 41,0	- 283,5	- 1 483,9
	actual	- 122,6	- 32,9	- 354,2	- 20,9	- 91,0	- 165,1	- 19,4	- 142,1	- 2,3	- 179,1	- 27,2	- 20,5	- 14,2	- 39,5	- 308,7	- 1 539,7
Chapter 13 — VAT resource from the current financial year	estimated	817,1	546,7	8 232,2	502,4	2 300,2	5 428,2	312,0	3 576,9	78,1	1 524,1	818,8	443,3	426,5	764,0	5 271,3	31 041,8
	actual	817,0	547,4	8 232,2	507,0	2 300,2	5 428,2	312,0	3 576,9	78,1	1 524,1	818,8	443,3	426,5	807,7	5 562,2	31 381,6
Chapter 31 — Balance of the VAT resource in respect of previous financial years	estimated	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	actual	10,9	- 4,0	- 367,9	17,2	162,0	28,9	94,8	112,6	- 2,0	42,7	- 43,2	26,3	21,7	23,9	- 173,2	- 49,3
Chapter 14 — GNP resource from the current financial year	estimated	1 144,2	750,3	9 586,2	567,9	2 600,0	6 503,1	352,6	5 277,0	88,3	1 722,7	964,7	501,1	563,7	929,8	5 958,3	37 509,9
	actual	1 117,7	734,0	9 364,6	560,7	2 539,9	6 352,8	344,5	5 155,0	86,2	1 682,9	942,4	489,5	550,7	962,4	6 128,4	37 011,7
Chapter 32 — Balance of the GNP resource in respect of previous financial years	estimated	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
	actual	4,0	- 11,5	- 46,3	4,7	80,9	- 83,5	85,7	- 39,1	- 0,1	21,1	- 13,9	21,5	17,2	95,3	364,3	500,3
Chapter 15 — Financing of the UK correction	estimated	141,0	92,4	687,4	70,0	320,4	801,3	43,4	650,2	10,9	212,3	118,8	61,7	69,5	114,6	- 3 393,9	—
	actual	141,0	92,6	687,4	70,6	320,3	801,3	43,4	650,2	10,9	212,3	118,8	61,7	69,5	120,1	- 3 567,9	- 167,8
Chapter 35 — Final calculation of the financing of the UK correction	estimated	2,6	1,3	11,1	3,0	9,6	- 20,3	4,4	31,2	0,8	- 3,8	- 14,2	0,7	- 3,1	- 16,4	- 6,9	—
	actual	2,5	1,3	10,9	2,8	9,2	- 20,0	4,4	31,6	0,7	- 3,7	- 13,9	0,7	- 3,1	- 16,1	- 8,7	- 1,4
Total own resources	estimated	3 243,8	1 665,4	21 631,4	1 302,4	5 925,9	14 154,5	904,5	10 800,2	198,5	5 051,4	2 127,4	1 172,2	1 187,1	2 161,4	10 380,6	81 906,7
	actual	3 196,0	1 656,3	21 069,0	1 350,8	6 231,3	13 994,1	1 059,6	10 765,6	194,1	5 091,5	2 053,6	1 227,7	1 210,8	2 348,9	11 083,4	82 532,7

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 duties and sugar and isoglucose levies.

Graph 1.1 — Community revenue (for details see Tables 1.1 and 1.2)



(1) After deduction of 10 % for collection expenses incurred by the Member States.

Source: 1998 and 1999 revenue and expenditure accounts.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Traditional own resources

Applicable legislation

1.6. The specific legislation for traditional own resources includes:

- (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

1.7. In the context of the Statement of Assurance (see Chapter 8), the audit of traditional own resources covers the customs and agricultural duties that are established and entered in the accounts (A accounts) of the Member States on the basis of the declarations submitted to the customs authorities for the release of goods for free circulation in the Community. The audit of the legality and regularity of the underlying transactions does not include imports which are not declared or which have escaped customs surveillance.

⁽⁵⁾ OJ L 293, 12.11.1994, p. 9.

⁽⁶⁾ OJ L 155, 7.6.1989, p. 1, as codified by Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000, which took effect on 31 May 2000.

⁽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.

1.8. The Court takes into consideration separately the inherent risk represented by irregular imports and other risks to traditional own resources which may result in amounts due not being recorded in the accounts. In the context of its other tasks, it has carried out specific audits centred on the evaluation of 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 management of the securities and guarantees provided for in the Community Customs Code to protect the collection of traditional own resources ⁽¹⁰⁾. 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 ⁽¹¹⁾, the Commission shows a figure of 1 096 million euro, corresponding to the cumulative amount of the traditional own resources at stake in cases of irregularity and fraud reported by the Member States for the years 1995 to 1998.

1.9. In addition to the amounts entered as revenue in the revenue and expenditure account, the notes to the balance sheet show a provision for the first time for the total amount receivable from Member States for own resources which have not yet been collected but have been entered in separate accounts (the B accounts) (see paragraph 8.6). The outstanding amount shown on these accounts as at 31 December 1999 was 1 951,9 million euro.

1.10. The Court also examined the procedures in Member States for the entry in the accounts and aggregation of traditional own resources.

Audit findings

1.11. In the course of the Court's audit, it was found that established entitlements amounting to 3,0 million euro were made available to the Commission with significant delays. When amounts are made available late, Member States are liable to pay default interest under Article 11 of Council Regulation (EEC, Euratom) No 1552/89 (cited in paragraph 1.6 above).

⁽¹⁰⁾ Special Report No 8/99 (OJ C 70, 10.3.2000).

⁽¹¹⁾ Protecting the Communities' financial interests and the fight against fraud — Annual Report 1998, COM(1999) 590 final.

1.12. As has been the case for several years⁽¹²⁾, there were problems both with the reliability and with the nature of the separate accounts (the B accounts). Under Article 6(2) of Council Regulation (EEC, Euratom) No 1552/89, Member States enter in the B accounts established entitlements which have not yet been recovered and for which no security has been provided, and may also enter in the B accounts established entitlements for which security has been provided but which have been challenged and might upon settlement of the disputes which have arisen be subject to change.

1.13. At the end of 1999 the net total amount standing on the B accounts, at 1 951,9 million euro, was 212,5 million euro (+ 12,2 %) higher than the figure at the end of 1998 (1 739,4 million euro). This increase represented new entries amounting to 514,4 million euro (23 % less than the new entries in 1998), reduced by recoveries during the financial year of 216,2 million euro and cancellations or write-offs amounting to 85,7 million euro. The resulting net increase remains in the usual range.

1.14. The Court's audits showed that despite the attention that has been drawn to the problem, in some Member States the procedures for compiling the B accounts are not yet fully reliable. Certain established entitlements that should have been entered in the A accounts and made available were wrongly entered in the B accounts, and there were also late or duplicated entries in the B accounts. However, the amounts noted were not material to the revenue and expenditure account as a whole.

1.15. As regards the nature of the B accounts, the Regulation leads to a mixture of established entitlements being entered without distinction according to the circumstances in which they arose and the probability of ultimate recovery. Some entries in the B accounts are amounts, technically unsecured, which are not in dispute and will generally be promptly paid; others relate to bankrupt or untraceable debtors and others are the subject of long-running legal procedures. There have also been differences between Member States' interpretations of the Regulation (see Special Report

No 8/99⁽¹³⁾). The Court welcomes the Commission's response that it does not hesitate to take the requisite measures when the rules are not obeyed, and underlines the need for the Commission to ensure that correct and uniform practices are followed in all Member States.

1.16. The statements sent quarterly by the Member States to the Commission do not analyse the B account balance brought forward by age or otherwise, and so do not provide an adequate base for the Commission to use for presenting a realistic value to the Community of the amounts due (see paragraph 8.6). For the period 1990 to 1999 as a whole, only 30 % of the amounts originally entered in the B accounts have been recovered. The balance includes some long-standing entries for which full recovery must now be regarded as very doubtful, although the considerable differences between Member States' legal systems prevent generalisation. As such it is not possible to assume that the previous recovery rate applies to the current outstanding balance. The Commission should require more detailed analysis by the Member States of the balances on the B accounts. This would serve as a basis for showing in the financial statements the amounts estimated to be recovered, and to improve management of the debt. Such treatment would be preferable to the procedure in 1999 of making 100 % provision.

Result of the audit

1.17. 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 of the Member States (see paragraph 1.7). The errors found during examination of the underlying transactions did not materially affect the accuracy of the revenue in the revenue and expenditure account. In one Member State, several cases of errors and inconsistencies in the customs declarations, which ought to have been detected by customs control procedures, were found at a single customs office. These cases require investigation and appropriate action by the national authorities and by the Commission as regards traditional own resources not made available or made available late.

⁽¹²⁾ Annual Report concerning the financial year 1998, paragraph 1.10; Statement of Assurance concerning activities financed from the general budget for the financial year 1997, paragraphs 8.13 and 8.14 (OJ C 349, 17.11.1998); Statement of Assurance concerning activities financed from the general budget for the financial year 1996, paragraphs 19.6 and 19.7 (OJ C 348, 18.11.1997).

⁽¹³⁾ Special Report No 8/99 (OJ C 70, 10.3.2000), paragraphs 51 to 53.

*VAT/GNP own resources***Applicable legislation**

1.18. The specific legislation for the VAT and GNP own resources includes:

- (a) Council Decision 94/728/EC, Euratom of 31 October 1994⁽¹⁴⁾ on the system of the European Communities' own resources, and Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989⁽¹⁵⁾ 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⁽¹⁶⁾;
- (b) Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989⁽¹⁷⁾ on the definitive uniform arrangements for the collection of own resources accruing from value added tax;
- (c) Council Directive 89/130/EEC, Euratom of 13 February 1989⁽¹⁸⁾ on the harmonisation of the compilation of gross national product at market prices.

Scope of the audit

1.19. The VAT and GNP resources are determined 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.

Audit findings

1.20. Member States are required to send assessment bases for years $n - 1$ and earlier to the Commission before 31 July in the case of VAT⁽¹⁹⁾ and 1 October in the case of GNP⁽²⁰⁾.

⁽¹⁴⁾ OJ L 293, 12.11.1994, p. 9.

⁽¹⁵⁾ OJ L 155, 7.6.1989, p. 1, as codified by Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000, which took effect on 31 May 2000.

⁽¹⁶⁾ OJ L 175, 13.7.1996, p. 3.

⁽¹⁷⁾ OJ L 155, 7.6.1989, p. 9.

⁽¹⁸⁾ OJ L 49, 21.2.1989, p. 26.

⁽¹⁹⁾ Articles 7 and 9 of Regulation (EEC, Euratom) No 1553/89.

⁽²⁰⁾ Article 3(2) of Directive 89/130/EEC, Euratom.

1.21. The late transmission in 1999 by several Member States of valid assessment bases, particularly GNP, reduced the time available for checking. The extent and nature of the checks performed by the Commission on the GNP data were not adequately documented⁽²¹⁾.

Result of the audit

1.22. Taking into account the limitation to the scope of the audit, 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.

FOLLOW-UP TO PREVIOUS OBSERVATIONS*Traditional own resources*

1.23. The Court examined the action taken by the Commission in the financial and regulatory spheres in response to the most significant observations made in the Annual Reports concerning the financial years 1994 to 1997, and in Special Report No 13/98 concerning the use of risk analysis techniques in customs control and the clearance of goods⁽²²⁾. The Court's evaluation of the remedial action taken in response to its observations is based on information available at the Commission.

Follow-up at financial management level

1.24. In its Annual Report concerning the financial year 1994, the Court referred to the traditional own resources that some Member States had not established or made available to the Commission, as they should have done in accordance with the regulations. These observations resulted in the establishment of arrears interest of 0,4 million euro, which was completely recovered. The checks carried out by the Commission, following the Court's observations on systematic delays in discharging the transit regime, led to the establishment

⁽²¹⁾ Special Report No 17/2000 on the Commission's control of the reliability and comparability of the Member States' GNP data, paragraph 57. To be published shortly in the Official Journal and available now on the Court's Internet Site.

⁽²²⁾ OJ C 375, 3.12.1998.

of arrears interest of 2,4 million euro, of which only 0,1 million euro was recovered. The financial follow-up of two of the five cases mentioned in the 1994 Annual Report that were being dealt with in the mutual assistance framework was still under way at the time of the inquiry.

1.25. The Court's observations in its Annual Report concerning the financial year 1995 dealt with the application of the inward-processing arrangements, the customs warehousing procedure, and customs union agreements. On the basis of these observations, the Commission recovered 3,6 million euro in arrears interest and 26 530 euro of principal. The Court had also observed a case of incorrect application of the Customs Union Agreement with Turkey during the period 1973 to 1995, consisting of the export to this country with ATR certificates of produce deriving from the inward-processing arrangements which had not been first released for free circulation. The Commission had taken the view that Community legislation did not allow retrospective recovery of the duties corresponding to the release for free circulation of the produce in question, but it had undertaken to ask the Member States to invalidate the duly delivered ATR certificates and to inform the Turkish authorities. The Court observes that the Commission approached the Member States in March 1997 and asked them to re-examine certificates issued during the period 1 March 1994 to 18 March 1995 only and that, according to information in the possession of the Commission, no Member State invalidated any ATR certificates.

1.26. The Court's Annual Report concerning the financial year 1996 contained observations on the Commission's and Member States' financial management, free zones, and inward-processing arrangements. These observations were followed up appropriately, as were those concerning the establishment and post-clearance recovery of traditional own resources.

1.27. The Annual Report concerning the financial year 1997 contained observations with no direct financial implications which concerned the use of risk-analysis techniques, as well as financial auditing observations on amounts of own resources not made available or made available late. The latter observations were adequately followed up; the Commission recovered the principal of 15,3 million euro and 1,3 million euro of arrears interest.

Follow-up at Community regulations level

1.28. The Court examined what the Commission had done to follow up the changes to the Community regu-

lations envisaged in its replies to the Court's observations in its Annual Reports concerning the financial years 1994 to 1997. In its replies, the Commission proposed changes to various regulations, in particular, those covering the transit regime, inward-processing arrangements, preferential tariff treatments, the management of irrecoverable claims, establishment and post-clearance recovery procedures and mutual assistance procedures as part of the fight against customs fraud.

1.29. During the period under review an amendment was made to Regulation (EEC, Euratom) No 1552/89⁽²³⁾ aiming to harmonise the financial information forwarded to the Commission by the Member States; another proposal to amend this Regulation, relating to the conditions for writing-off traditional own resources, was still being examined at the time of the enquiry⁽²⁴⁾.

1.30. The observations on mutual assistance and post-clearance recovery contained in the Annual Report concerning the financial year 1994 should, in particular, have resulted in an improvement in the provisions in the customs code relating to the period of time-barring and to the guarantee of customs debt. At the time of the Court's audit, these adjustments were still being discussed⁽²⁵⁾.

1.31. In the Community transit field, the Commission has not yet been able to implement the Court's proposal that the provisions of the code relating to the global guarantee should be strengthened. The current provisions continue to allow goods to be placed under the transit procedure, despite the fact that the global guarantee has become insufficient as a result of the volume of previous uncleared operations.

VAT/GNP own resources

Introduction

1.32. The GNP is the reference aggregate for calculating the fourth resource used to finance the Community budget. In this context, in 1999, a new edition of the

⁽²³⁾ Regulation (Euratom, EC) No 1355/96 (OJ L 175, 13.7.1996) amending Regulation (EEC, Euratom) No 1552/89 (OJ L 155, 7.6.1989).

⁽²⁴⁾ Document COM(1998) 209 final.

⁽²⁵⁾ Proposal for a European Parliament and Council Regulation (EC) amending Council Regulation (EEC) No 2913/92 establishing the Community Customs Code, COM(1998) 226 final, of 8 June 1998.

European System of Accounts (ESA 95) replaced the second edition of the European System of Integrated Economic Accounts (ESA 79) ⁽²⁶⁾. In its application ESA 95 takes more account of recent economic changes and the statistical progress made in recent years. For this reason, the GNP estimated according to ESA 95 is a more reliable and comparable indicator of Member States' ability to contribute to the budget. This new version is applicable to 'all Community acts that refer to the ESA or its definitions'. However, 'for budgetary and own resources purposes and, by way of derogation, ESA 79 is in force' ⁽²⁷⁾.

1.33. On three occasions ⁽²⁸⁾, the Court has observed and criticised the use of two systems of national accounting (ESA 79 and ESA 95).

1.34. In its Annual Report on the financial year 1997 and its Special Report No 6/98 concerning the assessment of the system of resources based on VAT and GNP ⁽²⁹⁾, the Court deplored the fact that two accounting systems were being used, arguing that a tool that was efficient and available for use was not being used. The Court observed that ESA 79 did not reflect the Member States' ability to contribute to the budget as well as ESA 95. Finally, the Court emphasised that, since ESA 95 was being used in other European Union policy areas, there was a risk of confusion in the choice of system of accounting standards.

1.35. In its Opinion 8/99 on a Council proposal for a decision concerning the European Union's system of own resources ⁽³⁰⁾, the Court noted the impact on own

resources of only using ESA 95 and replacing the concept of GNP by that of gross national income (GNI). The Court reminded the Council that the criteria for financing the Union must provide a better reflection of the Member States' ability to contribute to the budget.

The costs of the current dual system of accounting standards

1.36. As the Court has emphasised in previous observations ⁽³¹⁾, with the agreement of the Commission ⁽³²⁾ (which proposed using ESA 95 only in order to have a more reliable and comparable indicator of the Member States' ability to contribute to the budget), the current system is unsatisfactory.

1.37. Retaining ESA 79 means that the accounts, which are currently established using ESA 95, are converted by backwards extrapolation for the purposes of the own resources only ⁽³³⁾. This dual accounting represents an extra cost, for both the Member States' national statistical institutes and for the Commission's internal control.

1.38. Moreover, the process of converting data from ESA 95 to ESA 79 carries a potential risk of error. With regard to assessment base estimates, the growth rates calculated according to ESA 95 are applied, by approximation, to the assessment bases forecast according to ESA 79.

1.39. Finally, by not using ESA 95 for calculating the own resources, the Union is depriving itself of an indicator of Member States' ability to contribute to the budget which is of a better quality than ESA 79.

⁽²⁶⁾ Article 1(2) of Council Regulation (EC) No 2223/96 of 25 June 1996 on the European system of national and regional accounts in the Community (OJ L 310, 30.11.1996).

⁽²⁷⁾ Article 8(1) of Regulation (EC) No 2223/96.

⁽²⁸⁾ Annual Report on the financial year 1997 (OJ C 349, 17.11.1998).

Special Report No 6/98 concerning the Court's assessment of the system of resources based on VAT and GNP (OJ C 241, 31.7.1998).

Opinion No 8/99 on a Council proposal for a decision concerning the European Union's system of own resources (OJ C 310, 28.10.1999).

⁽²⁹⁾ Paragraphs 3.17, 3.20 and 3.21 of Special Report No 6/98.

⁽³⁰⁾ Paragraph 9 of Opinion No 8/99.

⁽³¹⁾ See paragraph 1.34.

⁽³²⁾ The Commission's replies to Special Report No 6/98, paragraphs 3.17 to 3.22. The Commission's replies to the Annual Report on the financial year 1997, paragraph 1.26.

⁽³³⁾ Commission Decision 97/178/EC, Euratom of 10 February 1997 on the definition of a methodology for a transition between the European System of National and Regional Accounts in the Community (ESA 95) and the European System of Integrated Economic Accounts (ESA second edition) (OJ L 75, 15.3.1997).

Decision on own resources

1.40. At its meeting on 8 May 2000, the Council (Ecofin) adopted a joint position on a draft decision ⁽³⁴⁾ with a view to using ESA 95 as the only reference for national accounting and, consequently, for calculating the own resources of the Community budget.

1.41. Once it is finally adopted, this decision will have to be ratified by the Member States.

Conclusion

1.42. The Court notes that the recent proposals for decisions take a similar approach to its previous observations. The draft decision ensures that only ESA 95 will be used in the context of national accounting (see paragraph 1.40). Implementing this change will avoid needless costs and make the system more satisfactory (see paragraphs 1.37 to 1.39).

OBSERVATIONS ON THE OUTWARD-PROCESSING ARRANGEMENT

1.43. The outward-processing relief arrangement is a customs procedure ⁽³⁵⁾ with economic impact used as an instrument of the Community commercial policy for facilitating trade, whereby goods may be temporarily exported from the customs territory of the Community and the products manufactured from such goods (compensating products) may be subsequently reimported with full or partial relief from import duties.

1.44. Outward-processing trade represents a diminishing percentage (2,2 % in 1997) of all Community imports, essentially because much of this trade is no longer dutiable under preferential trade arrangements with traditional outward-processing trading partners, such as traders in countries in central and eastern Europe. In most instances, traders use outward-processing as a safeguard against difficulties in obtain-

ing certificates of origin in the countries where outward-processing takes place. In 1995, the Commission estimated that duty relief under the outward-processing procedure had reduced traditional own resources by 556 million euro.

1.45. Outward-processing trade is concentrated geographically and by sector (textiles, electrical goods and electronics, aerospace, machinery, footwear, motor vehicles, optical and photographic, and furniture). In 1997, one Member State ⁽³⁶⁾ accounted for 48 % and six other Member States ⁽³⁷⁾ for a further 44 % of reimports under the outward-processing procedure.

1.46. In its Annual Report concerning the 1990 financial year, the Court came to an analogous conclusion to that in paragraph 1.56. The Community regulations on the outward-processing arrangements have not been amended.

Economic conditions

1.47. Article 148(c) of the Customs Code states that an 'authorisation shall be granted only where authorisation to use the outward-processing procedure is not liable seriously to harm the essential interests of Community processors (economic conditions)'.

1.48. The Court's enquiries, both in 1990 and 1999, established that there are wide differences in the way in which Member State authorities treat the basic requirement to examine economic conditions. Two Member States ⁽³⁸⁾ had already by 1990 given up requiring their officials to take into account the economic conditions when considering an application. Three Member States ⁽³⁹⁾ consider an increase in value to be sufficient as justification. Three other Member States ⁽⁴⁰⁾ require control without specifying any criteria. Four Member States ⁽⁴¹⁾ centralise applications for authorisations in interministerial administrative procedures. In one Member State ⁽⁴²⁾, the procedure for authorising outward-processing involves officials at directorate-general level with representatives from eight ministries and from the private sector.

⁽³⁴⁾ Council Decision concerning the European Community's system of own resources.

⁽³⁵⁾ Council Regulation (EEC) No 2913/92, Articles 146 to 160 (OJ L 302, 19.10.1992), and Commission Regulation (EEC) No 2454/93, Articles 748 to 787 (OJ L 252, 11.10.1993).

⁽³⁶⁾ Germany.

⁽³⁷⁾ Belgium, Luxembourg, France, Italy, the Netherlands and the United Kingdom.

⁽³⁸⁾ The Netherlands and the United Kingdom.

⁽³⁹⁾ Germany, Finland, Austria.

⁽⁴⁰⁾ Spain, France, Portugal.

⁽⁴¹⁾ Belgium, Greece, Ireland, Portugal.

⁽⁴²⁾ Italy.

1.49. During the audit, the Court did not come across any cases where a Community processor claimed that his interests had been seriously damaged because of an authorisation for outward-processing. Neither has the Court found any cases where an application was refused.

1.50. In September 1998, delegates from national customs administrations concluded, in a Mattheus seminar organised by the Commission, that prior examination of economic conditions was no longer justified for outward-processing.

Authorisation procedure

1.51. Two Member States ⁽⁴³⁾ accounting for more than half of reimports under outward-processing arrangements have simplified their authorisation procedures to a minimum by issuing authorisations on an 'ongoing' basis for unlimited quantities and unlimited periods. Another Member State ⁽⁴⁴⁾ applies an authorisation procedure that has the same effect. These procedures have been in place for many years.

Calculation of the customs-duty relief

1.52. In 1991, the Court concluded that the method used for calculating the duty should be simplified, as the differential method applied at that time was the main source of errors. In January 1998, during a Commission evaluation of the Court's 1991 report, the question of changing the method of calculation was raised again. To date no changes have been made to the calculation method. The differential method could be replaced by a calculation method based on the value added to compensating goods.

Vulnerability of outward-processing relief to fraud and irregularity

1.53. The Member States' customs authorities do not regard outward-processing as a customs procedure with major or substantial risk of fraud. According to a Commission report, this view is supported by extensive experience in international trade. However, the Court's enquiry established that the system is error-prone. The relief system presents some specific risks (e.g. the need to know the precise quantity and value of every item of

Community material in the reimported compensating goods). Most errors were discovered as a result of post-importation auditing of traders' records.

1.54. The Commission's Annual Report for 1998 ⁽⁴⁵⁾ summarising the communications by the Member States on their inspection activities in the field of traditional own resources (Annex 7) contains detailed information about the vulnerability of customs procedures to fraud and irregularity. Outward-processing relief accounted for 309 cases (1 220 411 euro) out of a total of 125 654 cases recorded (376 959 482 euro). In relative size, fraud and irregularities committed under the outward-processing procedure represented 0,3 %, the same as in 1997, but down from 1,76 % in 1996.

1.55. During the period 1996 to 1999, eight Member States reported 70 cases of irregularity concerning the outward-processing regime, representing a total amount of 5 646 109 euro. The Court analysed these cases to obtain an appreciation of the precise nature of the irregularities. It reached the conclusion that most of them concern the differential method for calculating duty, mentioned in paragraph 1.52. In addition, many irregularities concern the export of textile products that do not originate in the Community or the incorporation of this type of product into processed products.

Conclusion

1.56. The Court supports the Commission's proposals to modernise the customs procedures with economic impact. Specifically for outward-processing, the Court considers that:

- generally speaking, economic conditions need no longer be considered (see paragraphs 1.47 to 1.50),
- authorisations should not be granted in cases where the compensating products can benefit from preferential treatment (see paragraph 1.44),
- the prior authorisation procedure should be curtailed to an absolute minimum, so that the authorisation for relief is issued at the reimportation stage (see paragraph 1.51),
- the calculation procedure should be simplified (see paragraph 1.52).

⁽⁴³⁾ Germany, the Netherlands.

⁽⁴⁴⁾ United Kingdom.

⁽⁴⁵⁾ COM(2000) 107 final, 29 February 2000.

COMPARISON OF DATA FOR THE PURPOSES OF FIGHTING FRAUD

VAT fraud and risk analysis

1.57. VAT fraud⁽⁴⁶⁾ consists either of underreported sales or overstated production costs (intermediate costs) or, even, a combination of the two. The choice of the one or the other type depends on the sector of the economy in which the taxable person is operating and on the opportunities it offers.

1.58. Non-registered traders (the underground economy) are a special case of all-out fraud, since their activities are not declared to the tax authorities.

1.59. In the VAT field, some elements cause a heightened risk of fraud:

- (a) the large number of economic operators;
- (b) the complexity of the rules and the existence of special arrangements;
- (c) the exchange of goods and services, net of tax, between taxable persons established in different Member States;
- (d) the differing rates of VAT from one Member State to another;
- (e) the speed with which fraud mechanisms work;
- (f) the fragmentation of the single market into 15 separate administrative areas and insufficient cooperation between the Member States;
- (g) the limited resources available for controls.

⁽⁴⁶⁾ VAT fraud is only one part of a more general loss of tax revenue. The key financial matters of direct taxes and social security contributions and, in particular, excise duty are much more important than VAT alone. However, as the constituent elements of these different assessment bases are common to them all, the accounting 'consistency' at the level of the taxable persons affects all these taxes simultaneously.

1.60. Analyses of the phenomenon of fraud, including the one carried out by the Commission at the beginning of the year 2000⁽⁴⁷⁾, have shown that VAT only appears to be intrinsically 'self-policing', supposedly on the basis of the conflicting interests of the taxable persons⁽⁴⁸⁾: in fact, numerous mechanisms have been discovered which allow this principle to be got around.

1.61. On account, in particular, of the limited resources available to them, it is in the interest of the tax administrations of the Member States to target their controls according to the risk of fraud associated with particular operators. Controls can be targeted most advantageously on the basis of an appropriate risk analysis which makes use of both the information made available as a result of controls and information from other sources.

1.62. One of the instruments used to identify sectors at risk consists of comparing tax data (declarations by taxable persons of various taxes) with statistical data from different sources.

The use of statistics

1.63. In general, the procedures for comparing statistical data and tax data are limited to a comparison of the added value entered in the VAT declarations with the analogous aggregates estimated in the national accounting statistics.

1.64. A comparison of this kind has the disadvantage, however, of highlighting only one type of fraud mentioned in paragraph 1.57, i.e. reducing sales declared. As the comparison is based on the added value, only the production of goods and services is taken into account and their use in the economic process is not considered. A detailed analysis of fraud, however, would also involve a close examination of the phenomenon of the over-reporting of production costs by taxable persons. In order to carry out such an examination, direct scrutiny of the constituent elements of the added value and of intermediate consumption is necessary.

⁽⁴⁷⁾ See, in particular, the report from the Commission to the Council and to the European Parliament, third report on the application of Article 14 of Regulation (EEC) No 218/92 and fourth report under Article 12 of Regulation (EEC, Euratom) No 1553/89, COM (2000) 28 final, 28.1.2000.

⁽⁴⁸⁾ Theoretically, it is in the interest of each taxable person to ask for a receipt for his purchases, without which he cannot claim for a deduction of the VAT paid upstream.

The comparison of intermediate consumption

1.65. The Court obtained information on a methodology developed by a Member State in order to compare tax sources with statistical sources, both with regard to the production of goods and their intended use in the economic process.

1.66. The statistical data ⁽⁴⁹⁾ contain an estimate of all trade between producers of goods and services, upstream of their utilisation by the final users (households in the majority of cases). This allows a direct estimate of the intermediate consumption that is involved in the production process.

1.67. Where data of the same type but derived from tax declarations are available, any overreporting of intermediate consumption declared can be revealed, broken down by economic sector. One can also use this opportunity to identify the underreporting of sales.

1.68. At the same time, it is in the comparison of data originating from different sources — from statistical and tax sources — that the true difficulty to be resolved lies. The underlying concepts need to be made homogeneous.

1.69. At the Court's initiative, this method was applied in another country. This second experiment confirmed the validity of the methodological approach and proved convincing at the practical level even where amendments proved necessary because of the special features of the data available.

The results obtained

1.70. The audits showed that, for the two countries concerned, the production costs declared to the tax

authorities were greater than those derived from the national accounting statistics. Appreciable discrepancies were discovered ⁽⁵⁰⁾. This revealed the existence of a special type of fraud which attempts to reduce the VAT assessment basis by unduly increasing input costs.

1.71. As pointed out in paragraph 1.64, the use of added value alone undermines the comparisons, as any problems with the estimates upstream of these data (turnover and intermediate costs) are not taken into account.

Conclusion

1.72. The application of the methodology used in these two Member States should be extended to the other countries, provided the necessary amendments and improvements are made. Subject to cooperation between the tax authorities and statistical offices, an exercise of this kind can be carried out on the basis of existing data and, consequently, with no extra administrative burden for the taxable persons (see paragraph 1.69).

1.73. Improved knowledge of the situation which this would engender, in respect of the underreporting of sales and the overreporting of intermediate costs, by economic sector, might well lead to improvements to the risk analysis procedure and provide the correctives to the controls needed in order to improve their effectiveness (see paragraph 1.70). This would also answer the concerns expressed by the Commission in respect of the serious deficiencies affecting control strategies at national level ⁽⁵¹⁾. It is for the Commission and the Member States, in the light of their various responsibilities concerning the evaluation of national VAT systems and of controls in respect of the production of statistics, to take the appropriate initiatives.

⁽⁴⁹⁾ This concerns in particular the input-output framework. It describes in detail production activities and operations on products, putting resources and uses together under one heading. For a more detailed description see the definitions in ESA 95, in particular chapter 9 (OJ L 310, 30.11.1996, pp. 264 to 286).

⁽⁵⁰⁾ The differences vary from 10 to 20 %. The finding refers to a comparison carried out at the aggregated macro-economic level, for the private sector (apart from the financial sector and agriculture).

⁽⁵¹⁾ Report by the Commission to the Council and to the European Parliament, established in application of Article 14 of Regulation (EEC) No 218/92 and Article 12 of Regulation (EEC, Euratom) No 1553/89, COM(2000) 28 final, 28 January 2000.

COMMISSION'S REPLIES

INTRODUCTION

1.2. The Commission is very interested in any initiative concerned with combating VAT fraud and it is particularly keen on the actions listed in its reply to paragraphs 1.57 to 1.62. It should be borne in mind, however, that under Regulation (EEC, Euratom) No 1553/89, a Member State's VAT base is calculated solely from the revenue collected by that Member State.

IMPLEMENTATION OF THE BUDGET

1.5. Experience shows that it is particularly difficult to make forecasts for Title 9 (Miscellaneous revenue), as this is the sum of small amounts handled by a large number of authorising officers. For the same reason, the Commission believes that more detailed remarks would not necessarily improve the information already available.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Traditional own resources

Audit findings

1.11. The Commission acts on all cases where own resources are made available late. Whenever the Commission's own inspections or the Court's audits find that a payment has been made late, a request for default interest is sent to the Member State as quickly as possible.

1.12. The Commission can confirm that the separate accounts contain errors which may either be one-off or structural in nature. For the past four years the separate account has been one of the main subjects of the inspections carried out in all the Member States and this line will continue in the future. Whenever an anomaly is detected, the Commission takes the necessary action against the Member State, including infringement proceedings where necessary.

1.14. The Commission is aware of the difficulties connected with the centralisation of data in the separate account in some Member States. The Commission would stress that this centralisation is based on a large number of accounting ledgers kept at local level (customs offices) which are not computerised in all the Member States. The Commission regularly checks the entries in the separate account during its inspections, and corrections are made whenever anomalies are found.

1.15. As regards the harmonisation of the rules applying to the separate account, the aim of the Commission's inspections is to check that the account is kept in accordance with Community legislation. Anomalies found are followed up by appropriate action to secure the necessary accounting adjustments and, where appropriate, changes in the national rules to bring them into line with Community law. For example, infringement proceedings are being prepared against Germany which is refusing to accede to the Commission's requests. A review by Commission staff of 282 recent requests by Germany to write off amounts also revealed that 56 % of the cases were entered in the accounts incorrectly.

1.16. Although it considers that making a 100 % provision is an acceptable solution given the information available, the Commission will, when preparing the 2000 accounts, apply a method for calculating the balance sheet provision for the amounts of own resources entered in the separate accounts which takes account of the recovery figures in past years.

Result of the audit

1.17. The Commission will take the necessary action on the anomalies detected by the Court of Auditors in a customs office once it has finished analysing the matter.

VAT/GNP own resources

Audit findings

1.21. It is true that some Member States supplied their annual GNP data after the deadline and this reduced the time available for checking. This meant that the GNP figures could

not be supplied to the GNP Committee and to DG Budget earlier. Eurostat has taken steps to ensure that such delays do not recur. However, these delays in no way affected the quality of the checks performed on the data.

The Commission's scrutiny is not limited to just the annual GNP questionnaire but also covers the verification of the inventories and the results of control missions. The need for improved documentation is acknowledged in the Commission's reply to Special Report No 17/2000.

FOLLOW-UP OF PREVIOUS OBSERVATIONS

Traditional own resources

Follow-up at financial management level

1.24. The cases of fraud and irregularities in the mutual assistance framework mentioned in the Court's 1994 annual report which are still outstanding involve complex matters in which recovery action will be initiated where appropriate as soon as the administrative and judicial proceedings are complete.

The difference between the amounts of arrears interest demanded and the amounts actually paid is mainly accounted for by the fact that the Netherlands, which owed NLG 5 323 395,06, has declined responsibility. After sending a letter of formal notice in 1998 the Commission issued a reasoned opinion on 2 February 2000. As the Netherlands reply confirms its refusal to pay, the Commission is now considering court action.

1.25. The Commission confirms that where there is no request by the exporter for goods to be released for free circulation, Community law does not allow the administration to recover the customs duties simply because an ATR certificate was wrongly issued. The only step that could be taken was therefore to invalidate the certificates so that the import duties could then be collected by Turkey. The Commission therefore maintains that there was no loss of traditional own resources.

The request that the Commission sent to the Member States on 18 March 1997 following the Court's report to check the

validity of certificates issued was restricted to the period after March 1994 because of the three-year limitation which applies both in the Community and in Turkey.

Follow-up at Community regulations level

1.30. The improvement of the provisions relating to time-barring are still being discussed (codecision procedure). As regards the guarantee to be demanded in a post-clearance recovery procedure when the goods have already been placed on the market, the matter can be considered resolved in practice for operators who provide a standing guarantee for all their debts under the deferred payment procedure. The Member States were not in favour of a general requirement that operators subject to post-clearance recovery should provide a guarantee.

1.31. To remedy the problems detected, the Commission is acting via the reform of legislative provisions and by the establishment of the new computerised transit system, which will allow effective monitoring of guarantees by computerised management.

VAT/GNP own resources

Introduction

The costs of the current dual system of accounting standards

1.32 to 1.39. Article 8(1) of Regulation (EC) No 2223/96 on the European system of national and regional accounts in the Community (ESA95) does indeed prescribe the use of the second edition ESA (ESA79) for the purposes of the budget and Community own resources as long as Decision 94/728/EC, Euratom own resources is in force.

The Commission notes the Court's remark that this is not a satisfactory solution, firstly because ESA95 is a better indicator of the Member States' ability to contribute to the budget and secondly because it means that two accounting systems are being used simultaneously (ESA95 and ESA79).

The Commission agrees entirely with the Court and fully supports its position; it did, indeed, in a declaration in the Council minutes, specifically state in connection with Article 8(1) that it regretted that this provision would mean continuing to base the measurement of GNP for budgetary and own resources purposes on the national accounts deriving from application of the ESA second edition for as long as Decision 94/728 EC, Euratom on the own resources system remained in force,

whereas application of ESA95 would be more exhaustive and reliable.

OBSERVATIONS ON THE OUTWARD PROCESSING ARRANGEMENT

1.46. In 1998 the Commission presented a proposal for amending the Customs Code. The codecision procedure on this proposal is still in progress.

Economic conditions

1.47 to 1.50. No instance of a request for authorisation being rejected on the grounds of economic conditions has been reported to the Commission in recent years, which would confirm the findings of the Court's audit (see paragraph 1.49). The very wording of Article 148(c) of the Code shows, and administrative practice confirms, that Community interests are protected by a safeguard clause.

This safeguard clause approach, a conclusion confirmed at a Matthaeus seminar, was incorporated in the draft reform of the Code's implementing provisions relating to customs procedures with economic impact. It can therefore be said that substantial harmonisation of the Member States' practices is coming about.

Authorisation procedure

1.51. In 1996 the Commission carried out on-the-spot checks in Germany, Italy, the Netherlands and the United Kingdom which covered the outward processing arrangement. These checks brought to light a number of minor anomalies, concerning the rules in particular.

The draft reform of customs procedures with economic impact provides for a maximum period of validity for authorisations of three years. The possibilities for operators to use the outward processing arrangement without prior authorisation will be much more extensive.

Calculation of the customs duty relief

Vulnerability of outward processing relief to fraud and irregularity

1.52 to 1.55. The partial exemption available under the outward processing arrangement is calculated by the differential method. At present the only exception that the Code allows to the differential method is for repair work where partial exemption is determined by taking into account the value added in the third country.

The draft reform of customs procedures with economic impact providing for the introduction of calculating duty on the basis of the value added will first require the approval by the Council and Parliament of the Commission's 1998 proposal for the amendment of the Customs Code, which is currently being given a second reading under the codecision procedure.

The Commission is aware of the risks of error connected with the outward processing arrangement. However, as the budgetary implications are not very significant, the Commission, on the basis of a risk analysis, has targeted its inspections at areas which are much more sensitive from the point of view of the Community budget, but without completely forgetting the arrangement, which was one of the inspection topics for four on-the-spot inspections in 1996.

The risks of fraud and irregularities found to be inherent in the outward processing arrangement concern the differential method because of the complexity of the calculations. Calculating duty on the basis of value added should simplify the arrangement. The number of irregularities involving textiles under the outward processing arrangement, albeit tiny in relation to the total number of irregularities detected, is accounted for by the fact that the arrangement is mainly used for these products.

Conclusion

1.56. The Commission would point out that:

- the economic conditions are examined on the basis of the safeguard clause approach,
- as the uncertainties of the preferential arrangements for operators are well known, there would appear to be good reasons why they should seek a fall-back solution by asking for the outward processing arrangement,
- the reform of the Customs Code will reduce the use of the prior authorisation procedure,

— the reform will simplify the method of calculation.

COMPARISON OF DATA FOR THE PURPOSES OF FIGHTING FRAUD

VAT fraud and risk analysis

1.57 to 1.62. The Commission recently raised the issue of VAT fraud in its report based on Article 14 of Regulation (EEC) No 218/92 and on Article 12 of Regulation (EEC, Euratom) No 1553/89 ⁽¹⁾. This report, together with the work done by the Council's ad hoc tax fraud group, clearly shows that the maintenance of the transitional VAT system must be accompanied by tighter controls and administrative cooperation. The Commission has therefore announced that its priority will be to propose a strengthening of existing Community legal instruments on administrative cooperation and mutual assistance ⁽²⁾.

The report also recommends that Member States develop risk-analysis systems so that they can use the limited resources of the tax authorities to better effect. In its own area of competence the Commission supports any initiative taken by the Member States in this field, one means being financing under the Fiscalis programme for exchanges of officials and seminars on risk analysis.

The Commission would point out that the most serious form of VAT fraud concerns criminal organisations which exploit the weaknesses of the transitional VAT system for intra-Community transactions by means of a structured series of cross-border criminal operations within the European Community on which the VAT due is not paid or for which VAT credit balances are wrongly created.

1.59. The Commission believes that the elements cited by the Court do indeed increase the risk of fraud. It also believes

that another such element is the absence of a clear legal basis for international coordination of VAT investigations by OLAF/Commission.

The use of statistics

The comparison of intermediate consumption

1.63 to 1.69. Risk analysis is a systematic decision-making process based on the following elements: first collection and structured analysis of information, second structured identification of risks, and third structured analysis of identified risks. The aim is to target controls on individual operators presenting the highest risk. In the field of VAT it is based essentially on microeconomic data.

The Commission is not in a position to judge the merits of the method presented by the Court. It would, however, be very wary about applying this method as an additional instrument for refining risk analysis on VAT as the studies conducted to date have not produced definitive results.

Conclusion

1.72 and 1.73. The Commission is prepared to consider the merits of the method presented in the Court of Auditors' report. Its plan is, in collaboration with the two Member States in question, to discuss the matter with the representatives of all the Member States in the Advisory Committee on Own Resources, the body responsible in this area. If it were to be found that the trials conducted in these two Member States could be reproduced and provide a method that was of use to other national authorities, the Commission would have no hesitation in encouraging these authorities to add it to the other instruments referred to in the reply to paragraphs 1.57 to 1.62.

⁽¹⁾ COM(2000) 28 final of 28 January 2000.

⁽²⁾ Communication from the Commission to the Council and the European Parliament: A strategy to improve the operation of the VAT system within the context of the internal market. COM(2000)348 final of 7 June 2000.

CHAPTER 2 (*)

The common agricultural policy

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INTRODUCTION

2.1. This chapter concerns the expenditure of the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF-Guarantee) and the expenditure charged to chapter B2-51 (other operations in the agricultural sector).

2.2. Almost all of this expenditure is handled by paying agencies in the Member States. Every month the Commission advances an amount based on the payments declared in the previous month. The payments are booked monthly to the expenditure accounts, but subject to any corrections that may be necessary when the accounts are cleared at the end of the financial year.

2.3. This chapter consists of four parts:

- (a) the implementation of the budget for the financial year 1999;
- (b) the specific appraisal of the field of agriculture in the context of the Statement of Assurance for the financial year 1999;
- (c) the clearance of the accounts;
- (d) the follow-up to some special reports.

2.4. The Court has also published other observations, in the form of special reports and opinions, on the common agricultural policy. A list of these publications is included in an annex.

IMPLEMENTATION OF THE BUDGET

*Provisional appropriations**Initial budget*

2.5. For the financial year 1999 the initial appropriations under subsection B1 of the budget for the European Agricultural Guidance and Guarantee Fund — Guarantee Section (EAGGF-Guarantee) amounted to 40 940 million euro (including 205 million euro of provisional appropriations and the monetary reserve ⁽¹⁾ of 500 million euro) (see **Table 2.1**), i.e. 50,5 % of total operating appropriations for payment from the budget. These appropriations were equivalent to 90,6 % of the ceiling provided in the financial perspective (45 188 million euro), i.e. in the agricultural guideline.

Final appropriations

2.6. During the financial year these initial appropriations were amended by two supplementary and amending budgets (SABs) ⁽²⁾. These amendments led to a reduction of 402 million euro (0,9 %). The final appropriations therefore amounted to 40 038 million euro (excluding the monetary reserve) (see **Table 2.1**). Total movements — i.e. the sum of the transfers (see paragraphs 2.20 and 2.21) and the SABs — came to 4 142 million euro, i.e. 10,2 % of the initial appropriations (as against 5,2 % in 1998, see the Annual Report for 1998, paragraph 2.4).

Amount of expenditure

2.7. Expenditure amounted to 39 541 million euro (+ 2 % in comparison with 1998), i.e. 98 % of the appropriations available (see **Table 2.1**) and 87 % of the agricultural guideline. Plant products accounted for 67,6 % of the expenditure, animal products 23,9 %, ancillary expenditure 1,9 % and accompanying measures 6,6 %. Broken down by type, expenditure was mainly divided between direct aid (74,09 %), refunds (14,09 %), structural measures (6,94 %) and intervention measures (3,6 %). Structural measures and, to a lesser extent, refunds showed an upward trend, while direct aid and intervention measures fell slightly (see **Graph 2.1**).

⁽¹⁾ The monetary reserve is intended to cover (in respect of amounts above 200 million euro) unfavourable changes in the dollar/euro parity used for budget estimates. Conversely, any savings above 200 million euro due to a favourable change in this parity are to be transferred to the monetary reserve.

⁽²⁾ SAB No 4/99 (OJ L 339, 30.12.1999) and SAB No 5/99 (OJ L 88,10.4.2000).

2.8. The provisional appropriations initially earmarked for the EAGGF-Guarantee (205 million euro) were not used in accordance with their primary objective; they were allocated in SABs No 4/99 and No 5/99 to budget headings outside subsection B1 (to finance aid for the CEECs and for Kosovo). This is why some budget headings, for lack of these provisional appropriations, subsequently had to be increased ⁽³⁾ by transfers amounting to 169 million euro.

Calls on the monetary reserve

2.9. In view of the unfavourable change in dollar/euro parities ⁽⁴⁾, 219 million euro of additional expenditure was entered in the accounts. As stipulated in Article 12(1) of Council Decision 94/729/EC on budgetary discipline, the monetary reserve was not used, as the appropriations available under the headings concerned were sufficient to cover the expenditure. Nevertheless, strict application of the budgetary principle of specification ⁽⁵⁾ should have prevented the appropriations available being used for currency adjustments.

Entering of revenue in the expenditure budget

2.10. According to the principle of universality ⁽⁶⁾, revenue may not be assigned to particular items of expenditure and no offsetting adjustments may be made between revenue and expenditure. Nevertheless, negative amounts totalling 3 057,7 million euro (as against 2 498 in 1998, see the Annual Report for 1998, paragraph 2.11) still appear in the EAGGF-Guarantee accounts ⁽⁷⁾. The overall total for items showing negative balances was 1 473,1 million euro, whereas the budget was based on estimated revenue of only 647 million euro (+ 127 %).

⁽³⁾ B1-3 0 0: 13,7 million euro; B1-3 0 1 0: 12,2 million euro; B1-3 0 1 2: 28,3 million euro; B1-3 0 1 4: 0,9 million euro; B1-3 6 0 1: 10 million euro; B1-5 0 1 1: 104 million euro.

⁽⁴⁾ The budget was drawn up on the basis of a parity of 1 euro = 1,09 US dollar, whereas the average quotation over the reference period (1.8.1998 to 31.7.1999) was 1 euro = 1,11 US dollar. The chapters affected by the variations in the US dollar/euro parity are arable crops (120 million euro), sugar (21 million euro), fibre plants (62 million euro), refunds on certain goods obtained by processing agricultural products (12 million euro) and the POSEI programmes (4 million euro).

⁽⁵⁾ See Article 4 of the Financial Regulation.

⁽⁶⁾ See Articles 4 and 27 of the Financial Regulation.

⁽⁷⁾ Twenty-seven budget items (almost 14 % of the items) include negative expenditure.

Table 2.1 — EAGGF-Guarantee 1999

(Mio EUR)

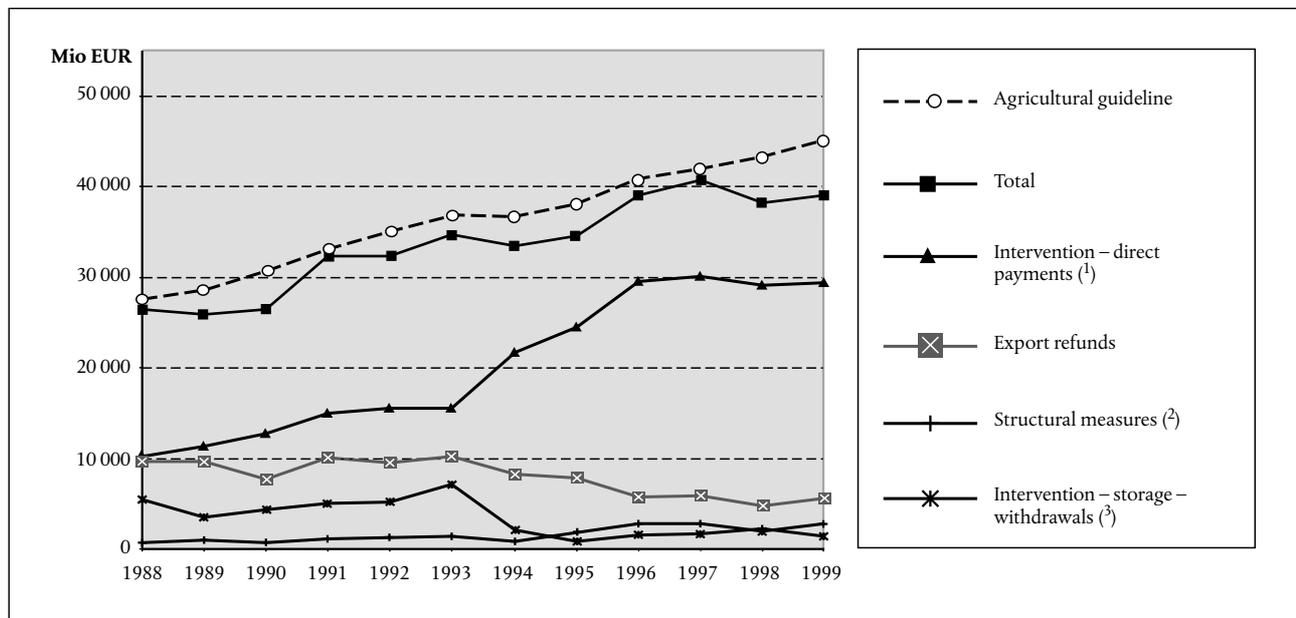
Financial perspective headings: 1. Subsection B1: EAGGF-Guarantee

	Total head- ing	Of which:				
		B1-1	B1-2	B1-3	B1-5	B1-6
	CA/PA	CA/PA	CA/PA	CA/PA	CA/PA	CA/PA
Financial perspective ceiling	45 188					
Development of the budget						
Initial appropriations ⁽¹⁾	40 940	27 022	9 706	1 095	2 617	500
Final appropriations available ⁽²⁾	40 538	26 979	9 606	856	2 597	500
Difference between initial and final appropriations	- 402	- 43	- 100	- 239	- 20	0
% (final-initial/initial)	- 1	0	- 1	- 22	- 1	0
Implementation of the budget						
Appropriations used ⁽³⁾	39 541	26 739	9 440	773	2 588	0
% of the final appropriations available	98	99	98	90	100	0
Appropriations carried over to 2000	33	0	0	33	0	0
% of the final appropriations available	0	0	0	4	0	0
Appropriations cancelled	964	240	166	50	9	500
% of final appropriations available	2	1	2	6	0	100

⁽¹⁾ Including the provisional appropriations (B0-4 0) and the monetary reserve of EUR 500 million.⁽²⁾ Including the monetary reserve of EUR 500 million.⁽³⁾ In commitments.

Source: 1999 revenue and expenditure account.

Graph 2.1 — Change in EAGGF expenditure, broken down by nature of expenditure (1988-1999)

⁽¹⁾ Intervention — direct payments: price compensatory aid plus withdrawals for arable crops.⁽²⁾ Structural measures: guidance premium plus accompanying measures.⁽³⁾ Intervention — storage — withdrawals: private storage plus public storage plus withdrawals excluding withdrawals for arable crops and minus milk levies received.

The other measures (Food aid) and other expenditure excluding accompanying measures are not included in the above chart. Because of the scale chosen, changes would not show.

Source: Commission accounts.

2.11. Of this 1 473,1 million euro, the balance from previous financial years accounted for 606 million euro (41,2 %) and the additional levies due on account of milk quota overruns came to 497 million euro (33,7 %). However, no estimate of revenue had been entered in the budget in respect of the latter item. It should be noted that, from the point of view of the principle of annuality, more than 40 % of these levies should have been entered in the accounts in 1998.

2.12. Revenue also came from profits which were made on the sale of stocks of agricultural products, mainly because of excessive depreciation (corresponding to the difference between the buying price and the estimated price on disposal). Revenue in respect of five categories of stocks had been estimated at 143 million euro. However, the actual return amounted to 286 million euro ⁽⁸⁾, i.e. double that amount.

2.13. Finally, almost 83 million euro of the 1 473,1 million euro concerned 19 budget items against which the total revenue estimates entered amounted to only 6 million euro.

Reductions in advance payments

2.14. One of the main features of the financial year 1999 is the scale of the reductions in advance payments imposed on various Member States, due, on the one hand, to shortcomings in the application of the integrated system and in the implementation of controls (Greece: 108 million euro; Portugal 5 million euro), and, on the other hand, to the absence of the additional levy payments on milk quota overruns (Greece 2 million-euro; Spain: 5,5 million euro; Italy 104,7 million euro for the 1998/1999 campaign and 224,9 million euro for the 1997/1998 campaign, and the United Kingdom 0,5 million euro).

2.15. Italy's late submission of its data on the additional levy payable on milk quota overruns for 1999 resulted in 134 million euro being booked to the financial year 2000. As the amount relates to the financial year 1999, its inclusion in the 2000 budget accounts breaches the rule of annuality. Similarly, 224 million euro relating to the financial year 1998 was received and accounted for in the current financial year.

⁽⁸⁾ Beef and veal: - 180,5 million euro (as against - 95); olive oil - 63,9 million euro (as against - 7); skimmed-milk powder - 27,7 million euro (as against - 30); rice - 11,4 million euro (as against - 6); butter and cream - 3 million euro (as against - 5).

Carry-overs from the preceding financial year: the supply of food aid to Russia

2.16. In order to supply food aid to Russia, 400 million euro in unused appropriations was transferred to the 'Food programmes' chapter of the 1998 budget by means of an SAB adopted in December 1998. Given the impossibility of implementing such a programme at the time (see the Annual Report for 1998, paragraph 2.16), these appropriations were the subject of a request for a non-automatic carry-over to the financial year 1999. In view of the time this procedure requires and the urgency of implementing the programme, the Commission immediately transferred 8 million euro ⁽⁹⁾ from the 'School milk' item to the 'Food aid for Russia' item. Of the 400 million euro, 336 million euro was spent and the balance was allowed to lapse. In the end it would have been more appropriate to include the appropriations directly in the 1999 budget by means of an amending letter.

2.17. The foodstuffs supplied came from European Union stocks and this, according to the Commission's estimates ⁽¹⁰⁾, was supposed to contribute to a reduction in storage costs and the cost of refunds for pigmeat. In reality, storage costs did not decline overall and the appropriations for export refunds for pigmeat had to be increased by an additional 61 million euro (+ 29 %). The Commission should determine the reasons for these increases. A possible explanation could be the delays and the reduction in deliveries to Russia, which left more stocks in storage. Even though the foodstuffs were not delivered until after 15 October 1999, 80,5 million euro was charged to the financial year as food aid expenditure. This expenditure ought to have been booked under depreciation of stocks, as, by the end of the financial year, these foodstuffs were still in the warehouse.

2.18. As the Court observed in 1991 and 1992 ⁽¹¹⁾, food aid for Russia, by its very nature, falls under 'External actions' rather than 'Agricultural expenditure'. There is no justification for financing this programme through EAGGF-Guarantee, especially as this type of aid to a third country is traditionally charged to Title B 7.2, 'Humanitarian and food aid'.

⁽⁹⁾ Transfer 9901.

⁽¹⁰⁾ See the Commission 'fiche financière' for the Regulation on food aid to Russia.

⁽¹¹⁾ Annual Report concerning the financial year 1991, paragraphs 2.47 et seq. (OJ C 330, 15.12.1992), Annual Report concerning the financial year 1992, paragraphs 2.108 and 2.109 (OJ C 309, 16.11.1993).

Management of the budget

2.19. The Court reviewed the information presented in the revenue and expenditure account relating to the management of the budget for the financial year and, in particular, the explanations concerning the differences between the budget initially approved and the appropriations used.

2.20. The Commission justifies numerous transfers (see paragraph 2.6) on the grounds that it was obliged to increase budget headings relating to refunds because of the low level of world prices. In addition, the number of transfers is influenced by the variable quality of the Member States' estimates. The estimates could be improved by imposing stricter deadlines on the Member States for the submission of the estimates and by setting up a more rigorous system to monitor estimates. With regard to direct aid, it should be possible to demand earlier notification of the payment forecasts. Some transfers were made in order to cover additional expenditure caused by delays, either in payments or in implementation, in respect of the programmes involving co-financing by the Member States⁽¹²⁾. The Commission should monitor the delays which have arisen in preceding years more closely in order to be able to make the necessary adjustments to the appropriations for the current year⁽¹³⁾.

2.21. In a number of cases (involving a total of 41,6 million euro⁽¹⁴⁾), withdrawals made from some budgetary items had to be offset by means of subsequent replen-

ishments. They can be seen to be transfers made purely for reasons of convenience⁽¹⁵⁾. Other withdrawals also indicate that amendments to the regulations or to certain factors which affected the previous year were not taken into account. The Commission should have made provision for the payments to be limited for 1999 in the case of permanent abandonment premiums in respect of areas under vines and premiums for tobacco (where there were withdrawals totalling 69 million euro⁽¹⁶⁾). The Commission should endeavour to tighten up the management of transfers.

2.22. Some stocks of agricultural products are subject to further depreciation at the year end. As in 1998, and for similar reasons⁽¹⁷⁾, the depreciation was overvalued (80 million euro, see paragraph 8.9). Overvaluation is contrary to the fundamental principles of budget management, because the excess depreciation from one financial year increases the availability of appropriations in the year in which the stocks are sold (see paragraph 2.12). The Commission should therefore review its depreciation procedures.

Computer systems

2.23. In the Annual Reports for the financial years 1997 and 1998⁽¹⁸⁾, the Court criticised the computer system used for the management of agricultural expenditure (AGREX) and recommended the installation of a new system. The Commission has made no appreciable progress on this matter (see also paragraphs 8.41 to 8.56).

Conclusion

2.24. Expenditure under subsection B1 amounted to 39 541 million euro, i.e. 98 % of the final appropriations (excluding the monetary reserve) (see paragraph 2.7). The transfers, which, together with the SABs, amounted to 4 141 million euro (i.e. more than 10 % of

⁽¹²⁾ With regard to rural development, Regulation (EC) No 1750/1999 stipulates that the estimates for the following financial year must be forwarded and must be within the set budget and provides for penalties in cases where the estimates are not adhered to.

⁽¹³⁾ For example transfers totalling 18 million euro in favour of 'olive oil consumption aid' account for 43,9 % of initial appropriations. These could have been avoided if the Commission had taken into account delays in payment which occurred during the preceding year. The justification for the transfer merely mentions an increase in the quantities subsidised, without referring to these delays.

⁽¹⁴⁾ In particular, in respect of budget Items B1-1 0 0 1, 1 0 1 2, 1 0 1 3, 1 0 1 4, 1 0 5 5, 1 0 6 2, 1 5 1 1, 1 8 5 4, 2 0 5 0, 2 1 2 3, 3 0 1 4, 3 1 0 0, 3 2 1 0, 3 6 0 0 and 3 6 0 1.

⁽¹⁵⁾ Transfers 9902, 9917 and 9918 (Item B1-1 0 0 1): comparison of the transfers shows the lack of logic in the steps taken. The same is true of transfers 9913 and 9917 (Item B1-1 5 1 1) where the withdrawal carried out by transfer 9913 had to be compensated for with an increase by means of transfer 9917. Likewise, transfer 9919 to Item B1-2 0 5 0.

⁽¹⁶⁾ Transfer 9914 (withdrawal of 7 million euro from B1-1 6 4 0) and transfer 9915 (withdrawal of 62 million euro from B1-1 7 1 0).

⁽¹⁷⁾ See Annual Report concerning the financial year 1998, paragraph 2.39(a).

⁽¹⁸⁾ Annual Report for 1997, paragraphs 2.24 and 2.25, and Annual Report for 1998, paragraphs 2.33 and 2.34.

the initial appropriations) (see paragraph 2.6), have enabled a high rate of utilisation of most of the budget headings and reflect the variations in the quality of the estimates both of revenue (see paragraphs 2.10 to 2.13) and of expenditure (see paragraphs 2.20 and 2.21). The Commission, in cooperation with the Member States, should make an effort to improve the quality of these estimates. Finally, the practice of entering negative expenditure must be reviewed, in the context of the revision of the Financial Regulation in particular (see paragraph 2.10).

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

2.25. The payments relating to the appropriations for 1999 under subsection B1 of the budget (39 541 million euro, see **Table 2.1**) were the subject of a sample-based examination, in the context of the Statement of Assurance, concerning the reliability of the accounts and the legality and regularity of the underlying transactions. Each transaction selected was examined at the paying agency, the local authority responsible and the final beneficiary. The observations concerning the substantive and formal errors found in the course of these checks are presented in paragraphs 2.26 et seq. Observations on the reliability of the accounts, on the other hand, can be found in paragraphs 8.1 to 8.19.

Legality and regularity of the underlying transactions

Substantive errors

2.26. Substantive errors are those errors which affect the value of the transaction selected. The error rate is high and their impact on overall expenditure is still considerable. However, more than two thirds of these errors occurred at final beneficiary level and the majority of them involved often minor overdeclarations of either surface area, in respect of plant products or accompanying measures (Germany, Denmark, Spain, France, Italy, Portugal, the United Kingdom), or of the number of head of livestock for animal premiums (Ireland, Portugal, the United Kingdom). Some of the errors involve undue payments for storage costs (ineligible expenditure, Finland) and the special beef premium (insufficient proof of slaughter, Germany).

2.27. With regard to the errors at the level of local management, in Greece some regional Unions of Cooperatives ⁽¹⁹⁾ made deductions from the amount of aid to be paid, from per hectare aid and from aid for the production of olive oil and for the production of tobacco ⁽²⁰⁾. At the central level, Community aid paid to the producers of olive oil, tobacco and cotton is also subject to a deduction of 3 %, which provisions a compulsory insurance fund (the ELGA). A deduction of 1 % is levied on olive oil production aid and paid to the National Confederation of Olive Oil Producers. In addition, in Spain, expenditure which was not eligible for Community co-financing was included in an operating fund for a fruit and vegetable producers' organisation. Lastly, Italy, once again ⁽²¹⁾, allowed some farmers exemption from payment of the supplementary levy that was due because milk quotas had been exceeded (238,7 million euro, see paragraphs 2.14 — 104,7 million euro and 2.15 — 134 million euro), which gave them a competitive advantage.

Systematic errors

2.28. These errors do not directly concern the transactions in the sample but affect all or part of a category of expenditure.

2.29. As pointed out in paragraph 2.27, Greece imposed an automatic deduction of 3 % from the amount of Community aid paid to producers of olive oil, tobacco and cotton to provision an insurance fund. These levies, which are not authorised by any Community text, totalled 49,4 million euro. At the local management level (commune of Sapes, Greece), the automatic deduction of 2 % from arable crop aid represented an undue deduction of 0,27 million euro for the benefit of the local Union of Cooperatives. Finally, the levy of 2,2 % applied by the Messara Union of Cooperatives (Prefecture of Iraklio, Greece) to olive oil production aid represents an undue levy of 0,16 million euro.

⁽¹⁹⁾ As in 1998, see the Annual Report for 1998, paragraphs 2.46 and 2.47.

⁽²⁰⁾ The deductions vary: 2 % for the regional Union of Cooperatives in respect of per hectare aid (Thrace), 2,2 % for the local Union of Olive Oil Producers' Cooperatives (Messara), 0,94 % for the local tobacco producers' group (Kolindros).

⁽²¹⁾ See the Annual Report for 1998, paragraph 2.45.

2.30. In Sweden, the cost of drawing up cartographic plans in 1998 had to be paid for by the producers before they could submit any applications for arable aid. This practice amounts to charging national administrative costs against Community aid in contravention of Community provisions. In this way Sweden recovered 3,5 million euro.

2.31. Finally, in Austria, within the framework of the 'Opul' environmental programme co-financed by the Community, the interest due on the amounts to be recovered was not calculated and recovered.

Formal errors

2.32. The formal errors noted have no effect on the value of the transactions examined. They stem from a failure to observe the terms of the regulations and are often the result of shortcomings in the management systems. The rate of these errors (not taking into account multiple errors affecting one and the same transaction) is also high. Eight out of 10 of these errors occur at local or central management level in the Member States.

2.33. As far as the management of payments at the Commission is concerned, an analysis of the monthly payment orders showed that in 11 out of 12 months (representing a total of 37 521 million euro, i.e. 94,4 % of payments) these payment orders were authorised outside the deadlines laid down in the regulations⁽²²⁾. The commitment of November 1998 (15 101 million-euro), which was entered on 19 August 1999 whereas the time limit, according to the regulations, was 20 February, represents an extreme example.

2.34. At the Member State level, the main formal errors found were caused by shortcomings in the carrying-out of the regulation checks. In France and Finland, for instance, the minimum percentage of area aid applications to be covered by on-the-spot checks was not always increased when the number of errors revealed by the initial examination of the files was too high. This is contrary to the provisions of Commission Regulation (EEC) No 3887/92⁽²³⁾. Lastly, it was not always possible

to ascertain that the minimum number of controls required by the regulations in the case of sugar export refunds had been complied with.

2.35. Other formal errors resulted from failure to comply with the provisions relating to the keeping of compulsory records. In Greece, for instance, there is still no olive oil register and the wine register is incomplete. Other cases showed that the records relating to olive oil production (Spain), milk production and livestock (Portugal) were on occasion incomplete.

The regulations

2.36. The absence of precise criteria in the regulations may give rise to differing interpretations in the Member States and thus to unequal treatment of the beneficiaries of aid.

2.37. For instance, Commission Regulation (EEC) No 3887/92 leaves it up to the Member States to determine the method used to measure areas of agricultural land and set accepted standards governing their utilisation. This Regulation has been supplemented with recommendations for its application⁽²⁴⁾. These provisions give the local authorities a great deal of room for manoeuvre. The result is that there may be variations in the technical tolerances associated with the measuring of land, even when conditions are identical. Likewise, local practices — which determine, for example, whether a hedge is eligible or not for per hectare aid — are just as variable since they, too, are determined by the local authorities and there are no well-defined criteria. This leads to unequal treatment of the farmers in the various Member States. The Commission should review these provisions and thus reduce the room for manoeuvre left to the local authorities.

2.38. Within the framework of the Swedish environmental programme, 50 % of the costs of courses, internships and demonstration projects — organised by the National Forestry Agency — is financed by the budget of the European Union (3,3 million euro in 1999). The cost of the projects includes direct costs and a part of the general costs charged by the regional agency, which is responsible for the projects. However, an on-the-spot inspection (at the Umeå regional agency) revealed that the method used to apportion the general costs led to the allocation of a higher share of the general costs to the projects co-financed by the Union than to the projects financed by Sweden alone. The regional agency

⁽²²⁾ As in 1998, see the Annual Report for 1998, paragraph 2.49.

⁽²³⁾ Commission Regulation (EEC) No 3887/92 of 23 December 1992 (OJ L 391, 31.12.1992) laying down detailed rules for applying the integrated administration and control system for certain Community aid schemes.

⁽²⁴⁾ Recommendations for on-the-spot measuring of areas of agricultural land, 20 April 1999 — VI/8388/94-FR-rev. 5.

seeks to justify the higher share allocated to the EU with the argument that the co-financed projects required more management energy and time. Neither Council Regulation (EEC) No 2078/92 ⁽²⁵⁾ nor its implementing provisions ⁽²⁶⁾ specify the nature of the costs, or the method of allocating them to the projects. This is why the Commission should send the necessary practical instructions on this point to the Member States.

2.39. Within the framework of this same Regulation (EEC) No 2078/92 the region of Lombardy (Italy) pays aid, co-financed by the Community (6 million euro in 1999), to farmers who have undertaken to reduce fertiliser use by at least 20 %. In the absence of an objective historical reference for the original level of fertiliser use (a requirement that is not clearly formulated in the Regulation) there is no guarantee that this objective can be achieved. Moreover, exclusively applying administrative checks on the quantities of plant-protection products bought or in stock — without seeking corroboration by means of chemical tests on the leaves of trees on the 22 000 or so holdings affected — does not serve to guarantee that the few products that are permitted will be used in smaller quantities and, therefore, does not guarantee that the aid has been duly paid.

2.40. The registration of sheep and goats is regulated by Council Directive 92/102/EEC. This stipulates (Article 4(1)(b)) that any keeper of sheep and goats shall keep a register that must contain 'an up-to-date statement of the number of live female sheep and goats which are over 12 months of age or which have given birth, present on the holding' ⁽²⁷⁾. The Irish authorities (102,8 million euro in premiums for ewes and female goats was paid to Ireland in 1999) applied a restrictive interpretation to this Article. The register used in Ireland does not therefore provide a permanent inventory of the animals present and supplies an adequate inventory only for the retention period. It does not permit satisfactory controls to be carried out outside this period. The Commission should take the necessary steps to ensure that the standards applicable to the registration of sheep and goats are the highest possible in all Member States.

⁽²⁵⁾ Council Regulation (EEC) No 2078/92 of 30 June 1992 (OJ L 215, 30.6.1992).

⁽²⁶⁾ Commission Regulation (EC) No 746/96 of 24 April 1996 (OJ L 102, 25.4.1996).

⁽²⁷⁾ Council Directive 92/102/EEC of 27 November 1992 concerning the identification and registration of animals (OJ L 355, 5.12.1992).

Conclusion

2.41. As regards the legality and regularity of the underlying transactions, the Court notes that for the financial year 1999 there is no sign of any significant improvement. This should encourage the Member States and the Commission to heighten the impact of controls, in particular by:

- (a) completing the implementation of the integrated administration and control system (IACS), which could be an important factor in improving the controls;
- (b) instituting measures that have a comparable effect for the common market organisations that are not yet subject to the IACS.

CLEARANCE OF ACCOUNTS

Introduction

2.42. In the course of 1999 the Commission took seven clearance-of-accounts Decisions (see **Table 2.2**), two in respect of 1995, the second Financial Decision for 1997, the first Financial Decision for 1998 and three Conformity Decisions. All these Decisions have been examined by the Court. In addition to the above Decisions, the Court also audited those Decisions taken in 2000 that specifically relate to the financial years 1995, 1998 and 1999: the second Financial Decision in respect of 1998, the Financial Decision for 1999 and two further Decisions regarding 1995.

Clearance of accounts under the system prevailing until 1996

Clearance of accounts 1995

Financial analysis

2.43. The expenses declared for the EAGGF year 1995 were cleared in four Decisions taken between February 1999 and July 2000 (see **Table 2.2**). This delay was primarily due to the need to await the outcome of conciliation cases before deciding on the corrections to be applied. In the mean time the expenditure concerned was disjoined.

Table 2.2 — Clearance Decisions

Decision No		EAGGF year	Corrections in Mio EUR	
Old clearance system				
3.2.1999	1999/187/EC	OJ L 61, 10.3.1999, p. 37	1995	429,1
28.7.1999	1999/596/EC	OJ L 226, 27.8.1999, p. 26		123,7
1.3.2000	2000/197/EC	OJ L 61, 8.3.2000, p. 15		38,5
5.7.2000	2000/448/EC	OJ L 180, 19.7.2000, p. 46		1,3
New clearance system				
3.2.1999	C1 ⁽¹⁾ 1999/186/EC	OJ L 61, 10.3.1999, p. 34	1996/1997	90
10.2.1999	F2 ⁽¹⁾ 1999/151/EC	OJ L 49, 25.2.1999, p. 42	1997 ⁽²⁾	
30.4.1999	F1 1999/327/EC	OJ L 124, 18.5.1999, p. 28	1998 ⁽²⁾	
4.5.1999	C2 1999/350/EC	OJ L 133, 28.5.1999, p. 60	1996/1997/1998	32
28.7.1999	C3 1999/603/EC	OJ L 234, 4.9.1999, p. 6	1996/1997	83,6
14.2.2000	F2 2000/179/EC	OJ L 57, 2.3.2000, p. 31	1998	2,6
28.4.2000	F 2000/314/EC	OJ L 104, 29.4.2000, p. 82	1999	1,7

⁽¹⁾ F : Financial Decision.

C : Conformity Decision.

⁽²⁾ See 1998 Annual Report paragraphs 2.54 and 2.55 (OJ C 349, 3.12.1999).

2.44. The corrections in respect of 1995 amount to some 592 million euro (see **Table 2.3**), almost twice as much as in 1994 (308 million euro). This increase is mainly due to large corrections for arable crops and animal premiums, where weaknesses were found in the application of the integrated administration and control system ⁽²⁸⁾, and for olive oil. Of the 592 million euro, some 140 million euro in respect of these three sectors relates to corrections for 1994 and earlier (of which 90 million euro had been disjoined in the decision for clearance of accounts 1994, see the Annual Report for 1998 ⁽²⁹⁾).

Clearance procedure

Mission reports and notification of the findings

2.45. A situation similar to 1994 was found in respect of 1995. With the exception of the arable crop sector, the mission reports and notification of findings were subject to long delays. For instance, in the meat sector, the notification of findings was produced on average 10 months after the mission. In the cases reviewed for pub-

lic storage and milk, the delay between the mission and the notification of corrections was more than 24 months. This is one of the reasons why the first decision was not taken until February 1999, more than 36 months after the 1995 EAGGF year end.

Conciliation Body

2.46. In the context of clearance of accounts 1994, Italy lodged an appeal to the Conciliation Body on the proposed correction for beef and veal (98/IT/098). The Conciliation Body's conclusion was that no reconciliation between the two parties was possible and the Commission's position was maintained. Nevertheless, the Italian authorities decided to lodge an appeal on the proposed financial correction for 1995 (98/IT/125), even though this correction was based on the same findings as for 1994. Similarly, Greece submitted cases 97/GR/077 and 98/GR/110 in successive years concerning fruit and vegetables, despite losing the appeal in respect of the earlier year. This suggests a possible misuse of the conciliation procedures on the part of the Member States.

Data provided by Member States

2.47. Some Member States had problems providing the Commission with accurate inspection statistics even several years after the on-the-spot controls had taken

⁽²⁸⁾ Council Regulation (EEC) No 3508/92 (OJ L 355, 5.12.1992, p. 1) and Commission Regulation (EEC) No 3887/92 (OJ L 391, 31.12.1992, p. 36).

⁽²⁹⁾ Annual Report for 1998 (OJ C 349, 3.12.1999), paragraph 2.64.

Table 2.3 — Summary of the Commission's clearance Decisions for 1995

(Mio EUR)

	B	DK	D	EL	E	F	IRL	I	L	NL	A	P	FIN	S	UK	Total
Expenses declared in 1995 (1)	1 562,1	1 389,1	5 329,9	2 350,6	4 788,3	8 351,8	1 468,8	4 258,1	13,6	1 843,3	82,4	683,8	59,2	76,5	3 397,1	35 654,4
Expenses disjoined from previous Decisions (2)	1,1	29,2	320,0	43,5	614,1	468,1	4,2	231,9	0,3	0,3	0,0	35,0	0,0	0,0	128,9	1 876,6
Expenses disjoined in 1995 (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	0,0	0,0	0,0	0,0
Amounts disallowed (4)	-2,0	-0,2	-21,8	-75,0	-184,7	-98,8	-5,9	-121,4	0,0	-19,0	0,0	-17,0	0,0	0,0	-46,9	-592,6
Expenditure cleared (5)	1 561,2	1 418,1	5 628,1	2 319,1	5 217,8	8 721,1	1 467,1	4 368,6	13,9	1 824,6	82,4	701,8	59,2	76,5	3 479,1	36 838,4
Expenditure charged in respect of the current year (6)	1 560,9	1 389,1	5 328,1	2 346,4	4 777,8	8 351,8	1 466,2	4 237,4	13,6	1 844,0	82,4	691,0	59,1	77,0	3 388,0	35 612,7
Expenditure charged to following year (7)														0,6		0,6
Amounts to be recovered by the EU (+) or paid to the Member State (-) (8)	0,8	0,2	20,0	70,8	174,1	98,8	3,3	100,7	0,0	19,7	0,0	24,2	-0,1	0,0	37,8	550,3

Exchange rate of currencies for Member State in euro : value of euro on 1.1.1999.

Exchange rate of currencies for Member State outside euro (DKK, GRD, SEK, GBP): value of euro on 1.1.1999:

DKK 7,4433

GRD 323,4

SEK 9,0985

GBP 0,7044

For the amounts disallowed the amounts in euro are taken from the tables in Annex V to the summary reports.

Expenditure cleared (5) = (1) + (2) + (3) + (4).

Amounts to be recovered or paid by the EU (8) = [(6) + (2) + (3) -(7)] -(5).

Source : Commission Decisions: 1999/187/EC of 3 February 1999,

1999/596/EC of 28 July 1999,

2000/197/EC of 1 March 2000,

2000/448/EC of 5 July 2000 and Annex V to the summary reports of 12.1.1999, 7.6.1999 and 9.11.1999.

place. In Spain, the first inspection statistics for 1995 were delivered in March 1997, revised in June and again in March 1998. This results in clearance delays. The Commission should set a deadline for the submission of such data, should base any corrections on the information available at that date, and should impose penalties on Member States which do not provide all this information on time.

Individual corrections

Integrated administration and control system

2.48. The integrated administration and control system was to be introduced in 1993 but was not due to be fully operational until January 1996 (it was later postponed until 1 January 1997). The Clearance Unit undertook a number of missions to assess progress in respect of arable crops and animal premiums for the financial years 1994 and 1995.

Arable crops

2.49. Corrections are due either to the failure by the Member States to reduce farmers' payments for a breach of the base area for the crop concerned⁽³⁰⁾ or to weak application of the control procedures set up under Article 6 of Commission Regulation (EEC) No 3887/92.

2.50. The Court has already commented upon the implementation of IACS in France in its Annual Report for 1996⁽³¹⁾, in particular the fact that farmers were not required to support their applications with documents which would enable the authorities to perform cross-checks on the areas claimed and the poor quality of physical controls. The Commission, in its reply, undertook to consider a correction for failure to carry out cross-checks, a key control that should lead to a 5 % correction. However, the Commission only applied a 2 % flat-rate correction for the inadequate quality of physical controls. A 5 % correction would have been 129 million euro higher than the 2 % applied on the basis of inadequate on-the-spot controls.

⁽³⁰⁾ Application of Article 2(6) of Council Regulation (EEC) No 1765/92 (OJ L 181, 1.7.1992, p. 12).

⁽³¹⁾ Annual Report for 1996 (OJ C 348, 18.11.1997), paragraphs 3.47 and 3.57.

2.51. The decision by the Commission to accept the proposal of the French authorities, whereby a greater number of physical controls could compensate for the lack of cross-checks, is considered to be unjustified. Both types of controls are complementary.

2.52. In Greece, the required cross-checks were not carried out until after the payment was made, thereby undermining the effectiveness of this control. This should be treated as a weakness under the Commission's definitions of key controls and should have led to a 5 % correction (an additional 10,5 million euro) rather than the 2 % applied.

2.53. In Germany, the Commission found weaknesses in both Mecklenburg-Western Pomerania and Hesse. However, only expenditure in respect of the former was subject to a financial correction. The Court's own findings⁽³²⁾ had confirmed the poor physical controls in Hesse. If the Commission felt it did not have enough audit evidence, it should have performed further work rather than simply dropping the correction of 2,2 million euro envisaged.

Animal premiums

2.54. Although several missions were undertaken to Member States to assess the quality of the on-the-spot controls and the implementation of the animal registers Directive⁽³³⁾, the corrections were primarily based on the inspection statistics furnished by the Member States.

2.55. However, the inability of some Member States to provide the Commission with inspection statistics on a timely basis and, in the case of Spain, several revisions of them should have led the Commission to question their validity and make further enquiries.

Milk super-levies

2.56. Most of the corrections made in the milk sector in the 1995 clearance decisions relate to super-levies (Greece, 4,4 million euro, campaign 1994/1995, paid in 1995, and Spain, 27 million euro, campaign 1993/1994, paid in 1994).

⁽³²⁾ Annual Report for 1996, paragraph 3.58.

⁽³³⁾ Council Directive 92/102/EEC (OJ L 355, 5.12.1992, p. 32) on the identification and registration of animals.

2.57. These corrections correspond to the amount of super-levies not credited by Member States to the EAGGF by 1 September following the end of the campaign, plus interest for late payment. The calculation of the correction is based on information supplied by Member States concerning the quantities of milk produced as well as interest rates to be applied. Thus the Commission, confronted with the problem of the reliability of the information obtained, undertook missions to the Member States to check that information. During these missions, it also evaluated the proper implementation of the control system laid down in the Regulation⁽³⁴⁾. The other main problem is related to the delays in obtaining the information from the Member States. These are the main reasons for the delay in making a correction for Spain.

2.58. The clearance unit is currently checking the reliability of the data for the 1995/1996 campaign payable in 1996. The Commission has detected many weaknesses in the management of milk quotas in Spain, Greece and Italy but no corrections have ever been applied. Where a Member State does not declare any super-levy and has an inadequate system for managing milk quotas, on the basis of past experience, it need not fear corrections, since, for example, none was made in relation to Spain for the 1994/1995 campaign. The Commission should have applied specific sanctions for these systems' weaknesses.

Olive oil

2.59. The corrections in this market amount to 107 million euro, mainly due to weaknesses in the management of production and consumption aid in Greece (28 million euro) and Spain (66 million euro). Part of these corrections relate to 1994 expenditure disjoined in the 1994 clearance of accounts: Greece, 22,2 million euro and Spain, 48 million euro. The Court was not in agreement with the correction applied in respect of 1994⁽³⁵⁾; the same remarks apply for 1995. There were no significant improvements between 1994 and 1995 and the flat-rate correction should therefore have been maintained at 10 % rather than the 5 % applied (an additional 8 million euro).

Conclusion

2.60. The value of corrections made in the clearance decisions for 1995 is much higher than in 1994 because

part of it relates to 1994 expenditure. Moreover, the introduction of the new procedure, with effect from 1996, meant that corrections for 1995 expenditure could not be included in a decision relating to 1996 or later. The corrections would have been at least 147,5 million euro higher, had the Commission applied the appropriate flat-rate corrections for key control failures (see paragraphs 2.51, 2.52 and 2.59). An additional sanction should have been applied to Member States that did not manage milk quotas properly. Once again, the delay in finally clearing the accounts (4,5 years) is prejudicial to the Community's financial interests.

Clearance of accounts under the post-1995 procedure

2.61. Under Commission Regulation (EC) No 1663/95 of 7 July 1995 regarding the procedure for the clearance of the accounts of the EAGGF Guarantee Section, the Member States must send to the Commission, not later than 10 February, the annual accounts of each of the paying agencies as at 15 October, with a certificate to the effect that they are true, complete and accurate. The certificate must have been issued before 31 January by a competent body which is independent of the paying agency. The certificate is to be based on an examination of procedures and of a sample of transactions, in accordance with internationally accepted auditing standards. On the basis of that certificate, the Commission, before 30 April, clears the accounts for the financial year ending 15 October of the previous year. In addition, the Commission has a maximum period of 24 months preceding its notification to Member States in which to take decisions to exclude expenditure that does not comply with Community rules (and, therefore, to recover the amount from the Member States).

Clearance of accounts 1998 (financial)

2.62. A total of 2 452 million euro was disjoined from the first financial clearance decision that was taken on 30 April 1999⁽³⁶⁾. On 14 February 2000, the Commission took a second decision⁽³⁷⁾ to clear the accounts of the four agencies concerned. Corrections of 2,6 million euro were applied.

⁽³⁴⁾ Commission Regulation (EEC) No 536/93 of 9 March 1993 (OJ L 57, 10.3.1993, p. 12).

⁽³⁵⁾ Annual Report for 1998, paragraphs 2.69 and 2.70.

⁽³⁶⁾ Annual Report for 1998, paragraphs 2.54 and 2.55.

⁽³⁷⁾ Commission Decision 2000/179/EC (OJ L 57, 2.3.2000, p. 31).

2.63. For Ofival (France) two payments were refused (0,2 million euro) and further corrections were made under conformity procedures ⁽³⁸⁾. For Denmark a correction of 0,6 million euro was made for failure to credit recoveries to the Fund. However the Commission's clearance unit subsequently agreed to reduce this correction by some 0,3 million euro — this will be adjusted in a conformity decision. The Commission asked the Certifying Body for Lower Saxony to carry out further testing on beef special premium payments. The results of the sample tested were extrapolated by the Commission and a correction of 1,8 million euro was applied. Further work by the Certifying Body for Cantabria enabled the Commission to clear the accounts without corrections.

Clearance of accounts 1999 (financial)

2.64. All accounts bar one ⁽³⁹⁾ were submitted by the 10 February deadline and the clearance decision was taken on 28 April 2000 ⁽⁴⁰⁾. The Commission initially notified the Member States concerned that 1 600 million euro in respect of five paying agencies would be disjoined from the decision. The provisional disjunction in respect of three of these accounts was cancelled following further work by/information received from the certifying bodies and for the other two the Commission decided not to disjoin any expenditure but rather to deal with the matters in conformity decisions. Financial corrections of 1,7 million euro were made in respect of four paying agencies (FEGA (E), CNASEA (F), Greece and Bremen (D)).

2.65. The accounts of 13 paying agencies (including FEGA, CNASEA and Gedidagep) were qualified by the certifying bodies (see **Table 2.4**). Most qualifications refer to conformity issues. The accounts for FEGA have been qualified for the fourth consecutive year. However, the Certifying Body carried out further work and issued a supplementary report and revised certificate in April 2000: all material reserves were withdrawn.

⁽³⁸⁾ For the calf premium scheme, 1,5 million euro, Commission Decision 2000/216/EC of 1 March 2000 (OJ L 67, 15.3.2000, p. 37).

⁽³⁹⁾ UK-IBEA (17.2.2000).

⁽⁴⁰⁾ Commission Decision 2000/314/EC of 28 April 2000 (OJ L 104, 29.4.2000, p. 82).

2.66. The correction for FEGA relates to ineligible VAT on food aid to Russia (0,3 million euro). For CNASEA the certifying body identified ineligible payments of 0,1 million euro for accompanying measures. The Commission also recommended that responsibility for the suckler cow scheme be transferred to Ofival, thereby removing the need for a separate paying agency (SDE). Furthermore, the certifying body has identified serious weaknesses in the French overseas departments, leading the Commission to call into question all of the expenditure.

2.67. The Greek authorities notified the Commission that they had overdeclared public storage expenditure for rice (1,3 million euro). The Greek certifying body only tested the payments in the sample of 231 transactions at paying agency level and not at the level of final beneficiary. This is a key control, given the nature of the system of payments. The Commission stated that this did not affect their opinion on the work carried out (Gedidagep is the third largest paying agency in terms of expenditure declared, see **Table 2.4**). On the other hand, the Commission considered that the certification for Bremen (83rd paying agency) was inadequate and applied a 10 % correction on the expenditure not adequately covered by the audit and considers that the paying agency should have its accreditation withdrawn.

Conformity decisions

First conformity decision

2.68. The first conformity decision in the context of the new clearance procedure was taken in February 1999 (see **Table 2.5**). It contains corrections of 90 million euro and covers EAGGF years 1996 and 1997. Most of these corrections were made for continuing weaknesses which had already led to corrections in previous years; Greece and Spain for olive oil (23,8 million euro and 34,4 million euro respectively) and for animal premiums in the United Kingdom (14,5 million euro).

Second conformity decision

2.69. The second conformity decision was taken in May 1999 and deals exclusively with the United Kingdom's over-thirty months scheme (OTMS) covering EAGGF years 1996, 1997 and 1998 (see **Table 2.5**). The 32,7 million euro correction concerns the EAGGF years 1996 to 1998 and relates to the 80 % advance paid on

Table 2.4 — Paying agencies by expenditure declared in 1999

No	Member State	Paying agency	Amounts declared (Mio EUR) (1)	% of total	Accounts qualified by the certifying bodies
1	Italy	AIMA	4 580,50	11,15	x
2	France	ONIC	4 501,40	10,95	x
3	Greece	GEDIDAGEP	2 611,60	6,35	x
4	United Kingdom	MAFF	2 293,80	5,58	
5	Ireland	DAF	1 680,40	4,09	
6	Spain	Andalucia	1 612,00	3,92	
7	Denmark	EU-Direktoratet	1 257,20	3,06	
8	United Kingdom	IBEA	977,00	2,38	
9	Germany	BLE	862,40	2,10	x
10	France	ONILAIT	846,60	2,06	
			21 222,90	51,64	
11	France	SIDO	811,50	1,97	x
12	Germany	Bayern StMELF	808,90	1,97	
13	Sweden	SJV	804,40	1,96	
14	Germany	Hamburg-Jonans	784,10	1,91	
15	Austria	AMA	777,00	1,89	
16	France	OFIVAL	764,00	1,86	x
17	Spain	Castilla y León	732,00	1,78	
18	Belgium	BIRB	727,00	1,77	
19	France	Services déconcentrés du Trésor	715,90	1,74	x
20	Spain	Castilla La-Mancha	687,40	1,67	
21	Spain	FEGA	676,30	1,65	x
22	France	FIRS	623,00	1,52	
23	France	ONIOL	616,80	1,50	x
24	United Kingdom	SOAEFD	588,50	1,43	
25	Finland	MMM	559,70	1,36	
26	Germany	Niedersachsen MELF	557,10	1,36	
27	Portugal	INGA	540,80	1,32	
28	Netherlands	PZ	471,00	1,15	
29	Spain	Extremadura	431,90	1,05	
30	Netherlands	HPA	421,30	1,03	
31	Germany	Mecklenburg-Vorpommern LM	379,70	0,92	
32	Spain	Aragón	378,60	0,92	
33	Germany	Brandenburg MELF	343,10	0,83	
34	Italy	DCCC	342,90	0,83	
35	Germany	Sachsen-Anhalt ML	338,40	0,82	
36	United Kingdom	WOAD	312,00	0,76	
37	Germany	Baden-Wurtemberg MLR	307,30	0,75	
38	Germany	Sachsen	279,00	0,68	
39	Belgium	Ministerie van Landbouw (DG3)	274,50	0,67	
40	Netherlands	LASER	273,90	0,67	
41	Germany	Nordrhein-Westfalen Westfalen	252,20	0,61	
42	United Kingdom	DANI	250,90	0,61	
43	France	ONIFLHOR	247,60	0,60	
44	Germany	Schleswig-Holstein MELFF	246,90	0,60	
45	Germany	Thuringen TLVwA	240,40	0,58	
46	Spain	Cataluna	230,90	0,56	x
47	France	CNASEA	178,80	0,44	x
48	Germany	Hessen HMILFN	173,40	0,42	
49	Spain	Valencia	130,70	0,32	
50	Spain	Canarias	125,70	0,31	
51	Germany	Rheinland-Pfalz MWVLW	123,80	0,30	
52	Portugal	IFADAP	118,90	0,29	
53	Netherlands	PVE	100,30	0,24	
54	Spain	Murcia	100,10	0,24	
55	Spain	Navarra	98,10	0,24	
56	Italy	ENR	93,80	0,23	
57	France	SAV	93,50	0,23	
58	France	ODEADOM	92,20	0,22	
59	Germany	Nordrhein-Westfalen Rheinland	87,70	0,21	
60	Spain	Galicia	81,00	0,20	
61	Austria	ZA Salzburg	66,80	0,16	
62	France	ONIVINS	51,10	0,12	
63	Netherlands	PT	47,90	0,12	
64	Ireland	DMNR	42,70	0,10	
65	Spain	Asturias	40,20	0,10	
66	Spain	Madrid	35,30	0,09	
67	Spain	Pais Vasco	34,00	0,08	
68	Spain	La Rioja	25,10	0,06	
69	Luxembourg	Ministère de l'agriculture	23,30	0,06	
70	United Kingdom	FC	20,00	0,05	
71	Spain	Cantabria	19,50	0,05	
72	Spain	Baleares	15,00	0,04	
73	Germany	Saarland MUEV	12,90	0,03	
74	Germany	Nordrhein.-Westfalen LfB	10,60	0,03	
75	France	OFIMER	9,30	0,02	x
76	Germany	Bayern StMLU	6,70	0,02	
77	Netherlands	DLG	6,60	0,02	
78	Germany	Hamburg WB	3,00	0,01	
79	United Kingdom	CCW	2,60	0,01	
80	Germany	Nordrhein-Westfalen LfA	2,20	0,01	x
81	Germany	Berlin SenWiTech	1,90	0,00	
82	Belgium	Organisme payeur de la Région wallone	1,30	0,00	
83	Germany	Bremen	1,30	0,00	
84	Belgium	Vlaamse Gemeenschap	0,30	0,00	
85	Spain	FROM	0,30	0,00	
86	Austria	BMLF Abt VI. B.8 (Wein)	0,30	0,00	
87	Netherlands	PVis	0,10	0,00	
88	Netherlands	MVO	0,00	0,00	
		Total	41 098,10	100,00	

(1) It must be noted that some of the Member States do not automatically deduct any negative amounts under the BP01-3700 (clearance of accounts) from the amounts they declare. However, the amounts shown in this table are the amounts actually declared by the Member States.

Table 2.5 — Corrections in the conformity decisions

(Mio EUR)

	1st conformity			3rd conformity		
	1996	1997	Total	1996	1997	Total
Public storage of cereals	0,0	0,0	0,0	31,0	8,1	39,1
Arable crops	3,5	0,0	3,5	9,9	4,4	14,3
Fruits and vegetables	2,3	3,8	6,2	2,3	0,0	2,3
Milk and milk products	3,3	3,3	6,6	0,1	11,0	11,1
Olive oil, etc.	58,2	0,0	58,2	- 1,8	- 3,6	- 5,4
Export refunds	0,0	0,0	0,0	0,1	0,0	0,1
Tobacco	0,7	0,0	0,7	0,0	1,3	1,3
Meat	14,5	0,0	14,5	12,8	4,9	17,6
Wine	0,0	0,0	0,0	0,4	2,7	3,1
Total	82,5	7,1	89,7	54,8	28,8	83,6

(Mio EUR)

	2nd conformity			
	1996	1997	1998	Total
UK Over Thirty Months scheme	12,7	17,39	2,6	32,69

NB : The Decision references are mentioned in Table 2.2.

rendering. The correction relates to the period between the start of the scheme (April 1996) and August 1997, during which the Commission and the Court carried out a number of visits to the UK to assess the implementation of the scheme. The Court's findings are summarised in its Special Report on BSE ⁽⁴¹⁾, paragraph 32 of which refers to the Commission's reservation concerning the financing of the first 250 000 animals killed under the scheme.

2.70. The correction made comprises two elements: for the period up to 4 July 1996, there was a 10 % flat-rate disallowance for some 205 000 animals claimed, and for the period from 4 July 1996 until 4 August 1997 there was a 5 % flat-rate disallowance for expenditure declared in respect of 1 425 000 animals killed under the scheme.

2.71. During the first of these two periods, key controls with regard to the eligibility of the cattle presented under the scheme, the movement of carcasses and ren-

dered material, storage and incineration were rarely or inadequately operating. In the Court's opinion, whilst it is clear that some form of control system was in place, its rudimentary nature, the overall lack of audit trail and the persistent weaknesses identified during the Commission's and the Court's visits warranted the 10 % correction applied.

2.72. According to the Commission, while representatives of the paying agency were present at stores from July 1996 onwards, problems concerning eligibility, movement of material and the physical and accounting controls over stocks continued until August 1997, when a new computer-based OTMS accounting system was introduced. In the Court's opinion these improvements were not sufficient to justify a reduction from 10 % to 5 % for the period July 1996 to August 1997. A 10 % correction would have implied a further 20 million euro.

Third conformity decision

2.73. The third conformity decision (84 million euro) covers the EAGGF years 1996 and 1997 (see **Table 2.5**). Most of the corrections (73 million euro) relate to late payments and other corrections which are determined

⁽⁴¹⁾ Special Report No 19/98 (OJ C 383, 9.12.1998).

at the level of the accounting unit of DG Agri. These corrections follow the same procedures as corrections determined by the clearance unit. Thus the same amount of time is needed to reach a decision. These corrections formalise deductions already made from the advances paid to the Member States.

Conclusion

2.74. The Commission took almost two years to make the first conformity decision under the new clearance of accounts system despite the fact that most corrections were for repeated weaknesses. The second conformity decision was a one-off decision and the third was essentially a book-keeping exercise. These decisions do not therefore give any indication of the 'normal' rhythm. Whilst there is no deadline specified in the Regulation, the Commission intends to take conformity decisions twice a year and this should ensure that corrections are made on a more timely basis.

2.75. The value of the corrections made under conformity decisions is relatively modest but the total values of conformity decisions cannot be predicted since they are primarily a function of the schemes examined by the Commission's clearance services and Member States' performance with regard to payment deadlines.

2.76. Given that the conformity decisions may cover a number of years, the final value of corrections (financial and conformity) for a given EAGGF year is not known until several years after the closure of the accounts. Thus, for 1996, there are further corrections contained in the fourth conformity decision⁽⁴²⁾ and others may be included in the fifth. This renders yearly comparisons impossible in the short term.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

Introduction

2.77. Information has been collected from the Commission and, where appropriate, Member State sources

⁽⁴²⁾ Commission Decision 2000/216/EC of 1 March 2000 to be examined by the Court in the context of the Annual Report for 2000.

about action taken relating to observations in Court reports on wine⁽⁴³⁾, milk quotas⁽⁴⁴⁾, skimmed-milk powder as animal feed⁽⁴⁵⁾ and importation at reduced rate of levy and disposal of New Zealand milk products and Swiss cheese⁽⁴⁶⁾.

2.78. A review of the information provided has revealed a number of matters for the attention of the budgetary authorities.

Wine

Background

2.79. The 1993 Annual Report⁽⁴⁷⁾ contained the results of an audit of the common market organisation (COM) in wine products. The European Parliament⁽⁴⁸⁾ asked for the Court's conclusions to be taken into account in any reform. The Council⁽⁴⁹⁾ invited the Commission 'to take inspiration from certain of the Court's recommendations in respect of the management and supervision' of the COM and the 'Member States to improve management and control', in line with the Court's recommendations.

2.80. In its report to Parliament on actions taken on the comments accompanying the discharge decisions for the financial year 1993⁽⁵⁰⁾, the Commission stated that:

⁽⁴³⁾ Annual Report concerning the financial year 1993 and Annual Report concerning the financial year 1996.

⁽⁴⁴⁾ Special Report No 4/93 on the implementation of the quota system intended to control milk production (OJ C 12, 15.1.1994).

⁽⁴⁵⁾ Special Report No 1/99 concerning the aid for the use of skimmed milk and skimmed-milk powder as animal feed (OJ C 147, 27.5.1999).

⁽⁴⁶⁾ Special Report No 4/98 on importation at reduced rate of levy into the Community and disposal of New Zealand milk products and Swiss cheese (OJ C 127, 24.4.1998 and OJ C 191, 18.6.1998).

⁽⁴⁷⁾ OJ C 327, 24.11.1994.

⁽⁴⁸⁾ Report accompanying the discharge resolution for the financial year 1993, (OJ L 141, 24.6.1995).

⁽⁴⁹⁾ Comments accompanying the recommendations on the discharge to be given to the Commission, Council Document SN 1289/95.

⁽⁵⁰⁾ COM(95) 666 final.

- (a) work was undertaken to update and refine management tools which would allow closer monitoring of economic trends in the wine sector, offer better controls and make them more effective;
- (b) it regularly checked the Member States' audit and internal control systems;
- (c) it expected the vineyard register to become the determining factor for the payment of premiums to producers.

2.81. In 1996, the Court concluded ⁽⁵¹⁾ that the main weaknesses highlighted in its 1993 report persisted. The Council, in its comments accompanying the recommendations on the discharge to be given to the Commission for the financial year 1996 ⁽⁵²⁾, insisted that it should aim to improve both management and monitoring of the COM when drawing up reform proposals in the context of Agenda 2000.

2.82. A Commission reform proposal in 1994 was not adopted by the Council. A new proposal in 1998 ⁽⁵³⁾ led to the reform of the COM by Council Regulation (EC) No 1493/1999 ⁽⁵⁴⁾, with effect from the 2000/2001 wine year.

2.83. The evolution of the budgetary expenditure for the wine COM is shown in **Table 2.6**.

Controlling the volume of wine placed on the market

2.84. Both the 1993 report and the 1996 follow-up drew attention to the imbalances on the wine market, in particular the market for table wine. In 1993, wine stocks represented approximately 11,7 months' consumption (excluding processing). In 1999, stocks remained identical for the EU-12 and represented 11,6 months for the EU-15, so that the overall balance of the market is still unsatisfactory. The Commission expects a decrease in consumption (excluding

processing) of table wine for the wine years 1998/99 and 1999/2000 and decided, on 5 November 1999, to open preventive distillation of up to 10 million hl of table wine for the wine year 1999/2000.

Distillation and price levels

2.85. The Court's 1993 report and the 1996 follow-up pointed out that intervention prices were, in some cases, set at a level which made distillation more profitable than selling on the market or grubbing-up.

2.86. Council Regulation (EC) No 1493/1999 reduces the number of distillation measures but does not limit the volume of wine qualifying for distillation. However, it requires that any variation in the minimum price, i.e. the price the distiller has to pay to the producer, and in aid amounts, must be established by the Commission in consultation with the management committee, instead of being calculated on the basis of non-representative data, as was previously the case. This is intended to eliminate the 'availability of intervention as an artificial outlet for surplus production' ⁽⁵⁵⁾, but the result will depend upon how accurately the prices set by the Commission take account of the actual market situation.

Grubbing-up

2.87. The 1993 audit concluded that grubbing-up (permanent abandonment scheme) had not had any significant effect on the level of production. The 1996 follow-up confirmed this observation. In an evaluation ⁽⁵⁶⁾, the Commission admitted that the effect of the grubbing-up programmes in reducing output was, relative to their cost, slight.

2.88. The Court also drew attention to the contradiction between the grubbing-up premiums and the replanting schemes financed by the EAGGF Guidance Section: unproductive vineyards were grubbed up while very productive vineyards were planted.

⁽⁵¹⁾ Annual Report concerning the financial year 1996 (OJ C 348, 18.11.1997).

⁽⁵²⁾ Council Document SN 2017/98.

⁽⁵³⁾ OJ C 271, 31.8.1998, p. 21.

⁽⁵⁴⁾ Council Regulation (EC) No 1493/1999 of 17 May 1999 (OJ L 179, 14.7.1999, p. 1).

⁽⁵⁵⁾ OJ C 271, 31.8.1998; COM(98) 370 final preamble 35.

⁽⁵⁶⁾ Commission, 'OCM viti-vinicole, évaluation et défis pour l'avenir', 14.4.1993.

Table 2.6 — Budget expenditure for the Wine COM

(Mio EUR)

	2000	1999	1998	1997	1996
	Estimate	Outturn	Outturn	Outturn	Outturn
Export refunds	43,0	27,4	41,2	59,7	40,8
Storage of wine and wine must	50,0	41,2	54,9	49,1	27,9
Distillation	239,0	187,1	247,0	221,7	57,9
Compulsory distillation	63,0	60,6	65,8	69,3	54,0
Technical costs	1,0	1,9	2,8	3,0	6,7
Financial costs	p.m.	0,0	0,1	0,2	0,5
Other costs	17,0	12,9	18,6	14,6	8,3
Depreciation of stocks	126,0	114,5	122,9	207,6	8,3
Aid for the use of must	133,0	161,4	132,6	166,4	148,8
Final abandonment — vines	35,0	9,0	15,1	242,1	333,1
Other	p.m.	- 1,5	- 1,2	- 3,6	- 1,4
Total (a)	707	614,6	700	1 030,1	776,9
Total COM (b)	35 220	36 177,5	36 405,7	38 155,5	36 983,5
Percentage (a)/(b)	2,0	1,7	1,9	2,7	2,1

Source : General budget of the European Union (1998 and before) and preliminary draft general budget 1999 and 2000. For 1999 provisional position as at 31.12.1999.

2.89. While the 1999 reform maintains the abandonment premiums, it also permits replanting on a significant scale. This approach is not likely to significantly lower the overall production level.

Reliability of information

2.90. Reliable information about production potential and stocks is necessary for the Commission to monitor market changes and correct imbalances. The old system provided for an annual harvest declaration by every producer. The 1993 Annual Report highlighted numerous irregularities in harvest declarations, the treatment of the data which they contained and checks on information from producers. The 1996 follow-up showed that the situation had not improved.

2.91. Commission Regulation (EC) No 1294/96⁽⁵⁷⁾ introduced penalties, including exclusion from the aid system for the producers who did not submit their annual declarations or submitted them in an incomplete or incorrect form.

⁽⁵⁷⁾ Commission Regulation (EC) No 1294/96 of 4 July 1996 (OJ L 166, 5.7.1996, p. 14).

Vineyard register

2.92. Council Regulation (EEC) No 2392/86⁽⁵⁸⁾ required Member States to establish a vineyard register within six years as an essential instrument for market management and for controlling support measures and planting schemes. The register was to permit identification of every parcel planted with vines and every vine-growing holding, as well as information on the characteristics of the areas concerned, the declarations made, aid received and production level. The 1993 audit revealed the unreliability of the registers and the delays in establishing them. Further effort would be necessary in order to collect all the information required for identifying the vineyards and verifying all the data.

2.93. In 1995⁽⁵⁹⁾, the European Parliament criticised the delay in establishing the vineyard register. It also called on the Commission to make the establishment of a satisfactory vineyard register a precondition for payments to Member States.

⁽⁵⁸⁾ Council Regulation (EEC) No 2392/86 of 24 July 1986 (OJ L 208, 31.7.1986, p. 1).

⁽⁵⁹⁾ Report accompanying the discharge resolution for the financial year 1993, (OJ L 141, 24.6.1995).

2.94. The time limit for the introduction of the register was extended to the end of 1998 by Council Regulation (EC) No 1549/95⁽⁶⁰⁾, which also provided for the register to be established in a simplified form (reference charts of parcels). Time limits were again extended by Council Regulation (EC) No 1631/98⁽⁶¹⁾, until 31 December 1999 in the case of Spain⁽⁶²⁾ and 31 December 2000 for Greece and Portugal. The successive extensions of the time limits were decided despite the express wishes of the European Parliament and further delayed the Commission's access to necessary management information.

2.95. Article 16 of Regulation (EC) No 1493/1999 introduces a requirement for the compilation of an inventory of production capacity, showing the surface area planted with vines, classified on the basis of variety (as established by each Member State), existing planting rights and any national or regional provisions adopted pursuant to production potential. Member States that do not establish such an inventory will not be able to apply the derogations relating to replanting, have access to restructuring aid or grant new planting rights. This should enable the Commission to better monitor production potential including planting rights.

Specialised control body

2.96. Council Regulation (EEC) No 2048/89⁽⁶³⁾ was intended to improve controls in the wine sector by the creation of a specialised control body within the Commission. The 1993 report mentioned the unsatisfactory staffing situation in this control body and the use of temporary employees and concluded that it was doubtful whether it would be effective. Parliament made a similar comment⁽⁶⁴⁾. The 1996 follow-up showed little change.

⁽⁶⁰⁾ Council Regulation (EC) No 1549/95 of 29 June 1995 (OJ L 148, 30.6.1995, p. 37).

⁽⁶¹⁾ Council Regulation (EC) No 1631/98 of 20 July 1998 (OJ L 210, 28.7.1998, p. 14).

⁽⁶²⁾ According to the Commission services, the Spanish authorities had not yet confirmed the completion of the establishment of the vineyard register (as of the end of March 2000).

⁽⁶³⁾ Council Regulation (EEC) No 2048/89 of 19 June 1989 (OJ L 202, 14.7.1989, p. 32).

⁽⁶⁴⁾ OJ C 271, 31.8.1998; COM(98) 370 final preamble 35.

2.97. Article 72(3) of Regulation (EC) No 1493/1999 requires the Commission to set up 'a body of specific officials' to collaborate with the competent authorities of the Member States in on-the-spot checks, in order to ensure that the wine sector rules are uniformly applied. The rules for applying Article 72 are to be laid down in a Commission regulation to be adopted in consultation with the management committee. No implementing provisions have been adopted so far, even though the provisions of Regulation (EEC) No 2048/89 were repealed under the reform, including the obligation for the Commission to ensure that 'such officials possess the technical expertise and appropriate experience to carry out the checks in question'⁽⁶⁵⁾.

2.98. There is thus little assurance that the specialised control body can be in place by the time the reform enters into force despite Parliament's requests to recruit candidates quickly or redeploy staff with the requisite skills and experience, thereby strengthening the control body⁽⁶⁶⁾.

Conclusion

2.99. The proposal for the 1999 reform of the wine COM and other initiatives taken by the Commission were only a partial response to observations in the Court's Annual Reports for 1993 and 1996. Progress has been made in three areas:

- (a) setting of prices for the distillation scheme (paragraph 2.86);
- (b) stricter rules on information to be provided by producers (paragraph 2.91);
- (c) introduction of an inventory of production potential (paragraph 2.95).

2.100. Weaknesses still exist regarding:

- (a) grubbing-up while replanting with more productive vines (paragraph 2.89);
- (b) delayed implementation of vineyard registers (paragraph 2.94);
- (c) staffing of the specialised control body (paragraph 2.98).

⁽⁶⁵⁾ Council Regulation (EEC) No 2048/89 of 19 June 1989 (OJ L 202, 14.7.1989, p. 32).

⁽⁶⁶⁾ COM(95) 666 final.

Milk quotas

The quota system

2.101. Special Report No 4/93 ⁽⁶⁷⁾ concluded that the persisting milk overproduction made further reduction of the overall level of quotas necessary. It also pointed out that the penalty imposed if the reference fat content were exceeded lacked the dissuasive effect needed to curb the resulting surplus butter production.

2.102. In 1993 the Commission shared the view that the overall level of quotas should be reduced. Nevertheless, the Council ⁽⁶⁸⁾ subsequently increased the overall quota. Further increases in the quota of up to 2,4 % were agreed under Agenda 2000, taking the total from 117,5 million tonnes to 120,3 million tonnes.

2.103. The Commission did not agree that penalties for overrunning the reference fat content were inadequate, but the rise in fat content continued after the quota system was introduced in 1984/1985. The Court estimates that, in 1998/1999, the higher fat content (equivalent to 250 000 tonnes of butter) implied additional disposal costs of about 300 million euro for the 1999 budget.

2.104. The report also noted that 'any quota system tends to be self-perpetuating because of the economic benefits which it brings the recipient producers' ⁽⁶⁹⁾. Milk quotas introduced in 1984 for five years were extended as part of Agenda 2000, maintaining the system until 2006 ⁽⁷⁰⁾ and probably 2008. The quota regime created a new asset for milk producers at no cost to them. In one Member State, the acquisition of quotas was eligible for financing under the structural measures of the EAGGF-Guidance Section.

⁽⁶⁷⁾ Special Report No 4/93 on the implementation of the quota system intended to control milk production (OJ C 12, 15.1.1994).

⁽⁶⁸⁾ Council Regulation (EEC) No 1560/93 of 14 June 1993 (OJ L 154, 25.6.1993, p. 30).

⁽⁶⁹⁾ Special Report No 4/93, paragraph 5.18.

⁽⁷⁰⁾ Council Regulation (EC) No 1256/1999 of 17 May 1999 (OJ L 160, 26.6.1999, p. 73).

Conclusion

2.105. The overall situation has not significantly changed. The continuing structural surplus means that public storage and disposal measures will continue to be needed.

2.106. In its opinion on Agenda 2000 ⁽⁷¹⁾, the Court warned that the increases in quotas proposed, and subsequently agreed, would lead to an even greater surplus in the milk market and a continued heavy financial burden on the EU budget.

2.107. The Community co-financing of purchases of quotas created by the Community, at no cost to producers, cannot be considered as sound financial management.

Use of skimmed milk and skimmed-milk powder as animal feed

Background

2.108. In order to dispose of surplus production in the milk sector, the European Union subsidises the use of skimmed milk (SM) and skimmed-milk powder (SMP) as animal feed ⁽⁷²⁾. The subsidies paid amounted to 382 million euro in 1999 and 367 million ecus in 1998. Special Report No 1/99 ⁽⁷³⁾ pointed out that only one third of the skimmed milk and skimmed-milk powder available on the European market is consumed at market prices, without receiving subsidies. The aid for skimmed milk and skimmed-milk powder used in animal feed facilitated the disposal of some 40 % of the EU's annual production.

⁽⁷¹⁾ Opinion No 10/98 of the Court of Auditors, paragraph 49 (OJ C 401, 22.12.1998).

⁽⁷²⁾ The disposal measures for the use of SM and SMP as animal feed were provided for by Council Regulation (EEC) No 986/68 (OJ L 169, 18.7.1968, p. 4). Specific regulations applied for the different types of measures: for liquid skimmed milk, Commission Regulation (EEC) No 1105/68 (OJ L 184, 29.7.1968, p. 24); and for compound feedingstuffs and SMP for the feed of calves, Commission Regulation (EEC) No 1725/79 (OJ L 199, 7.8.1979, p. 1).

⁽⁷³⁾ Special Report No 1/99 concerning the aid for the use of skimmed milk and skimmed-milk powder as animal feed (OJ C 147, 27.5.1999).

Measures taken by the Commission

2.109. Commission Regulation (EC) No 2799/1999⁽⁷⁴⁾ takes into account several of the Court's observations, in that:

- (a) clear quality criteria are fixed for the skimmed milk and skimmed-milk powder for which aid is granted, including the fixing of a minimum protein content;
- (b) the special arrangements for the payment of aid for skimmed-milk powder that has been denatured or processed into compound feed in the territory of another Member State are repealed with effect from 1 July 2000⁽⁷⁵⁾;
- (c) the rules concerning administrative and on-the-spot controls are clarified.

2.110. Commission Regulation (EEC) No 1105/68 on detailed rules for granting aid for skimmed milk for use as feed, for which the Court's audit had shown a number of administrative control problems, was also repealed from 1 January 2000.

Conclusion

2.111. The Commission reacted quickly and took into account several of the observations in Special Report No 1/99. However, because the modified rules⁽⁷⁶⁾ allow for a long time lag between the compliance inspection and the actual use of the skimmed milk and skimmed-milk powder for which aid is claimed, compliance of the skimmed milk or skimmed-milk powder with the protein, moisture and fat content requirements is no longer ensured.

2.112. The Commission still needs to provide a comprehensive analysis or study justifying the current high aid level for skimmed milk and skimmed-milk powder.

⁽⁷⁴⁾ Commission Regulation (EC) No 2799/1999 of 17 December 1999 (OJ L 340, 31.12.1999, p. 3).

⁽⁷⁵⁾ Commission Regulation (EC) No 2800/1999 of 17 December 1999 (OJ L 340, 31.12.1999, p. 28).

⁽⁷⁶⁾ Article 16(1) of Commission Regulation (EC) No 2799/1999.

Dairy products imported at preferential rates

Background

2.113. Special Report No 4/98⁽⁷⁷⁾ contained the results of the audit in 1996 of the import and disposal of New Zealand (NZ) dairy products imported at preferential rates of duty and of investigations into the import of Swiss cheese, also at preferential rates of duty.

2.114. Imports of NZ butter and cheese were controlled by fixed quotas and conditions of eligibility relating to origin, age, maximum fat content and method of manufacture. There was no quota for Swiss cheese, but minimum free-at-frontier prices were to be respected and rates of duty varied with the level of the minimum free-at-frontier price, the lower the price the higher the duty. If any of the quotas were exceeded or the eligibility conditions were not met, duty had to be paid at the full rate.

2.115. The primary responsibility for the control of respect of quotas and conditions of eligibility was allocated to agencies in the non-EU exporting country authorised to certify conformity of the consignment with the quotas and/or eligibility conditions (the New Zealand Dairy Board (NZDB) and the Swiss Cheese Union (SCU)) with the customs services of importing Member States bearing a subsidiary responsibility.

2.116. **Table 2.7** shows the volumes of butter and cheese imported under these arrangements in the period covered by the audit.

2.117. The main findings can be summarised as follows:

- (a) UK Customs and Excise (UK C & E) had never, of its own initiative, examined whether the quota limits had been respected, had not checked that the declared weights were correct, had not verified the fat contents of the imported products and had never carried out any *ex post* controls of the conditions of eligibility to the quotas;

⁽⁷⁷⁾ Special Report No 4/98 on importation at reduced rate of levy into the Community and disposal of New Zealand milk products and Swiss cheese (OJ C 127, 24.4.1998 and OJ C 191, 18.6.1998).

Table 2.7 — New Zealand butter and cheese quota quantities, imports of Swiss cheese

Calendar year unless otherwise stated	New Zealand butter quota quantity (tonnes)	Year	New Zealand Cheddar quota quantity (tonnes)	Swiss cheese quantity imported (tonnes)
1990	61 340	1990	6 500	28 365
1991	58 170	1991	6 500	33 411
1992	55 000	1992	6 500	38 720
1993	51 830	1993	6 500	35 570
1994	51 830	1994	6 500	32 009
1995 (to 30.6)	25 915	1995	6 500	32 111
1995/1996	76 667			

Source : New Zealand quota regulations and Comext.

(b) neither the Commission nor the UK authorities had requested information from the NZDB (as the issuing agency) to assess the particulars set out in the IMA ⁽⁷⁸⁾ certificates; the Commission had failed to systematically monitor the preferential import arrangements.

These weaknesses had led to the irregularities described in **Table 2.8**, which also indicates the amounts of duty underpaid as estimated in Special Report No 4/98.

2.118. The report recommended that the Commission take appropriate action to monitor the recovery of the amounts involved, introduce more effective requirements for control of imports at reduced rates of duty, review the validity of the IMA 1 system, remove the New Zealand Dairy Board from the list of agencies

⁽⁷⁸⁾ IMA 1 (Inward Monitoring Arrangements) certificates were introduced by Commission Regulation (EEC) No 1767/82 (OJ L 196, 5.7.1982) particularly for Swiss cheese to be imported into the Community at reduced rates of levy. Their use has since been extended to other dairy products from other third countries. Their purpose is to certify that the conditions of entitlement to the reduced rates of levy have been met. They are issued by approved agencies in the third countries. Annex VII to Regulation (EC) No 1600/95 (OJ L 249, 17.10.1995) lists the agencies approved for the issue of IMA 1 certificates. For New Zealand the authorised agency from 1 July 1995 was the New Zealand Dairy Board. Prior to that date, a similar certification system existed under Protocol 18 to the Act of Accession of Denmark, Ireland and the United Kingdom under which the New Zealand High Commission was the certifying body. For Switzerland, the Swiss Cheese Union was the authorised agency.

approved for the issue of IMA 1 certificates (as was done for the Swiss Cheese Union), and initiate in-depth controls of other quota agreements involving reduced rates of duty.

2.119. In its replies to the special report, the Commission did not dispute the observations on the irregularities concerning breaches of the NZ quota and quota eligibility conditions but, contrary to the opinion of the Court, considered that the duty underpaid did not reflect either a loss of own resources or any potential benefit to the importers. It stated that;

- (a) it would continue to monitor recovery action;
- (b) it had initiated technical talks to ensure that the system would function properly in future;
- (c) should it prove necessary when all elements were available, it would make an appropriate proposal regarding the issuing agency (NZDB);
- (d) it had insufficient resources to conduct in-depth examinations of other preferential arrangements itself but would ask Member States to give priority to such when undertaking examinations.

2.120. The EU Council, in its report on discharge for 1997 ⁽⁷⁹⁾, recommended that the Commission take measures to recover the sums involved, introduce obligatory

⁽⁷⁹⁾ SN 1812/99 of 16.2.1999.

controls on imports at reduced rates of duty, review the IMA 1 certification system and initiate in-depth controls of other quota imports at reduced rates of duty.

2.121. In its report on the postponement of discharge for 1997 ⁽⁸⁰⁾, the European Parliament invited the Commission:

- (a) to support the UK's efforts to recover the sums due to the EU budget;
- (b) to assess the seriousness of the matter, and of the negligence, for the four alleged irregularities;
- (c) on the basis of these criteria, to assess in which cases sanctions should be applied in accordance with Article 239 of the Customs Code;
- (d) to take account of the opinion of the World Trade Organisation (WTO), without prejudging the possibility of appeal;
- (e) to ensure that the New Zealand Government assume a monitoring role in the IMA 1 certification system in order to avoid the conflict of interest created by the fact that NZDB was simultaneously beneficiary and monitor of the arrangements;
- (f) to enact binding rules for the control of imports at reduced rates of duty under quota arrangements and revise the IMA 1 certification system;
- (g) to support the legitimate right of Community importers to be able to import products at reduced rates of duty in accordance with the same conditions granted to exporters from countries benefiting from preferential agreements.

Action by the UK authorities

2.122. UK Customs and Excise's action to protect the Community's financial interests and to quantify and notify the vast majority of the debts has been generally

commendable in a complex and time-consuming case. As at 31 March 2000, debts notified totalled 325,9 million euro, none of which has been collected and made available to the EU (see **Table 2.8**), given that all these amounts are under appeal. A strategy to ensure that effective controls are in place and executed has also been adopted. However, the UK authorities:

- (a) did not use their statutory powers to obtain stock records for the period 3 December 1993 to 1 May 1995, thus allowing that period to go out of time for the notification of debts in respect of irregular removals from warehouse;
- (b) did not formally notify the Commission of the NZDB's refusal of 24 November 1998 to provide information on the fat content of butter from dairies other than those for which such data had been obtained during the Court's audit until after the Court's follow-up in January 2000;
- (c) did not notify debts in respect of continuing fat content failures, preferring to use the provisions of a draft regulation which was not adopted until 8 May 2000 and which has no retroactive effect;
- (d) did not review the control strategy for imports of dairy products at preferential rates of duty from other non-EU countries and did not initiate any in-depth control of such imports; and
- (e) the UK C & E has refused to provide the Court with the opinion of its legal service on the possible assistance of the NZDB in providing security for the hearing of the appeals and has yet to forward a copy of the Tribunal's reasoning behind the ruling that the NZDB was not obliged to assist its subsidiary companies in providing such security.

2.123. Moreover, in the intervening period the prospects for recovery have deteriorated because:

⁽⁸⁰⁾ OJ C 279, 1.10.1999.

Table 2.8 — New Zealand dairy products: summary of arrears estimated, notified and collected in the United Kingdom*(in Mio EUR converted at the exchange rate of 31.12.1999)*

Special Report No 4/98 paragraphs	Description of irregularity	Arrears estimated Special Report No 4/98		Arrears notified		Arrears collected
3.4-3.6	Butter — breach of quota limits		1,3		3,7	0
3.9-3.10	Butter — incorrect release from warehouse	(a)			130,2	0
3.11-3.21	Butter — irregular fat content > 81,9 %	(b)	87,0		153,8	0
3.23-3.27	Butter not manufactured directly from milk or cream		28,0		36,4	0
3.7-3.8	Butter and cheese — underdeclared weights	(a)			1,8	0
3.37-3.39	New Zealand cheese — irregular end-use		1,5			0
	Total		117,8	(c)	325,9	0

NB: (a) To be quantified by United Kingdom Customs and Excise.

(b) The figures in the table for fat content and for total arrears may eventually be increased by EUR 95 million.

(c) Includes double counts by United Kingdom Customs and Excise of some EUR 21 million.

Source: United Kingdom Customs and Excise and Special Report No 4/98 (OJ C 127, 24.4.1998).

- (a) the principal debtor, Anchor Foods Ltd, sold its assets for EUR 14,2 million to a new company, also a 100 % subsidiary of the NZDB. The new company accepted responsibility for trade debts of 62 million euro for purchases of butter from the NZDB, but it did not accept liability for debts arising from breaches of quota limits and infringements of eligibility conditions;
- (b) taking into account the assets of the company, the Tribunal has ruled that the UK authorities should accept a security of only 7,7 million euro in respect of appeals against debts amounting to 325,9 million euro;
- (c) the Tribunal also ruled that the NZDB was not obliged to assist Anchor Foods Ltd in providing security for the appeals. However, the Tribunal declared that the reasoning for this ruling was not for publication on the grounds of commercial confidentiality;
- (d) the hearings of the appeals have been delayed considerably, the first being expected to take place in September 2000.

Action in the Netherlands

2.124. In 1995 Milk Products New Zealand Ltd (MPNZ) began to import butter under the NZ quota directly into the Netherlands. Physical checks including laboratory analysis of an early consignment revealed that the weight had been underdeclared and that the fat content exceeded the quota conditions. The resulting demand for additional duties of 924 672 euro (calculated at the full rate) is still before the Dutch national appeal bodies.

2.125. In April 1997, the Court provided the Dutch authorities with a copy of an NZDB fax indicating that the fat content of butter for another direct shipment into the Netherlands was in excess of the permitted maximum and suggested that the Dutch authorities liaise with the UK C & E regarding NZDB data on the fat content of other direct shipments. The Dutch authorities have not taken any action in response to the Court's communication. Imports of NZ butter into the Netherlands totalled 25 000 tonnes in 1999.

Action by the Commission

- effect from 1 July 2000 within the framework of a general revision of procedures relating to imports of NZ butter ⁽⁸²⁾;
- 2.126. The Commission:
- (a) has kept itself informed of the progress of quantification, notification and collection of duties underpaid on imports of NZ butter and cheese into the UK but has not verified the completeness of those notifications and thus was unaware of the UK's failure to notify the debts mentioned in paragraph 2.122(a). The Commission should recover the amounts involved because the UK has not complied with Article 2 of Council Regulation (EEC, Euratom) No 1552/89 ⁽⁸¹⁾ and thus must bear the financial responsibility;
 - (b) has similarly kept itself informed of the progress of notification of duties underpaid in the Swiss cheese case which, as at February 2000, totalled some 52,8 million euro, of which 4,8 million euro had been collected and made available to the EU;
 - (c) has full information on the progress of collection of duties underpaid on imports of NZ butter into Italy, partial information on progress in the Netherlands but no information for Belgium and Spain where NZ butter was also imported directly;
 - (d) as a result of considerations by the World Trade Organisation (WTO) Disputes Panel, has accepted that spreadable butter is eligible for the NZ quota provided that it is not manufactured from stored material. In its response of 25 November 1999 to a request by the UK authorities of 14 September 1999, the NZDB, whose manufacturing specification indicates that stored material is used, has refused to provide details of the raw materials used in the manufacture of spreadable butter. Moreover, this refusal was not communicated to the Commission until after the Court's audit visit in January 2000. Given the Court's observations in Special Report No 4/98 and the subsequent refusals by the NZDB to provide information to the UK authorities, the Court considers that the Commission could have taken earlier action to remove the NZDB from the list of agencies approved for the issue of IMA 1 certificates. Instead, the NZDB has been removed with
 - (e) emphasises that it does not have the power to require Member States to speed up the procedures relating to the collection of the duties underpaid ⁽⁸³⁾;
 - (f) has reviewed the IMA 1 system and has introduced with effect from 1 July 2000, *inter alia*, an obligatory minimum rate of control of 3 % for imports at reduced rates of duty and a clearly defined methodology for testing butterfat ⁽⁸⁴⁾;
 - (g) has initiated action to recover from the UK the duties underpaid for cheese for processing put to an irregular use as a result of an error by the UK C & E;
 - (h) as a direct result of the findings in the New Zealand and Swiss cheese cases, has not carried out or initiated any specific in-depth controls of imports of other agricultural products at preferential rates of duty;
 - (i) apart from the New Zealand case, has made only one request for information from an IMA 1 certifying body necessary to assess the particulars set out on the IMA 1 certificates and this was to Norway.

Collection of underpaid duties

2.127. The prospects for collection of any significant amount from the 325,9 million euro at stake in the NZ

⁽⁸²⁾ Commission Regulation (EC) No 970/2000 of 8 May 2000 (OJ L 112, 11.5.2000).

⁽⁸³⁾ Under Community law, the collection of traditional own resources is delegated to the Member States, who are obliged to make every effort to ensure that these resources are established, entered in the accounts, recovered and made available on time. (Council Decision 94/728/EC, Euratom of 31 October 1994 on the System of the European Communities' Own Resources and Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989, OJ L 155, 7.6.1989, p. 1).

⁽⁸⁴⁾ Commission Regulation (EC) No 970/2000 of 8 May 2000 amending Regulation (EC) No 1374/98 laying down detailed rules for the application of the import arrangements and opening tariff quotas for milk and milk products (OJ L 112, 11.5.2000, p. 27).

⁽⁸¹⁾ Regulation (EEC, Euratom) No 1552/89 of 29 May 1989 (OJ L 155, 7.6.1989, p. 1).

Table 2.9 — Summary of duties underpaid and collected by Member State

(Mio EUR)

Member State	New Zealand			Switzerland			Total outstanding
	Notified	Collected	Outstanding	Notified	Collected	Outstanding	
Belgium	outstanding			not applicable			
France	not applicable			3,9	3,90	0	0
Germany	not applicable			1,3	0,90	0,40	0,40
Italy	1,70	0	1,70	48	0	48,00	49,70
Netherlands	0,90	0	0,90	not applicable			0,90
Spain	outstanding			not applicable			
United Kingdom	325,92	0	325,92	not applicable			325,92
Totals	328,52	0	328,52	53,20	4,80	48,40	376,92

Source: United Kingdom Customs and Excise and OLAF.

case in the UK, should the Tribunal uphold the demands made by the UK C & E, are remote, the maximum amount at present being unlikely to exceed the security of 7,7 million euro. The importer has sold its assets to another subsidiary of the NZDB, which has not accepted liability for debts arising from alleged quota infringements. In the Swiss cheese case 4,8 million euro of duties underpaid have been collected, with some 48 million euro under appeal, for the most part in Italy. **Table 2.9** summarises the position by Member State for both cases.

Conclusion

2.128. Bearing in mind that the Swiss cheese investigations were initiated in 1993/1994 and the results of the

audit of NZ dairy products were notified to the Commission and Member States in March 1997, the Court concludes that the progress of collection of arrears is too slow.

2.129. Although some measures have now been taken to ensure that the specific problems with preferential imports of milk products from New Zealand are unlikely to recur, the Commission's action has been slow. Furthermore, there has been no specific action, resulting from the New Zealand and Swiss cheese cases, to ensure similar breaches of regulations do not occur for imports of other agricultural products at preferential rates.

THE COMMISSION'S REPLIES

IMPLEMENTATION OF THE BUDGET

Provisional appropriations

2.8. The appropriations under Subsection B1 of the EAGGF Guarantee Section were sufficient to cover all its expenditure. The use of provisional appropriations would nevertheless have involved a compulsory transfer to the headings concerned.

Entering of revenue in the expenditure budget

2.10 to 2.13. The amounts to be recovered from Member States and operators are by nature very difficult and arbitrary to estimate. Most such amounts arise either from a failure by the Member States to comply with the rules (overshooting deadlines, absence of checks, clearance of accounts, etc.), or from faults committed by operators (amounts recovered in the context of irregularities and fraud, the milk levy, etc.) It would be unwise to attribute overestimated revenue to poor management and fraud without having minimum data in support of such an assumption.

2.11. In the case of revenue from additional milk levies, an amount of EUR 224,85 million was indeed deducted in 1999 from the advances made to Italy for the 1997/1998 marketing year. It was not possible to book these levies in 1998 because the questionnaire returned by the Member State in time for the deadline of 1 September 1998 did not indicate that the quotas had been overrun. It was not until the revised questionnaire (see Regulation (EC) No 82/96) was transmitted in March 1999, that the overrun was revealed. The Commission immediately took the appropriate steps to recover the amounts due and not disbursed by Italy.

2.12. With regard to the discrepancies in revenue on sales, Regulation (EC) No 1883/78 stipulates that stocks are to be valued at the end of the financial year at the estimated selling price, to ensure that potential losses are not carried forward to the following financial years. As a precaution, so that future budgets will not be burdened with overvalued stocks, the Commission's policy has always been to depreciate the stocks of products other than cereals at the lowest estimated selling price.

Moreover, the largest discrepancies were chiefly recorded in two sectors. In the case of beef and veal, sales, not including the quantities intended for Russia, had been estimated at 120 000 tonnes; almost twice that quantity was actually sold. This explains both the buoyancy of selling prices and the

higher amount recorded. In the case of olive oil, these stocks were not expected to sell at very advantageous prices, since very large quantities had been sold into intervention during the marketing year.

2.13. The 19 items quoted by the Court relate to sums recovered in cases of irregularities and fraud.

Reductions in advance payments

2.15. The Commission is aware of this problem and is exploring what steps should be taken to avoid a recurrence of this situation.

Carry-overs from the preceding financial year: the supply of food aid to Russia

2.16. The Commission agrees with the Court that it would have been preferable to finance the food-aid operation for Russia from appropriations in the 1999 budget. Contrary to the Commission's intentions, however, the Council and Parliament decided to use appropriations remaining available from the 1998 budget and carried forward to 1999. The Budgetary Authority opted for this solution on 24 November 1998, before the 1998 SAB and the 1999 budget had been adopted. (See the Commission's reply to the 1998 Annual Report).

2.17. The impact on technical storage costs was not felt in 1999, firstly because of the delays in delivery when the programme was suspended by the Russian authorities with the result that the goods remained in store longer than anticipated and, secondly, because the removal costs had to be paid out during that financial year.

Expenditure on refunds for pigmeat increased because the refund rates for exports to Russia had to be appreciably raised in order to guarantee trade flows and ensure sufficient supplies to the Russian Federation over and above the food-aid operation.

Booking expenditure under depreciation of stocks would have prevented the transparency needed to establish the total cost of this operation.

Management of the budget

2.20. Concerning the reliability of the Member States' forecasts, in 1999 the Commission carried out a feasibility study

which showed how difficult it would be to improve forecasts, except in the case of supporting measures and rural development; for these, Commission Regulation No (EC) 1750/1999 provides for penalties where forecasts differ appreciably from actual expenditure.

Proposals for transfers are based not only on Member States' forecasts, but also on expenditure already incurred and reviews of market developments.

2.21. The Commission sometimes makes transfers within a budget article, and must thereafter restore the article to its original situation. However, such transfers are made so that expenditure can be booked quickly rather than left outstanding pending more lengthy procedures.

Only one transfer was made under each of the budget headings 'Permanent abandonment premiums in respect of areas under vines' and 'Tobacco premiums' during the financial year 1999. Since other budget headings had to be topped up at the end of the financial year, these transfers removed the amounts in question from those headings in accordance with the Financial Regulation. In the case of 'Tobacco premiums', the under-consumption of appropriations resulted from a change in the rules at the end of December 1998, i.e. well after the 1999 preliminary draft budget had been drawn up and after the Commission departments had drafted the letter of amendment.

2.22. As explained above at point 2.12, the rules are designed to ensure that the stocks to be carried forward are estimated in such a way that potential losses are not transferred to subsequent financial years.

Moreover, evaluation of the estimated selling price and the ensuing further depreciation are not the only factors that determine the revenue from sales booked during the following financial year. Whether the sale of stocks results in losses or revenue depends on the difference between the average book value (value of stocks carried forward + value of purchases) and the actual selling prices.

If the quantities bought in during the following financial year are smaller than forecast at the time the budget is being prepared, the average book value will not increase as much as expected and this will result in substantial revenue.

Computer systems

2.23. Turning to the computerised system for the management of agricultural expenditure, the Commission had to cope

with pressing difficulties in adapting existing systems to take account, firstly, of the introduction of the euro in the accounting systems of the paying agencies and, secondly, of the need to make computer systems Y2K-compliant. Both these operations were completed successfully. The Commission also carried out a feasibility study in 1999 to assess the possibility of creating a detailed database containing all the information on payments to individual beneficiaries, as requested by all the Community institutions. During the study about half the Member States' paying agencies were examined in detail to determine the feasibility of this project.

In view of the positive conclusions of the study and in the light of the needs arising from the reform of the Commission and the new requirements to be taken into account in the context of the proposal to recast the Financial Regulation, a call for tenders is currently being prepared, so that a start can be made on developing a new computer system able to meet all these new requirements.

Conclusion

2.24. As stated in point 2.20 above, following the study carried out in 1999 the Commission has adopted rules wherever possible to improve the reliability of forecasts. It should also be remembered that transfers become necessary when the Budgetary Authority makes across-the-board reductions in appropriations.

With regard to the practice of entering 'negative expenditure', the proposal to recast the Financial Regulation should satisfy the Court's requirements.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Legality and regularity of the underlying transactions

Substantive errors

2.26. The Court's findings concerning expenditure under the EAGGF Guarantee Section point to a level of substantive errors that is lower than for the budget as a whole. Nevertheless, the Court found the level of error unacceptably high.

The Commission has some general comments on the DAS cases in the EAGGF Guarantee Section. Guarantee Section expenditure is managed jointly by the Member States and the Commission. The administration and controls are performed by the Member States while the Commission supervises and

audits the work of Member States. The Commission also recovers amounts incorrectly spent by the Member States in its so-called clearance decisions. For each DAS case, then, the specific knowledge resides with the authorities of the Member State. It is worth noting that neither the Commission nor the Member States have had very much time to study the substantive errors found by the Court. In several cases the Member States' comments have not yet been received. 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. For a number of the cases found by the Court and already known to the Member States beforehand, the Member States have already initiated recovery procedures.

The errors found by the Court fall into several categories. In a number of cases, the Commission shares the Court's view that errors have been made and will take the necessary steps to recover the amounts involved.

In other cases, the Commission shares the Court's criticism of practices applied in some Member States, particularly where deliberate deductions are made from aid payments to beneficiaries to cover administrative expenses. However, the Commission is of the view that these practices were not illegal at the time and cannot therefore be considered as errors. At the Commission's initiative, the relevant regulations have already been amended to explicitly forbid such practices. The new rules are now being applied but were not in force at the time of the transactions analysed by the Court.

In the case of a number of substantive errors found by the Court, the findings are based on the principle of annuality of the budget and the rules for depreciation of stocks. There is full agreement that the transactions in question incur no loss to the Community budget. The Court and the Commission disagree only on which budget year these transactions should be charged to.

With regard to arable crops and animal premiums, the Court has discovered a substantial number of small errors, after taking the technical tolerances into consideration. These errors relate in many cases to amounts of less than EUR 100. In accordance with the rules for the integrated administration and control system (IACS), these errors are considered minor amounts which do not need to be recovered since the cost of recovery would be disproportionate. To avoid or substantially reduce such minor errors in the future, it would probably be necessary to set up a more costly and burdensome control system. This raises the policy issue of determining the appropriate number of controls from a cost-benefit point of view. The regulations in force in most cases require a minimum of 5 % or 10 % checks by Member State administrations. Substantially reducing the number of small errors currently not detected

by the Member States' inspection systems would require a very substantial increase in the number of checks and thus in the resources allocated to these inspection systems by Member States. It is an open question whether 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 penalties applied by the Member States to the final beneficiaries are of a similar magnitude as the most probable loss to the EAGGF that can be extrapolated from the DAS sample.

Recoveries under the clearance of accounts procedure currently amount to around EUR 600 million per year. 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. Furthermore, the inspection and penalty systems in the Member States also lead to reductions in expenditure, particularly for arable crops. In this sector the penalties applied by the Member States result in no aid being paid for around 2 % of the eligible area, thereby reducing Community expenditure by some EUR 300 million. Similar kinds of penalty systems are applied in other sectors.

Based on current figures, the clearance procedure and the inspection and penalty systems thus save the Community budget EUR 900 million to EUR 1 000 million yearly. This amount is of the same order of magnitude as the most probable loss to the Fund that can be extrapolated from the Court's DAS sample, although it is difficult to compare the clearance decisions with the DAS sample directly.

Apart from auditing the Member States and applying financial corrections, the Commission is also working on improving the systems used by the Member States. For example, it has proposed that all Member States adopt geographical identification systems in order to reduce human error in submitted claims and to improve control systems generally. The relevant regulation is now in force. Another example of preventive action initiated by the Commission is the development and refining of the animal identification system.

2.27. With regard to the deductions made by the local and central Greek bodies from area aids, the Commission has been making financial corrections of 2 % under the clearance procedure since the financial year 1993. It will continue to do so until the Greek authorities put a stop to these deductions. Since Regulation (EC) No 1259/1999 establishing common rules for direct support schemes under the common agricultural policy entered into force on 1 January 2000, payments under the support schemes are paid in full to the beneficiaries (see Article 2 of and the Annex to that Regulation).

Turning to the deductions from aid for olive oil, cotton and tobacco, the Community rules do not prohibit this practice provided the beneficiaries of the aid agree to the deductions. The Commission departments have clarified this issue in an interpretative note.

In the case of Italy, the Commission has initiated infringement proceedings (97/2228).

Systematic errors

2.28 to 2.31. The amounts in question will be corrected under the clearance of accounts.

Concerning Greece, see the reply to point 2.27 above. It should be pointed out that Community legislation specifies when such levies are not permitted, as in the case of Regulation (EC) No 3887/92. When the rules do not expressly prohibit such practices, it cannot be categorically stated that they are not permitted.

Formal errors

2.32. Although formal errors do not affect the value of the transactions examined, the Commission departments make a correction when evaluating such errors contained in individual cases likely to entail flat-rate corrections.

2.33. The booking of payments of EAGGF Guarantee Section expenditure was delayed as a result of difficulties encountered when introducing the computerised central accounting system Sincom 2.

2.34 to 2.35. The Court's remarks on area aid, sampling of milk powder and export refunds for sugar in France, the olive cultivation and vineyard registers in Greece, the production of olive oil in Spain and milk and livestock production in Portugal will, if necessary, give rise to flat-rate corrections under the clearance of accounts.

In addition, the Commission is not happy that the Court, when considering compliance with Regulation (EEC) No 3887/92 in point 2.33, is taking the number of errors detected as the only criterion for increasing the inspection rate. Other parameters should also be taken into account, including the size of the areas checked and for which errors were found. In this connection, the Commission presented guidelines to the Member States in 1999 for determining the increase in the inspection rate according to the areas not found in relation to the areas inspected.

It should not be overlooked that the number of errors found can be a sign of the quality of the checks carried out.

The regulations

2.36 to 2.38. To ensure that the Community rules are properly and uniformly applied throughout the Union, and to avoid unequal treatment of beneficiaries, the Commission takes every opportunity (at each stage of the adoption procedure and during application) to explain the most complex points which could lead to divergent application. Thus, it regularly provides collections of interpretative notes and guides (*vade-mecums*) in the context of the Management Committees.

2.37. Concerning Regulation (EC) 3887/92 on applying the integrated administration and control system, in May 2000 the Member States received a collection of all the interpretative notes relating to the questions they had asked. In addition, Regulation (EC) 2801/1999 of 21 December 1999 clarified a number of points in Regulation (EC) No 3887/92.

The Commission will shortly be proposing a further amendment to Regulation (EC) No 3887/92, this time to clarify the matter of the eligibility of hedgerows.

2.38. The Commission departments concerned with the EAGGF Guarantee Section use the criteria set out in the rules on eligibility (Regulation (EC) No 1685/2000) for the Structural Funds.

Rule No 1 stipulates (at point 1.7) that 'overheads are eligible expenditure provided that they are based on real costs which relate to the implementation of the operation part-financed by the Structural Funds and are allocated pro rata, to the operation, according to a duly justified fair and equitable method'.

2.39. For the Italian regions where auditing detected this type of anomaly, flat-rate corrections of 5 % were proposed.

It should be noted that there are alternative methods for checking the reduction of fertilisers and that the analysis method is not always reliable.

2.40. In cases where Article 4(b) of Directive 92/102/EEC is indeed not complied with, the Commission shares the opinion of the Court.

The Commission submitted a report to the Council of Ministers on the identification and recording of sheep and goats in July 2000.

Conclusion

2.41. In view of the number of errors detected by the Court, the Commission considers that the legality and compliance with the rules of the underlying transactions is reasonably well assured and that the inspection arrangements are functioning satisfactorily.

- (a) IACS, which is a continually evolving system of preventative measures and cross-checks, saves the Community budget approximately EUR 300 million a year.
- (b) As for introducing IACS for the other common market organisations, on 17 July 2000 the Council adopted Regulation (EC) No 1593/2000 amending Regulation (EEC) No 3508/92 to give the Member States discretion to design their own arrangements for applying the system to other aid schemes and to make them compatible with the main features of IACS.

CLEARANCE OF ACCOUNTS

Clearance of accounts under the system prevailing until 1996

Clearance of accounts 1995

Clearance procedure

Mission reports and notification of the findings

2.45. The main reason why the clearance of accounts procedure is so lengthy is that Member States' rights of defence must be respected. Indeed, failure to respect these rights resulted in the Commission losing Case C-61/95 before the Court of Justice. A detailed analysis of all the stages of the clearance procedure shows that at least 645 days are needed to terminate a procedure leading to a Commission Decision.

Conciliation Body

2.46. The Conciliation Body has sole responsibility for cases submitted for its opinion in accordance with the criteria laid down in the Decision of 1 July 1994.

Data provided by Member States

2.47. The Commission considers that the flat-rate correction applied to Spain was partly due to the lack of inspection statistics.

The Commission departments will pay close attention to whether the Member States comply with the deadlines by which they must send data.

Individual corrections

Arable crops

2.50 and 2.51. The correction applied was based on the finding that the on-the-spot checks were of insufficient quality. This shortcoming is a breach of a key control. However, it was decided to apply a flat-rate correction of only 2 % because the EAGGF's findings concerned only two French departments. Carrying out on-the-spot checks is not the responsibility of the two departments visited, but rather of the 17 regional offices of the ONIC. The two departments concerned belonged to two different regional offices of the ONIC, which is why the Commission chose to make a correction at national level, concluding that the existence of similar shortcomings in the other regions could not be ruled out. However, the shortcomings detected did not necessarily point to a financial risk at national level warranting a correction of 5 %.

2.52. In the case of Greece, the Commission takes the view that it would have been difficult to impose a correction of more than 2 % in a year still in the middle of the transitional period for introducing the integrated system. The shortcomings detected for the 1994 harvest did not relate to on-the-spot checks or any other key controls (unlike subsequent harvests, where problems relating to on-the-spot checks were noted). Following the guidelines set out in the Commission's working paper (on the calculation of financial consequences), and given that a high risk could not be concluded on the basis of the clearance findings, the Commission was obliged to propose a correction rate of 2 %, particularly since the Commission is required by Article 5(2) of Council Regulation (EEC) No 729/70, as amended by Regulation (EC) No 1287/95, to take account of the nature and gravity of the infringement and the financial loss suffered by the Community when evaluating the amounts to be excluded. In conclusion, then, since the deficiencies concerned ancillary controls, the 5 % correction proposed by the Court would have been against the rules.

2.53. With regard to the Court's proposal for Hessen, the Commission dropped its proposal for a correction in the light of the Conciliation Body's report ruling that the proposal for

a flat-rate correction was not well-founded according to normal auditing rules, from the point of view of either procedure or substance. At the time of the conciliation procedure, the German authorities had submitted documentation consisting of 560 individual inspection reports showing that measuring had indeed been carried out, contrary to what was suggested in some activity reports of local branch offices, which gave the impression that such measuring had not taken place.

Animal premiums

2.55. The Commission's staff did indeed have problems obtaining reliable information from Spain within an acceptable time-frame. It was mainly for this reason that, in proposing recent amendments to Regulation (EEC) No 3887/92, the Commission introduced time limits for supplying the type of statistical data in question.

As regards Spain itself, the Commission continues to pay particular attention to the data supplied, and several on-the-spot audits are planned in various Autonomous Communities during 2000.

Milk super-levies

2.57. The corrections applied for Spain and Greece are the result not of calculations based on information supplied by the Member States but rather of exhaustive auditing work by the Commission auditors to establish accurate data and to formulate numerous recommendations to the national authorities with a view to improving their administration of the regime. Most of these recommendations have been followed up by the Member States and their management systems have been significantly improved thereby.

Penalties for deficiencies in administration of the regime have been applied in the past under the compromise of the Council of Ministers in October 1994 for the milk years from 1989 to 1993: EUR 1,464 million for Spain and EUR 8 million for Greece.

2.57 and 2.58. The clearance of accounts auditors are in the final stages of proposing corrections for Greece, Spain and Italy, amongst others, in respect of the 1995/1996 milk year. It is hoped that an ad hoc decision will be taken in December 2000 in this regard. It is not possible to clear the accounts for milk years at an earlier stage because the checks carried out by the Member States can take up to four years to be completed.

The Court is correct that Member States with an inadequate management system are not penalised if they fail to declare an

overshoot of quota. The clearance of accounts unit is very aware of this deficiency in the quota legislation. Furthermore, even if there is an overshoot of quota, the only penalty permitted by the legislation as it is currently framed is payment of additional levy and interest for late payment. The Commission's departments are exploring how to provide the legal framework to penalise Member States for inadequate management and also how to establish the basis on which to apply such a correction. The only possible avenue at the moment is to open infringement proceedings, and this step has been taken for both Spain and Italy (Ref. 97/2227 and 97/2228).

In the particular case of Spain for 1994/1995, the fact that there was no overshoot was both noted and scrutinised. It should be noted that actual milk deliveries to dairies in Spain increased during this period and that an overshoot was avoided by the perfectly legal means of transferring direct-sales quota to deliveries. Since the Commission auditors found no particular anomalies, no penalty would have been possible.

Olive oil

2.59. The Commission's decision to reduce the financial corrections for Greece and Spain for the 1993/1994 marketing year from 10 % to 5 % was adequately explained in the Commission's reply to paragraphs 2.69 and 2.70 of the 1998 Annual Report of the Court of Auditors. Since the systems have neither improved nor worsened significantly since then, the correction of 5 % for these two Member States has been maintained in subsequent years.

Conclusion

2.60. The Commission does not agree that corrections should have been greater than EUR 147,5 million. The EAGGF's proposed decisions are based on compliance with the established criteria, the information and evidence transmitted by the Member States during the accounts clearance procedure and the principle of equal treatment between Member States.

Clearance of accounts under the post-1995 procedure

Clearance of accounts 1999 (financial)

2.67. The Commission's departments have noted the Court's opinion, expressed in earlier reports, that the work of the Greek certifying body can be improved. This matter will be discussed later in the year. Nevertheless, the Greek certifying

body has examined over 260 additional transactions for a number of different regions and schemes. Taking into account all the work that has been done, which goes well beyond mere sampling, the Commission's departments considered that the results were acceptable for clearance.

Conformity decisions

Second conformity decision

2.69 to 2.72. The Commission does not share the Court's opinion that a flat-rate correction of 5 % was unsuitable. The UK authorities did improve their control systems, largely as the fruit of their own experience but also due, in no small part, to the many on-the-spot audits of the OTMS (over-thirty-month scheme) undertaken by both the Commission and the Court's own staff.

Conclusion

2.74. The Commission stresses that it is unrealistic to expect to make the transition from one clearance system to another overnight. Between 1996 and 1999, the Commission covered considerable ground on clearing the agricultural accounts. It cleared the EAGGF Guarantee Section accounts for the financial year 1994 and almost all of the financial year 1995 and even adopted three clearance decisions under the new procedure.

2.75. What the Court calls the 'modest' corrections under the new clearance of accounts procedure were able to be decided in 1999 because they had been included in the observations made under the old system for the financial year 1995, cleared in March 1999.

Follow-up to previous OBSERVATIONS

Wine

Controlling the volume of wine placed on the market

2.84. Although the evolution of the table-wine sector has not been fully satisfactory during recent years, the Commission wishes to emphasise that the level of stocks in 1998/1999 is around 20 million hectolitres lower (- 30 %) than some 10 to 15 years ago. Stocks of table wine have indeed increased

somewhat in recent years, but not as much as table-wine production. In order to reduce stocks at the end of the 1999/2000 marketing year, in March 2000 the Commission decided to increase the volume of preventive distillation opened in November 1999 from 10 to 12 million hectolitres.

Distillation and price levels

2.85 and 2.86. Under the new market organisation for wine, fewer distillation measures are available and they no longer provide an assured outlet for growers not intending to produce for sale on the market. The distillation measure carried over from the former market organisation, i.e. the distillation of by-products, is a quality measure not a price-support measure. It is intended to ensure the quality of wines by avoiding the over-pressing of grapes. The price received for the by-products cannot be considered as an incentive to increase production.

Preventive distillation has been abolished. There is now a voluntary distillation measure to supply the potable alcohol market. This measure is intended to preserve an outlet (wine spirits and wine alcohol) that would otherwise be lost, which would mean giving up the equivalent of 300 000 hectares of vineyards. Growers get a guaranteed price for their wine, but distillers will only sign a contract for distillation of wine up to the volume of distilled products (wine spirits or alcohol) that they can sell on the market (there is no Community intervention for the alcohol produced).

The new market organisation provides for the possibility of opening a crisis distillation measure. This will only be launched on an ad hoc basis in cases of proven market problems; any price paid would not, by definition, be profitable for producers.

Under the new market organisation, intervention prices are no longer based on a system of guide prices. While the Council Regulation establishes the possibility of differentiating the minimum price paid to growers under the measure to supply the potable alcohol sector, the Commission will base its use of this option on the practical experience gained during the first years of application and, as indicated, in consultation with the Management Committee.

Grubbing-up

2.87. Since 1988, the premium scheme for abandonment of areas under vines has reduced wine-growing potential by some 500 000 ha. In other words, it has reduced production throughout the European Union by 25 000 000 hl/year. The

Council, after receiving Parliament's opinion, decided to keep this scheme under the new market organisation, making a few adjustments to give the Member States more leeway to tackle regional structural problems.

2.88. The various regulations governing the EAGGF Guidance Section allowed the Member States to use some of these funds (not a very significant proportion of the total) for restructuring vineyards. This restructuring did not increase potential since the varieties used to produce quality wine psr (produced in specified regions) are still much less productive than the original varieties used for table-wine production. Moreover, the bodies governing the system of registered designations of origin of quality wines psr severely restrict the authorised yields.

2.89. The new abandonment scheme is limited to specific areas with socioeconomic problems. These areas are to be determined by each Member State and the number of hectares to be grubbed will be very small.

In the context of the reform of the market organisation in wine, the Council agreed to grant the producer Member States a very small number of new planting rights:

- the area granted is 51 000 ha (plus a Community reserve of 17 000 ha), which amounts to approximately 1,5 % of the area under vines in the Community, staggered over the period of prohibition on new plantings (10 years),
- Member States may grant these hectares only to areas producing quality wines for which demand exceeds supply,
- it must also be remembered that the area under vines in the Community is shrinking under the rule prohibiting new plantings because of natural wastage (closing of vineyards, voluntary abandonment, etc.), which means that the new hectares granted are unlikely to offset these natural losses.

Reliability of information

2.90 and 2.91. Regulation (EC) No 1294/96 continues to apply under the new market organisation. Therefore, the unsatisfactory situation highlighted in the previous reports should be fully addressed by that Regulation.

Vineyard register

2.92 to 2.95. The delay incurred by certain Member States in setting up their vineyard register can be explained by the complexity of the wine sector. The new Council Regulation

requires Member States to undertake to make stringent checks on production potential with the aim of preventing any increase in the production of wine without outlets. The benefits of the aid schemes introduced by the new market organisation are subject to this undertaking, which has taken concrete form in the shape of an inventory of wine-growing potential which must be drawn up before any restructuring programmes and the like may be implemented. This inventory will serve as a reference and will make it possible to monitor the situation and trends in supply in the years to come.

Specialised control body

2.96 to 2.98. The creation of a specialised control body within the Commission is provided for under the new wine regime introduced by Regulation (EC) No 1493/1999 (Article 72). As stated, the specialised control body will not be in place by the time the reform enters into force. However, a transitional measure, already voted by the Management Committee, will extend the existing rules on control until 30 November 2000. In practice, creation of this specialised control body depends on the availability of resources, which is somewhat doubtful. Therefore, it is more realistic to strengthen the control activities of the national control bodies in the wine sector and to increase their collaboration with the Community inspectors.

Conclusion

2.99 and 2.100. The new common organisation of the market in wine (Council Regulation (EC) No 1493/1999), which entered into force on 1 August 2000, is expected to have a positive impact on overall market balance, especially for table wines. In addition to restrictions in distillation measures, the new market organisation focuses on market requirements and political constraints (i.e. WTO commitments); restructuring measures will be available to help growers adapt their production to market demand, which should bring down overproduction. The measures envisaged under the new market organisation should address most of the shortcomings described by the Court. Grubbing is better managed than before and the register, which should be in place in all the Member States before the end of this year, will be a useful instrument with which to establish the inventory provided for in Regulation (EC) No 1493/1999.

Milk quotas

The quota system

2.101 to 2.102. The previous reply given by the Commission in 1993, relating to the situation at the time is no longer relevant in view of the major developments that have taken

place since then (external markets, internal consumption, a real reduction in producer prices as a result of inflation, etc). In any case, the increases in quotas in 1999 are part of a balanced overall political agreement sought by the Council and Parliament which it is not the Commission's place to discuss. These increases were linked to a cut in institutional prices which should have a positive impact on consumption. The increases themselves mostly correspond to quantities already being produced.

2.103. The Commission takes the view that the increase in fat content must be neutralised, rather than heavily penalised with the risk of creating illegal channels for disposal of surplus milk fat. It therefore considers that the current coefficient (provided for in Article 2(2) of Commission Regulation (EEC) No 536/93) is perfectly justified and achieves its goal of keeping the total volume of milk production within the fixed quantity.

2.104. While Regulation (EC) No 1256/1999 extended the quota system until 2008, it also provides for the Council to review the situation in 2003 on the basis of a Commission report, with the aim of abolishing the current quota system after 2006.

The Court refers to the use of Community funds to acquire milk quotas. It should be stressed that the Irish example quoted by the Court concerns only the reallocation of quotas, under very strict terms, to categories of producers with priority. This expenditure was partly refunded by the EAGGF. Similar requests from Italy and Spain, which did not target priority producers, were refused as being not compatible with the above Regulation.

Conclusion

2.106. Milk accounts for more than 18 % of the gross value of agricultural production and so is one of the main sources of income for many farmers, while the milk sector's share in EAGGF expenditure is steadily dwindling (41 % in 1980, 6, 3 % in 1999). It is therefore not correct to say that the financial burden on the budget remains heavy. On the contrary, experience shows that these measures are effective, since they have led to substantial savings without destroying the sector.

Use of skimmed milk and skimmed-milk powder as animal feed

Conclusion

2.111. The Commission considers the new inspection arrangements for the quality control of skimmed milk and skimmed-milk powder to be adequate. Indeed, under the new arrangements, a larger proportion of subsidised products are

checked, since the controls relate not only to products being processed at the time of physical inspection but also to stocks of products held at that time. If controlled products are properly identified, there is no danger that they will be substituted after inspection and before processing.

2.112. As in the past, the Commission continues regularly to monitor the parameters that play a role in fixing the aid level. Efforts are also being made to improve the recording of these analyses and to base them on a more systematic approach.

Dairy products imported at preferential rates

Background

2.117.

(a) The principle underlying the inward monitoring arrangement or IMA 1 system, as stated in the preamble to Commission Regulation (EEC) No 1767/82, is that a third country authorised to use the system has primary responsibility for ensuring compliance with both the eligibility criteria and the quantitative limits. Hence the UK customs service considered this traditional trade in salted butter, involving only two importers, to be low risk.

(b) As the Commission has already pointed out in its reply to the initial report, queries on possible breaches of the quantitative limits were passed to the United Kingdom authorities in 1983. Assurances that the quota limits had not been exceeded were received from the UK authorities and confirmed after further checks had been requested.

2.118. See the Commission's replies to points 2.119, 2.121, 2.122(a) and 2.123.

2.119. The Commission has honoured these undertakings. As the Court rightly states, the Commission undertook to pursue these tasks. It should also be stated that these undertakings have been fulfilled, monitoring continues, the technical talks have been concluded and a new Regulation adopted, which provides, inter alia, for the Food Assurance Agency of New Zealand's Ministry of Agriculture and Forestry (MAF FOOD) to be the issuing agency for IMA 1 certificates.

2.120. As has been consistently pointed out, the Commission is not empowered to recover customs debts from the debtor. That is the responsibility of the Member States. The Commission monitors action taken by the Member States.

2.121. The Commission has responded to each of the requests made by Parliament. Liaison with the UK authorities regarding the recovery process is ongoing, as are reviews of the specific circumstances in which the alleged irregularities arose and the applicability of Article 239. A regulatory amendment made in 1999 took account of the World Trade Organisation's opinion. Further regulatory amendments made this year include a change in the IMA certificate-issuing authority, introduction of a minimum control regime and a change to facilitate the participation of Community importers.

Action by UK authorities

2.122 to 2.125. The Commission cannot of course reply directly on behalf of the authorities of individual Member States, so its replies are limited to its own actions. However, where appropriate the Commission will contact the Member State(s) involved to ascertain their point of view and where necessary request that suitable remedial action be taken.

2.122.

- (a) The Commission has noted the UK authorities' concerns as to the possible risk to the criminal proceedings envisaged at that time by the use of statutory powers to obtain the records.
- (b) See the reply at 2.126(d).
- (c) The Commission notes the UK authorities' explanation that the size of the consignment necessitated taking numerous samples to ensure that the results were representative. As only three of the 22 samples taken indicated possible marginal failures, the Commission is considering its position as to whether or not the consignment as a whole might be declared ineligible.
- (d) The Commission welcomes the UK authorities' intention to review their control strategy in the light of further investigations they have undertaken.
- (e) The Commission will contact the UK authorities to obtain the legal advice on which they decided not to pursue the NZDB (New Zealand Dairy Board) for a contribution to the security. It will notify the Court of subsequent developments.

2.123. On the basis of the information collected in the course of its monitoring activities, the Commission notes that the UK authorities are pursuing recovery of the established but contested debts.

Action by the Commission

2.126.

- (a) The Commission has already replied to this point in its answer to point 2.122(a) above.
- (c) Since the follow-up visit on 1 March 2000, follow-up action has been taken in respect of Spain and the Netherlands. Legal advice is still being sought with regard to the situation in Belgium.
- (d) The Commission does not agree with the Court's conclusion that it would have been appropriate to take action earlier. Before taking the necessary regulatory action to change the issuing agency, the Commission needed to have sufficient evidence to ensure that its action, which would have had implications for its general trade relations with New Zealand, was justified under WTO rules. The UK notified the Commission in February 2000 that the NZDB had refused to provide the requested information. The NZDB informed the Commission that it was not refusing to supply information, but wished to do so in the context of the tribunal proceedings on back duties, which was the context in which the UK wished to use the information. However, with the agreement of the New Zealand Government, the Commission had already incorporated the change of issuing agency in the Commission Regulation then under preparation to better specify the control arrangements relating to imports of milk products. This Regulation entered into force on 1 July 2000. To have separated the matter of the issuing authority from the other provisions of the Regulation would not have significantly accelerated the change of issuing authority, nor would it have been in the best interests of bringing into force a comprehensive and effective new system.
- (e) Community customs legislation requires Member States to use all the means at their disposal to recover customs debts. The law specifies that all available means should be used but does not set any time limits.
- (f) The Commission has carried out a review of the IMA 1 system. The review focused on the system as it applies to New Zealand butter but its conclusions have led to considerable improvements in the rules governing the IMA 1 system as it applies to all third countries which have negotiated with the Commission.

On 7 May 2000 the Commission adopted Regulation (EC) No 970/2000 amending Regulation (EC) No 1374/98 laying down detailed rules for the application of the import arrangements and opening tariff quotas for milk and milk products.

- (g) The United Kingdom authorities have replied to the Commission questioning the legal basis for the demand for payment. The Commission expects that the UK will establish its final position shortly. Should agreement not be reached at that time, the Commission will have no option but to consider infringement proceedings.
- (h) The Commission's reply to Special Report No 4/98 (quoted at point 2.119 of this report) made it clear that because of resource constraints and in view of the work already undertaken on imports with preferential rates of duty, the Commission could not undertake further in-depth controls itself but would ask Member States to do so. However, the Commission considers that account should also be taken of its detailed monitoring activities, which have not so far revealed a need for in-depth controls. Twice yearly the Commission scrutinises the licences issued for WTO minimum access quotas for the central and east European countries (CEECs). In addition, as all third countries using the IMA 1 system are aware, having been sent a copy of Regulation (EC) No 970/2000, it will tighten controls in the following ways:

- Member States will be obliged to carry out a minimum number of physical checks on weight and eligibility requirements,
- the Commission must be sent a copy of every IMA 1 issued,
- import licences may only be issued with the approval of a single central authority (usually the Commission),

- for each quota, the Member States must monitor and report the total quantity they release into free circulation during the quota period.

Collection of underpaid duties

2.127. Court rulings on the importers' appeals against all the established debts are still awaited. The Commission notes that the UK authorities have complied with the relevant provisions of Community legislation by suspending action to recover the debts only on payment of the maximum amount of security, as determined by a court of law, that the importers could pay without incurring serious economic or social difficulties. The Commission is also aware that the UK authorities took legal action to ensure that the assets were not undervalued for the purposes of the sale.

Conclusion

2.128. The collection of arrears is proceeding in accordance with Community legislation, which provides for an independent appeals process. This is currently being followed. For New Zealand butter, both the importers and the UK authorities proposed a form of negotiated settlement in an effort to resolve the matter promptly, but such a solution would not have been compatible with Community law.

2.129. The Commission has already stated, in its reply to point 2.126(d), that it considers its action timely. Without prejudice to the principle under the IMA 1 system that the certificate-issuing agency is responsible for ensuring compliance with the eligibility criteria and quantitative limits, new requirements have been introduced for imports of milk products. These are listed in the Commission's reply at point 2.126(h).

CHAPTER 3 (*)

Structural measures

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INTRODUCTION

3.1. This chapter deals with heading 2 of the financial perspective concerning structural measures. It examines the implementation of the four Structural Funds (SF): the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Guidance Section of the European Agriculture Guidance and Guarantee Fund (EAGGF-Guidance), the Financial Instrument for Fisheries Guidance (FIFG) and the Cohesion Fund (CF). These five financial instruments taken together account for almost all of the appropriations entered under Subsection B2 of the budget, 'Structural operations, structural and cohesion expenditure, financial mechanism, other agricultural and regional operations, transport and fisheries'.

3.2. The appropriations allocated to the SFs are differentiated appropriations. They are managed on the basis of multiannual programming. Each intervention has its own indicative financing plan which sets out the Community aid. As a rule, the financial contributions are committed in annual instalments and are disbursed in the form of advances and interim and final payments.

IMPLEMENTATION OF THE BUDGET

Introduction

3.3. 1999 was the last financial year of the 1993 to 1999 financial perspective (FP) and of the Structural

Funds' 1994 to 1999 programming period. Important features of the financial year were the differences between the Funds' programming and the allocations provided for in the financial perspective, the reprogramming of most of the SF measures periods, the underutilisation of commitment and payment appropriations, a concentration of operations at the end of the year, and numerous transfers of appropriations, which significantly altered the structure of the 1999 budget.

Financial perspective allocations

3.4. As laid down in the Interinstitutional Agreement of 29 October 1993 on budgetary discipline and improving the budgetary procedure ⁽¹⁾, technical adjustments and changes associated with the procedures for implementing structural measures were made to the financial perspectives for the financial years 1994, 1995, 1996 and 1997. The fact that appropriations for commitment from the 1994 to 1997 financial years were underutilised led to 3 294 million euro ⁽²⁾ from these financial

⁽¹⁾ OJ C 331, 7.12.1993, p. 1.

⁽²⁾ Special Report No 16/98 on the implementation of appropriations for structural operations for the 1994 to 1999 programming period, Tables 6 and 7 (OJ C 347, 16.11.1998, p. 48).

years appearing in heading 2 of the financial perspective for the financial year 1999 and to these appropriations being entered in the 1999 budget on top of the amounts initially anticipated.

3.5. For the financial year 1998, the amount of unused allocations for structural operations under heading 2 of the financial perspective totalled 260 million euro. The financial perspective for the financial year 1998 was not adapted to the implementation procedures and, in particular, this unused allocation was not taken into account. Consequently, for the 1994 to 1999 period, the total allocation for heading 2 was less than the result of allocating structural operation resources and the legal obligations arising from the Commission decisions to grant.

3.6. By its very nature, such a change to the 1998 implementation procedures could only have been made in 1999 and, thus, after the budget concerned had been approved. However, sufficient instruments were available to remedy this situation. For example, the financial perspective could have been revised and a supplementary and amending budget could have been implemented, given that, when the Interinstitutional Agreement of 29 October 1993 on budgetary discipline was concluded, the institutions undertook to allocate to the budget the appropriations needed to meet the Communities' legal obligations and political commitments (see paragraph 16). The final result was that, taking into account the decommitments made and the decisions to grant aid that were adopted, 179 million euro of obligations contracted by the Commission had no cover in the 1999 budget. Some commitment appropriations for completing operations from the 1994 to 1999 period were not entered in the budget for the financial year 2000, which will mean that the appropriations budgeted for the 2000 to 2006 programming period will be used for measures from the previous programming period. Moreover, the sum mentioned above, which is divided between the ERDF, ESF, EAGGF-Guidance and the Community initiatives to the amounts of 71, 27, 21 and 60 million euro respectively, is part of the aid which was provided for and not committed mentioned in the potential off-balance sheet debts.

The implementation of appropriations

3.7. **Table 3.1** traces the implementation of appropriations for structural measures according to the way they are presented in heading 2 of the financial perspective. 36 038 million euro of commitment appropriations were available for the Structural Funds and 3 129 million euro for the Cohesion Fund. In total, the respective utilisation rates were 93,5 % and 100 %. Available payment appropriations totalled 28 781 million euro for

the Structural Funds and 1 877 million euro for the Cohesion Fund. The utilisation rates were 86,7 % and 91,4 % respectively.

3.8. **Table 3.2** shows in detail the implementation of the appropriations in Subsection B2 of the budget ('Structural operations, structural and cohesion expenditure, financial mechanism, other agricultural and regional operations, transport and fisheries') covered by heading 2 of the financial perspective⁽³⁾. The amount by which appropriations were underutilised varies from fund to fund and objective to objective. Community initiatives and Objective 2 had the lowest implementation rates. These relatively low rates are due in particular to late approvals and reprogrammings (see paragraphs 3.18 to 3.22).

3.9. Few appropriations were cancelled, as the majority of unused appropriations were carried over to the financial year 2000⁽⁴⁾. With regard to the Structural Funds, this involved 2 203 million euro of commitment appropriations and 3 748 million euro of payment appropriations. For the commitment appropriations, carry-overs represent 6 % in total and respectively 2,8 %, 9,3 %, 1,7 % and 17,7 % for the ERDF, ESF, EAGGF-Guidance and the Community initiatives. For payment appropriations, carry-overs represent 12 % in total and respectively 20 % and 25 % for the ERDF and the Community initiatives. For the Cohesion Fund, carry-overs, totalling 158 million euro (8 %), concerned only payment appropriations.

3.10. Moreover, within the framework of the ESF, the Commission carried out commitments for some 1998 instalments of some programmes on the basis of appropriations from the 1999 budget year, because the appropriations in question had been used up the previous year. This situation is the result of an inadequate annual allocation of ESF appropriations, which still does not take into account the actual needs that result from changes to the financial plans.

3.11. From the very beginning of the financial year, for every budget heading⁽⁵⁾, it was clear that the 1999 budget was not adapted to the true position of the SF. The Commission corrects any mismatches between the

⁽³⁾ Titles B2-5 to B2-9 of Subsection B2 of the budget do not concern structural measures.

⁽⁴⁾ Document SEC(2000) 481 of 15 March 2000. Commission Decision. Carry-overs of appropriations from the financial year 1999 to the financial year 2000 (differentiated appropriations).

⁽⁵⁾ See paragraph 3.4 of the 1998 Annual Report.

Table 3.1 — Development and implementation of the 1999 budget

(Mio EUR)

Heading of financial perspective: 2. Structural measures								
	Total heading		Of which:					
			Structural Funds		Cohesion Fund		EEA	
	Commitment appropriations	Payment appropriations						
Financial perspective ceiling	39 025		35 902		3 118		5	
Budget development								
Initial appropriations ⁽¹⁾	39 025	30 450	35 902	27 568	3 118	2 877	5	5
Final available appropriations ⁽²⁾	39 173	30 658	36 038	28 781	3 129	1 877	5	0
Budget implementation								
Appropriations used	36 820	26 664	33 691	24 948	3 129	1 716	0	0
% of final available appropriations	94	87	93	87	100	91	0	100
Appropriations carried over to 2000	2 203	3 748	2 203	3 591	0	158	0	0
% of final available appropriations	6	12	6	12	0	8	0	0
Cancelled appropriations	150	246	144	242	0	3	5	0
% of final available appropriations	0	1	0	1	0	0	100	0

⁽¹⁾ Budget finally approved by the European Parliament on 17 December 1998 (OJ L 39, 12.2.1999).

⁽²⁾ Budget appropriations amended after taking into account the amending and supplementary budgets and transfers, including appropriations carried over from 1998, the appropriations from revenue resulting from third-party shareholdings and other revenue corresponding to a specific use and appropriations made available again.

For further information on the implementation of the budget, please turn to Diagrams III and IV in Annex I to this report.

Source: 1999 revenue and expenditure account.

appropriations entered in the budget and actual requirements by means of transfers, concerning almost all budget headings. Transfers carried out within the structural measures totalled, in absolute terms, 4 115,5 million euro and 5 583,4 million euro, respectively, for commitment and payment appropriations, which represents 10,5 % and 18 % of initial appropriations. These transfers explain the wide differences between the implementation rates in respect of appropriations available and initial appropriations.

3.12. For example, a withdrawal of 1 000 million euro took the implementation rate for Cohesion Fund payment appropriations from 59,6 % to 91,4 %. For the ERDF, the implementation rate for payment appropriations in respect of available appropriations (79,4 %) is lower than the implementation rate for initial appropriations (87,4 %), because the supplementary sums transferred, totalling 1 286 million euro, were not used in the end.

3.13. Furthermore, the Commission has still not managed to improve its procedure for calculating budget estimates for SF payment appropriations. With this aim

in mind, and as part of SEM 2000, a budget information exchange network was established by the Commission with the finance ministries in the Member States.

3.14. However, the timetable for forecasting Member States' requests for payment does not allow estimates to be taken into consideration, because they are drawn up after the preliminary draft budget. In 1999, the forecasts of requests for payment by the Member States (32 652 million euro) proved to be close to the actual requests made (31 446 million euro). Taking into account the implementation of payment appropriations (24 948 million euro), 6 498 million euro remained at the end of the year pending appraisal and payment. The Commission should therefore review requirements for payment appropriations for the year 2000 and, where necessary, suggest that the budgetary authority adopt the necessary measures, such as, for example, an amending budget.

3.15. Furthermore, 1999 was again characterised by a concentration of a large number of operations at the

Table 3.2 — Budgetary implementation for measures and Structural Funds during the 1999 financial year

(Mio EUR)

		Budget reference	Appropriations		Implementation	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)	Appropriations carried over to financial year 2000	Appropriations cancelled at year-end		
			Initial budget	Final budget after SAB and transfers					Amount (c) - (d) - (g)	% (h)/(c)	
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	
For the year	C	EAGGF-Guidance	B2-1 0	5 164,0	5 233,3	5 110,3	99,0	97,6	88,1	34,9	0,7
		FIFG (fisheries)	B2-1 1	808,0	694,9	693,8	85,9	99,8	0,4	0,7	0,1
		ERDF	B2-1 2	15 646,0	15 780,6	15 341,5	98,1	97,2	439,1	0,0	0,0
		ESF	B2-1 3	9 611,0	9 520,2	8 546,4	88,9	89,8	882,3	91,5	1,0
		Community initiatives	B2-1 4	4 256,0	4 431,7	3 644,1	85,6	82,2	786,4	1,2	0,0
		Anti-fraud measures	B2-1 5	0,8	0,8	0,8	100,0	100,0	0,0	0,0	0,0
		Implementation, monitoring, evaluation	B2-1 6	3,0	1,6	1,1	37,8	70,8	0,0	0,5	29,2
		Transitional measures etc.	B2-1 8	413,3	239,0	217,7	52,7	91,1	7,0	14,3	6,0
		Subtotal 'Structural Funds'	B2-1	35 902,0	35 902,0	33 555,7	93,5	93,5	2 203,2	143,1	0,4
		Cohesion Fund	B2-3	3 118,0	3 118,0	3 117,7	100,0	100,0	0,0	0,3	0,0
	EEA Financial Mechanism	B2-4	5,0	5,0	0,0	0,0	0,0	0,0	5,0	100,0	
	Total		39 025,0	39 025,0	36 673,4	94,0	94,0	2 203,2	148,4	0,4	
	P	EAGGF-Guidance	B2-1 0	3 774,0	3 774,0	3 774,0	100,0	100,0	0,0	0,0	0,0
		FIFG (fisheries)	B2-1 1	482,0	572,0	571,9	118,6	100,0	0,0	0,1	0,0
		ERDF	B2-1 2	12 702,6	13 989,0	11 127,3	87,6	79,5	2 853,5	8,1	0,1
		ESF	B2-1 3	7 246,3	7 246,3	7 245,8	100,0	100,0	0,0	0,5	0,0
		Community initiatives	B2-1 4	3 042,0	2 782,0	1 995,1	65,6	71,7	733,5	53,4	1,9
		Anti-fraud measures	B2-1 5	0,8	0,8	0,5	63,4	63,4	0,0	0,3	36,6
		Implementation, monitoring, evaluation	B2-1 6	3,0	1,6	1,0	34,3	64,3	0,0	0,6	35,7
		Transitional measures etc.	B2-1 8	317,2	207,3	167,5	52,8	80,8	3,6	36,1	17,4
Subtotal 'Structural Funds'		B2-1	27 568,0	28 573,0	24 883,2	90,3	87,1	3 590,7	99,1	0,3	
Cohesion Fund		B2-3	2 877,0	1 877,0	1 716,0	59,6	91,4	157,7	3,3	0,2	
EEA Financial Mechanism	B2-4	5,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0		
Total		30 450,0	30 450,0	26 599,2	87,4	87,4	3 748,4	102,4	0,3		
Carry-overs from previous year	C	ERDF	B2-1 2	8,5	8,5	8,5	100,0	100,0	0,0	0,0	0,0
		Community initiatives	B2-1 4	20,4	20,4	19,3	94,6	94,6	0,0	1,1	5,4
		Subtotal 'Structural Funds'	B2-1	28,9	28,9	27,8	96,2	96,2	0,0	1,1	3,8
	Total		28,9	28,9	27,8	96,2	96,2	0,0	1,1	3,8	
	P	ERDF	B2-1 2	20,5	20,5	0,0	0,0	0,0	0,0	20,5	100,0
		Community initiatives	B2-1 4	130,3	130,3	64,4	49,4	49,4	0,0	65,9	50,6
Transitional measures etc.		B2-1 8	54,1	54,1	0,0	0,0	0,0	0,0	54,1	100,0	
Subtotal 'Structural Funds'	B2-1	204,9	204,9	64,4	31,4	31,4	0,0	140,5	68,6		
Total		204,9	204,9	64,4	31,4	31,4	0,0	140,5	68,6		
Appropriations made available again (after decommitments)	C	ERDF	B2-1 2	76,2	76,2	76,2	100,0	100,0	0,0	0,0	0,0
		Community initiatives	B2-1 4	28,3	28,3	28,3	100,0	100,0	0,0	0,0	0,0
		Subtotal 'Structural Funds'	B2-1	104,5	104,5	104,5	100,0	100,0	0,0	0,0	0,0
		Cohesion Fund	B2-3	11,4	11,4	11,4	100,0	100,0	0,0	0,0	0,0
	Total		115,8	115,8	115,8	100,0	100,0	0,0	0,0	0,0	
Appropriations made available (after reuse of repayments of advances)	C	ERDF	B2-1 2	2,8	2,8	2,8	100,0	100,0	0,0	0,0	0,0
		Subtotal 'Structural Funds'	B2-1	2,8	2,8	2,8	100,0	100,0	0,0	0,0	0,0
		Total		2,8	2,8	2,8	100,0	100,0	0,0	0,0	0,0
	P	ERDF	B2-1 2	2,8	2,8	0,0	0,0	0,0	0,0	2,8	100,0
		Subtotal 'Structural Funds'	B2-1	2,8	2,8	0,0	0,0	0,0	0,0	2,8	100,0
Total		2,8	2,8	0,0	0,0	0,0	0,0	2,8	100,0		
Total	C	EAGGF-Guidance	B2-1 0	5 164,0	5 233,3	5 110,3	99,0	97,6	88,1	34,9	0,7
		FIFG (fisheries)	B2-1 1	808,0	694,9	693,8	85,9	99,8	0,4	0,7	0,1
		ERDF	B2-1 2	15 733,5	15 868,1	15 429,0	98,1	97,2	439,1	0,0	0,0
		ESF	B2-1 3	9 611,0	9 520,2	8 546,4	88,9	89,8	882,3	91,5	1,0
		Community initiatives	B2-1 4	4 304,7	4 480,4	3 691,7	85,8	82,4	786,4	2,3	0,1
		Anti-fraud measures	B2-1 5	0,8	0,8	0,8	100,0	100,0	0,0	0,0	0,0
		Implementation, monitoring, evaluation	B2-1 6	3,0	1,6	1,1	37,8	70,8	0,0	0,5	29,2
		Transitional measures etc.	B2-1 8	413,3	239,0	217,7	52,7	91,1	7,0	14,3	6,0
		Subtotal 'Structural Funds'	B2-1	36 038,2	36 038,2	33 690,8	93,5	93,5	2 203,2	144,2	0,4
		Cohesion Fund	B2-3	3 129,4	3 129,4	3 129,1	100,0	100,0	0,0	0,3	0,0
	EEA Financial Mechanism	B2-4	5,0	5,0	0,0	0,0	0,0	0,0	5,0	100,0	
	Total		39 172,6	39 172,6	36 819,9	94,0	94,0	2 203,2	149,5	0,4	
	P	EAGGF-Guidance	B2-1 0	3 774,0	3 774,0	3 774,0	100,0	100,0	0,0	0,0	0,0
		FIFG (fisheries)	B2-1 1	482,0	572,0	571,9	118,6	100,0	0,0	0,1	0,0
		ERDF	B2-1 2	12 726,0	14 012,3	11 127,3	87,4	79,4	2 853,5	31,5	0,2
		ESF	B2-1 3	7 246,3	7 246,3	7 245,8	100,0	100,0	0,0	0,5	0,0
		Community initiatives	B2-1 4	3 172,3	2 912,3	2 059,5	64,9	70,7	733,5	119,2	4,1
		Anti-fraud measures	B2-1 5	0,8	0,8	0,5	63,4	63,4	0,0	0,3	36,6
		Implementation, monitoring, evaluation	B2-1 6	3,0	1,6	1,0	34,3	64,3	0,0	0,6	35,7
		Transitional measures etc.	B2-1 8	371,3	261,3	167,5	45,1	64,1	3,6	90,2	34,5
Subtotal 'Structural Funds'		B2-1	27 775,7	28 780,7	24 947,6	89,8	86,7	3 590,7	242,4	0,8	
Cohesion Fund		B2-3	2 877,0	1 877,0	1 716,0	59,6	91,4	157,7	3,3	0,2	
EEA Financial Mechanism	B2-4	5,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0		
Total		30 657,7	30 657,7	26 663,6	87,0	87,0	3 748,4	245,7	0,8		

NB: C = commitments; P = payments.

Sources: Sincom and revenue and expenditure account.

end of the financial year. More than 50 % of Structural Fund commitments were entered in the last quarter, 26 % of them in December. Likewise, almost all the transfers were effected in the last quarter, 77 % and 30 % being made in December for commitment and payment appropriations respectively.

Review of the Commission's comments on the financial management

3.16. A review of the information provided by the Commission in Volume I of the revenue and expenditure account revealed that, for this financial year, the explanations provided for the SF budget headings represent a change of direction in comparison with those from preceding years. Previously, the Commission cited the delayed or advanced implementation of interventions at Member State level as justification for differences between, on the one hand, the budget initially approved and appropriations finally available and, on the other, the appropriations finally available and the appropriations used ⁽⁶⁾. For the financial year 1999, the Commission analyses the differences in terms of the limitations of the financial management system established for the SF from the points of view of budgetary management and monitoring the implementation of programmes. These analyses lead to conclusions which are similar to observations made by the Court on a number of occasions.

3.17. With regard to the Cohesion Fund, the explanations provided for the implementation of the related payment appropriations emphasise the late arrival of requests for payment, which prevented the complete implementation of this type of appropriation. It should be noted, however, that the Cohesion Fund is managed primarily on the basis of individual projects that are clearly identified by the Commission and that this approach should enable the Commission to control the management of payment appropriations much more precisely than is possible for the Structural Funds.

Reprogramming

3.18. A massive reprogramming of financial plans and interventions took place in 1999. The same thing occurs at the end of every programming period, with the aim of making it possible to commit the whole of the funding provided for the Structural Funds in the financial

perspective. Since the 1999 allocation can only be committed if the expenditure actually incurred by final beneficiaries represents 40 %, 80 % and 100 % of the total amount of expenditure set out in the financial plans corresponding to the 1998, 1997 and 1996-1994 instalments respectively, the objective of the rescheduling exercise is to ensure that the amounts entered in the financial plans for previous years coincide with the expenditure actually incurred in those years.

3.19. Reprogramming the majority of more than 1 100 Community interventions currently being implemented resulted in the approval of numerous decisions to modify aid in the last days of 1999, which meant that it was not possible to carry out the corresponding commitment and payment operations in time. This explains the underutilisation of commitments and payments that was observed, as well as the carry-overs of appropriations to the financial year 2000 (see paragraph 3.41).

3.20. Every amendment to the financial plans must follow national appraisal procedures, with the participation and cooperation of the various parties, and must be referred to the Monitoring Committee. It must then be examined within the Commission, which involves consultation of many departments in several Directorates-General. This process thus lasts for several months, during which the normal course of the measures concerned is disrupted. The existence of two texts of the programmes (the one in force and the one that will probably be adopted) causes uncertainty at management level. Moreover, some Commission departments do not make payments during the appraisal procedures, pending a final decision. The application of these unwieldy procedures at the Commission coincided with the preparations for the new 2000 to 2006 period, internal reorganisation and the changeover to a new accounting system, none of which made the task easier.

3.21. The Court has repeatedly pointed out the imperfections in the procedure for making commitments in yearly instalments and has recommended that the system be abandoned ⁽⁷⁾. It is provided for in the Structural Funds regulations, but it contravenes the very principle of differentiated appropriations as laid down in Article 1 of the Financial Regulation, according to which commitment appropriations cover the total cost of legal obligations contracted for multiannual measures.

⁽⁶⁾ For example, in the ERDF Chapter (B2-12) in 1998, the explanation given was that the levels of underimplementation mentioned were due to Member States being slow to implement interventions, and that it was thus their responsibility to remedy the situation.

⁽⁷⁾ Opinion No 4/97 (OJ C 57, 23.2.1998) and Special Report No 16/98.

3.22. The principal aim of reprogramming is to make it possible to enter commitments in respect of existing legal obligations. Entering commitments for all the Community's legal obligations at the time when they are entered into would allow the Commission and Member States to avoid allocating large amounts of resources to reprogramming.

IMPLEMENTATION OF PROGRAMMING PERIODS

3.23. In 1999 the administration of the Structural Funds was still concerned with measures from three programming periods: the current period (1994 to 1999), the previous period (1989 to 1993), and the period before the 1988 reform. In June 1999 the regulations establishing the new provisions for the Structural Funds for the 2000 to 2006 period were adopted and work was begun on the drafting of the new Community support frameworks (CSF) and the Single Programming Documents (SPD). However, taking account of the date of adoption of the regulations and the duration of the procedures for adopting the decisions, the programming period did not begin, as it ought to have, on 1 January 2000. On that date, for Objective 2⁽⁸⁾, the eligible zones had still not been defined fully⁽⁹⁾. As for the Community initiatives, the related guidelines had not been adopted, which means that it will only be possible to approve the first programmes during the last quarter of 2000 at the very earliest. The guidelines for the EQUAL Community initiative⁽¹⁰⁾ were only adopted in April 2000. The result is that the first projects will only be approved in 2001. The programming and implementation period for this Community initiative will therefore be reduced by at least one year. The same was true of the previous programming period.

⁽⁸⁾ The aim of Objective 2 for the 1994 to 1999 period was to revive regions, cross-border regions or parts of regions (including employment catchment areas and urban communities) seriously affected by industrial decline. For the 2000 to 2006 period the aim is to support economic and social revival of zones suffering from structural difficulties.

⁽⁹⁾ Moreover, Italy appealed against the Commission in order to have Decisions 1999/503/EC and 1999/504/EC repealed (OJ L 194, 27.7.1999). These Decisions establish, respectively, population ceilings and indicative amounts of commitment appropriations for Objective 2 of the SF for the 2000 to 2006 period.

⁽¹⁰⁾ Regulation (EC) No 1262/1999 of 21 June 1999, Article 5 (OJ L 161, 26.6.1999).

The 1994 to 1999 period

General Aspects

3.24. The resources available for this period and for the four Structural Funds totalled 160 982 million euro, of which 106 497 was for Objective 1 regions. **Tables 3.3** and **3.4** show the progress of the 1994 to 1999 programming period for Community support framework measures and Community initiatives respectively, in terms of commitments and payments. By their very nature, these data cannot be considered representative of the true progress of the interventions, nor of the payments made to final beneficiaries. Whatever their level of implementation, the Community's commitment amounts to 100 % for almost all interventions (see paragraphs 3.18 and 3.19), and the payments are made on the basis of fixed percentages of commitments.

3.25. The Commission has not set up any database that would allow it to monitor the allocation of available resources to the various objectives, Community initiatives, Member States and Funds, as well as the allocations to the various forms of intervention (operational programmes, global subsidies or individual projects), in relation to all the Structural Funds for the 1994 to 1999 period.

3.26. The various departments at the Commission have the data necessary to monitor the operations that they administer, and databases, which are sometimes incomplete, also exist within the Directorates-General responsible (Garfield in DG Regio, Feorient in DG Agriculture or Adabas — replaced by SEA on 1 November 1999 — in the Employment DG). However, there are no tools for constructing an overview of the progress of Structural Funds programming. In these circumstances, reconstructing the actual situation is a difficult task which relies on information forwarded by various departments that must be continually updated, given the new programmings and constant transfers of staff.

3.27. Furthermore, the Commission has not yet installed a data system that would allow it to monitor progress achieved on the ground by CSFs and individual measures. Knowledge of how the SF are implemented is still obtained on the basis of annual reports, the contents and, paradoxically, the frequency of which are very variable. The result is that no precise information can be provided concerning the true state of the measures as at 31 December 1999. That is why the Commission

Table 3.3 — Structural Funds — Community support frameworks: Edinburgh allocations, 1994 to 1999 programming period and implementation 1994 to 1999

(Mio EUR)

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom	Total
Edinburgh allocations	1 916,200	797,800	20 484,300	14 565,500	33 112,000	14 061,500	5 855,400	20 733,700	90,200	2 287,200	1 537,100	14 585,500	1 615,300	1 341,900	11 916,300	144 899,900
Programming period 1994 to 1999	1 888,900	753,900	20 396,700	14 530,900	33 185,900	13 859,200	5 826,200	20 856,300	86,400	2 248,700	1 566,600	14 590,000	1 638,400	1 341,300	11 828,800	144 598,200
By Objective:																
Objective 1	760,600		14 238,300	14 530,900	27 509,700	2 276,900	5 826,200	15 407,400		158,800	174,600	14 590,000			2 459,000	97 932,400
Objective 2	354,900	124,200	1 628,800		2 505,600	3 914,700		1 464,400	15,400	676,400	106,300		192,700	168,300	4 764,100	15 915,800
Objective 3 and Objective 4	483,700	313,200	2 020,000		1 917,100	3 331,900		1 784,000	23,900	1 122,500	415,600		358,600	548,800	3 485,600	15 804,900
Objective 5a Agriculture	186,000	129,500	1 154,800		438,000	1 799,200		807,400	39,800	89,000	435,600		337,300	119,400	206,000	5 742,000
Objective 5a Fishing	25,400	133,000	77,300		124,200	197,100		114,500	1,100	45,900	2,100		24,200	42,100	63,500	850,400
Objective 5b	78,300	54,000	1 277,500		691,300	2 339,400		1 278,600	6,200	156,100	432,400		204,900	153,000	850,600	7 522,300
Objective 6													520,700	309,700		830,400
By Fund:																
ERDF	866,694	121,953	8 712,250	9 886,720	18 853,830	5 613,210	2 680,220	11 803,030	15,462	612,976	373,282	9 078,920	444,940	372,380	5 582,490	75 018,357
ESF	738,280	350,210	7 033,230	2 564,670	8 853,810	4 788,700	2 038,810	4 981,480	27,540	1 415,960	556,570	3 281,520	543,610	688,580	5 547,820	43 410,790
EAGGF-Guidance	256,960	148,710	4 500,080	1 944,410	4 316,380	3 234,590	1 058,350	3 737,640	42,390	162,440	634,570	2 024,290	621,580	234,170	591,710	23 508,270
FIFG	27,050	132,980	151,160	135,100	1 161,850	222,710	48,770	334,190	1,130	57,230	2,100	205,270	28,360	46,210	106,600	2 660,710
Non-programmed allocations	27,300	43,900	87,600	34,600	- 73,900	202,300	29,200	- 122,600	3,800	38,500	- 29,500	- 4,500	- 23,100	0,600	87,500	301,700

Structural Funds — Implementation 1994 to 1999

(Mio EUR)

	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Austria	Portugal	Finland	Sweden	United Kingdom	Total
Commitments 1994 to 1999	1 891,354	764,880	20 267,868	14 380,141	32 686,810	13 768,870	5 822,840	20 677,670	85,122	2 221,365	1 537,010	14 421,430	1 615,090	1 332,784	11 370,590	142 843,824
ERDF	866,694	124,530	8 707,328	9 886,721	18 447,760	5 561,850	2 652,550	11 817,230	15,462	606,125	373,280	8 980,650	445,090	363,594	5 584,730	74 433,594
ESF	737,630	348,730	6 911,290	2 413,380	8 760,820	4 745,760	2 036,730	4 958,690	27,350	1 412,560	556,570	3 250,580	544,830	688,580	5 084,050	42 477,550
EAGGF	259,980	158,640	4 498,090	1 944,940	4 316,380	3 238,550	1 084,790	3 567,560	41,180	145,450	605,060	1 984,930	596,810	234,400	595,390	23 272,150
FIFG	27,050	132,980	151,160	135,100	1 161,850	222,710	48,770	334,190	1,130	57,230	2,100	205,270	28,360	46,210	106,420	2 660,530
Payments 1994 to 1999	1 336,840	605,410	15 939,740	10 608,945	26 783,470	10 114,700	5 070,740	13 168,270	63,397	1 374,640	1 212,010	12 950,400	1 045,829	937,160	7 846,850	109 058,401
ERDF	529,140	80,660	6 884,270	7 081,255	14 274,400	3 584,880	2 241,470	8 312,200	8,897	324,960	250,450	8 206,720	284,509	248,550	3 171,030	55 483,391
ESF	593,810	312,180	5 483,880	1 679,810	7 692,800	3 755,650	1 772,490	3 011,690	25,500	956,200	480,070	2 823,340	384,920	480,550	4 184,440	33 637,330
EAGGF	193,370	95,320	3 445,910	1 734,190	3 752,240	2 620,630	1 012,990	1 676,800	28,670	76,270	479,810	1 752,230	354,340	168,510	398,620	17 789,900
FIFG	20,520	117,250	125,680	113,690	1 064,030	153,540	43,790	167,580	0,330	17,210	1,680	168,110	22,060	39,550	92,760	2 147,780
Level of completion of commitments in relation to programming (%)	100,13	101,46	99,37	98,96	98,50	99,35	99,94	99,14	98,52	98,78	98,11	98,84	98,58	99,37	96,13	98,79
Level of completion of payments in relation to programming (%)	70,77	80,30	78,15	73,01	80,71	72,98	87,03	63,14	73,38	61,13	77,37	88,76	63,83	69,87	66,34	75,42

Edinburgh allocations: Commission DG Budget : the sums represent the amounts of money allocated at the Edinburgh Council after indexation to 1999 prices and after reallocations.

Programming: Commission; provisional figures. The sums represent the SPD, CSF and OP programmings adopted by the Commission as at 31 December 1999.

Implementation in Commitments and Payments: Sincom.

Source: Commission.

Table 3.4 — Structural Funds — Community initiatives: Edinburgh allocations, 1994 to 1999 programming period and implementation 1994 to 1999

(Mio EUR)

Community initiative	Edinburgh allocations	Programming	Non-programmed allocations	Commitments	Level of completion of commitments in relation to programming (%)	Payments	Level of completion of payments in relation to programming (%)
Interreg II	3 598,20	3 596,25	1,95	3 325,98	92,48	1 925,66	53,55
Leader II	1 800,30	1 793,05	7,25	1 722,54	96,07	932,93	52,03
ADAPT and Employ	3 565,60	3 556,05	9,55	3 443,33	96,83	2 159,19	60,72
SME	1 028,80	1 027,16	1,64	941,31	91,64	557,65	54,29
URBAN	900,30	898,32	1,98	858,17	95,53	469,88	52,31
PESCA	305,50	301,18	4,32	301,42	100,08	159,95	53,11
Rechar II	471,00	470,89	0,11	465,53	98,86	350,36	74,40
Resider II	571,60	571,69	-0,09	555,24	97,12	315,40	55,17
RETEX	578,10	577,51	0,59	529,09	91,62	366,01	63,38
Konver	700,20	700,17	0,03	653,29	93,30	449,13	64,15
REGIS II	649,60	649,03	0,57	617,09	95,08	393,82	60,68
PEACE	503,10	503,15	-0,05	449,10	89,26	264,80	52,63
TOTAL	14 672,30	14 644,45	27,85	13 862,09	94,66	8 344,78	56,98

Edinburgh allocations : Commission DG Budget : the sums represent the amounts of money allocated at the Edinburgh Council after indexation to 1999 prices and after reallocations.

Programming: Commission; provisional figures. The sums represent the SPD, CSF and OP programmings adopted by the Commission as at 31 December 1999. Implementation in Commitments and Payments: Sincom.

Source: Commission.

does not provide information on the actual state of programmes at Member State level. Moreover, it is still not easy to obtain overall information on the types of project that are co-financed and the impact of them.

3.28. A limited analysis by the Court of the information available to the Commission concerning the progress of multi-Fund and EAGGF-Guidance operational programmes in two Member States and the position of the Community REGIS II initiative confirmed the fact that the Commission does not have any data-processing system that reflects the situation on the ground. The analysis showed that the state of progress of OPs in general reflects an implementation rate that is below the objective set in terms of expenditure.

Objective 2 programmes from the 1994 to 1996 period

3.29. The distinguishing feature of the 1994 to 1999 programming period for Objective 2 was the fact that it was implemented in two phases: 1994 to 1996 and 1997 to 1999. In the first phase, commitments were supposed to be made in the Member States before 31 December 1996 for the measures concerned — SPD

and OP. The final beneficiaries then usually had a further period of two years within which to make their payments. Under Article 21 of Regulation (EEC) No 4253/88, Member States were to forward the documents needed for the closure to the Commission within six months and, if the requests were eligible, the Commission was, as a general rule, supposed to pay the final balance within a maximum of two months, and in any case before 31 August 1999.

3.30. With regard to the ERDF, there was a total of 72 interventions in the 1994 to 1996 programming period. All of these programmes were adopted late, at the end of 1994 or even in 1995. This delay at the beginning of the programmes led to a concentration of operations in 1996 and to a situation where 11 % of the aid initially programmed was transferred to the second phase, 1997 to 1999.

3.31. **Table 3.5** shows the state of progress of these programmes by Member State. A total amount of 4 859,4 million euro was committed and a total of 4 059,5 million euro was paid, leaving a grand total of

Table 3.5 — Objective 2 (1994 to 1996), state of progress: decision, commitments, ERDF payments — Situation as at 15 January 2000

(Mio EUR)

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ERDF No	Name and description	1994 to 1999							1994 to 1997			1998			1999		
		Decided a	Committed b	Paid c	Still outstanding a-c	Committed/decided (%)	Paid/committed (%)	Paid/decided (%)	Decided	Committed	Paid	Decided	Committed	Paid	Decided	Committed	Paid
941013005	SPD Aubange Objective 2	0.900	0.900	0.720	0.180	100,00	80,00	80,00	0.900	0.900	0.259	0,000	0,000	0,461	0,000	0,000	0,000
941013006	SPD Liege Objective 2	67,872	67,872	55,330	12,542	100,00	81,52	81,52	67,872	67,872	55,330	0,000	0,000	0,000	0,000	0,000	0,000
941013007	SPD Limburg Objective 2	27,096	27,096	21,759	5,337	100,00	80,30	80,30	27,096	27,096	21,759	0,000	0,000	0,082	0,000	0,000	0,000
941013008	SPD Turnhout	14,756	14,756	11,805	2,951	100,00	80,00	80,00	14,756	14,756	9,360	0,000	0,000	2,445	0,000	0,000	0,000
Belgium — Total		110,623	110,623	89,614	21,009	100,00	81,01	81,01	110,623	110,623	86,226	0,000	0,000	2,988	0,000	0,000	0,000
940113002	SPD North Jutland Objective 2	37,720	37,720	33,449	4,271	100,00	88,68	88,68	37,720	37,720	33,449	0,000	0,000	0,000	0,000	0,000	0,000
940113003	SPD Lolland Objective 2	6,022	6,022	4,818	1,204	100,00	80,00	80,00	6,022	6,022	4,818	0,000	0,000	0,000	0,000	0,000	0,000
Denmark — Total		43,742	43,742	38,266	5,476	100,00	87,48	87,48	43,742	43,742	38,266	0,000	0,000	0,000	0,000	0,000	0,000
940213009	SPD Niedersachsen Objective 2	30,450	30,450	27,313	3,137	100,00	89,70	89,70	30,450	30,450	24,360	0,000	0,000	2,953	0,000	0,000	0,000
940213010	SPD Berlin Objective 2	98,380	98,380	80,701	17,679	100,00	82,03	82,03	98,380	98,380	80,701	0,000	0,000	0,000	0,000	0,000	0,000
940213011	SPD Bremen Objective 2	30,924	30,924	26,613	4,311	100,00	86,06	86,06	30,924	30,924	26,613	0,000	0,000	0,000	0,000	0,000	0,000
940213012	SPD Nordrhein-Westfalen Objective 2	241,292	241,292	195,116	46,176	100,00	80,86	80,86	241,292	241,292	195,116	0,000	0,000	0,000	0,000	0,000	0,000
940213013	SPD Rheinland-Pfalz Objective 2	15,463	15,463	15,463	0,000	100,00	100,00	100,00	15,463	15,463	7,732	0,000	0,000	4,639	0,000	0,000	3,093
940213014	SPD Saarland Objective 2	33,643	33,643	28,019	5,624	100,00	83,28	83,28	33,643	33,643	19,584	0,000	0,000	8,435	0,000	0,000	0,000
940213015	SPD Schleswig-Holstein Objective 2	10,142	10,142	8,114	2,028	100,00	80,00	80,00	10,142	10,142	8,114	0,000	0,000	0,000	0,000	0,000	0,000
940213016	SPD Hessen Objective 2	13,547	13,547	10,838	2,709	100,00	80,00	80,00	13,547	13,547	10,838	0,000	0,000	0,000	0,000	0,000	0,000
940213017	SPD Bayern Objective 2	71,118	9,048	7,624	0,506	127,11	84,26	107,11	7,118	9,048	7,624	0,000	0,000	0,000	0,000	0,000	0,000
Germany — Total		480,959	482,889	399,801	81,158	100,40	82,79	83,13	480,959	482,889	380,681	0,000	0,000	16,028	0,000	0,000	3,093
941109018	Aragon Objective 2	38,007	38,007	31,276	6,731	100,00	82,29	82,29	38,007	38,007	30,674	0,000	0,000	0,601	0,000	0,000	0,000
941109019	Baleares Objective 2	7,761	7,761	1,522	6,239	100,00	81,60	81,60	73,091	73,091	59,644	0,000	0,000	-0,831	0,000	0,000	0,000
941109020	O. P. Cataluna Objective 2	340,745	340,745	306,557	34,188	100,00	89,97	89,97	340,745	340,745	306,557	0,000	0,000	0,000	0,000	0,000	0,000
941109021	Madrid Objective 2	104,273	104,273	88,735	15,538	100,00	85,10	85,10	104,273	104,273	110,492	0,000	-6,219	33,764	0,000	0,000	0,000
941109022	Navarra Objective 2	17,700	17,700	17,700	0,000	100,00	100,00	100,00	17,700	17,700	14,160	0,000	0,000	0,000	0,000	0,000	3,540
941109023	La Rioja Objective 2	8,014	8,014	6,411	1,603	100,00	80,00	80,00	8,014	8,014	6,411	0,000	0,000	0,000	0,000	0,000	0,000
941109025	OP Pais Vasco Objective 2	264,884	264,884	242,195	22,689	100,00	91,43	91,43	264,884	264,884	242,195	0,000	0,000	0,000	0,000	0,000	0,000
Spain — Total		781,384	781,384	699,083	82,301	100,00	89,47	89,47	781,384	788,434	662,008	0,000	-7,050	33,534	0,000	0,000	3,540
951413001	SPD Finland Objective 2	44,669	44,669	38,120	6,549	100,00	85,34	85,34	44,669	44,669	38,120	0,000	0,000	0,000	0,000	0,000	0,000
Finland — Total		44,669	44,669	38,120	6,549	100,00	85,34	85,34	44,669	44,669	38,120	0,000	0,000	0,000	0,000	0,000	0,000
940313031	SPD Aquitaine Objective 2	89,776	89,776	74,871	14,905	100,00	83,40	83,40	89,776	89,776	74,871	0,000	0,000	0,000	0,000	0,000	0,000
940313032	SPD Basse Normandie Objective 2	39,966	39,966	34,741	5,225	100,00	86,93	86,93	39,966	39,966	34,741	0,000	0,000	0,000	0,000	0,000	0,000
940313033	SPD Bretagne Objective 2	73,091	73,091	59,644	13,447	100,00	81,60	81,60	73,091	73,091	59,644	0,000	0,000	0,000	0,000	0,000	0,000
940313034	SPD Haute Normandie Objective 2	118,010	118,010	101,535	16,475	100,00	86,04	86,04	118,010	118,010	101,535	0,000	0,000	0,000	0,000	0,000	0,000
940313035	SPD Pays de la Loire Objective 2	106,648	106,648	87,262	19,386	100,00	81,82	81,82	106,648	106,648	87,262	0,000	0,000	0,000	0,000	0,000	0,000
940313036	SPD Poitou - Charentes Objective 2	44,222	44,222	37,996	6,226	100,00	85,92	85,92	44,222	44,222	37,996	0,000	0,000	0,000	0,000	0,000	0,000
940313037	SPD Centre Objective 2	14,191	14,191	11,353	2,838	100,00	80,00	80,00	14,191	14,191	11,353	0,000	0,000	0,000	0,000	0,000	0,000
940313038	SPD Champagne - Ardennes Objective 2	45,458	45,458	37,689	7,769	100,00	83,09	83,09	45,458	45,458	37,689	0,000	0,000	0,000	0,000	0,000	0,000
940313039	SPD Languedoc - Roussillon Objective 2	31,483	31,483	43,194	8,289	100,00	83,90	83,90	31,483	31,483	43,194	0,000	0,000	0,000	0,000	0,000	0,000
940313040	SPD Midi - Pyrennees Objective 2	33,171	33,171	28,639	4,532	100,62	85,81	86,34	33,171	33,171	21,534	0,000	0,000	0,000	0,000	0,000	7,105
940313041	SPD Nord - Pas-de-Calais Objective 2	259,120	259,120	215,218	43,902	100,00	83,06	83,06	259,120	259,120	215,218	0,000	0,000	0,000	0,000	0,000	0,000
940313042	SPD Provence - Alpes - Côte d'Azur Objective 2	91,396	91,396	76,494	14,902	100,00	83,69	83,69	91,396	91,396	76,494	0,000	0,000	0,000	0,000	0,000	0,000
940313043	SPD Picardie Objective 2	98,839	98,839	81,818	17,021	100,00	82,78	82,78	98,839	98,839	81,818	0,000	0,000	0,000	0,000	0,000	0,000
940313044	SPD Alsace Objective 2	16,132	16,132	12,906	3,226	100,00	80,00	80,00	16,132	16,132	12,906	0,000	0,000	0,000	0,000	0,000	0,000
940313045	SPD Auvergne Objective 2	42,681	42,681	37,509	5,172	100,00	87,88	87,88	42,681	42,681	37,509	0,000	0,000	0,000	0,000	0,000	0,000
940313046	SPD Bourgogne Objective 2	31,412	31,412	26,766	4,646	100,00	85,21	85,21	31,412	31,412	26,766	0,000	0,000	0,000	0,000	0,000	0,000
940313047	SPD Franche-Comte Objective 2	41,773	41,773	37,681	4,092	100,00	90,20	90,20	41,773	41,773	28,269	0,000	0,000	9,411	0,000	0,000	0,000
940313048	SPD Lorraine Objective 2	80,182	80,182	69,351	10,831	100,00	86,49	86,49	80,182	80,182	69,351	0,000	0,000	0,000	0,000	0,000	0,000
940313049	SPD Rhône - Alpes Objective 2	61,698	61,698	51,040	10,658	100,00	82,72	82,72	61,698	61,698	51,040	0,000	0,000	0,000	0,000	0,000	0,000
960313001	National technical assistance programme (Objective 2)	1,036	1,036	0,504	0,532	99,97	48,65	48,63	0,323	1,008	0,504	0,286	0,000	0,000	0,427	0,028	0,000
France — Total		1340,286	1340,491	1126,290	213,996	100,02	84,02	84,03	1339,572	1340,463	1109,773	0,286	0,000	9,411	0,427	0,028	7,105
940513014	SPD Valle d'Aosta Objective 2 (FESR) (1994 to 1996)	0.308	0.308	0.246	0.062	100,00	80,00	80,00	0.308	0.308	0.154	0,000	0,000	0,092	0,000	0,000	0,000
940513015	SPD Lombardia Objective 2 (FESR) (1994 to 1996)	18,962	18,962	15,170	3,792	100,00	80,00	80,00	18,962	18,962	9,481	0,000	0,000	0,000	0,000	0,000	5,689
940513016	SPD Friuli Venezia Giulia Objective 2 (FESR) (1994 to 1996)	12,990	12,990	9,215	3,775	100,00	70,94	70,94	12,990	12,990	15,710	0,000	0,000	0,000	0,000	-2,720	0,000
940513017	SPD Liguria Objective 2 (1994 to 1996)	56,195	56,195	44,956	11,239	100,00	80,00	80,00	56,195	56,195	44,956	0,000	0,000	0,000	0,000	0,000	0,000
940513018	SPD Piemonte Objective 2 (FESR) (1994 to 1996)	102,429	102,429	82,343	20,086	100,00	80,39	80,39	102,429	102,429	82,343	0,000	0,000	0,000	0,000		

Table 3.6 — State of progress of Objective 2 programmes (1994 to 1996)

Member State	Number of programmes	Number of programmes closed as at 31.12.1999	Number of programmes with an extension to the deadline for payments	Number of programmes for which a request for final payment has been submitted	Number of programmes for which a request for final payment has not been submitted
Belgium	4		3	1	—
Denmark	2			2	—
Germany	9	1	6	2	—
Spain	7	1		6	—
Finland	1			1	—
France	19		17	2	—
Italy	11		3	8	—
Luxembourg	1			1	—
Netherlands	5		3	2	—
United Kingdom	13		4	5	4
Total	72	2	36	30	4

Source: European Court of Auditors.

799,9 million euro, or 16,5 %, still outstanding at 31 December 1999.

3.32. As of 31 December 1999, only two of the 72 programmes had been closed. The Commission granted deferrals of payment deadlines for periods of no longer than one year for 38 programmes (see **Table 3.6**).

3.33. With regard to the ESF, there was a total of 73 interventions in the first phase of the CSF2. The Commission services received final claims for 64 operational programmes and 56 were closed by the end of 1999.

Periods prior to 1994

3.34. At 31 December 1999, the amounts still outstanding for the periods prior to 1994 were 1 481,2 million euro, 170 million euro and 80 million euro for ERDF, ESF and EAGGF-Guidance, compared with 1 877,4 million euro, 360 million euro and 113 million euro at 31 December 1998. About 20 % of these amounts still outstanding, and in particular for the ERDF, concerned measures decided before the reform of the Structural Funds in 1988.

3.35. Amounts still outstanding at 31 December 1999 for the 1989 to 1993 programming period correspond to 272, 39 and 43 measures for the ERDF, ESF and EAGGF-Guidance respectively, compared with 337, 94 and 64 at 31 December 1998.

3.36. In previous Annual Reports and in its Special Report No 14/98 ⁽¹¹⁾, the Court described the weaknesses at Member State and Commission level that were at the root of these delays in closing measures. These included, in particular, the fact that Member States sent in the necessary documents late or in incomplete form and that the Commission was slow in appraising the files. At the beginning of 1999 requests for final payment had been submitted for almost all the measures. However, only 26 % of the total amounts still outstanding at 31 December 1998 were settled in 1999.

3.37. The nature of the problems which made it difficult to close these files was not such as to justify a delay of several years. The problems should have been tackled straightaway, under the partnership agreement, as soon as the first difficulties arose. In particular, this was true for the results of checks carried out by the Commission and the Court of Auditors during the implementation of the measures. The Commission and the Member States should also have already resolved the difficulties caused by the inadequacy of some final reports and requests for final payment, as well as uncertainties concerning the financial plans. Delays in closing interventions would thus be limited to cases which are still pending for legal reasons.

⁽¹¹⁾ Special Report No 14/98 on the closure of the forms of ERDF assistance (OJ C 368, 27.11.1998, p. 1).

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

3.38. A sample check was carried out on commitments and payments covered by the appropriations for 1999 in respect of the Structural Funds and other structural actions (commitments of 36 820 million euro ⁽¹²⁾ and payments of 26 663,6 million euro ⁽¹³⁾ — for further details see **Tables 3.1, 3.2, 3.3 and 3.4**). This check was designed to assess both the reliability of the accounts and the legality and regularity of the operations with a view to issuing the Statement of Assurance. The sample consisted of 30 commitments, 99 payments and 62 outstanding commitments.

3.39. It should be remembered with regard to the Structural Funds that each advance payment, interim payment and final payment only becomes payable once the appropriate national authorities have presented a suitable volume of incurred expenditure in the context of a declaration of expenditure, and that requests for final payments must be accompanied by an implementation report relating to the instalment in question.

3.40. Community contributions under the Cohesion Fund are paid in the form of advances which are based on the project's state of progress as certified in the reports submitted with the payment request. These reports show the progress that has been made, notably with regard to the material 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 duly justified cases) and it is disbursed once the Member State concerned has submitted a report stating that the project has been completed in accordance with the objectives.

Legality and regularity of the underlying transactions

Commitments

3.41. 2 377 million euro of legal commitments made before 31 December 1999 were not entered in the

⁽¹²⁾ 27 849 million euro of which had not given rise to any payments by the end of the financial year.

⁽¹³⁾ 33 % of the total payments made from the general budget.

accounts as financial commitments until 2000. They are included in the 1999 accounts as potential debts (see paragraph 8.16).

Payments

3.42. Almost all the substantive errors directly affecting the legality and regularity of the underlying transactions occurred in the Member States, at the level of the final beneficiaries (which also include public bodies managing programmes or measures).

3.43. As the Court has made clear in all its reports in support of its Statements of Assurance since 1995, 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. The Court nevertheless considers that the number of anomalies occurring in the declarations of expenditure co-financed by the Community is still high.

3.44. The most significant substantive errors were ones that have been pointed out in previous financial years, namely :

- (a) expenditure and actions which are ineligible according to the regulations, eligibility rules or the requirements specific to the forms of assistance;
- (b) cases where the Member State has declared to the Commission eligible expenditure in excess of that which was actually incurred;
- (c) expenditure included in the declarations to the Commission as eligible which is not supported by adequate probative evidence or documentation;
- (d) the Court's sample of transactions revealed cases where the rules on public procurement and on the environment were not respected;
- (e) incorrect calculation of the amounts declared as eligible expenditure;
- (f) unauthorised deductions made from Community payments to final beneficiaries.

3.45. The other isolated substantive errors which were detected concerned failure to respect the projects' objectives, presentation of invalid invoices in support of the expenditure declaration, and inclusion in the expenditure declaration of expenditure already established as being ineligible.

3.46. Furthermore, with regard to VAT, the relevant eligibility data sheet for the 1994 to 1999 programming period was often interpreted incorrectly by the national authorities concerned, who considered that central administrations held to be final beneficiaries 'are liable actually and definitively' for the VAT on the operations which they manage within the ambit of structural actions. These central administrations argue that VAT cannot be considered to be a genuine cost. Several cases were noted within the sample where VAT was incorporated in this way. For certain actions the Community financing may exceed 100 % of the total net expenditure on the action.

3.47. The formal errors detected could be attributed to:

- (a) inclusion by final beneficiaries of lump sums for which there was no supporting documentation;
- (b) failure to comply with procedural rules;
- (c) failure to comply with the system of closure by annual instalment, in the case of the ESF.

3.48. In some cases insufficient documentary evidence was provided in support of the amounts declared, resulting in an incomplete audit trail. It was therefore impossible to comprehensively assess the legality and regularity of the relevant underlying transactions.

3.49. Moreover, in the case of two of the interventions included in the sample and closed in 1999, one of which was an ERDF Objective 2 operational programme and one a major Cohesion Fund project, detailed reviews were conducted of all the payments made for these interventions for the programming period in question. As was the case in previous financial years, these checks showed, *inter alia*, that the significant errors noted in respect of the interventions that had been closed had a direct impact on the level of Commission payments.

3.50. The detailed audit of the Cohesion Fund project

closed in 1999 (to which the Fund contributed 311 million euro) showed that:

- (a) the investment is still affected by structural problems and the objective, stated in the contract, for quality, reliability and durability of the project was not fully achieved, resulting, *inter alia*, in delays in the provisional technical commissioning of the project by the Member State. The Commission should therefore not have made the final payment in 1999 until it had conducted an on-the-spot check in liaison with the national authorities;
- (b) at the project implementation stage, the Commission accepted revenue forecasts which subsequently proved to have been substantially underestimated. A sounder estimate would have had a significant impact on the amount of aid granted from the Cohesion Fund;
- (c) the ceilings for the cost components of the investment provided for in the decision concerning the project were not adhered to, and the decision was not amended to allow for the fact that these ceilings had been exceeded;
- (d) the European Union's contribution, including EIB and ECSC loans, amounts to 95 % of the identifiable cost of the project as it stands, including compulsory purchase costs, which are considered ineligible, but excluding financing fees, exchange-rate fluctuation costs and other expenditure, whose direct connection with the project is not established clearly. The contribution thus exceeds the maximum intervention rate of 90 %;
- (e) monitoring was inadequate at both national and Community level;
- (f) the accounting system which the final beneficiary (concessionaire) authorised the Court's representatives to inspect did not allow for reconciliation of construction costs and declared expenditure from the viewpoint of eligibility. It is important for the Court and the Commission to be able to check that the developer's costs, which serve as the basis for the payments made by the concessionaire and are considered eligible expenditure, comply with the eligibility rules.

3.51. The intensified audit of the 1989 to 1991 Objective 2 operational programme which was closed in 1999 (and for which the ERDF paid 13,6 million euro) revealed

that, following a reorganisation of the administrative bodies responsible for managing the majority of the projects financed under the OP, none of the original supporting documentation was available for the audit of these projects. Part of the audit trail could be reconstructed using copies, but it was not possible to obtain adequate assurance for a large number of the projects. In some cases neither evidence of the tender process nor the contracts were available and in other cases some or all of the invoices were missing. Where copies of invoices could be audited, ineligible costs were identified. For most cases no proof of payment was provided. The amounts of eligible expenditure declared to the Commission by the national authorities were in some cases higher than the amounts incurred. The delay in final closure of the OP does not appear to have been caused by the problems identified above. Rather, it was due to an extremely slow and drawn out exchange of correspondence between the Commission services and the national authorities over the format the final report should take.

3.52. An intensified audit of eight projects included in a measure coming under an EAGGF-Guidance operational programme revealed that errors had arisen in two of these eight projects. An on-the-spot check on these two projects revealed, in one case, errors in the attestations and showed that some of the work done corresponded only partially to the work scheduled.

Outstanding commitments

3.53. The Court's audit of outstanding commitments at Commission level revealed a number of cases where decommitments should have been made before the end of the budgetary year 1999. The outstanding amounts were not justified in a third of the transactions audited in the ESF and in 28 % of the transactions audited in the EAGGF-Guidance budgetary areas. The Commission should take steps to decommit these amounts.

3.54. The Commission did not justify a number (22 %) of the sample of outstanding commitments audited for the ERDF area of the budget. Most of these were very old and for 8 % of the sample it was evident that no more payments would take place and the amounts should have been decommitted. The Commission should take steps to resolve the issues which prevent the closure of these programmes.

Other observations

Management of the ESF's accounting procedures

3.55. In order to administer the European Social Fund, the Commission uses a local computer system⁽¹⁴⁾ at the Employment DG and the computerised budget system (Sincom⁽¹⁵⁾). During 1999, these two systems were changed, which led the Court to examine how they operate.

3.56. The local system was designed for the operational management of ESF programmes. The budget, on the other hand, is supposed to be managed in detail by Sincom, since that is the Commission's official accounting system. However, the Court found that the validity and past records of applications for ESF advances or final payments can only be traced using the local system and the files for each OP held in the Employment DG's archives. This is especially true for the very numerous cases of transactions which have been grouped together in batches, for example, final payments and advances. In these cases, it is not possible to use the computer systems to monitor whether ESF regulations have been complied with. Instead, the files have to be analysed in depth.

3.57. When it examined the introduction of the Employment DG's new local ESF management system, the Court found significant weaknesses in terms of the security of the database which allow unauthorised users within the DG to make changes to the database. In some cases, it is even possible for people from outside to gain access to the system without leaving any trace. When the system was being introduced, the Commission's project management guidelines were not followed. The Court has forwarded to the Commission its recommendations for remedying this situation which could endanger the management of the ESF.

3.58. In its 1994 Annual Report (see paragraph 5.10), the Court reported on differences it had uncovered between the financial data in the Employment DG's local system and the budgetary accounting system (Sincom). A check on the introduction of the new local system (SEA) showed that the two systems are still not reconciled fully and regularly on a two-way basis.

⁽¹⁴⁾ Until 1 November 1999, 'Adabas', from that date on 'SEA'.

⁽¹⁵⁾ From 1 January 1999, in Sincom II version with the components 'SI2' and 'SAP R/3'.

The implementation of recovery orders (ESF and EAGGF-Guidance)

3.59. The Court reviewed the management of recovery orders issued by the Employment DG and the Guidance section of AGRI DG. This gave rise to the following observations.

3.60. In January 1999, the Commission replaced the Sincom I budget system with a new version, Sincom II. During the Court's audit in March 2000, the application for managing recovery orders in Sincom II had still not been developed. This weakness makes it impossible to gain access to data selected according to predefined management criteria.

3.61. With regard to the audit of the procedures and the implementation of recovery orders, which was conducted by examining a number of files held by Commission departments, the Court found that adequate management procedures for monitoring recovery orders did not exist, either at the level of the authorising DGs or in the Budget DG. Files are sometimes lost or filed in historical archives or the administrators in the authorising DG are not aware that the recovery orders exist. Thus, with regard to the Employment DG, out of the five Member States examined, the departments responsible for four of them were not aware that there were recovery orders that were still open.

3.62. During the review of recovery procedures, the audit highlighted the lack of coordination between the authorising DGs, the Budget DG and the legal service. This causes considerable delays in dealing with files and, consequently, in recovering the amounts due.

3.63. The same audit also showed that the Commission does not regularly reclaim interest on arrears when a debtor either does not pay or pays late. This is contrary to the provisions of the Financial Regulation (Article 49). The interest in question amounts to several million euro. Indeed, by way of example, outstanding recovery orders for the Employment DG at the start of the financial year 1999 stood at 49,1 million euro, including 15,5 million euro dating from before 1995.

Overhead charges

3.64. The Commission Decisions of 23 April 1997⁽¹⁶⁾ (eligibility data sheet No 5) stipulate that overheads

⁽¹⁶⁾ OJ L 146, 5.6.1997.

should be charged in a fair and reasonable way, in accordance with generally accepted accounting rules.

3.65. During its audits, the Court found wide variations in the way overhead charges are taken into account. Some promoters (training bodies) do not invoice them, whilst others do, in some cases, for more than 60 %.

3.66. The Court's audits also highlighted the fact that some promoters declare overhead charges that are calculated on a lump-sum basis and not based on true costs, so as to inflate them and enable the promoters to make a profit that is not allowed under the rules for the Social Fund. In several cases, they were included in declarations of expenditure by way of subcontracting costs. This practice inflates the total costs, and hence increases the ESF subsidy.

3.67. In the new programming period (2000 to 2006), the use of overhead charges and lump-sum payments should be kept under strict control. Procedures for calculating overhead charges and lump-sum amounts should preferably be defined when the programmes are approved. It should also be possible to check them when payment of the balance is requested.

3.68. For the Leader II initiative, the Court identified overhead charges ranging from 0 % to more than 80 %.

Implementation of the Regulation on financial control

3.69. Regulation (EC) No 2064/97⁽¹⁷⁾ is intended to strengthen the financial controls that the Member States are required to exercise over operations co-financed by the Structural Funds. The implementation of this Regulation was the subject of observations in the Court's Annual Report concerning the financial year 1998 (see paragraphs 3.14 to 3.19).

3.70. Article 8 of this Regulation states that requests for final payment should be accompanied by independent closure statements. Under Commission Regulation (EC) No 2406/98⁽¹⁸⁾, Article 8 need not be applied to forms of intervention for which the first decision

⁽¹⁷⁾ Commission Regulation (EC) No 2064/97 of 15 October 1997 (OJ L 290, 23.10.1997).

⁽¹⁸⁾ Commission Regulation (EC) No 2406/98 of 6 November 1998 (OJ L 298, 7.11.1998).

granting assistance sets 1 January 1997 as the final date by which Community and national commitments must have been contracted. As a result, the independent audit statement provided for in Article 8 is not required, neither for the period 1989 to 1993 nor for the operational programmes and Objective 2 SPDs for the programming period 1994 to 1996, and by the end of 1999 no independent audit closure statements concerning the 1994 to 1999 and 1997 to 1999 programming periods (Objective 2) had been sent to the Commission.

3.71. In April 1999 the Commission produced the English language version of its Structural Funds audit manual, which it sent to all Member States. However, the translation into the 10 other languages of the European Union was only available towards the end of 1999. Appendix 2 to this audit manual is directly relevant to Member States in their implementation of Regulation 2064/97 and contains practical guidelines. However, by the end of 1999 Member States had already put into practice their own methodology for complying with this Regulation and are not able to revise their procedures retrospectively.

3.72. The Commission's Structural Funds audit manual states that the Commission services will check the satisfactory application of the minimum requirements contained in Regulation (EC) No 2064/97 during audits of national management and control systems at all levels. The Commission has not verified the quality of the progress made in the Member States in applying this Regulation: up until the end of 1999 no Commission department had examined working methodology or visited Member States to establish the quality of the checks being carried out by the Member States.

3.73. In order to determine what use to make of the closure statements it will receive, the Commission should obtain assurance that the methodology that the Member States are applying is acceptable.

3.74. Under Article 9 of Regulation (EC) No 2064/97 Member States are required to submit by 30 June each year a report on their application of this Regulation in the previous calendar year. The reports in respect of 1998 are diverse in quality, style and depth of information provided. The Commission should issue a minimum framework as guidance on what it requires to be in these reports.

Controls by the Commission and the Member States

3.75. The on-the-spot checks performed by the Commission's audit departments, supplemented by the controls performed by national audit services under the protocols agreed between the latter and Financial Control, remain inadequate. This is especially true as concerns the ERDF and the Cohesion Fund in the case of interventions in which requests for final payment have been made: only five major interventions for closure were examined during the 36 on-the-spot checks conducted in 1999 (reports on which were forwarded to the Court), which targeted 81 interventions of varying financial importance. The aims of the audit cannot always be identified in the audit reports, and nor can the method used to select the sample of projects examined. It is similarly often difficult to establish a link between the examination of the systems and the control of individual projects. Regarding controls performed while interventions were being implemented, following up the results of the control proves difficult and the issues raised are liable to be deferred until the closure of these interventions. The controls performed under the protocols by the national audit services are regularly carried out under Regulation (EC) No 2064/97 which aims to facilitate the control of at least 5 % of expenditure. The results of these controls were rather variable. The audit reports did not always indicate the method used to select the projects controlled or/and did not always specify whether a real examination of the systems had been conducted, nor did they contain any observations based on financial or physical checks. These results are also of variable use to the Commission's management and control departments.

Conclusions and recommendations

3.76. The Court can only observe that the level of anomalies noted in the expenditure declarations remains high. The continued existence of a significant volume of errors after the closure of the operational programme shows that there is little chance that errors in expenditure declarations will be detected and corrected. It was moreover predictable that the financial control measures taken by the Commission (approval of eligibility datasheets, adoption of Regulation (EC) No 2064/97, more precise closure procedures for the 1994 to 1999 programming period, and the introduction of protocols between Financial Control and the relevant national authorities) would not yet have had a real impact on the reliability of the expenditure declarations.

3.77. The Court must stress the need to devote greater effort to the supervision and control of the closure of programmes. With this in mind, optimum use should be made of the protocols signed with the national audit services in the Member States. The reform of internal control at the Commission should take into account the new possibilities that these protocols present.

3.78. The Commission should pay closer attention to the introduction within the Member States of the new financial control provisions laid down in Regulation (EC) No 2064/97.

3.79. At the level of the Member States, there is a need to reinforce financial procedures and increase the effectiveness of internal control systems applied by the national/regional management bodies in order to reduce the incidence of errors in future financial years.

3.80. The Commission should review the regulations and decisions (eligibility datasheets) in order to better target the use of Community funding to those activities the budgetary authority intended. The Court has again noted significant differences between the operational programmes as regards the coverage of overhead charges by the ESF. Special attention should be paid to this issue when implementing the next programming period 2000 to 2006.

3.81. As concerns the implementation of recovery orders, the Commission should equip itself with suitable management procedures.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

Introduction

3.82. The Court examined the information presented by the Commission on measures taken in response to the most significant past observations⁽¹⁹⁾. This limited review, conducted on the basis of information presented by the Commission, attempted to identify the areas

⁽¹⁹⁾ The follow-up dealt with observations concerning structural measures contained in the Court of Auditors' Annual Reports concerning the financial years 1994, 1995, 1996 and 1997, as well as Special Report No 3/96 on tourism policy and the promotion of tourism and Special Report No 14/98 on the closure of the forms of ERDF assistance.

where such measures had been taken, without checking in depth how they were implemented. These observations concerned errors or irregularities that required financial corrections (ERDF), as well as specific problems of financial management and co-financing (ESF and EAGGF-Guidance).

Financial corrections (ERDF)

3.83. The Court followed up 48 observations contained in its Annual and Special Reports relating to the financial years 1996 and 1997, for which it believed a financial correction should have been made⁽²⁰⁾. In some cases, these financial corrections, which concern declared expenditure, should have given rise to a recovery order.

⁽²⁰⁾ It is worthwhile repeating the framework within which financial corrections can be made in the Structural Funds:

- (a) errors or irregularities may be detected as part of a Member State's everyday management of the Structural Funds and a change made without the Commission being formally notified. However, any irregularity that is the subject of an initial administrative or judicial investigation must be reported to the Commission in accordance with Regulation (EC) No 1681/94 (OJ L 178, 12.7.1994, p. 43);
- (b) errors or irregularities detected by the Commission itself, in particular during on-the-spot checks carried out in the Member States, or cases of infringement of Community law discovered in accordance with the procedure provided for in Article 226 of the Treaty, or by the Court of Auditors, are dealt with as follows:
 - (i) if a Commission examination, provided for in Article 24(2) of amended Regulation (EEC) No 4253/88 (OJ L, 31.12.1988) 'reveals an irregularity and in particular a significant change affecting the nature or conditions of the operation or measure for which the Commission's approval has not been sought', the Commission 'may reduce or suspend assistance' from the Community;
 - (ii) in other cases, the correction is made by deducting corresponding expenditure, as the projects or parts of projects affected by error may be replaced by other eligible projects and related expenditure if the programme or Community measure is in progress. If there are errors and irregularities relating to an ERDF, EAGGF-Guidance or FIFG measure that has been closed or is being closed, the excess amount paid on advances and interim balances gives rise to a recovery order. For the ESF, the excess amount paid on advances for an annual instalment reduces the payments relating to subsequent instalments by the same amount.

3.84. In 16 cases (33 %), the Commission or the Member States took corrective measures which the Court considers satisfactory.

3.85. In seven cases (15 %), corrective action was taken late. There are sometimes delays affecting cases for which the Commission had accepted the Court's remarks. Likewise, some irregularities which have been detected are only followed up effectively when the measure is closed or, sometimes, when notice of a Court audit is received. This kind of follow-up can only delay and complicate the closure process, which may already have been delayed for other reasons.

3.86. In 11 cases (23 %), corrective measures were applied but they proved to be inadequate or were the result of flawed procedures:

- (a) as a general rule, the Commission's follow-up is limited to specific cases of irregularities reported by the Court which, however, often illustrate weaknesses in the underlying systems (problems of eligibility, the reliability of expenditure declarations, compliance with environmental directives or rules for awarding public contracts, and enterprises that combine more than one type of subsidy). The Commission does not initiate any evaluation of risks of potential losses of Community funds or specific measures that might deal with the systematic nature of these irregularities. As a rule, the Commission expects management to improve in the medium term in the context of the general structural measures that it is undertaking ⁽²¹⁾;
- (b) as the Court has pointed out on several occasions ⁽²²⁾, the Commission rarely applies the procedure provided for in Article 24 of Council Regulation (EEC) No 4253/88 relating to reducing, suspending or cancelling Community assistance in cases where the Commission disagrees with the Member States regarding the corrections that need

⁽²¹⁾ See in particular the Commission's replies to paragraphs 21.20 to 21.22 of the DAS relating to the financial year 1996, to paragraph 8.79 of the DAS relating to the financial year 1997 and to paragraphs 3.35 to 3.37 of the Annual Report of the Court of Auditors relating to the financial year 1998.

⁽²²⁾ See the Annual Reports of the Court of Auditors relating to the financial years 1994 and 1995, paragraphs 5.42 to 5.44 and paragraphs 6.16 to 6.19 and Special Report No 16/98 of the Court of Auditors on the implementation of appropriations for structural operations for the 1994 to 1999 programming period, paragraph 6.47, OJ C 347, 16.11.1998, p.48.

to be made to some measures. Other solutions are possible, for example, the de facto suspension of payments for several months, or even several years, pending the settlement of the difference with the Member State concerned. Subsequent payments may also be reduced by the part of the co-financing that the Commission is disputing, whereas the financial provisions in the CSF annexes stipulate that payments may only be made if the level of declared expenditure reaches precise thresholds.

3.87. In two cases, representing 4 % of the number of cases audited (one case of the combination of ERDF aid with national aid and one case of non-compliance with Council Directive 85/337/EEC ⁽²³⁾ on the assessment of the effects of certain public and private projects on the environment), the Commission did not take corrective measures because it disagreed with the Court's observations.

3.88. Finally, the Commission could not demonstrate that it had followed up 12 cases (25 %), although it had undertaken to do so. These cases concerned a range of different situations, such as expenditure that was ineligible or had been incurred after the deadline, a change in the use made of the aid without this being reported to the Commission, payment of the final balance without the results of the audit carried out by the Financial Controller being taken into account, problems relating to the justification of declared expenditure, or even inadequate procedures for checking competition rules.

3.89. Under Article 7 of the basic regulation for the Structural Funds, operations financed by structural measures must comply with Community policies. On several occasions, the Court has emphasised ⁽²⁴⁾ the risk of unwittingly financing operations that do not comply with the procedures and principles laid down in Community policies, especially those concerning environmental protection, State aid and the awarding of public contracts. In order to limit these risks, it is essential that effective cooperation procedures are established by the various directorates-general that may be involved within the Commission.

3.90. However, the Court's audit revealed that in some cases there was a lack of communication between Commission directorates-general on projects that did not

⁽²³⁾ Council Directive 85/337/EEC of 27 June 1985 (OJ L 175, 5.7.1985).

⁽²⁴⁾ See the Annual Reports of the Court of Auditors relating to the financial years 1996 and 1998, paragraphs 6.53 to 6.68 and paragraphs 3.54 to 3.59.

comply with Article 7. This explains the lack of follow-up.

3.91. In conclusion, it can be estimated that, for the 48 cases examined, the amount of expenditure corrected or being corrected totals 280 million euro ⁽²⁵⁾, of which 23,5 million euro was in respect of the application of Article 24 (two cases). These corrections should lead to a reduction in Community assistance of 17,8 million euro. The amounts to be repaid, however, total only 5,2 million euro, since most of the corrections were to measures that had not been closed.

3.92. The Court estimates that the expenditure that is still to be corrected amounts to 57,6 million euro and that Community payments to be repaid amount to 6,8 million euro.

ESF and EAGGF-Guidance

Social dialogue

3.93. In its Annual Report on the financial year 1994 ⁽²⁶⁾, the Court reviewed Community expenditure in the field of 'social dialogue'. On the basis of the Court's observations, the Council states in its recommendation on granting discharge for the financial year 1994 that measures for promoting social dialogue must be better targeted and emphasises the need for strict control of initiatives financed by the Community. In 2000, during the review of the follow-up, it emerged that the Commission had not undertaken the measures it had agreed to carry out in its replies to the Court's observations, in particular, in the field of evaluations or in respect of the increase in the number of organisations to be financed (workers' organisations and employers).

3.94. The social policy agreement stipulates that the Commission should take care to support trade unions and employers equally. In 1994, the number of measures financed by the Commission in favour of

employers was far below the number for workers. In 1999, the situation had hardly changed, except that workers' organisations and employers are now submitting more joint applications for assistance.

3.95. An audit of the accounting records demonstrated that the Commission should have made a recovery order for 67 901,31 euro in February 1994, following an observation by the Court. The recovery procedure was only set in motion on 25 February 2000, that is to say, after the Court's visit to follow up previous observations.

3.96. Council Directive 94/45/EC ⁽²⁷⁾ concerning the establishment of a European Works Council (budget heading B3-4 0 0 3) was supposed to have been transposed by the Member States by 22 September 1996 at the latest. Only five Member States complied with the transposition deadline set in the directive. Nine Member States transposed it later and on 21 October 1999 the Court of Justice found the Grand-Duchy of Luxembourg to be in breach of its obligations for not having transposed the directive.

National co-financing

3.97. The Court's Annual Reports since 1994 ⁽²⁸⁾ have contained observations on national public co-financing.

3.98. In practice, national funds are not always disbursed at the same time as Community funds. Substantial improvements may still be made. In fact, as there are two different procedures for requesting funds (one for Community funds and another for national funds), the regions primarily use the procedure which serves only to release Community payments, in view of the volume of funds concerned.

3.99. The Court detected shortfalls or delays in national co-financing, which might hinder proper implementation of the various forms of intervention. The Commission itself has also detected shortcomings in this field in some Member States.

⁽²⁵⁾ This amount does not include some corrections such as, for example, those made to Spanish measures because of the deduction of a management charge applied by the prime contractor, the final beneficiary, to contractors. These corrections are difficult to calculate in their totality.

⁽²⁶⁾ The Court of Auditors' Annual Report concerning the financial year 1994, paragraphs 5.105 to 5.112.

⁽²⁷⁾ Council Directive 94/45/EC of 22 September 1994 (OJ L 254, 30.9.1994).

⁽²⁸⁾ Paragraphs 5.63 and 5.64 of the 1994 Annual Report, paragraphs 6.51, 6.54 and 6.57 of the 1995 Annual Report and paragraphs 7.54, 7.56, 7.57 and 7.68 of the 1996 Annual Report.

FINANCIAL MANAGEMENT OF STRUCTURAL MEASURES

Introduction

3.100. The audits carried out by the Court in 1999 in respect of structural measures concerned in particular:

- (a) the principle of additionality (Special Report No 6/99 (OJ C 68, 9.3.2000));
- (b) the development of industrial sites (Special Report No 7/99 (OJ C 68, 9.3.2000));
- (c) youth employment (Special Report No 3/2000 (OJ C 100, 7.4.2000));
- (d) the International Fund for Ireland and the special programme of support for peace and reconciliation in Northern Ireland and in the border counties of Ireland (Special Report No 7/2000 (OJ C 146, 25.5.2000));
- (e) the Cohesion Fund (Special Report No 15/2000 (OJ C 279, 2.10.2000)).

3.101. Despite the diversity of the subjects covered, comparison of the observations made in the Special Reports mentioned in the previous paragraph reveals a recurrence of certain shortcomings, particularly with regard to the regulations and the procedures for implementing them, the relationship between Community measures, and the assessment and management of the measures.

Regulations and implementing procedures

3.102. The efficiency and effectiveness of the SFs depends in particular on the implementing arrangements defined by the Commission, which aim to implement measures according to the spirit of the legislation. Several audits revealed the need to clarify concepts and implementing procedures in order to prevent disparity of practice in the Member States and improve implementation of the Funds.

3.103. Thus, although the impact of SF assistance is subject to observance of the principle of additionality (which aims to prevent SF appropriations from being

used as substitutes for Member States' structural expenditure), the Court found varying interpretations and implementation problems that could have a significant influence on the assessment of this aspect. Procedures for verifying additionality have been agreed between the Commission and the Member States, but they have not eliminated the existing difficulties.

3.104. As regards the Cohesion Fund (CF), the financial-analysis and cost-benefit-analysis practices applied to projects should be subject to specific guidelines, so that they are applied more uniformly in the various countries. Similarly, defining the terms 'project' and 'project phase' should help prevent the Fund's contribution from going, in some cases, to projects that are almost finished, have already been completed or have already benefited from the SF, (or, in some cases, to groups of projects with expenditure amounting to the threshold figure of 10 million euro, when it is difficult to establish whether consistent groups are involved).

Relationship between Community measures

3.105. Several types of Community measures may be implemented in a given territory without being coordinated. A single Fund may provide various types of assistance. At present, the norm is for structural interventions to be planned by each ministry separately.

3.106. Thus, the considerable similarity between the measures under the Irish Peace initiative and the International Fund for Ireland (IFI) and other SF measures resulted in overlapping, inefficiencies and delays in implementing the measures, aspects which were exacerbated by the lack of adequate publicity.

3.107. As regards the youth employment measures, greater synergy must be achieved between multifund operational programmes, along with increased coordination between directorates-general acting in a single area. Furthermore, the national action plans (NAPs) should be more concrete and rigorous and the ESF measures more closely linked to them. Lastly, the Court found no evidence of a plan or an overall strategy as regards ESF and EAGGF-Guidance aid for young farmers. Its impact has not been evaluated since 1994.

3.108. The search for synergies between the CF and the other Funds is important, in particular because the CF jointly finances individual projects only, no real attempt is made in terms of planning to provide a coherent overview. However, although particular emphasis is supposed to be placed on this aspect in applications for CF aid, this is not always the case.

3.109. As regards the development of industrial sites, the ERDF assistance examined as part of the audit showed little synergy with other Community measures or actions and the operators were ill-informed of the opportunities offered by, for example, the ESF or EIB.

Evaluation of structural measures

Introduction

3.110. The Court has already had occasion to stress the importance of the analyses needed for planning structural measures, of project-selection criteria⁽²⁹⁾, objectives and indicators for monitoring the impact of measures and reliable statistical bases in the Member States⁽³⁰⁾. The results of macroeconomic evaluations of structural measures⁽³¹⁾ must be refined, and monitoring, assessments and (re-)programming must follow in the correct order⁽³²⁾.

Ex ante evaluation and choice of projects in the Member States

3.111. In order to maximise the impact of the SFs and to ensure that beneficiaries are treated equally, measures must be implemented as part of a regional development strategy. That strategy should be based on a diagnosis of requirements that takes into account an assessment of the existing situation and should set out the project-

selection criteria. The Commission should therefore encourage the Member States to create analytical and monitoring tools which promote more active and efficient management of the interventions as part of a genuine territorial project.

3.112. As regards industrial sites, the attempts that are occasionally made to produce an inventory of existing infrastructure are not always sufficiently up-to-date for planning purposes. Requirements are sometimes mentioned in ERDF programmes when no assessment of them has been made. A genuine analysis and the application of project-selection criteria are particularly justified where promoters in a region are competing with each other to develop sites and attract businesses.

3.113. In the case of measures to promote peace in Ireland there was an observed lack of a common definition of areas with the greatest need for Community assistance and, similarly of criteria for selecting projects and recipient social groups. In some cases the project assessments were limited, poorly documented and led to inconsistencies.

3.114. In the case of the CF, the Commission does not always have access to all the essential information required by the Regulations, although, in this case, it is the body responsible for deciding whether to provide assistance under the Fund. Cost-benefit or impact studies are not systematically produced.

Objectives and indicators

3.115. In its investigation into youth employment, the Court noted the absence of a standard definition of the age of 'young people' in the various OPs and SPDs, as well as a lack of clear objectives and performance indicators in the Member States.

3.116. In the case of the Peace initiative in Ireland, quantified objectives were not defined, in particular for socioeconomic measures, and procedures for gathering information on the impact of the projects were not implemented by all of the authorities responsible for management. In many cases, the data concerned only estimates. In view of the lack of a financial-management and monitoring system, no precise assessment of the programme had been made by the end of 1997.

⁽²⁹⁾ Special Report No 15/98 on the assessment of Structural Fund intervention for the 1989 to 1993 and 1994 to 1999 periods, paragraphs 3.3, 4.12 and 4.13 (OJ C 347, 16.11.1998).

⁽³⁰⁾ Special Report No 15/98, paragraphs 4.1, 4.15 to 4.21.

⁽³¹⁾ Special Report No 15/98, paragraph 4.18.

⁽³²⁾ Special Report No 15/98, paragraphs 4.22 to 4.26. Chapter 3 of the 1998 Annual Report, paragraphs 3.72 and 3.82 (OJ C 349, 3.12.1999).

3.117. As regards the development of industrial sites, shortcomings were also noted, and no distinction was made between gross and net jobs provided when businesses move to the sites. This distinction is important because businesses merely relocating from one site to another within a region do not directly provide new jobs. The lists of industrial sites sometimes drawn up by regional authorities provided a tool for checking the number of businesses and jobs which was more appropriate than the occupation rate alone.

3.118. The indicators used in the context of the CF are very often the same as those used in the case of the ERDF for programming purposes and as part of an overall objective. Furthermore, they are occasionally not detailed enough to provide a genuine assessment of the progress made on a project and to quantify its impact and performance, especially in view of the particular sectors concerned, namely transport infrastructure and the environment.

Macroeconomic assessments

3.119. New research has been carried out with the object of using macroeconomic models to evaluate the overall impact of structural aid granted to a Member State or a region⁽³³⁾. In the case of the CF, the models that were developed on the Commission's initiative have contributed to the methodology, the aim being to evaluate the macroeconomic impact of individual projects (effects on the region concerned, effects of other regions and the overall economy; the impact on cohesion and convergence). Although the findings, where comparable, are generally consistent, there is no real correlation between the methods used. The Commission should pursue its efforts in this area, improve the instrument for assessing projects from a macroeconomic standpoint and apply it more comprehensively as regards the four countries concerned.

Consideration of assessments

3.120. In its 1998 Annual Report (see paragraphs 3.60 to 3.84) the Court pointed out that insufficient account had been taken of the results of mid-term evaluations. This was confirmed with regard to the measures to assist the employment of young persons: the mid-term evaluation has had too little impact on

policy implementation in the last part of the programming period (1994 to 1999). The Commission and the Member States should implement the evaluation process more effectively. Greater consideration was, however, given to the findings and recommendations of the mid-term assessment of the Peace initiative, which made it possible to reorientate the priorities of the measures that make up the initiative.

Management of measures

3.121. Improvements should also be made in the actual management of measures at the Commission, mainly as regards coordination and controls, but also in the Member States.

At the Commission

3.122. The audit of the Youthstart initiative revealed shortcomings in the creation of transnational partnerships and the absence of a database providing an overview of project implementation. Furthermore, the results of the measures are not reported at the local level and no assessment is made of the transnational partnership. The Commission should take a more active role in coordination.

3.123. If the shortcomings as regards the verification of additionality are primarily caused by the inadequacy of the implementing measures, they also result, however, from the fact that there is no definition of the respective responsibilities of the four DGs involved and of their various departments. In many cases, contacts established with the Member States are informal, the relevant documents are spread between departments and files are incomplete.

3.124. Lastly, more resources should be devoted to checks in the Member States by Commission departments, in particular for the International Fund for Ireland and the CF. As regards the latter, the review of the implementation of projects should be intensified and the extent to which previous observations have been taken into consideration examined.

In the Member States

3.125. The audits revealed repeated omissions in respect of the eligibility of expenditure (e.g. declarations of recoverable VAT, simple accounting and expenditure provisions which do not concern the projects inspected, failure to meet the deadline for making payments, etc). These omissions can be progressively curtailed only by

⁽³³⁾ Special Report No 15/98, paragraphs 7.1 to 7.22.

increasing the number of checks in the Member States in respect of project managers and final beneficiaries.

3.126. Delays were noted in the implementation by the Member States of appropriate procedures. As regards additionality, information allowing it to be assessed was seldom provided by the deadlines stipulated and was sometimes not provided at all. The lack of specific provisions concerning the consequences of the Member States failing to meet their obligations provides the Commission with little means of reacting to these infringements. Until the end of 1997, the lack of a centralised database and of appropriate inspection mechanisms led to incomplete disclosure of information on the implementation of the Peace initiative in Ireland.

3.127. Lastly, in the area of competition, the audit of industrial sites revealed that, with regard to the practice of fixing the sale price of subsidised infrastructure, there had been a failure in most of the regions visited to implement either of the systems proposed by the Commission for excluding any aspect of State aid ⁽³⁴⁾.

GENERAL CONCLUSIONS

3.128. The budgetary implementation of structural measures in 1999, which was marked by a high level of transfers of appropriations, underlines the shortcomings of the budget forecasts and their link with the Financial Perspective. The reprogramming of most SF measures as implementation of the 1994 to 1999 programming period drew to a close explains why the 1999 appropriations were underutilised, for both commitments and payments, and also explains the carry-overs to the financial year 2000. If the principle of differentiated appropriations were fully applied, the recurrence of such a situation could be avoided.

3.129. The Commission should introduce data systems for all the SFs, in order, firstly, to record, on the basis of the resources available for a programming period, the allocation of commitments and payments to Objectives, Funds, Member States, CSFs, Community initiatives and various forms of assistance and, secondly, to follow the material and financial progress on the ground of CSFs and individual measures.

3.130. Although the Commission has made efforts to consider the Court's observations, the measures taken are aimed mainly at the 2000 to 2006 programming period and so they will have no immediate impact. It would be worthwhile, in partnership with the Member States, strengthening existing instruments for monitoring and control, at both Community and national level, in order to bring previous programming periods to a close.

3.131. The Commission's follow-up to the Court's observations should be more systematic and should not be limited to specific cases of irregularities reported by the Court, which often illustrate shortcomings in underlying systems.

3.132. As regards the Structural Funds, the Court, during its audit of the Employment DG's new local ESF-management system, found serious shortcomings in terms of the security of the database as well as differences between the financial data in the local system and the budget accounts data (Sincom) (see paragraphs 8.54 to 8.59).

3.133. The investigations carried out by the Court in 1999 showed that defining the concepts and rules for applying the regulations and improving links between measures (within and between the Funds and with other instruments such as those managed by the EIB) would enhance the effectiveness of the structural measures. An attempt should be made to make better use of *ex ante* assessments based on studies of the requirements of the regions concerned, the monitoring of measures (objectives and indicators) and *ex post* assessments. Organisation and management should be improved, at the Commission (responsibilities and on-the-spot checks) and in the Member States (eligibility of expenditure, delays in or failure to apply regulations).

3.134. With regard to employment measures, national action plans (NAPs) should be more concrete and rigorous. There is also a need for a better and more effective link between the ESF measures and the NAPs and, additionally, a need for quantified targets and performance indicators.

3.135. Lastly, the specific appraisal of structural measures within the context of the Statement of Assurance gave rise to the conclusions and recommendations which feature in paragraphs 3.76 to 3.81.

⁽³⁴⁾ Commission communication concerning elements of State aid contained in sales of land and buildings by public authorities (OJ C 209, 10.7.1997, p. 3).

THE COMMISSION'S REPLIES

IMPLEMENTATION OF THE BUDGET

Introduction

3.3. The specific reason for the massive reprogramming of the 1999 financial year is that 1999 was the last year of the 1994 to 1999 programming period and the financing plans for the programmes had to be adjusted in line with actual implementation so that the whole allocation in the financial perspective could be committed. Since there was some delay in the reprogramming, firstly a large number of transfers had to be made in order to bring the budget headings into line with reprogramming needs; secondly, the Directorates-General (DGs) for the Structural Funds did not have sufficient time to commit the appropriations and hence to make the relevant payments before the end of the 1999 financial year. Consequently, the appropriations were quite extensively underutilised at the end of the 1999 financial year and a large amount was carried over to the 2000 financial year.

In order to avoid such delays in reprogramming, the Commission had beforehand taken the precaution of sending the Member States a registered letter advising them to submit their programme amendments by 31 July 1999. That date took into account the procedural time required for the Commission to adopt amending decisions so that the appropriations could be committed by 31 December 1999 at the latest. Despite that advice, Member States did not submit their reprogramming requests until the final quarter of 1999, which inevitably delayed the Commission's processing of the files.

Financial perspective allocations

3.5 to 3.6. As the Court points out, the unused portion of the allocations entered in the 1998 and 1999 budgets, including those resulting from re-budgeting amounts unused in previous financial years, was not transferred to subsequent financial years under the annual procedure of adjustment to the implementing conditions stipulated in the Inter-institutional Agreement then in force. The Commission has always taken the view that commitments not used during a programming period should in principle be re-entered in the budget only during that same period, without transfer to financial years of the following period.

Re-budgeting, in the course of 1999, commitment amounts not used in the 1998 financial year would not have been fully in accordance with paragraph 10 of the Inter-institutional Agreement, which states that 'The two arms of the budgetary authority, acting on a proposal from the Commission, undertake to authorise the transfer to subsequent years (i.e. $t+1$ and/or subsequent years) ... allocations ... not used in the previous year. [i.e. $t-1$]' and goes on to state in the next subparagraph that 'The European Parliament and the Council will take decisions on these proposals before 1 May of year t , ...'. As the beneficiaries of structural measures, Member States knew how the Commission interpreted these provisions, which are designed to avoid an excessive accumulation of transfers to the final year of the programming period.

3.6. The total amount of the obligations which were contracted by the Commission and which could not be covered by the 1999 budget is not yet final; it could still be amended in the light of additional checks by the Structural Fund DGs. Moreover, Budget DG, in agreement with the Structural Fund DGs, has made provision for financing the amount needed to cover those obligations by means of external transfers from the 'innovative actions and technical assistance' headings, since those headings contain the only allocations not programmed during the next period (2000 to 2006). In addition, the transfers will relate to the 2000 appropriations which will probably not be used for innovative actions, given the late launch of the relevant operations.

In 1999 the Commission took precautions by proposing a transfer of EUR 176 million from the 'transitional measures and innovative actions' headings.

The supplementary and amending budget (SAB) instrument was not available, however, since the heading ceiling had been reached without revision of the financial perspective. Since revision for a limited amount with respect to the overall allocation for the 1994 to 1999 period would have proved particularly cumbersome, the Commission opted for budget management measures.

The implementation of appropriations

3.11. The Commission takes the view that forecasting is made difficult by the current financial management rules, which give Member States great flexibility to adjust their programmes in the light of practical implementation, including as regards preparing the preliminary draft budget (PDB).

Although the forecasts for 1996 to 1998 were fairly accurate at chapter level, it has to be said that this required highly dynamic management within chapters (offsetting the surplus allocation under one item against the deficit under another in the same chapter). By contrast, reprogramming was a major feature of implementation in 1999, resulting in significant underutilisation overall (see Commission reply to paragraph 3.3).

For the future, a simpler budgetary structure, as in the 2000 budget, should make it easier to manage appropriations. The difficulty of producing reliable forecasts should be resolved by the new financial management provisions of the Regulation laying down general provisions on the Structural Funds (automatic commitments and intermediate payments through reimbursing expenditure actually paid) and by requiring Member States to submit forecasts for the current and the following financial year.

3.12. The Commission acknowledges the inaccuracy of the payment appropriations forecast made when drawing up the PDB 2000 in April 1999. Realising at the beginning of 2000 that its forecasts were excessively high, the Commission presented to the budgetary authority a duly substantiated proposal that appropriations should be transferred to other budget headings in accordance with the Financial Regulation (see also paragraph 3.17).

3.13 to 3.14. Under SEM 2000 (sound and efficient management) the Commission has indeed set up a budget information exchange network with Member States' finance ministries and this is proving increasingly effective. The Commission is also in the process of setting up an advance warning system for revising Member States' initial budget estimates of payment appropriations; under the system, the current financial year's budget estimates will be adjusted around October/November, by taking into account new needs; for the system to work properly, Member States will clearly have to make an active contribution.

Review of the Commission's comments on the financial management

3.17. In the Commission's view, the difference between Structural Fund programmes and Cohesion Fund projects has little influence on its ability to foresee how national authorities will stagger their submission of payment requests.

Taken as a whole, within the overall transfer of payment appropriations, in 1999 the Commission brought allocations into line with needs. The final implementation of Cohesion

Fund payment appropriations reached 91,4 % of the allocation. The underutilised sum at the end of 1999 amounted to EUR 158 million; most of those appropriations had been proposed for authorisation at the end of 1999, but the transactions were cancelled for technical reasons. The Commission therefore decided to allow the those appropriations to be carried forward.

The payments authorised at the end March 2000 for the Cohesion Fund amounted to EUR 283 million.

Reprogramming

3.18. See reply to paragraph 3.3.

3.19. See reply to paragraph 3.3.

3.20. The situation varies according to the Structural Funds.

As regards the European Agricultural Guidance and Guarantee Fund (EAGGF), Guidance Section and the European Social Fund (ESF), the appraisal procedure for amending decisions does not slow down the processing of payments. Whatever happens, the forms of assistance are managed on the basis of the latest financing plan in force. If need be, an additional payment is made following revision.

In the case of the European Regional Development Fund (ERDF) the Commission is aware that, as regards its departments, this process has, in the past, slowed down paying Community funds to Member States and hence implementing the budget. However, once the new Regulations on the Funds are applied the question will no longer arise.

3.21 to 3.22. Annual instalments form part of the system introduced by the general Regulation on the Structural Funds; the financial perspective; the Interinstitutional Agreement; and the Decision on own resources which includes an annual ceiling for commitment appropriations (1,335 % of GNP). This prevents such programmes being committed in their entirety when they are adopted, because this would be refused by the budgetary authority. However, the budgetary authority's undertaking to enter the heading ceiling in the budget each year makes it possible to ensure that the Community's legal liability is covered.

Annual instalments retain a special significance because they determine the duration of Community liability and hence the maximum flow of Community payments at any given point in time.

Admittedly, entering only the annual instalments in the accounts does not reflect all the legal liabilities contracted by the Community, which is why the Commission records those liabilities among the off-balance-sheet transactions shown in the revenue and expenditure account.

IMPLEMENTATION OF PROGRAMMING PERIODS

3.23. The Commission presented its proposals for Regulations on the Structural Funds in March 1998 in the hope that the Council would be able to adopt the new rules at the end of 1998 or at the beginning of 1999, so that programming for the new period (2000 to 2006) could actually be launched from 1 January 2000 onwards for the three Structural Fund Objectives, including Objective 2, and the Community initiatives. However, the Council did not adopt the Regulations until 21 June 1999 and they entered into force on 29 June 1999.

Before Objective 2 programming can begin, the list of eligible areas in each Member State has to be drawn up. So that the lists could be adopted more quickly, on 23 June 1999 (i.e. immediately after the Council had adopted the Regulations) the Commission sent to all the Member States the data relating to applying the Community criteria contained in Article 4(5) and (6) of Regulation (EC) No 1260/1999. To ensure uniform presentation of all the area proposals and facilitate their appraisal, on the same day the Commission also sent standard tables to be completed to Member States.

On 1 July 1999 the Commission set the eligible population ceiling for each of the 12 Member States covered by Objective 2. It also asked each Member State to submit its proposed list of areas eligible under that Objective as soon as possible, and at the latest by 31 August 1999. By that date, only one Member State was able to send a proposal which complied with the rules to the Commission. Area proposals in accordance with the Regulation were received between 16 August 1999 and 21 June 2000.

For both the above reasons, i.e. the date when the Council adopted the Regulations and the dates when the Member States' proposals were received, the only lists of areas eligible under Objective 2 which the Commission was able finally to adopt before the end of 1999 were those for Belgium, the Netherlands, Finland and Denmark. The other Member States' lists were approved during the first quarter of 2000, except for Italy, whose Objective 2 areas were approved by the Commission at the end of July 2000.

It should be stressed that the Community initiative programmes are subject to deadlines resulting from the system of programming and interinstitutional consultation required.

The new Regulation providing for the establishment of Equal was adopted in June 1999. From July onwards the Commission conducted extensive consultations on its draft communication to Member States setting out the guidelines for this new Community initiative programme. The draft was then sent to the other institutions, for their opinion, in October 1999. The final approval was sent to the Commission departments in February 2000.

The 1994 to 1999 period

General aspects

3.24. While accounts may provide a general comparative measure of all the programmes' progress or lack thereof, they are not actually relevant to the individual level of assistance.

For monitoring purposes, the reports referred to in the replies to paragraphs 3.26 and 3.27 are much more useful and better targeted.

In the case of the ESF, the system of annual closure of instalments requires the national authorities to send to the Commission each June a statement of the expenditure effected by the promoters of projects part-financed during the financial year *n*-1. The Employment DG therefore receives data which reflects more accurately how the assistance is really progressing.

3.25. The data to which the Court refers are available in the annual accounts, but may not be cumulated over the whole period. For the new programming period (2000 to 2006), the Commission is currently setting up a joint information system which will record all the data available on programming and financing assistance in respect of all the Structural Funds.

3.26. In the Commission's opinion, an overview of programmes' progress is particularly needed at the level of each CSF (Community support framework) and each form of assistance. The monitoring committees' work (annual reports, working papers for discussion) provides the Commission with that overview, which it subsequently summarises in its annual reports on the implementation of the Structural Funds. The databases to which the Court refers are used for the financial management of each fund, and are not directly linked to the monitoring of programming. The Commission has decided to set up a joint database which can be managed interactively and directly by its Directorates-General and the Member State concerned to serve as a single point of reference for measures under the various Structural Funds.

3.27. The Commission monitors forms of assistance at the level of subprogrammes and measures. Information on physical and financial implementation at individual action level is available to national managing authorities on request. The Commission uses that information when carrying out on-the-spot checks, for example, and is in the process of making it flow more systematically and homogeneously.

Categorising part-financed projects by type is quite complex, since the same project may fall within various categories. Based on experience gained during the previous programming period, the Commission is in the process of completing new coding which will be used for all part-financed projects for the 2000 to 2006 period.

3.28. The system of advances and balance of annual instalments provided for in the standard clauses admittedly means that percentage implementation at Community budget level can be higher than that on the ground. For the new period (2000 to 2006), these financial implementation rules have been amended so that declarations of expenditure will be submitted at regular intervals.

Objective 2 programmes from the 1994 to 1996 period

3.29. Most requests for payment of the final balance were not submitted in 1999.

Closures have been carried out only in respect of those programmes for which the Commission has received and accepted the final implementation report. The final reports for the other programmes are either being examined by the Commission departments, are the subject of a request for correction, or have not yet been submitted. In these cases, payment of the balance has not been made.

In practice, the deadline for payment of the final balance is extended by the time needed to evaluate the final reports, to make the necessary corrections to them (usually supplementary information), and to resolve the various problems outstanding (irregularities or suspected infringements, investigations in progress, legal proceedings pending, etc.).

Since the programme closure transaction is particularly sensitive from the financial management viewpoint, the Commission is under an obligation to verify beforehand with Member States the accuracy of the data submitted and the outturn of the clearance operation. This verification normally takes an additional two months.

In practice, therefore, the deadline set for closing most Objective 2 programmes from the 1994 to 1996 period is the end of 2000. The Commission is taking appropriate steps to achieve this.

3.32. At the end of September 2000, 10 more operations had been closed. The Commission intends to close a significant number between now the end of the year, based on information supplied by Member States.

Periods prior to 1994

3.34 to 3.37. The Commission is endeavouring to close all programmes from the pre-1994 periods as soon as possible and in accordance with the rules in force.

The cooperation of the Member States is essential for closing the programmes. That being so, Article 52(5) of the new Regulation on the Structural Funds sets final deadlines for submitting applications for final payment. These are: 31 March 2001 for programmes approved by the Commission before 1 January 1994 and 31 March 2003 for programmes approved by the Commission between 1 January 1994 and 31 December 1999.

By decision of 9 September 1999 (SEC(1999) 1316), the Commission laid down a procedure allowing it to close any programmes for which the requisite documents are not submitted by the relevant deadline.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Legality and regularity of the underlying transactions

Commitments

3.41. Since 1999 was the last year of the previous programming period (1994 to 1999), the programmes' financing plans had to be adjusted in line with actual implementation in order to commit all the Edinburgh allocations. Mainly because of delays in Member States' reprogramming, the Structural Fund DGs did not have sufficient time to effect the commitments by the end of 1999 and so underutilisation of appropriations was very high. It was possible to cover most of the remaining needs by carrying appropriations forward from

1999 to 2000. The others could not be covered because, within budget headings and chapters, the appropriations available for carrying forward did not match the remaining commitments needed. Also, because of Member States' late reprogramming, the Commission was not able to make the transfers needed to avoid that mismatch.

To sum up, there was considerable underutilisation of appropriations at the end of 1999 and a large proportion of the appropriations available was carried over to 2000 so that assistance from the Structural Funds could be committed; the budgetary authority was informed.

Payments

3.43. The Commission shares the Court's view that these substantive errors in the expenditure declarations do not necessarily have a financial impact on the Communities' budget.

3.44 to 3.46. The Commission will investigate the cases mentioned by the Court and make the necessary financial corrections.

Because of the very short time available, the Commission has not yet received replies from Member States in respect of all the cases and has not completed its detailed examination of the comments in detail. Nevertheless it has been noted that, for example as regards the cases of non-compliance with the environmental rules referred to in point (d), the projects in question were generally completed without other irregularities, and that the correction to be applied should be proportional to the seriousness of the detected irregularity and its impact on the Communities' budget. For several of the cases referred to in point (c) (ineligible expenditure and actions), the detected errors concern administrative practices which might be questionable but which do not clearly constitute irregularities, or which are based on provisions which lend themselves to differing interpretations. Despite the Commission's efforts to draw up eligibility rules for the various types of expenditure, it is not possible to cover all eventualities and grey areas inevitably remain. The Commission can apply financial corrections only if an infringement of a clear and precise provision has been detected but is considering whether the rules should be adjusted or clarified. Lastly, in several cases the Member State has already admitted the irregularity and has undertaken to rectify it.

This analysis suggests that the level of errors detected by the Court is not evidence that a significant proportion of Com-

munity funds are being misspent, but rather that deficiencies exist in the Member States' financial control of the funds which are typical of the management of any complex programme. While the Commission will proceed with recovery where justified, the priority must be to maintain progress in improving the financial management and control systems.

With regard to VAT eligibility, and while admitting that the Court's restrictive interpretation of datasheet No 15 is possible, the Commission has to date followed a different interpretation based on considering public or private bodies or companies which are responsible for placing orders for work to be liable for VAT as final recipients. In structural assistance, each State body acts as a separate entity with its own budget and has to pay VAT without being able to recover it.

The Commission takes the view that the Court's interpretation entails difficulties and distinctions of a political, economic and even practical nature. For example, VAT paid by regions, municipalities or certain public bodies would be eligible, whereas that paid by central government bodies would not. Applying such a criterion would also result in unjustifiable distinctions between Member States on the basis of their administrative structure. Lastly, assigning public works to an intermediary body 100 % funded by the State budget would suffice for the VAT to be deemed eligible.

The Commission nevertheless recognises the importance of avoiding the risk of diverging interpretations. For the future it is therefore ready to provide any clarification needed with regard to existing legislation.

3.48. The draft Regulation on management and control of the Structural Funds (which the Commission adopted in July 2000) reinforces the requirements previously stipulated in Regulation (EC) No 2064/97 as regards ensuring adequate audit traceability, for example by expressly requiring Member States to set up procedures to ensure that the location of all documents relating to specific payments is recorded and that those documents are available for inspection.

3.49. On the basis of Member States' replies to the Court's comments on the assistance in question, the Commission does not accept all the error findings and would point out that the direct impact on Commission payments is more limited than the Court states.

3.50.

(a) The Commission made the final payment because it considered that the requirements stipulated in Article D(2)(d) of Annex II to Regulation (EC) No 1164/94 regarding payment of the final balance had been met, *inter alia*:

— the bridge part-financed by the project in question had been opened to traffic in March 1998 and the Member State had submitted the application for payment of the balance in July 1998,

— before agreeing to pay, the Commission checked that all the requirements laid down in the decision (COM(94) 3905 of 21 December 1994) had been met and that the project had actually been completed. The Commission carried out an extremely detailed appraisal before approving the final payment, as is borne out by the fact that final payment took place 12 months after the application,

— a final report containing the information required by the Regulation had been submitted to the Commission,

— the Member State certified that the project had been carried out in accordance with the objectives.

The Commission will nevertheless examine closely the technical problems identified by the Court, and will effect any recovery which proves necessary.

(b) The Commission is required to base its decisions on the best information available at the time of the project's approval.

(c) The Commission takes the view that formal amendment of a decision is not necessary, except in the case of ceilings which are expressly set by expenditure category or substantive changes which affect the nature of the measure. In general, these are indicative cost breakdowns which reflect an estimate drawn up at the time of the application.

The final breakdown of eligible costs almost always differs from that drawn up initially, because of adjustments made for many reasons during the project's implementation.

In this instance the Commission considered that the project had been carried out in compliance with the objectives laid down in the decision, and that it was not necessary to amend the decision because the project had not been significantly changed in terms of objectives or actual costs.

(d) The Commission considers that, in compliance with Article 9(2) of Regulation (EC) No 1164/94 and par-

ticularly taking into account total project expenditure (including all the factors forming the basis for granting the EIB loan), the 90 % limit was not exceeded.

(e) The Commission monitored the project in accordance with the Regulation, using the physical and financial indicators provided by the monitoring system set up.

(f) Admittedly, where work had been carried out on the basis of a turnkey contract it was more difficult to verify the eligibility of expenditure.

3.51. Following the audit of the operational programme in question (carried out by the Court in 1997), which identified a lack of original supporting documentation for declared expenditure as a result of administrative reorganisation, the Commission departments had extensive contact with the national authorities. When the Commission closed the programme it agreed that, on the basis of work undertaken by the relevant authority in order to assemble supporting evidence, expenditure for which there was no adequate evidence would be excluded from the programme. Although the Court has identified expenditure for which there is a lack of supporting evidence, some of the amount at issue arises from the system for charging the cost of in-house professional services which the Commission had accepted. If account was taken only of the ineligible expenditure accepted by the Member State, the overpayment level would be less than that found by the Court.

It is correct that the length of time taken by the national authorities to submit a final report which met the approval requirements contributed to the delay in closing the programme. The protracted correspondence on this issue related to the report's substance as well as its format.

3.52. The Commission will ensure that the Member State concerned takes the necessary corrective measures.

Outstanding commitments

3.53. With regard to the ESF, in three of the six cases identified by the Court the Commission considers that the files were continually monitored. Despite regular reminders from the managing unit, the national authorities were not able to submit admissible applications for final payment until the spring of 2000. These were examined during the summer of 2000 and the corresponding decommitments are in progress. In the fourth case, decommitment was effected in June 2000. Lastly, in the two remaining cases, a special mission was organised

to the Member State in July 2000 during which a decommitment proposal was put forward. Following the Member State's ratification of the proposal in September 2000, the Commission is now able to initiate the closure and decommitment procedure for these programmes.

3.54. The old commitments referred to generally concern measures which are in the process of being closed but for which the Commission does not have the information needed to effect closure. The Commission intends to accord priority to examining these cases during the last quarter of 2000.

Other observations

Management of the ESF's accounting procedures

3.56. The SI2 system includes a function which enables the background to commitments and payments to be retraced.

Even if an application for final payment and an application for an advance are processed on the same day, they constitute two separate accounting transactions.

The Structural Fund rules require account to be taken, when paying advances, of financial implementation in previous financial years. For example, an initial advance may be reduced to below 50 % of the commitment if declared expenditure is insufficient compared with the advances already paid.

The detail of the calculation which, in this example, leads to a reduction in the amount of the advance does not need to appear in the Commission's SI2 central accounting system. However, the local non-accounting databases SEA and OP Admin provide the information needed to calculate the amount of the advance, i.e. both the amount of the payments already made for the form of assistance in question and the level of the expenditure submitted by the national authorities. The manager's grounds are set out on a calculation sheet incorporated into the file relating to the form of assistance in question; the file is available in the Employment DG's archives.

3.57. The security weaknesses which the Court's auditors found when checking the set-up of the Employment DG's new local system for managing the ESF have been acknowledged and corrective measures have been taken.

Owing to a lack of human resources, in the case of this project the Employment DG has not always been able to follow the project management guideline which recommends separating

the project management, application development, and data access functions. The SEA development team comprises just two developers and a part-time project leader, and it is correct that in certain cases, and particularly when introducing a new computer programme for the first time, a number of manual operations in the database could be performed only by someone conversant with the system, i.e. a member of the development team. A procedure has been set up to ensure that essential manual operations in the database are at least formally recorded. The Court's recommendations have therefore been implemented to the extent that available resources allow.

3.58. There is data reconciliation between the Employment DG's local system and SI2. In the past, the Sincom1 system sent a file containing the closed operations to the Employment DG's local system at the time (Adabas) a file containing the closed down operations. The data were reconciled manually every six weeks. The SEA system can now consult the Sincom2 database every day in order to check that the closed operations on Sincom2 do indeed correspond to level 4 of the transactions on SEA.

There was nevertheless a possibility that an amendment on SI2 of amounts entered onto SEA would not be reflected on the SEA system because the latter is only an instrument for proposing financial transactions which subsequently have to be validated on SI2. The Employment DG is working on setting up a reporting mechanism which will enable any such discrepancies to be identified and investigated.

The implementation of recovery orders (ESF and EAGGF — Guidance)

3.60. The Sincom2 system permits monitoring of each recovery order from issue by the authorising department to approval by the accounting officer, although it is true that it does not yet permit checks on whether or not amounts have actually been recovered. The final system must take account of the current reorganisation of the Commission's financial departments.

The Commission recognises that the Sincom2 application for the management of recovery orders has not yet been completed and that significant improvements still need to be made. However, the Commission is aware of how important is the recovery of debts for sound financial management, and undertakes to introduce effective tools in the near future and, in any event, before the end of the financial year 2000.

The question of the recovery of debts has been included in the reform under Action 96, which the Commission is currently implementing.

3.61. The Commission is aware that its management system for recovery orders needs thorough improvements and it intends to deal with this as part of the reorganisation of its financial departments. Among the measures to be taken in order to give authorising DGs and the accounting officer's department suitable means for monitoring recovery orders is the provision of an effective reporting tool.

3.62. The Commission realises that coordination of the different departments involved in the recovery procedure must be stepped up to ensure that debts are recovered more quickly.

It recognises the difficulties it is having in managing the sums owed to it. Although the existing system for the issue of recovery orders functions correctly, orders are not monitored as well as they should be and the actual recovery of amounts wrongly paid is slow and dogged by practical difficulties. That is why the question of the recovery of debts was included in the reform. Action 96, now being implemented by the Commission, will clarify the division of responsibilities between the authorising DGs, the Budget DG and the Legal Service.

3.63. One of the improvements to be introduced will be a systematic demand for interest on arrears from debtors who do not pay within the time limits laid down.

Overhead charges

3.65. Given the wide range of both situations in the Member States and measures part-financed, eligibility datasheet No 5 lays down an acceptable rule for the allocation and justification of overhead charges.

During on-the-spot checks, the Commission verifies that overhead charges are allocated to the project 'in an equitable manner, in accordance with generally recognised accounting standards'. During such checks, the Commission systematically rejects excessive and unjustified overhead charges and demands corresponding corrections.

3.66. The use of a lump sum in ESF projects is, in itself, not a problem, provided that justification is provided for the actual costs, the hours declared have actually been worked and the prices used reflect market costs.

In addition, the Commission pays particular attention to the question of non-existent or unnecessary subcontracting, the

aim of which is basically to increase the costs claimed, for example, for overhead charges.

The Commission therefore drew up eligibility datasheet No 4.2, which stipulates that unjustified subcontracting or subcontracting that does not bring any added value is not permitted.

3.67. The Commission examined the question of the treatment of indirect costs when formulating its proposal for a regulation on eligible expenditure for the new programming period (2000 to 2006) to replace the eligibility datasheets. It concluded that, in view of the diversity of final beneficiaries and types of project funded by the different Structural Funds, it was not appropriate to lay down fixed percentages or a specific method of calculation. However, point 1.7 of new Rule No 1, set out in the Annex to Regulation (EC) No 1685/2000, provides that overheads must be based on real costs that relate to the part-financed operation and must be allocated pro rata to the operation according to a duly justified fair and equitable method.

3.68. In the early stages of the programme, expenditure on the setting up and installation of local groups can account for a large percentage of costs, since the selection and funding of individual projects has not yet begun. As implementation progresses, this percentage falls to a more reasonable level within limits generally fixed in the programmes. This, in part, explains the differences between the operating costs and overhead charges for different groups.

Implementation of the Regulation on financial control

3.71. It is important to note that the Structural Funds audit manual was developed as a framework to be used by Commission auditors when carrying out on-the-spot checks in Member States. It also contains guidance on the application of Regulation (EC) No 2064/97. It was distributed to Member States for information but could not be made mandatory.

Some Member States have distributed the manual as internal guidelines or instructions, while others keep it as a reference document.

A draft of the Manual was first presented to member States in May 1998. It was then revised in the light of comments from Member States and professional audit bodies. Furthermore, the guidance on application of Regulation (EC) No 2064/97 was discussed on numerous occasions with

Member States in seminars and in bilateral meetings after the adoption of the Regulation in October 1997.

The contents of the manual were therefore not new to Member States when the final version was distributed in 1999.

3.72 to 3.73. The Commission is aware of the need to check the application of the minimum requirements of Regulation (EC) No 2064/97, particularly before the closure of the programmes for the 1994 to 1999 period (1997 to 1999 for Objective 2 programmes) which is provided for from 2002.

The Commission has already obtained useful information on the application of the Regulation from the coordination meetings with Member States and the Article 9 reports. Progress on implementing the minimum requirements has also been checked during some of the on-the-spot checks carried out by the Commission. However, the Commission intends to intensify checks on compliance with the Regulation during 2001.

3.74. The Commission agrees that it would be useful if the reports received from Member States had a consistent structure and contained the same type of information. Such guidance is provided in the section on 'The form of Article 9 reports' in its last 'Progress report on implementation of Regulation (EC) No 2064/97' of June 2000, based on the information received from Member States in their Article 9 reports and additional clarifications and information given at the coordination meetings.

The following five points are highlighted as basic information that should be included in the reports:

- reference to any changes in control and management systems including the audit trail,
- comments on relevant points of Article 3 (minimum of 5 %, checks, control methods),
- information about the independent organisation/person provided for in Article 8,
- problems of systematic character and follow-up,
- report on the investigation and treatment of irregularities.

Controls by the Commission and the Member States

3.75. It should be noted that on-the-spot checks carried out by the Commission and by national audit bodies have been improved as a result of the protocols.

Although the Commission is making an effort to carry out checks on programmes about to be closed, measures or projects that are about to be closed should not be the sole target for on-the-spot checks. With regard to the multiannual nature of the programmes, it is neither possible nor useful to concentrate all audits in the final phase preceding closure. Other factors should also be taken into account when assessing the risks and deciding on the programme of an inspection visit. Furthermore, checks on operations that are, for example, midway through implementation make it possible to make any necessary corrections at an earlier stage and thus prevent irregularities.

The audit manual sets out a methodology that is increasingly being used by the Commission departments for auditing the Structural Funds.

As a result of the protocols, the Commission receives a large number of reports from Member States every year. Copies of all these reports are sent to the Court.

The Commission has already started to discuss with Member States a more uniform structure for audit reports as provided for in the audit manual. The Commission also intends to improve the follow-up of the audit results contained in the reports from national audit bodies.

Conclusions and recommendations

3.76. The level of errors found by the Court is not evidence that a significant proportion of Community funds are being misspent, but rather that deficiencies exist in the Member States' financial control of the funds which are typical of the management of any complex programme. The main priority must be to maintain progress in improving the financial management and control systems.

The Commission is of the opinion that the actual effects of the measures to improve the reliability of expenditure declarations will be seen in the coming financial years, although on-the-spot checks are already revealing an improvement in management by the Member States. The point 3.2 action plan drawn up by the Commission during the 1998 clearance procedure lays down a timetable setting out the likely date of first impact on the DAS (statement of assurance) of the measures concerning structural operations adopted by the Commission.

For the new programming period (2000 to 2006), the adoption of the two Commission Regulations on financial management and control and financial corrections respectively, currently under discussion in the Structural Funds committees, will further boost the effort made so far by setting out in more detail the precise obligations of the Member States and providing rules on the measures to be taken where shortcomings are found in the Member States' management and control systems.

Finally, many irregularities are detected and corrected prior to closure even though it remains difficult to exclude all remaining risk of errors, particularly for the closure of programmes to which the provisions of Regulation (EC) No 2064/97 are not applicable.

3.77. The Commission agrees with the Court's analysis and intends to continue making maximum use of the protocols signed with the Member States. Checks on the closure of programmes will be a priority.

3.78. The Commission agrees with the Court. It intends to intensify its examination of Member States' compliance with the control requirements contained in Regulation (EC) No 2064/97.

3.79. The Commission is using fully the possibilities contained in Article 53 of Council Regulation (EC) No 1260/1999, concerning the detailed rules of implementation.

Accordingly, on 12 July this year it adopted draft Commission Regulations on financial management and control and financial corrections.

3.80. The Commission has adopted detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the eligibility of expenditure of operations part-financed by the Structural Funds (Commission Regulation (EC) No 1685/2000 (OJ L 193, 29.7.2000)). The question of indirect costs is covered by point 1.7 of Rule No 1 laid down in the Annex to the Regulation which provides that overheads must be based on real costs which relate to the part-financed operation and must be allocated pro rata to the operation according to a duly justified fair and equitable method.

3.81. The Commission accepts the Court's comments and is currently examining the problem as part of the reorganisation of its financial departments.

FOLLOW-UP OF PREVIOUS OBSERVATIONS

Financial corrections (ERDF)

3.85 to 3.86. The Commission is endeavouring, subject to the resources available, to implement the appropriate corrective measures. However, these involve certain procedures, exhaustive checks, interdepartmental consultations, meetings and extended contact with the authorities and beneficiaries concerned in the Member States and then possibly the application of Article 24 of Regulation (EEC) No 4253/88.

The legal means and resources currently available do not permit the Commission to apply fully the measures the Court is calling for.

Within the legal framework laid down for the new period 2000 to 2006, the Commission is currently developing the legal mechanisms required to make financial corrections in the way the Court indicates.

However, within the limits of its resources, the Commission has always looked carefully at the Court's comments with a view to improving management of the ERDF.

The Commission accepts shortcomings in the follow-up of three cases, for which it will reopen the procedure with the Member States concerned. In the other eight cases, corrections have either already been made to expenditure or are in the process of being made.

3.87. It should be recalled that, when following up the Court's comments, the Commission must take account of all the information available to it in support of its decisions.

These two cases were discussed in the 1997 DAS. Following that exercise, the Commission examined the information supplied by the Court and the Member States concerned and came to the conclusion that there were insufficient grounds for acting on the Court's comments.

3.88. In the Commission's opinion, its follow-up was unsatisfactory in six cases (12 % of the 48 cases examined by the Court). As regards those cases, the Commission either has opened the Article 24 procedure in order to make the appropriate financial correction or is currently examining the evidence and, where appropriate, taking the necessary measures. The other six cases involve problems relating to the justification of declared expenditure, as referred to by the Court, concerning which the Commission has carried out examinations

and contacted the competent authorities in the Member States with a view, inter alia, to improving the management of the 1994 to 1999 programmes.

3.89 to 3.90. The Commission's decision-making process for all programmes part-financed by the ERDF includes inter-departmental consultations in order to ensure compliance with the conditions laid down in Article 7 of the Regulation, in particular the rules on public contracts and State aid.

3.91 to 3.92. For the nine cases in which the Commission accepts a total or partial lack of a follow-up, the total expenditure still to be corrected is estimated at EUR 13 million. The difference between this and the sum of EUR 57,6 million referred to by the Court is explained by:

- cases in which the Commission considers the corrections it has made to be adequate (EUR 21,2 million),
- one case in which the Commission disagrees with the Court's comments (see paragraph 3.87) (EUR 14,5 million), and
- one case that is the object of legal proceedings before the Court of Justice (EUR 8,9 million).

The amount to be repaid is estimated to be EUR 5 million.

ESF and EAGGF Guidance

Social dialogue

3.93. The following four paragraphs (3.92 to 3.95) concern measures that are not financed by the European Social Fund (Structural Funds) but from a budget heading managed directly by the Commission.

Since March 1999, the Commission has improved its selection procedure thanks to the creation of a selection committee, composed of three officials, that selects for Community support from all proposals only such projects that are in line with the remarks to budget heading B3-4 0 0 0. All proposals are examined thoroughly taking into consideration their general quality, their added value with regard to the objectives of the budget heading, their Community dimension, their visibility and their cost effectiveness.

During the second half of 2000, DG Employment will commission an expert to carry out an independent evaluation of the efficiency and targeting of projects carried out with finan-

cial support from budget heading B3-4 0 0 0 under call for proposals VP/1999/05.

3.94. All social partners' organisations listed in Annex I to Commission communication [COM (98) 322 final of 20 May 1998] were informed of the call for proposals and were invited to propose projects for Community funding. In accordance with the objectives of 1999 budget heading B3-4 0 0 0, EUR 6,6 million was committed for a total of 105 projects.

Neither employers' organisations nor other organisations that can apply for subsidies for the achievement of B3-4 0 0 0 objectives or under general budget regulations have been discriminated against. Most joint projects were carried out with a trade union as financial leader simply because trade unions often have better organised office structures at European level.

3.95. A recovery order was issued on the basis of calculations made by the managing department concerned and the Commission is currently examining the debtor's reply.

3.96. In the Commission's opinion, the Court's remark is excessive. Although it is true that only five Member States complied with the transposition deadline of 22 September 1996, four others transposed the Directive into national law by 15 November 1996 and three others before the end of April 1997. Only two Member States are significantly late (the Directive does not apply to the remaining Member State).

National co-financing

3.98. The Commission, inter alia, during its inspection visits, encourages the national authorities to adjust their national legislation to ensure that both national and Community funds reach the final beneficiaries at the same time. Italy is a good example of this. The national authorities have adopted the 'Delibere CIPE' for the provision of the national joint financing planned for ESF measures, including the additional resources for indexing.

3.99. Article 17 of the Structural Fund coordinating Regulation, Council Regulation (EEC) No 4253/88, as amended by Regulation (EC) No 2082/93, lays down that the financial contribution from the Funds is calculated in relation to either the total eligible cost or the total public or similar eligible expenditure (national, regional or local, and Community). In the latter case, the existence of national public fund

ing is an essential condition for the payment of the Community contribution. In the former case, on the other hand, the national contribution may be replaced by other public or private contributions, which has often led to complaints from the other partners in the programme. While the Commission gives its opinion in the Monitoring Committees and endeavours to find solutions, under the existing rules it has no power over the contributions from the various partners.

For the next programming period, Article 32 of Regulation (EC) No 1260/1999 lays down that Commission payments are to cover services actually provided on the ground and paid for. This means that the national appropriations must already have been mobilised and therefore limits the risk of inadequate national funding as referred to by the Court.

FINANCIAL MANAGEMENT OF STRUCTURAL MEASURES

Regulations and implementing procedures

3.102. The Commission lays down implementing arrangements that are obligatory in all Member States in all cases in which this is provided for by Council regulations. In other cases, the principles of subsidiarity and partnership apply and the Commission lays down guidelines, which are not compulsory. It is not the Commission's responsibility to interpret the existing rules.

The concepts and implementing rules for Structural Fund assistance have been set out in the spirit of the general Regulation in four vade-mecums sent to the Member States. The vade-mecums define and set out in a coherent order the different stages of the programming, implementation and evaluation procedure and lay down harmonised monitoring and evaluation indicators.

However, in accordance with the principle of subsidiarity, the Commission is currently drawing up Commission regulations laying down implementing rules for the general Structural Fund Regulation, in particular as regards eligibility criteria, management and control systems and financial corrections.

3.103. The Commission recognises that, since the introduction of the principle of additionality in 1989, some Member States have had difficulties in the transmission and evaluation of information as regards both methodology and frequency.

In order to resolve those problems, on a proposal from the Commission, the Council simplified the additionality procedure for the 2000 to 2006 programming period, both with regard to certain rules on the method to be followed and the timetable for monitoring additionality. During the prior verification of additionality for the 2000 to 2006 programming period, carried out in 2000, the Commission did not encounter any major difficulties with the Member States on methodology or interpretation of the Regulation, having provided them with a working paper setting out, where this was found to be necessary, the rules adopted by the Council.

3.104. The Cohesion Fund Regulation provides for the funding of projects, stages of projects and groups of projects. During the negotiations on Regulation (EC) No 1164/94, the Commission introduced the concept of a project stage and subsequently made it clear to the Member States that financially independent project stages are:

- stages which correspond to a functional entity (e.g. sewage treatment works) or which are defined in geographical terms (e.g. successive sections of a motorway or clearly delimited railway line), or
- stages corresponding to a given period of project implementation and to certain works which are physically identified by means of suitable, quantified indicators and which are carried out in the course of this period.

It should be pointed out that the Commission has repeatedly given clear explanations of this at meetings of the various monitoring committees.

The new Regulation stipulates that the project or project stage for which funding is granted must comprise a series of works that result in an operational project or independent stage.

The Commission stresses that expenditure should not be grouped together artificially in order to reach the EUR 10 million threshold. However, the Commission recognises the advantages of grouping certain projects whose geographical location or nature contribute to achieving a particular, quantifiable objective in a given geographical area — see the new provisions laid down in Regulation (EC) No 1265/1999 amending Annex II to Regulation (EC) No 1164/94 (Article A(4)).

Relationship between Community measures

3.105. The strategy for implementing measures in a given territory is negotiated between the Commission and the national and regional authorities and then laid down in the CSF (Community support framework) or SPD (single programming document).

Similarly, the implementation of measures is monitored by the monitoring committees for the CSFs, SPDs or multifund programmes, on which sit representatives of the various national authorities. Community initiative programmes are examined by the monitoring committees for the CSFs and SPDs.

That does not mean that the same Fund cannot finance similar measures in the same territory implemented by public authorities at different levels. However, such measures may not be mutually exclusive, for example, the construction of a road which is both national and local.

In addition, the negotiations on operational programmes and Community initiatives for the new programming period will take account of experience gained during implementation of measures during the previous programming period. In particular, the reduction of the number of Community initiatives from 14 to four will allow a significant reduction in the number of individual programmes and will permit the implementation of similar measures under different programmes.

3.106. The Commission is particularly mindful of the co-ordination of Community assistance in Northern Ireland and in the border counties of Ireland for this new round and it is emphasised in the new Structural Fund and IFI Regulations. As a first step, since 1 May 2000, the Commission's management of IFI and that of the Peace II programme have been transferred to the same unit in DG Regional Policy. On the ground, the Commission welcomes the proposal that the Special EU programmes body will be the managing authority for both Peace II and Interreg III. Finally, during discussions on the new programmes, the Commission will propose a number of measures to reinforce the co-ordination of forms of assistance, for example a 'one-stop shop' for the two OPs in Northern Ireland, a common database on applications for funding, computerised exchange of information on projects part-financed with IFI, the presence of a representative of IFI in the Peace II Monitoring Committee, co-ordination between locally based partnership structures, etc.

As regards publicity, the Commission will make full use of the recent implementing rules for information and publicity about assistance from the Structural Funds ⁽¹⁾. It has been agreed that the Northern Ireland CSF Monitoring Committee will adopt a communication strategy to be implemented, in the form of communications plans, under the two OPs. A similar approach will be promoted, in cooperation with the board of IFI, in order to publicise the Community's participation in the projects financed by IFI.

3.107. As regards the national action plans (NAPs), the Court's comment that they should be more concrete and rigorous is addressed mainly to the Member States who draw up their NAPs on the basis of the employment guidelines proposed by the Commission and adopted by the Council every year. Should the action undertaken not be concrete or rigorous, this is stated in the Joint Employment Report and can lead to the Commission proposing that the Council adopt a recommendation on the subject.

Several guidelines address the question of youth employment. One asks the Member States to ensure that by 2002 all unemployed young people be offered a new start before they have been unemployed for six months. Another one tackles the problem of people leaving school early and the problems faced by young people with learning difficulties. Yet another looks at how young people can be equipped with a greater ability to adapt to technological change and with skills relevant to the labour market.

For the new programming period, the ESF has been geared towards providing support to Member States for the implementation of their NAPs. Since the launch of the employment strategy, Member States have been asked to report on how ESF measures support their employment strategies (also financially) and hence employability measures targeted at young people. Since the link between the European employment strategy and the ESF has been created through the new ESF legislation, it is now up to Member States to gear ESF measures to employment strategy.

The financial effort made by the ESF and the EAGGF Guidance Section in the area indicated by the Court has two different aims (in the case of the EAGGF Guidance Section the adjustment of agricultural structures and in that of the ESF

⁽¹⁾ Commission Regulation (EC) No 1159/2000 of 30 May 2000 on information and publicity measures to be carried out by the Member States concerning assistance from the Structural Funds (OJ L 130, 31.5.2000, p. 30).

the promotion of youth employment), included under two different Objectives in the general Structural Fund Regulation and therefore under two different development strategies (Community support frameworks for regional development in one case and a Community initiative in the other). The Commission has ensured that there is no contradiction or incompatibility between the measures financed under the two instruments but it cannot set out an overall strategy for them beyond the planning provided for in the rules.

3.108. The Commission would like to point out that the basic Cohesion Fund Regulation does not provide for programming. For projects adopted in 1994 to 1999, the Commission endeavoured to ensure synergy and coherence between ERDF and Cohesion Fund measures. The Cohesion Fund Regulation, as amended by the Council, introduces improvements that should allow increased efficiency. The amendments introduced by Regulations (EC) No 1264/1999 and (EC) No 1265/1999 lay down that the Member States must provide the information necessary to permit assessment of the consistency of projects with a sectoral or territorial strategy.

For 2000 to 2006 the Commission asked Member States to draw up a reference framework for Cohesion Fund operations, which should permit them to strengthen synergies and ensure consistency. At the end of June 2000, a number of Member States drew up the reference frameworks for transport and the environment. Others included details in the 2000 to 2006 Community support framework.

3.109. ERDF assistance for the development of industrial sites is in the great majority of cases granted to public bodies (often local authorities). These use ERDF aid to develop such sites, which they then sell or rent out on market terms to private undertakings, usually small firms. Such measures therefore benefit undertakings only indirectly. They are implemented independently of other Community measures targeted directly at undertakings, either to facilitate productive investments (ERDF and/or EIB (European Investment Bank)) or to develop skills (ESF). Information on the various types of aid available to businesses is the responsibility of the authorities responsible for implementing the programme in question and may not be provided by the promoters of the industrial sites concerned. Monitoring committees, especially when representing a wide partnership, are excellent forums where synergies between the different parties involved can be developed. It is there that detailed information about the possibilities offered by the ESF or the EIB can be given by representatives of the Commission or the Bank.

The development of industrial sites is not an end in itself but rather an instrument for structural assistance and should

therefore be evaluated on the basis of its contribution to the overall objectives of that assistance independently of any direct or indirect links with other measures part-financed by Community funds.

Knowledge of the various sources of Community funding varies greatly from region to region and from sector to sector. The Commission takes the view that the Court's remark on lack of information does not apply to most of the beneficiaries of industrial-zone projects part-financed by the ERDF.

Evaluation of structural measures

Ex-ante evaluation and choice of projects in the Member States

3.111. The Commission agrees with the Court that the strategy must be based on a real analysis of requirements. As the Commission proposed, the rules on this point were strengthened (Article 41 of Regulation (EC) No 1260/1999). The background documents for 2000 to 2006 (*vade-mecum* on the content of the plan, guide to ex-ante evaluation, negotiating mandates) dealt specifically with this point, which was covered further by the ESF's own guidelines on matters relating to human resources.

The analysis of the plans for 2000 to 2006 carried out so far shows real progress.

Since the 1989 reform, the Commission has not been involved in selection and management at the level of projects part-financed by the Structural Funds. It is involved at the level of the multiannual programmes, but shares responsibilities with the Member States.

3.112. Like those for 1994 to 1996, the rules for 2000 to 2006 do not, except in the case of major projects, require the beneficiary to undertake an evaluation at the level of a project or a measure.

The solution to the question raised by the Court is to be found in the correct identification of the criteria for the selection and establishment of mechanisms to prevent unfair practices as regards competition and relocation.

3.113. The areas most in need were targeted through mainly two indices of deprivation applied respectively north and south of the border, the Rubson index in Northern Ireland and the Gamma index in the border counties of Ireland.

The implementation, monitoring and evaluation problems identified with regard to the Community's assistance under Peace in the border counties of Ireland are, in part, attributable to the circumstances at the time the programme was launched. There was, in 1995, a need to proceed with programme implementation in order to coincide with the wider peace process in Northern Ireland. Moreover, given the programme's strong social dimension and its innovative nature, targeting and monitoring were not always immediately appropriate or practicable. As noted, the programme is being continuously improved on the basis of monitoring and evaluation findings. In addition, the lessons of the first Peace programme have been taken into account during the development of the current Peace II initiative.

Under the separate 'Peace and reconciliation' priority, the CSF for Northern Ireland will set out guidelines for specific and additional eligibility criteria which will be applied to the Peace II programme. All Peace II funding bodies will therefore have a common set of criteria for the selection and appraisal of projects. This guarantees that the Peace II programme will differ from other EU assistance by promoting economic and social development which focuses on the social groups, areas, sectors and activities which have been most affected by the community divide and conflict in Northern Ireland.

3.114. The ex-post evaluation of the Cohesion Fund projects in progress demonstrates clear progress in the provision of information and the quality of the cost/benefit analyses. The Commission has also taken the following initiatives:

- the application form for 2000 to 2006 was altered to require more information,
- the guide to cost/benefit analyses is being updated,
- a technical assistance contract has been signed with the EIB to improve the targeting of project analysis,
- the Commission sends the ex-post evaluation of each project to the national authorities. A summary of the lessons to be drawn from the first phase is drawn up and sent to the Member States concerned so that the situation can be further improved.

Objectives and indicators

3.115. In the absence of more precise Community rules governing the 1994 to 1999 programming period, it was up

to the Member States to adopt binding legislative provisions. By definition, these reflect the different economic and social situations in the various countries although there may sometimes be differences within countries which are organised on a federal or regional basis.

In the case of the EAGGF Guidance Section, however, Regulation (EC) No 950/97 and its successor Regulation (EC) No 1257/1999 set 40 as the upper age limit to be regarded as a young farmer.

The Commission is aware of the weakness of objectives and indicators in the programmes for 1994 to 1999. Accordingly, the new Regulation governing the Structural Funds imposes an obligation to fix quantified objectives (where they lend themselves to quantification) for each item of assistance. The 2003 mid-term evaluation will provide a good opportunity for assessing the validity and relevance of the quantifications included in the programmes.

3.116. In line with the non-prescriptive and 'bottom-up' nature of this Community initiative, no quantified physical and impact targets were set in the initial Peace I programme document. However, in the course of implementation, a comprehensive set of monitoring indicators has been developed (Optimum monitoring questionnaire) and a strategic evaluation model has been drawn up by the programme's external evaluator to prepare the final ex-post evaluation.

Based on this experience, a set of output, result and impact indicators specific to the 'Peace and reconciliation' CSF priority has been developed for the new round of funding. These indicators will complement socioeconomic indicators and targets defined by other priorities. They will be integrated in a comprehensive financial and management reporting system.

3.117. The Commission agrees with the Court that any relocation which is unfair or undertaken only to seek aids under the guise of setting up in an industrial area is unacceptable. However, a judgment on the establishment of small firms on industrial areas must also take account of the beneficial effects on the environment and of the positive externalities which such firms enjoy as a result of their installation. The Commission regards the growth of employment as a useful indicator of the utility of investment in an industrial area but it agrees with the Court as regards its inadequacies as far as relocations are concerned.

3.118. The indicators used for Cohesion Fund purposes reflect the physical and financial progress of projects and are not indicators of the progress, results and impact of programmes like those used by the ERDF. Each project financed by the Cohesion Fund has its own monitoring indicators which

vary from one to another depending on the nature of the project. They should not therefore be confused with the indicators of an ERDF programme.

Macroeconomic assessments

3.119. The Commission stated its position on this point in response to the Court's two special reports: that on evaluation and that on the Cohesion Fund. The position of the Commission on the analysis of the macroeconomic impact and the initiatives it has taken may be summed up as follows:

- in the Member States which are major beneficiaries of structural assistance, and in particular the cohesion countries, the Commission has carried out for 2000 to 2006 an evaluation of the macroeconomic impact using the QUEST II and Hermin models so as to secure comparable results,
- in eastern Germany and southern Italy, considerable progress has been made in macroeconomic modernisation through the development of econometric models of the Hermin type, which incorporate measurement of the structural impact on the supply side,
- at regional level, the Commission is encouraging initiatives to draw up models to assess the macroeconomic impact. However, the Commission would stress that these initiatives must be justified on a cost-efficiency basis and the lack of adequate statistical series at regional level severely limits the quality and feasibility of these exercises.

At project level, the Commission has supported an approach to develop models to estimate macroeconomic impact, particularly for the Cohesion Fund. This exercise is producing interesting results, particularly concerning the relationship between public investment, private investment and employment and the 'spillover' effects generated by projects of a structural nature. However, the Commission considers that some distancing from the exercise is required to make the best possible analysis of the value they add in operational and decision-making terms as compared with more microeconomic techniques.

Consideration of assessments

3.120. In its reply to paragraphs 3.60 to 3.84 of the Court's 1998 Annual Report, the Commission acknowledged

that the mid-term evaluations had not always had the expected impact on programming but stressed that the exercise was innovative in nature, that there existed exemplary cases for certain programmes and that the rules would be improved for the 2000 to 2006 programming period thanks to the experience acquired. The same comments apply to the specific case of the evaluation of measures to assist the employment of young persons.

As for the effectiveness of evaluation procedures, it should be noted the 1994 to 1999 programming period saw the establishment and development of a culture of evaluation under the Structural Funds in the context of a close partnership between the Commission and the Member States. This encouraged the acceptance of evaluation as a management tool and encouraged the incorporation of its results into programme implementation. This partnership will be continued in the next programming period: Articles 40 to 43 of the new Regulation provide for cooperation on evaluation between the Member States and the Commission and clarify the responsibilities of each at various points in the cycle. The Commission has amplified these provisions through documents providing guidance on the indicators, monitoring and evaluation, as regards both the Structural Funds in general and the ESF. These have been made operational and amplified in the new programmes during negotiations going beyond the statutory requirements (establishment of steering committees, immediate appointment of assessors, etc.).

Management of measures

At the Commission

3.122. The process of constructing the transnational partnership is inevitably a long one. The second call for projects demonstrated that clear progress had been made, partly thanks to the construction of an instrument for the computerised management of transnationality.

The establishment of thematic groups comprising the national authorities of the ESF, the technical assistance bodies and Commission staff should mean that the results can be distributed at all levels.

Transnationality has been evaluated at programme level by the Member States (at mid-term) and by the Commission (at the end of the programming period). The results of this final evaluation at Community level have been available since June 2000 under the titles: 'Final EU-wide evaluation of the Community initiative Adapt' and 'Final EU-wide evaluation of the

Community initiative Employment'. Some 40 transnational partnerships have been selected at random for analysis of compliance with the four principles of the CIPs, including transnationality, an exercise which could not have been carried out for the thousands of projects part-financed.

3.123. The Commission accepts that in the past the various departments concerned with additionality have had some problems of coordination since they belong to different Directorates-General: Regional Policy, Employment, Economic and Financial Affairs and Agriculture, which received the same information or different bits of information.

To avoid these problems, responsibilities for this matter have been allocated as follows:

- DG Regional Policy is in charge of monitoring additionality as regards Objective 1; it receives technical assistance from DG Economic and Financial Affairs,
- DG Employment is responsible for verifying additionality as regards Objectives 2 and 3; in 2000 to 2006 this will be done together and at the same time using the same data (expenditure on active labour market measures) for both Objectives.

All decisions will be discussed jointly by the relevant departments of each Directorate-General and the information will be sent to all the officials concerned.

3.124. It is planned that Commission staff will conduct on-the-spot audits of IFI (International Fund for Ireland) projects by the end of 2000. In accordance with the Council Regulation on the Community financial contribution to the IFI (International Fund for Ireland) ⁽²⁾, the Commission will submit, not later than 1 April 2001, a report to the budgetary authority which will include the results of the verifications and controls carried out on the ground by its staff.

In the Member States

3.125. The Commission agrees with the Court that more checks in the Member States are needed.

⁽²⁾ Council Regulation (EC) No 214/2000 of 24 January 2000 on Community financial contributions to the International Fund for Ireland, (OJ L 24, 29.1.2000, p. 7).

The rules currently in force, mainly Regulation (EC) No 2064/97 for 1994 to 1999, require the Member States to have checks carried out by independent bodies on at least 5 % of the total eligible expenditure of each programme before it is closed (from 2001 on).

For the new period 2000 to 2006, the Regulation governing the funds and the implementing rules (now under discussion) also increase the checks on project managers and final beneficiaries.

3.126. Since the end of 1997, the central databases required by the Peace I programme document have been created. They contain data on project applications and approvals as well as the information provided by project promoters in accordance with the optimum monitoring questionnaire (OMQ). These data, together with regular interviews of sub-programme leaders, have been used in the preparation of progress reports for the monitoring committee and in analyses made by the outside assessor.

As regards additionality, see 3.103.

GENERAL CONCLUSIONS

3.128. The annual amounts of appropriations for commitments in the financial perspective have been correctly entered in the budget. It is only in terms of implementation that actual expenditure has been lower than the total funding planned for the period.

Reprogramming work did not permit the adoption of definitive decisions, which would allow the budgetary implementation of the appropriations available, until very late in the year, so that most of the appropriations which had not been implemented at the end of the year had to be carried over.

Annual instalments form part of the system introduced by the general Regulation on the Structural Funds, the financial perspective, the Interinstitutional Agreement and the Decision on own resources, which includes an annual ceiling on commitment appropriations (1,335 % of GDP). This prevents such programmes being committed in their entirety when they are adopted, because this would be refused by the budgetary authority.

Since entering only the annual instalments in the accounts does not reflect all the legal liabilities contracted by the Community, the Commission enters these commitments among the balance-sheet transactions shown in the revenue and expenditure account.

3.129. For the new programming period 2000 to 2006, the Commission is introducing a joint information system which will record all the data available on the programming and financing of assistance for all the Structural Funds. As regards the physical progress of items of assistance, the Member States will provide the Commission only with aggregate indicators in the context of the annual report.

3.130. As far as it is able, the Commission is taking steps to improve on-the-spot inspections of assistance, particularly when earlier programmes are closed.

The current provisions on inspection and monitoring (mainly Regulation (EC) No 2064/97 for 1994 to 1999) require the Member States to inspect at least 5 % of total eligible expenditure when each item of assistance is completed.

Article 8 of that Regulation requires the national authorities to send the Commission a statement summarising 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.

3.131. The Commission agrees that the follow-up of observations should be systematic; that is why it has presented an action plan laying down verifiable goals which will be constantly monitored.

3.132. The shortcomings regarding security detected by the Court in a part of the ESF's local management system have been corrected as stated at paragraph 3.56. With regard to the link between DG Employment's local system (SEA) and Sincom 2, there is already a system for the daily reconciliation of data on the operations closed. However, DG Employment is introducing a mechanism to hold over cases where an amendment is made in SI2 after it has been transferred to SEA.

3.133. The concepts and rules for implementing assistance from the Structural Funds in accordance with the spirit of the general Regulation are contained in the four guides common to all the Structural Funds, which set out and list in logical fashion the various stages of the process of programming, implementation and evaluation, and the uniform indicators for monitoring and evaluation. Relations between measures within the funds and between the funds are dealt with when the CSFs or SPDs are drawn up and in the multifund programmes.

As regards coordination with the EIB, the Commission, with the support of the Bank, has taken the initiative of holding regular exchanges of views on each country to look together at areas of assistance and possible synergies between finance from the two institutions. Furthermore, EIB staff take part in negotiating the CSFs, SPDs and OPs with the Member States and will attend meetings of the monitoring committees whenever this is desirable.

The implementation of evaluations has been improved thanks to the new rules which make the SWOT method the normal way of defining needs, quantifying goals for monitoring and the ex-post evaluation of results; this new procedure will enable lessons to be drawn for the future.

3.134. For the new programming period, the ESF has been geared towards supporting Member States when implementing their NAPs. Since the launch of the employment strategy, Member States have been asked to report on how ESF measures support their strategy, as well as on financial matters.

Indicators and targets are fundamental to the management by objectives developed under the European employment strategy. While performance indicators on the labour market situation and on the first three guidelines are in place and have been used since the launch of the strategy, a series of structural indicators for the remaining employment guidelines are being developed jointly by the Commission and the Member States under the aegis of the Employment Committee. The Commission and the European Parliament were in favour of additional targets last year but this was not accepted by the Council. The Lisbon European Council proposed additional targets in a number of areas. They will be taken into account in the further development of the guidelines.

CHAPTER 4 (*)

Internal policies

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(*) The Commission's replies are on page 127.

INTRODUCTION

4.1. The European Union's internal policies focus in particular on the implementation and development of the single market. They cover four complete subsections of the budget and several headings in another subsection. After the Commission's reorganisation in 1999, the responsibility for implementing the internal policies and managing the corresponding budgets now lies mainly with 12 Directorates-General and the Secretariat-General; the latter's internal policies budget headings, however, will, in future, be managed by the Justice and Home Affairs Directorate-General.

4.2. The internal policies measures concern:

- (a) training, youth, culture, audiovisual media, information and other social operations (subsection B3);
- (b) energy, Euratom nuclear safeguards and environment (subsection B4);
- (c) consumer protection, internal market, industry and trans-European networks (subsection B5);

- (d) research and technological development (subsection B6);
- (e) other agricultural operations, other regional operations, transport as well as other measures concerning fisheries and the sea (Titles B2-5 to B2-9 of subsection B2).

4.6. Similarly, the comments concerning the JRC are restricted to appraisals of the various activities carried on by the JRC, and do not constitute a breakdown of the budgetary implementation of the headings managed by the Centre.

4.7. Besides the fact that the comments are incomplete and fail to cover all the budget headings concerned, they also lack consistency. Indeed, although certain comments do address budgetary implementation, others go no further than making general observations on the programmes concerned.

IMPLEMENTATION OF THE BUDGET

4.3. Internal policies account for a global budgetary amount of 5 243 million euro in final payment appropriations, of which 3 120 million euro is for research and technological development. This sum is spread over some 200 budget headings and articles, the amounts for which range from several thousand euro — 68 000 euro for the heading B5-4 2 1 'Completion of measures for the improvement of agricultural structures in Portugal and for financial cooperation in Greece' — to 1 753 million euro for the heading B6-5 4 1 1 'Completion of the 4th framework programme'.

4.4. An analysis of the *revenue and expenditure accounts* ⁽¹⁾ showed that the Commission has only formulated comments on 48 headings totalling 1 226 million euro, or barely 25 % of the appropriations entered in the budget. The Commission has provided no breakdown of the budgetary implementation for the other headings, 62 of which accounted for appropriations in excess of 3 million euro. For example, there is no breakdown by the Commission of the implementation of heading B3-1 0 0 1 for the financing of the Socrates programme, even though this heading received 182 million euro in payment appropriations.

4.5. As regards the funding of research policy, the Commission makes general observations and describes the measures taken to implement the 5th framework programme. Comments are also included for the 10 budget headings of this programme. For the other headings and most notably B6-5 4 1 1 'Completion of the 4th framework programme' which received 1 753 million euro in payment appropriations there is no specific breakdown. It should be noted that this figure alone is higher than the cumulative total for the headings on which specific comments were made in respect of internal policies.

4.8. **Tables 4.1a** and **4.1b** below show the use of the available appropriations for internal policies in 1999. **Table 4.1c** below shows the most significant changes in the budget implementation between 1998 and 1999.

4.9. **Tables 4.2** and **4.3** and **Graphs 4.1** and **4.2** show the use of both commitment and payment appropriations in 1999 by quarter:

- (a) overall the quarterly breakdown of commitments shows a concentration at the end of the budget year. The distribution of payment appropriations was carried out in a relatively even manner, from the second quarter onwards;
- (b) most notably, because of the delay in the legislative decision ⁽²⁾ and the time necessary to initiate implementation, 90 % of the total commitments for budget line B6-6 (Fifth Framework Programme) were made in the last quarter of 1999. These commitments, which amounted to 47 % of the total commitments in 1999 for all research budget headings, meant that the Commission followed with the provisions of art. 2, paragraph (1)(a) of Decision No 182/1999/EC concerning the Fifth Framework Programme, which fixed the Community's participation for the period 1998-1999 at a maximum of 3 140 million euro. Payments were made against 10 % of these commitments in this quarter;

⁽²⁾ Decision No 182/1999/EC of the European Parliament and of the Council of 22 December 1998 concerning the fifth framework programme of the European Community for research, technological development and demonstration activities (1998 to 2002) (OJ L 26, 1.2.1999). It was noted that, in its budget, the Commission considers the start of the programme as being 1999 and not 1998.

⁽¹⁾ Sec (2000) 537-EN — Budg/C/2.

Table 4.1a — Evolution and implementation of the 1999 budget

(Mio EUR)

	Total internal policies and research		Research and technological development (B6)		Consumers, internal market, labour market, TEN (B5)		Education, youth, culture, information and social operations (B3)		Others = Energy, environment and agricultural operations (B4 and parts of B2)	
	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations
Financial perspective ceiling ⁽¹⁾	6 386,0									
Evolution of the budget										
Initial appropriations	5 806,7	5 069,6	3 450,0	3 038,4	1 097,6	878,2	790,7	745,1	468,4	407,9
Final appropriations available	6 144,5 ⁽²⁾	5 242,7 ⁽²⁾	3 632,9	3 119,7	1 136,2	915,0	884,4	802,0	484,1	404,5
Difference between final and initial appropriations	337,8	173,1	182,9	81,3	38,6	36,8	93,7	56,9	15,7	-1,9
% difference (final-initial/initial)	6	3	5	3	4	4	12	8	3	0
Implementation of the budget										
Appropriations used	5 891,0	4 473,1	3 465,9	2 574,9	1 104,1	848,0	849,3	687,4	471,7	362,8
% of final appropriations available	96	85	95	83	97	93	96	86	97	89
Appropriations carried over to 2000	182,7	413,8	154,3	345,2	7,9	22,2	20,1	35,9	0,5	10,5
% of final appropriations available	3	8	4	11	1	2	2	4	0	3
Appropriations cancelled	70,8	355,8	12,7	199,6	24,2	44,8	15,0	78,7	11,9	32,7
% of final appropriations available	1	7	0	6	2	5	2	10	2	8

⁽¹⁾ The Community Budget: The facts in figures, Table 16 - (SEC (99) 1100-EN).

⁽²⁾ Including EFTA - Contributions as per tables 5 and 6 of volume IV of the revenue and expenditure accounts and balance sheets (SEC(2000) 1624-FR).

Source: Revenue and expenditure accounts and balance sheets (SEC (2000) 538-FR).

Table 4.1b — Implementation of the 1999 budget by title/subsection

(Mio EUR)

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 (%)
B2-5	Other agricultural operations	145,800	148,243	139,854	95,9	94,3	131,700	140,900	130,938	99,4	92,9
B2-6	Other regional operations	17,000	17,000	17,000	100,0	100,0	22,000	19,500	18,019	81,9	92,4
B2-7	Transport	21,200	21,200	21,136	99,7	99,7	19,200	19,200	15,787	82,2	82,2
B2-9	Other measures concerning fisheries and the sea	48,950	55,150	54,810	112,0	99,4	35,550	35,750	35,411	99,6	99,1
	Total in B2	232,950	241,593	232,800	99,9	96,4	208,450	215,350	200,155	96,0	92,9
B3-1	Education, vocational training and youth	441,700	486,733	477,853	108,2	98,2	397,818	432,037	377,629	94,9	87,4
B3-2	Culture and audiovisual media	92,110	131,158	122,994	133,5	93,8	97,347	121,424	99,072	101,8	81,6
B3-3	Information and communication	106,240	106,910	97,097	91,4	90,8	113,590	113,010	90,177	79,4	79,8
B3-4	Social dimension and employment	150,640	159,638	151,377	100,5	94,8	136,210	135,492	120,571	88,5	89,0
	Total B3	790,690	884,439	849,321	107,4	96,0	744,965	801,963	687,449	92,3	85,7
B4-1	Energy	40,580	42,031	40,583	100,0	96,6	36,326	34,946	27,762	76,4	79,4
B4-2	Euratom nuclear safeguards	16,400	16,400	15,335	93,5	93,5	15,700	13,900	13,717	87,4	98,7
B4-3	Environment	178,450	184,098	182,907	102,5	99,4	147,212	140,264	121,047	82,2	86,3
	Total B4	235,430	242,529	238,825	101,4	98,5	199,238	189,110	162,526	81,6	85,9
B5-1	Consumer policy and consumer health protection	23,850	23,850	22,349	93,7	93,7	19,450	19,450	19,013	97,8	97,8
B5-2	Aid for reconstruction	2,234	2,234	2,208	98,8	98,8	2,234	2,234	2,208	98,8	98,8
B5-3	Internal market	134,645	138,975	131,314	97,5	94,5	128,195	136,320	119,810	93,5	87,9
B5-4	Industry	92,017	92,017	92,009	100,0	100,0	93,950	93,950	83,821	89,2	89,2
B5-5	Labour market and technological innovation	208,980	214,138	197,294	94,4	92,1	135,272	135,286	116,444	86,1	86,1
B5-6	Statistical information	22,725	33,003	32,788	144,3	99,3	24,779	30,957	27,155	109,6	87,7
B5-7	Trans-European networks	584,690	585,302	580,788	99,3	99,2	451,990	456,990	445,660	98,6	97,5
B5-8	Cooperation in the fields of justice and home affairs	21,900	42,000	41,316	188,7	98,4	15,900	35,500	30,825	193,9	86,8
B5-9	Measures to combat fraud and support expenditure for internal policies	6,600	4,700	4,078	61,8	86,8	6,400	4,290	3,155	49,3	73,5
	Total B5	1 097,641	1 136,219	1 104,144	100,6	97,2	878,170	914,977	848,091	96,6	92,7
B6-1	Joint Research Centre — staff and resources	210,738	251,314	250,748	119,0	99,8	216,797	244,126	232,708	107,3	95,3
B6-2	Joint Research Centre — direct operating appropriations EC framework programme (1998 to 2002)	38,800	39,243	34,942	90,1	89,0	14,863	17,072	11,791	79,3	69,1
B6-3	Joint Research Centre — direct operating appropriations EAEC framework programme (1998 to 2002)	11,262	11,190	10,745	95,4	96,0	4,978	4,978	4,143	83,2	83,2
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes	p.m.	107,419	17,212	n.a.	n.a.	29,296	106,289	43,976	150,1	41,4
B6-5	Indirect action (shared-cost projects) — completion of earlier projects	p.m.	93,954	47,466	n.a.	n.a.	2 034,444	2 059,558	1 850,440	91,0	89,8
B 6-6	Indirect action (shared-cost projects) — fifth framework programme (1999 to 2002)	3 189,200	3 129,786	3 104,826	97,4	99,2	738,057	687,697	431,806	58,5	62,8
	Total B6	3 450,000	3 632,906	3 465,939	100,5	95,4	3 038,435	3 119,720	2 574,864	84,7	82,5
EFTA contributions ⁽³⁾	Provisional appropriations (Chapter B0-40) in B2, B3 + B5		6,807					1,590			
	Total	5 806,711	6 144,493	5 891,029	101,5	95,9	5 069,258	5 242,710	4 473,085	88,2	85,3

⁽¹⁾ Initial 1999 budget plus appropriations carried over.

⁽²⁾ Supplementary and amending.

⁽³⁾ As per tables 5 and 6 of volume IV of the revenue and expenditure accounts and balance sheets (SEC(2000) 1624-FR).

NB: p.m. = token entry; n.a. = not available.

Source: Revenue and expenditure accounts and balance sheets (SEC(2000) 538-FR).

Table 4.1c — Comparison of the most significant changes in the budget implementation 1998 with 1999*(Mio EUR)*

Title/Subsection of the budget	Heading	Appropriations utilised in 1998 ⁽¹⁾		Appropriations utilised in 1999		Percentage rate 1998/1999 (%)	
		Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations
B3-1	Education, vocational training and youth	438,211	301,734	477,853	377,629	9,0	25,2
B3-3	Information and communication	110,831	101,055	97,097	90,177	- 12,4	- 10,8
B4-3	Environment	140,384	121,487	182,907	121,047	30,3	- 0,4
B5-5	Labour market and technological innovation	181,861	89,781	197,294	116,444	8,5	29,7
B5-7	Trans-European networks	545,608	410,628	580,788	445,660	6,4	8,5
B5-8	Cooperation in the fields of justice and home affairs	15,290	8,339	41,316	30,825	170,2	269,6

⁽¹⁾ Figures see Annual Report for the financial year 1998.

Table 4.2 — Utilisation of commitment appropriations in 1999 by quarter

(Mio EUR)

Title	1st quarter	2nd quarter	3rd quarter	4th quarter	Total	
B2-5	Other agricultural operations	2,945	33,156	25,592	78,161	139,854
B2-6	Other regional operations	0,000	0,000	17,000	0,000	17,000
B2-7	Transport	2,939	2,161	3,019	13,017	21,136
B2-9	Other measures concerning fisheries and the sea	2,090	40,821	0,124	11,775	54,810
	Total in B2	7,974	76,138	45,735	102,953	232,800
B3-1	Education, vocational training and youth	47,391	211,786	59,962	158,714	477,853
B3-2	Culture and audiovisual media	52,974	5,258	10,770	53,992	122,994
B3-3	Information and communication	13,883	25,287	20,134	37,793	97,097
B3-4	Social dimension and employment	34,095	17,087	24,843	75,352	151,377
	Total B3	148,343	259,418	115,709	325,851	849,321
B4-1	Energy	3,049	8,331	6,040	23,163	40,583
B4-2	Euratom nuclear safeguards	6,179	1,603	3,424	4,129	15,335
B4-3	Environment	6,238	21,624	79,040	76,005	182,907
	Total B4	15,466	31,558	88,504	103,297	238,825
B5-1	Consumer policy and consumer health protection	2,416	8,651	4,632	6,650	22,349
B5-2	Aid for reconstruction	2,208	0,000	0,000	0,000	2,208
B5-3	Internal market	40,892	19,838	29,599	40,985	131,314
B5-4	Industry	0,000	88,862	1,055	2,092	92,009
B5-5	Labour market and technological innovation	8,817	8,704	121,696	58,077	197,294
B5-6	Statistical information	3,106	6,705	4,826	18,151	32,788
B5-7	Trans-European networks	0,382	8,933	529,438	42,035	580,788
B5-8	Cooperation in the fields of justice and home affairs	0,063	6,828	17,227	17,198	41,316
B5-9	Measures to combat fraud and support expenditure for internal policies	1,053	0,306	0,540	2,179	4,078
	Total B5	58,937	148,827	709,013	187,367	1 104,144
B6-1	Joint Research Centre — staff and resources	115,777	53,000	19,624	62,347	250,748
B6-2	Joint Research Centre — direct operating appropriations EC framework programme (1998 to 2002)	3,260	5,097	9,568	17,017	34,942
B6-3	Joint Research Centre — direct operating appropriations EAEC framework programme (1998 to 2002)	1,323	1,931	1,777	5,714	10,745
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes ...	24,508	5,853	- 17,407	4,258	17,212
B6-5	Indirect action (shared-cost projects) ... completion of earlier projects	109,170	- 0,435	- 78,209	16,940	47,466
B6-6	Indirect action (shared-cost projects) ... fifth framework programme (1999 to 2002)	85,062	81,969	141,701	2 796,094	3 104,826
	Total B6	339,100	147,415	77,054	2 902,370	3 465,939
	Total	569,820	663,356	1 036,015	3 621,838	5 891,029

Source: Quarterly reports on the implementation of the budget as well as revenue and expenditure accounts and balance sheets.

Table 4.3 — Utilisation of payment appropriations in 1999 by quarter

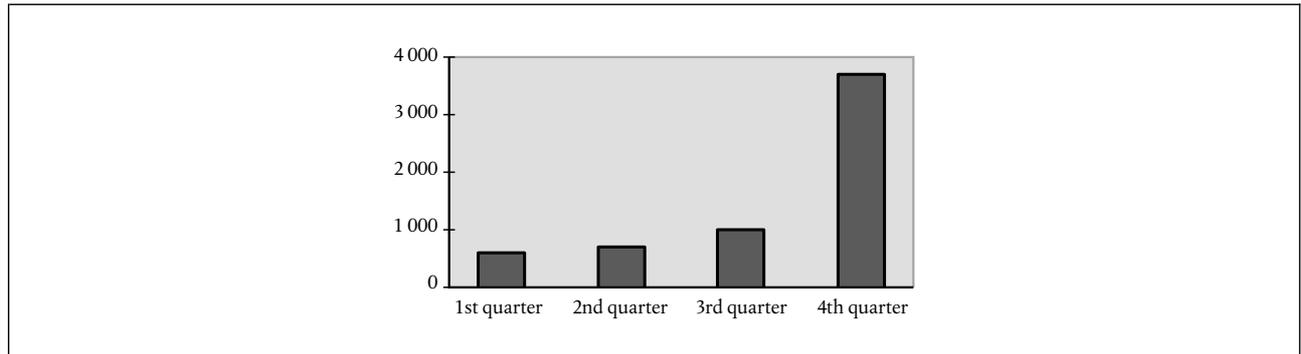
(Mio EUR)

Title	1st quarter	2nd quarter	3rd quarter	4th quarter	Total	
B2-5	Other agricultural operations	10,048	37,350	17,794	65,746	130,938
B2-6	Other regional operations	0,002	0,654	4,108	13,255	18,019
B2-7	Transport	1,892	3,324	2,143	8,428	15,787
B2-9	Other measures concerning fisheries and the sea	2,684	3,316	16,104	13,307	35,411
	Total in B2	14,626	44,644	40,149	100,736	200,155
B3-1	Education, vocational training and youth	19,873	105,374	154,238	98,144	377,629
B3-2	Culture and audiovisual media	14,689	19,986	28,914	35,483	99,072
B3-3	Information and communication	6,378	19,141	28,190	36,468	90,177
B3-4	Social dimension and employment	31,831	24,290	33,860	30,590	120,571
	Total B3	72,771	168,791	245,202	200,685	687,449
B4-1	Energy	0,000	8,840	8,445	10,477	27,762
B4-2	Euratom nuclear safeguards	2,404	2,651	5,099	3,563	13,717
B4-3	Environment	13,308	16,465	36,450	54,824	121,047
	Total B4	15,712	27,956	49,994	68,864	162,526
B5-1	Consumer policy and consumer health protection	2,384	5,244	7,992	3,393	19,013
B5-2	Aid for reconstruction	0,674	0,383	0,736	0,415	2,208
B5-3	Internal market	19,553	47,503	26,866	25,888	119,810
B5-4	Industry	0,086	0,644	82,665	0,426	83,821
B5-5	Labour market and technological innovation	9,467	13,881	80,620	12,476	116,444
B5-6	Statistical information	5,384	7,248	6,927	7,596	27,155
B5-7	Trans-European networks	33,178	72,046	202,254	138,182	445,660
B5-8	Cooperation in the fields of justice and home affairs	9,322	2,680	9,762	9,061	30,825
B5-9	Measures to combat fraud and support expenditure for internal policies	0,385	0,518	0,469	1,783	3,155
	Total B5	80,433	150,147	418,291	199,220	848,091
B6-1	Joint Research Centre — staff and resources	40,917	69,639	60,336	61,816	232,708
B6-2	Joint Research Centre — direct operating appropriations EC framework programme (1998 to 2002)	0,101	1,380	4,034	6,276	11,791
B6-3	Joint Research Centre — direct operating appropriations EAEC framework programme (1998 to 2002)	0,116	0,681	1,155	2,191	4,143
B6-4	Joint Research Centre — direct action — completion of previous joint and supplementary programmes ...	12,535	13,710	8,815	8,916	43,976
B6-5	Indirect action (shared-cost projects) ... completion of earlier projects	157,213	851,880	370,674	470,673	1 850,440
B6-6	Indirect action (shared-cost projects) ... fifth framework programme (1999 to 2002)	11,028	30,398	108,870	281,510	431,806
	Total B6	221,910	967,688	553,884	831,382	2 574,864
	Total	405,452	1 359,226	1 307,520	1 400,887	4 473,085

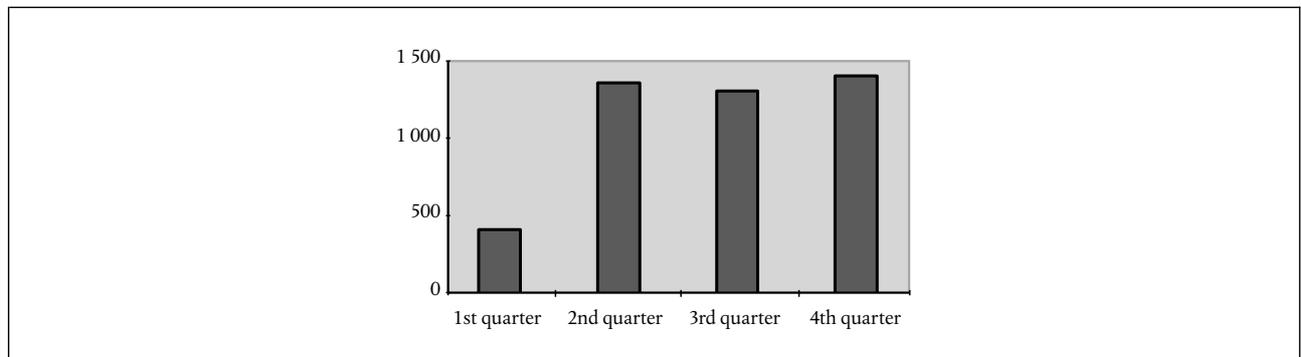
Source: Quarterly reports on the implementation of the budget as well as revenue and expenditure accounts and balance sheets.

Graph 4.1 — Utilisation of commitment appropriations in 1999 by quarter

(Mio EUR)

**Graph 4.2 — Utilisation of payment appropriations in 1999 by quarter**

(Mio EUR)



- (c) contrary to the overall quarterly utilisation, the payments for social dimensions (title B3-4) were spread relatively evenly throughout the year and those for industry (title B5-4) occurred almost entirely (99 %) in the third quarter.

4.11. 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 claims. The final payment is made after submission and approval of the final deliverables and the financial report.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Nature of the expenditure

4.10. 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.

4.12. Certain other parts of the expenditure in the area 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

4.13. The objective of the audit of the Internal Policies area was to obtain sufficient and appropriate audit evidence to contribute to the Statement of Assurance on

the general budget for 1999, as well as through additional work on the legality and regularity of the underlying transactions, to formulate a specific appraisal for the area.

4.14. 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 were audited on the spot at the final beneficiary. Advances on contracts and payments based on invoices for fixed price contracts were audited at the Commission.

Main audit findings

Commitments

4.15. The audit of commitments revealed some cases of mainly formal errors. The majority of these errors referred to incorrect due dates.

Payments

4.16. In the payments audited a significant number of errors, both substantive and formal, were detected. The substantive errors were mainly related to final beneficiaries having overstated the actual costs, mostly by including ineligible expenditure. The majority of the formal errors related to non-compliance with the contract by the final beneficiaries and a smaller number related to the procedures of the Commission.

4.17. No errors were detected in the advance payments and contractually fixed payments. Where payments are based upon cost claims made by final beneficiaries however, which is particularly important in the research area, a significant number of errors were found mainly due to the over-declaration of overhead costs and the lack of supporting documentation.

4.18. The cost claim based errors, especially in the research area, derive from the system in place. The payments are based on the declarations provided by the final beneficiaries, showing actual expenditure incurred. Little or no verification of the costs declared is done,

other than for formal consistency and general plausibility, by the Commission. Furthermore, hardly any incentive exists for the final beneficiaries to avoid over-declarations since there are no contractual penalties and no risks other than having to repay the amounts found to be overpaid.

Conclusions and Recommendations

4.19. 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.

4.20. In order to reduce the risk of non-eligible expenditure being declared by final beneficiaries, more effort should be made by the Commission to better define in the contracts, and to explain to the beneficiaries, the definitions of eligible expenditure. Furthermore, the Commission should consider introducing contractual penalties for overcharging in order to make sure that the beneficiaries correctly apply the rules set out in the contract.

4.21. In the Fifth Framework Programme the system of reimbursement of cost claims on the basis of declarations provided by final beneficiaries continues. The Commission has, however, introduced an option for a fixed overhead rate. The Commission should keep this under review to ensure that it does not on average permit excess recovery of overhead costs incurred.

4.22. More effort should be made during the selection of projects to verify the proposed costs and during the monitoring of the projects to verify the costs claimed. This could be done for example by a request to the contractor for supporting documentation, for calculations made, for example for overheads, for time charged for personnel or for contracts signed and invoices paid.

4.23. The Commission's control on cost claims submitted by beneficiaries must be intensified and improved. The Court is pleased to note that the Commission, in accordance with the previous recommendations of the Court, has increased the number of on-the-spot audits. However, the number of audits performed is still relatively small compared to the number of beneficiaries. The Court would therefore ask the Commission to also consider introducing a policy whereby beneficiaries with

cost claims exceeding a certain amount, have to provide a certificate from an external auditor confirming the accuracy of the costs claimed and the eligibility of the expenditure under the terms of the contract.

FOLLOW-UP OF PREVIOUS OBSERVATIONS

4.24. Previous observations have been followed up in two areas: first, whether the Commission has taken action on observations of the Court which had financial consequences, and second, development in the allocation of staff following the criticism in the Court's special report on the JOULE-Thermie programme ⁽³⁾.

4.25. Nine contracts at the Transport and Energy DG (formerly DG XVII) and eight contracts at the Research DG (formerly DG XII) were re-audited to verify whether the Commission had carried out the actions it had agreed in the light of the Court's observations:

- (a) at the Transport and Energy DG the action agreed had been taken in the case of three contracts. The Commission was still acting on four others, and in the other two instances the Commission's follow-up was insufficient or late;
- (b) at the Research DG, the Commission had taken the agreed action in the case of three contracts and was still acting on two others. In the other three cases it had either not followed up the Court's findings or the follow-up was insufficient or late.

4.26. Thus, the Commission had taken the action agreed for six of the seventeen contracts, with actions continuing on six others. The Commission should make a greater effort to carry out action agreed in the light of audit findings.

4.27. As early as 1994, the Court reported on the problems of appointing scientific personnel to perma-

⁽³⁾ Special Report No 17/98 on support for renewable energy sources in the shared-cost actions of the JOULE-Thermie programme and the pilot actions of the Altener programme, together with the Commission's replies (OJ C 356, 20.11.1998).

nent posts involving administrative tasks ⁽⁴⁾. In 1998 the Court also established, in the course of the examination of the JOULE-Thermie programme for renewable energy sources, that '26 of 48 posts financed through the budget appropriations for JOULE-Thermie were occupied by staff working on tasks outside the JOULE-Thermie programme'.

4.28. As the JOULE-Thermie programme was terminated at the end of the Fourth Framework Programme, a follow-up review with regard to its staff (all grades) was carried out on the programme which can be considered the successor of JOULE-Thermie, i.e., the programme 'Preserving the ecosystem-Energy' (budget line B6-6 1 4 2).

4.29. This review showed that, in early 2000, 73 (87 %) of the 84 posts available for this programme for 1999 were occupied, 55 of which were in the DG for Research (29A, 13B and 13C) and the remaining 18 were in the DG for Energy and Transport. With regard to the Research DG, 42 staff (76 %) were directly involved in the programme or the coordination of the programme, while the remaining 24 % (13 staff, only B and C grades) were working in horizontal services such as informatics, personnel, audit, communication and finance. Although this percentage is still high, it has considerably decreased as compared to the situation referred to in paragraph 4.27. It was also noted that no staff funded by budget line B6-6 1 4 2 worked in another scientific area or in the field of nuclear energy. This is a major improvement.

4.30. The Court recommends that the Commission should continue its efforts to ensure that posts specifically awarded by the budgetary authorities to individual programmes are assigned directly to those programmes. Any attribution to horizontal tasks necessary for these programmes should be transparent.

AUDITS CARRIED OUT BY THE COMMISSION

Global overview

4.31. **Table 4.4** summarises the information received from various Directorates-General as well as the Secretariat-General of the Commission on the number

⁽⁴⁾ Special Report No 6/93 concerning the European research and development programmes in the field of information technology (the Esprit programmes) (OJ C 45, 14.2.1994).

Table 4.4 — Internal audits completed in 1999 ⁽¹⁾

Directorate-General	Number of audits completed		Number of contracts audited		Number of open contracts		Value of audited contracts (Mio EUR)		Value of open contracts (Mio EUR)		Amounts recoverable or reduced payments as a result of the internal audits (Mio EUR)	
	1998 ⁽²⁾	1999	1998 ⁽²⁾	1999	1998 ⁽²⁾	1999	1998 ⁽²⁾	1999	1998 ⁽²⁾	1999	1998 ⁽²⁾	1999
AGRI—Agriculture (ex DG VI) ⁽⁴⁾	n.a.	3	n.a.	19	n.a.	504	n.a.	2,00	n.a.	78,93	n.a.	0,11
EAC — Education and Culture (ex DG XXII — Education, etc.)	28	77	97	134	4 970	3 963	120,92	105,98	296,68	345,40	0,34	3,25
(ex DG X — Information, Culture etc.)	23	42	95	77	6 011	1 461	9,76	8,37	157,98	124,30	1,55	0,03
EMPL — Employment and Social Affairs (ex DG V) (new DG EMPL) (new DG SANCO)	11	9 (5) (4)	41	30 (18) (12)	4 704	3 016 (2 210) (806)	7,13 ⁽³⁾	6,11 ⁽³⁾ (4,91) (1,20)	13,99 ⁽³⁾	193,97 ⁽³⁾ (124,90) (69,07)	0,43	0,18 (0,14) (0,04)
TREN — Energy and Transport (ex DG XVII — Energy)	37	25	58	86	3 322	2 317	74,37 ⁽³⁾	67,59	516,46	785,27	(⁷)	0,82
(ex DG VII — Transport)	46	24	78	108	922	906	142,50	201,65	1 625,35	2 106,80	0,25	0,31
ENTR — Enterprise (ex DG III — Industry)	5	1	24	4	1 002	(⁷)	5,72	4,57	2 057,48	(⁷)	1,14	0,15
(ex DG XXIII — Enterprise, Policy, Distributive, Trade, etc.)	3	5	3	5	390	(⁷)	0,64	1,25	36,00 ⁽³⁾	(⁷)	0,02	0,02
ENV — Environment (ex DG XI)	65	16	65	30	2 540	2 848	28,39	5,11	296,18	360,98	0,40	0,08
FISH — Fisheries (ex DG XIV)	n.a.	3	n.a.	12	n.a.	171	n.a.	2,54	n.a.	181,46	n.a.	0,03
SANCO — Health and Consumer Protection (ex DG XXIV)	5	7	15	13	143	368	1,11	2,70	25,40	20,70 ⁽³⁾	0,00	0,15
(ex DG VI) ⁽⁴⁾ ⁽⁵⁾	n.a.	5	n.a.	5	n.a.	n.a.	n.a.	225,55 ⁽⁵⁾	n.a.	n.a.	n.a.	98,60 ⁽⁵⁾
INFSO — Information Society (ex DG XIII)	10	13	12	54	1 349	2 490	12,25	19,29	1 949,19	6 434,00	6,35	1,57
MARKT — Internal Market (ex DG XV)	0	0	0	0	124	80	0,00	0,00	4,85	6,92	0,00	0,00
RTD — Research (ex DG XII)	69	74	132	126	11 099	8 734	55,20	46,60	5 668,00	5 020,00	2,80	1,90
TAXUD — Taxation and Customs Union (ex DG XXI)	3	3	3	3	(⁷)	147	1,20	0,24	(⁷)	44,35	0,18	0,04
SG — Secretariat General	1	17 ⁽⁶⁾ ⁽⁶⁾	1	44 ⁽⁶⁾ ⁽⁶⁾	1	(⁷)	39,00	10,28	39,00	(⁷)	0,00	(⁷)
Total	306	324	624	750	36 577	27 005	498,19	484,28	12 686,56	15 703,08	13,46	8,64

⁽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' denoted 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 only the 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 1998 Annual Report, Table 4.5. The 1998 figures are, however, not totally comparable with those of 1999, due to the Commission's reorganisation.

⁽³⁾ Commission's share only.

⁽⁴⁾ Chapter B2-5 1.

⁽⁵⁾ Veterinary and phytosanitary actions. Value of audited contracts means here claims of the Member States. Comparable information for 1998 had not been available.

⁽⁶⁾ Concerns budget lines, for which comparable information for 1998 had not been available; includes a budget line under B7-6 0 (Community measures to support NGOs).

⁽⁷⁾ Not specified.

NB : n.a. = not available.

Source: Commission services.

of audits they completed in 1999 in the field of internal policies and research. The findings of these audits generally confirm the results of the Court's audit work for the Statement of Assurance (see paragraphs 4.15-4.23).

4.32. A comparison with the data for 1998 shows that the Commission has roughly maintained its level of audits. If the audits are excluded for which no comparable data were available for 1998, then the total number of audits completed in 1999 decreased by 3 %, while the number of contracts audited increased by 7,5 %. Excluding the veterinary and phytosanitary actions, the recoverable amounts decreased from 13,46 million to 8,64 million euro, or from 2,7 % to 1,8 % of the value of the audited contracts (484,28 million euro).

4.33. The number of audits completed and number of contracts audited increased especially in the fields of the information society and telecommunications (DG INFSO, ex-DG XIII) as well as education, training and youth (DG EAC, ex-DG XXII). The same applies, with regard to the number of contracts audited, to energy and transport (DG TREN, ex-DG XVII and VII, respectively), while in the fields of industry (DG ENTR, ex-DG III) and environment (DG ENV, ex-DG XI), fewer audits were completed and contracts audited.

4.34. A comparison of the 1999 with the 1998 figures shows for many DGs a considerable change in the ratio between value and number of open contracts.

Analysis of the Directorate-General for Research's audit reports

4.35. The Court examined an extensive sample of 46 reports, covering 63 contracts audited, made available by the Commission on audits that were completed in 1999. 21 of these reports concern audits carried out by its own staff. The other 25 were placed with various external consultants. The main findings concerned the duration, results and quality of these inquiries.

4.36. As regards the duration (see **Table 4.5**) the average time required by the DG for Research's internal audit services for carrying out and analysing the inquiries was more than 25 months, where they were carried out internally, and almost 21 months where they were conducted by outside service providers. In both cases this

period covers two practically equivalent periods, that required to carry out the inquiry and the drafting of the audit report and that taken by the DG for Research's internal audit services to draw up a summary report. If the length of the first period appears acceptable, the time needed to draw up the summary report is excessive. In some cases more than four years elapsed between the start of the audit and the drafting of a summary report.

4.37. It is important that the results of such audits become available as quickly as possible because in 26 cases the audits concluded that the amount of the Community's financial contribution needed to be changed. In 22 cases this change involved beneficiaries repaying a total amount of 1 036 188 euro, i.e. on average, 4,8 % of the total amounts audited. In 4 cases the Commission had to make an adjustment in favour of beneficiaries for a total of 38 712 euro, representing 0,18 % of the total audited amounts. If account is taken of the fact that 15 of the 46 audits carried out were not related to the audit cost claims, 26 of the remaining 31 led to the finding that the Commission had paid incorrect amounts (see **Table 4.6**).

4.38. These findings reveal a weakness in the management procedures of the contracts, whether due to insufficient appraisal and/or monitoring on the Commission's part or even the impossibility of obtaining assurance as to the validity of the cost statements presented by the beneficiaries, which are the key factor on which the authorisation of payments is based.

4.39. DG Research qualified 4 out of 25 audit reports established by external consultants as 'unsatisfactory' without indicating the reason for this rating.

THE STAFF SITUATION OF THE DIRECTORATE-GENERAL FOR RESEARCH

Introduction

4.40. Employment in the EU's Institutions and bodies is governed by the 'Staff Regulations of Officials and the Conditions of Employment of Other Servants of the

Table 4.5 — Time analysis of DG Research audit reports

Type	No of audits	Period from audit start to date of report (in months)					Period from date of report to final assessment (in months)					Total period from audit start to final assessment (in months)					Average cost of the audit (EUR)	No of audits assessed as insufficient
		No information available ⁽⁶⁾	< 6	6 to <12	12 to <24	≥ 24 ⁽³⁾	No information available ⁽⁶⁾	< 6	6 to <12	12 to <24	≥ 24 ⁽⁴⁾	No information available ⁽⁶⁾	< 6	6 to <12	12 to <24	≥ 24 ⁽⁵⁾		
Internal ⁽¹⁾	21	12	4	3	1	1	11	6	2	1	1	—	1	4	3	13	—	—
External ⁽²⁾	25	8	5	3	7	2	5	10	3	4	3	1	3	7	4	10	10 112	4

⁽¹⁾ Executed by DG Research (ex DG XII) services.

⁽²⁾ Executed by external audit firms.

⁽³⁾ The maximum was 27 months for an internal audit and 45 months for an external audit.

⁽⁴⁾ The maximum was 36 months for an internal audit and 42 months for an external audit.

⁽⁵⁾ The maximum was 46 months for an internal audit and 54 months for an external audit.

⁽⁶⁾ The reports did not permit the calculation of the period.

Source: Analysis made by the Court based on the Commission's information.

Table 4.6 — Summary on audits and adjustments ⁽¹⁾

	Total number of audits	Audits NOT requiring review of cost claim	Audits requiring review of cost claim	Total audited costs (EUR)	Adjustments in favour of the EU					Adjustments in favour of contractors					No adjustments			
					Number of audits	% of audits ⁽²⁾	Total audited costs (EUR)	Adjustment (EUR)	Level of adjustment on audited costs (%)	Number of audits	% of audits ⁽²⁾	Total audited costs (EUR)	Adjustment (EUR)	Level of adjustment on audited costs (%)	Number of audits	% of audits ⁽²⁾	Total audited costs (EUR)	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	
Internal Audits	21	5	16	12 053 733	12	75,0	3 995 814	544 641	13,6	2	12,5	432 648	7 175	1,7	2	12,5	7 625 271	
External Audits	25	10	15	9 419 736	10	66,7	7 300 347	491 546	6,7	2	13,3	1 117 618	31 537	2,8	3	20,0	1 001 771	
General	46	15	31	21 473 469	22	71,0	11 296 161	1 036 188	9,2	4	12,9	1 550 266	38 712	2,5	5	16,1	8 627 042	
Level of adjustment in favour of the EU on total audited costs									4,8	Level of adjustment in favour of contractors on total audited costs					0,2			

⁽¹⁾ For the preparation of this table the adjustment considered is the global one for the audit, not the individual one for each of the projects audited.

⁽²⁾ In relation to the number of audits stated in column (3).

Source: Analysis made by the Court based on the Commission's information.

European Communities' ⁽⁵⁾. Under these Regulations, EU employees are divided into two categories 'Officials' and 'Other Servants' ⁽⁶⁾.

4.41. The Commission has carried out specific programmes of limited duration in the field of research since the beginning of the seventies. Highly specialised personnel had to be recruited for specific tasks to enable the managerial tasks involved in the individual research projects authorised in the research programmes at that time to be performed. Because of the limited timescale of these projects, the personnel employed in the field of research as 'Other Servants' were mainly given fixed-term contracts.

4.42. The Court analysed the staff situation of the Directorate-General for Research as regards the number of officials (Category A), their allocation, type of employment and seniority by end 1999.

Assessment of the staff situation

4.43. Out of a total of 742 Grade-A posts available, 52 (i.e. 7 % of the total) were vacant on 31 December 1999 (see **Table 4.7**). The 690 posts in this staff category that were actually occupied, broken down by number and percentage, are given in **Table 4.8**. The length of service of the 421 temporary Category-A staff showed that 231 (55 %) of this staff had worked as temporary agents for more than five years and 88 of them (21 %) for more than 10 years.

4.44. An analysis of the various posts on the basis of the duties involved (see **Table 4.9**) revealed the following:

- (a) temporary staff are employed almost exclusively as technical and scientific managers;
- (b) all the auxiliary staff have an administrative function, whereas the majority of permanent officials (108) are technical and scientific managers (administration: 72; administrative research: 6);
- (c) a large number of the temporary and auxiliary staff, i.e. 50, are no longer assigned to scientific tasks, but administrative ones.

⁽⁵⁾ Council Regulation No 259/68 of 29 February 1968 (OJ L 56, 4.3.1968), as amended by numerous Regulations.

⁽⁶⁾ The latter term covers the four groups of staff employed under contract: temporary, auxiliary and local staff, and experts.

4.45. 11 units of DG Research do not employ any officials, but only other servants (a total of 55 temporary agents and 7 auxiliary staff in Category-A posts, plus 10 experts). The high number of Category-A staff (23 officials and 86 temporary staff) in the unit for 'Administrative Management of Association Agreements', i.e. almost 16 % of the total A-grade staff employed by DG Research, should also be noted. This unit is also characterised by a relatively high seniority of its temporary staff: a total of 29 staff have been temporary agents for between five and 10 years, while a further 26 staff have been temporary agents for more than 10 years.

4.46. The Commission decided in 1996 the 'rebalancing of the research personnel structure' ⁽⁷⁾ over the period 1996-2005, whereby progressively a proportion of 40 % officials, 35 % temporary staff and 25 % other staff to assure flexibility should be reached. Four years after this decision, the staff situation in DG Research is that 27 % are officials in higher positions, 61 % are temporary staff and 12 % are other staff.

4.47. According to the Commission's decision in 1996, this 'rebalancing' of the personnel structure was to be achieved by appointing specific staff, having at least 10 years service, as permanent officials, following internal competitions. This explains the fact that, out of 35 probationary officials at Grades A5 to A3 in the Directorate-General for Research (22 % of all officials at these Grades), 26 had been employed at the Commission for over 10 years (see **Table 4.7**). These people had been given various consecutive temporary contracts before being established.

4.48. The Court approved in the course of 1999 two special reports, published in 2000, related to internal policy matters; one report concerned the FAIR programme, the other one the trans-European telecommunications networks.

FAIR PROGRAMME (FISHERIES, AGRICULTURE & AGRO-INDUSTRIAL RESEARCH) ⁽⁸⁾

4.49. The Court's audit involved examining the procedures for managing and following-up actions implemented in connection with Community research

⁽⁷⁾ COM(94) 671 of 22 December 1994, and doc. E/27/96 of 19 January 1996 (written procedure).

⁽⁸⁾ Special Report No 9/99 (OJ C 92, 30.3.2000).

Table 4.7 — Grade and length of service of staff in DG Research

Officials	Length of employment to date					Total						
	< 3 years	3 to 5 years	5 to 10 years	10 to 20 years	> 20 years							
A 8	1	0	0	0	0	1						
A 7	4	1	5	1	0	11						
A 6	1	0	10	3	2	16						
A 5	0	1	10	28	3	42						
<i>of which on probation</i>	0	1	5	8	0	14						
A 4	3	2	2	45	39	91						
<i>of which on probation</i>	0	0	2	13	3	18						
A 3	0	0	4	9	12	25						
<i>of which on probation</i>	0	0	1	2	0	3						
Total	9	4	31	86	56	186						
Temporary staff	Length of employment to date										Total	(1)
	< 3 years (1)		3 to 5 years (1)		5 to 10 years (1)		10 to 20 years (1)		> 20 years (1)			
A 8	9	9	6	6	0	0	0	0	0	0	15	15
A 7	44	39	18	16	2	2	1	1	0	0	65	58
A 6	51	51	23	23	36	32	9	9	0	0	119	115
A 5	5	5	10	7	70	68	32	30	0	0	117	110
A 4	9	9	8	7	34	30	35	35	3	3	89	84
A 3	6	5	1	1	1	1	5	4	3	3	16	14
Total	124	118	66	60	143	133	82	79	6	6	421	396
Auxiliary staff												
A III	2		—		—		—		—		2	
A II	17		—		—		—		—		17	
A I	6		—		—		—		—		6	
Total	25		—		—		—		—		25	
Experts	(No information available)											
Vacant posts												
Total for DG												

(1) Of whom in the field of 'Science and Technology'.

Source: Analysis made by the Court based on the Commission's information.

activities in the field of agriculture and fisheries and, more particularly, on the FAIR specific research programme, which was allocated a budget of 658 million ecu for the duration of the Fourth Framework Programme. It focused on analysing the rules, procedures and resources employed by both the Commission's managing Directorates-General and a selection of recipients of research contracts.

4.50. The main results of the audit may be summarised as follows:

- (a) as the three co-managing DGs' respective responsibilities and powers had not been formalised, the management of the programme lacked clarity and homogeneity;
- (b) the lack of pre-defined quantified objectives made it difficult to measure the results;
- (c) the evaluation procedures specific to the FAIR programme drawn up by the managing

Table 4.8 — Rate of percentage of officials and other staff

Number of posts	%	Occupied by
151	22	Permanent officials
35	5	Probationary officials
421	61	Temporary staff
58	8	Experts
25	4	Auxiliary staff
690	100	Total

Source: Analysis made by the Court based on the Commission's information.

departments were inadequate and, in some cases, poorly applied;

- (d) cases were identified where the regulatory or contractual provisions had not been adhered to and shortcomings and weaknesses were detected in the manner in which the management, monitoring and control procedures were implemented.

4.51. On the basis of these audit findings, the Court recommends that the Commission should develop relevant indicators that will enable the obligations regarding the evaluation of programmes to be met, increase efforts to coordinate the programme with the other Community programmes and improve the programme's procedural homogeneity and consistency by relying on computerised tools and formalising the role of the lead DG. The Court also calls on the Commission to improve the legal quality of its contracts, increase the independence of expert assessors and clarify the key procedures for implementing the programme.

TRANS-EUROPEAN TELECOMMUNICATIONS NETWORKS

4.52. The Court's special report No 9/2000 ⁽⁹⁾ examined the development and implementation of the EU policy concerning the trans-European telecommunications networks (TEN-Telecom) and the related measures

carried out under the EU research and structural funds policies.

4.53. The following principal observations resulted from the audit:

- (a) the EU's lengthy consultative and decision-making procedure did not suit the requirements of an innovative and highly-dynamic sector where market forces gained acceptance for the internet as a worldwide web; there is a risk that assisted projects will not reflect current market trends;
- (b) the TEN general rules which are directed towards larger-scale infrastructure measures are less appropriate to TEN-Telecom which promotes near-market projects for telematic applications and services;
- (c) there are similarities with the research programme on telematics applications of common interest, which may also finance near market feasibility studies, validation tests and pilot projects but at lower rates of aid; the Commission has not carried out a full examination of the continuing need for support for near market projects under TEN-Telecom; in each case where aid is granted for such actions it should be clearly demonstrated that they are well justified and would not be achieved without EU subsidy;
- (d) the Commission's description of the TEN-Telecom support measures in its various reports as cofinancing feasibility studies could be misinterpreted as it

⁽⁹⁾ Special Report No 9/2000 (OJ C 166, 15.6.2000).

Table 4.9 — Breakdown of staff in DG Research by area of activity

Area of activity	Officials			Temporary staff			Auxiliary staff			Experts	Vacant posts			
	A 3	A 4/A 5	A 6-A 8	A 3	A 4/A 5	A 6-A 8	A I	A II	A III		A 3	A 4/A 5	A 6-A 8	A
General operation	3	47	22	0	0	0	0	0	0		0	3	1	0
Research: administration	2	4	0	2	12	11	6	17	2		0	0	0	0
Science and technology	20	82	6	14	194	188	0	0	0	58 ⁽¹⁾	3	5	17	23

⁽¹⁾ Listed under 'Science and Technology', as there is no information concerning their area of responsibility.

Source: Analysis made by the Court based on the Commission's information.

contracted projects which included multi-annual activities rather than pure studies;

- (e) the Commission has not developed a clear strategy in the structural funds vis-à-vis market liberalisation and privatisation of telecommunications. It made structural fund payments for telecommunications to a Member State despite ongoing infringement procedures against this Member State for failing to transpose market liberalisation directives.

4.54. The assessment and reporting of results of the TEN-Telecom programme by the Commission were not comprehensive. The Court recommends that the Commission provide the Council and the Parliament with details of the TEN-Telecom actions and its assessment of the extent to which their objectives have been achieved. The Commission has stated in its answer to the special report that an in-depth evaluation of the action will take place between May and September 2000, where the relevance of the objectives, priorities and implementing measures will be analysed.

THE COMMISSION'S REPLIES

IMPLEMENTATION OF THE BUDGET

4.5. *The analysis in the revenue and expenditure account takes the form of a long introduction on the implementation of research policy, followed by a quantitative description of the first projects selected under this framework programme.*

In accordance with Article 173 of the Treaty, these developments are set out in greater detail in the annual report on the research sector, which is the main source of information for monitoring research activities. As regards completion of earlier programmes, in particular those contained in Item B6-5 4 1 1 of the budget (Completion of the framework programme (1994 to 1998)), this involves the clearance of contracts still outstanding for the various individual programmes. The breakdown of budget implementation, which is now set out in an annex to the Article 173 report, will in future be included in the revenue and expenditure account.

4.6. *Tables of equivalence are attached to the revenue and expenditure account to break down the various activities of the JRC (Joint Research Centre) and set out the cost of staff, resources and specific appropriations. The JRC annual report, which provides additional information, is published after examination by its Board of Governors. The Commission is prepared to provide further information in the revenue and expenditure account.*

4.7. *In the near future the Commission plans to start a detailed analysis of the monitoring of current budget implementation to comply more effectively with the criteria of relevance, clarity, transparency and simplification.*

4.9.(b). *In 1999 the research appropriations (Title B6 of the budget) were used in accordance with the schedule of utilisation for the first year of a framework programme, in which virtually all the commitments are concentrated in the final quarter of the year, with the exception of the appropriations for the Joint Research Centre (JRC).*

The stages leading up to conclusion of the contracts have to be strictly adhered to in order to safeguard the scientific quality of the projects selected.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Nature of the expenditure

4.12. *The fixed-price system normally applies to contracts for services or supplies, i.e. contracts forming one order for*

which total costs can be accurately determined before signature. There are thus fixed-price contracts for certain operations involved in the implementation of research policy (e.g. operations with objectives and associated costs which can be precisely determined in advance, such as the exploratory premiums to SMEs (small and medium-sized enterprises)).

Main audit findings

Payments

4.16. *With respect to the substantive errors, the act of making the payments themselves was not in error; under the present cost-statement system, unless an error can be detected when checking the cost statement, it has to be paid in full. Only an on-the-spot audit can detect the type of overcharging which was found by the Court. Furthermore, all payments are contractually specified as a continuation of the advance and they are subject to audit and correction should errors be found during a subsequent audit.*

4.17. *With the present system, payments are contractually due after the technical progress of the project and those items which are contained in the cost statements have been checked. The fact that no errors were found in advances and contractually fixed payments shows that there is not a problem with the authorisation of payments, but that the present system of cost declarations signed by contractors needs to be reviewed. This review is in progress.*

4.18. *The Commission recognises the problems involved in the repayment of actual costs. The system has therefore been considerably reinforced in the fifth framework programme (see replies to paragraphs 4.20 and 4.51). Further improvements and simplifications are now being developed (see reply to paragraph 4.21).*

However, the Commission would point out that this system was established to provide as appropriate a response as possible to the specific features of research policy. By its nature, it rules out the possibility of accurately determining in advance the costs which will be involved in research. These costs are unpredictable and lead to subsequent adjustments in line with the expenditure actually incurred.

Repayment is based on a declaration of the costs actually incurred by the contractors and on the possibility of an audit.

The accuracy of the costs repaid and the expenses incurred is verified by comparing the budget negotiated and the financial (declaration of costs) and scientific (certifying that the work has been carried out) reports submitted. These may subsequently be corrected by means of financial audits on the spot.

Although no 'contractual penalties' are provided for in the contracts, the Commission can still terminate the contract or the participation of a contractor, as well as obtain repayment in the event of overcharging, if there are serious financial irregularities.

Conclusions and Recommendations

4.19. The findings relating to payments by the Court during its on-the-spot audits of beneficiaries confirm the analysis of the Commission that a review of the system is needed to reduce the danger of overcharging by contractors. Work is in progress on this issue (see the Commission's replies to paragraphs 4.16 and 4.17).

4.20. The Commission has already made a number of changes to the system under the fifth framework programme. It has, for instance, provided a more detailed definition of these costs in the implementing regulation and in the contracts. It has also drawn up documents which will help participants with the financial arrangements relating to contracts with Directorate-General Research (DG RTD) and which are made available to the public on its new website. Finally, it has also given a more detailed description of the contractual penalties and has made it easier for them to be applied by adopting the method of offsetting debts against other payments to the same contractor.

The Commission shares the Court's view that administrative penalties would also be likely to reduce the risk of ineligible expenditure. This requires adoption of a sectoral Council regulation based on the Regulation of 18 December 1995 on the protection of the Community's financial interests.

4.21. The Commission set up a working party which produced a report in February 2000 proposing a number of improvements and simplifications in the management of research programmes. Some of the main conclusions were that two pilot actions should be undertaken: use of flat rates and use of audit certificates with cost statements. Preparatory work on a revision of the financing rules is under way.

For the time being, the Commission is considering how extra flat-rate elements could be incorporated in the contracts. Its

review cannot, however, ignore the concerns of the contractors, the Member States or the European Parliament.

4.22. Checking proposed costs is already part of the selection process. The Commission will investigate, as part of the ongoing work to improve the management of Directorate-General Research (RDT) programmes, what further steps should be taken. Given the mass of documentation involved, contractors must keep documents and receipts for all costs incurred by themselves in relation to the contracted project for verification and on-site audits by the Commission. This does not, however, prevent a contractor from submitting specific supporting documents in response to requests from the Commission's departments.

4.23. In the research sector, the Commission has set itself the objective of auditing up to 10 % of contractors and has in practice substantially increased its control activities and expenditure. However, its new audit strategy goes further than the quantitative aspect since it extends the types of audit carried out and reduces audit times, as well as planning the audit better.

The certification of cost claims exceeding a certain amount could indeed be regarded as a solution despite the additional cost this would entail.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

4.25.

(a) The Commission agrees that one contract was neglected for too long, but it has been settled in the meantime.

With regard to the other case signalled by the Court, the Commission, aware of the importance of recovering entitlements in the interests of sound financial management, will endeavour to introduce and put into operation appropriate instruments for this purpose in the near future.

(b) Commission departments will bring to a rapid conclusion cases where action is still needed.

4.29. The Commission welcomes the Court's comments on the considerable improvements made to the management of the establishment plan for the programme 'Preserving the ecosystem — Energy'. As the Commission stated in its reply to the Court's special report of 1998 on the JOULE-Thermie

programme, it was possible to make these improvements in 1999 during the redeployment of staff following the transition between the fourth and fifth framework programmes.

The Commission agrees with the Court's analysis, but would point out that the percentage of staff allocated to this programme comes to 87 %.

4.30. The Commission would stress that the tasks involved in implementing an individual programme go further than the process of planning, evaluation, negotiation and monitoring of contracts. Implementation also involves tasks of general policy and administrative coordination. The human resources are allocated during internal hearings at the start of the budget year. The activity-based budgeting (ABB) now employed will make it easier to identify the horizontal lines and thus introduce more clarity in the current presentation of the breakdown of staff.

AUDITS CARRIED OUT BY THE COMMISSION

Analysis of the Directorate-General for Research's audit reports

4.35. In total 74 on-the-spot controls covering 126 contracts were audited in 1999 by DG RTD. Out of 74 on-the-spot controls, 45 were carried out by DG RTD's own staff, while the remaining 29 were carried out by external auditing firms.

4.36. Of the 74 audit files closed in 1999, audits were closed on average within 19 months. Within the framework of the new audit strategy put in place by DG Research, priority has been given to closing the outstanding on-the-spot controls. 1999 was therefore a transition year where, as a first priority, past audits were closed and new controls were launched. A key objective of the new strategy is to reduce considerably the duration of the audit. To date, it is on average 12 months.

4.37. In fact, 4,1 % of the total amount paid will be recovered (taking into account 74 audits). Although this is still too high, it should be noted that the audits of DG Research in 1999 were in part focused on high-risk areas and not on a pure random sample basis. The Commission is continuing its effort to reduce this level.

4.38. These audit findings underline the relevance of the changes made in the fifth framework programme to three categories of expenditure — personnel, overheads and subcontracting:

- for personnel costs, there is a more detailed definition,
- for overheads, there is now a possibility of opting for a flat rate,
- for subcontracting, the contract obliges the contractor to send a copy of the invoices to the Commission and allows for an audit of the subcontractors.

4.39. DG RTD systematically evaluates the performance of the external contractors. The four unsatisfactory reports (due to the poor quality or delayed transmission of the final report by the external contractor) have been one reason for changing the framework contract for external auditing of the year 1999.

THE STAFF SITUATION OF THE DIRECTORATE-GENERAL FOR RESEARCH

Assessment of the staff situation

4.44.

- (a) The temporary staff are allocated to scientific and technical duties as the Commission organises selection procedures for this type of staff.
- (b) Auxiliary staff are taken on as required (for all types of support tasks) in accordance with the Staff Regulations and the arrangements applicable to other servants.
- (c) Auxiliary staff and seconded national experts are taken on for all types of tasks.

4.45. The relatively high number of senior category A staff in the Unit 'Administration Management of Association Agreements' reflects the specific situation for fusion research. Fully in accordance with the Programme Decision in the field of nuclear energy 1998 to 2002 (1999/175/Euratom), scientific and technical staff are working in the different fusion laboratories in Europe. These staff are formally allocated to DG RDT. In addition, due to the closure of the JET Joint Undertaking at the end of 1999, many of its relatively senior staff have joined this unit to work in the different laboratories in Europe, maintaining and distributing valuable knowledge and experience. The number of Euratom staff in the associated laboratories is decreasing due to retirements.

4.46. and 4.47. The Commission decided in 1996 to rebalance the structure of all its research staff as part of the new research staff policy.

This policy has produced tangible results which are consistent with the objectives laid down, since the staff structure for all categories within the Directorates-General in the research sector has increased from 23 % officials in 1996 to 34 % in 1999 and, according to the forecasts, the proportion of officials should rise to 37 % in 2000. To sum up, the Commission will continue to advance towards the objectives laid down in 1996 by the new research staff policy. They will be achieved before 2005.

FAIR PROGRAMME (FISHERIES, AGRICULTURE & AGROINDUSTRIAL RESEARCH)

4.50.

- (a) The Fair programme evolved from a series of programmes which were run separately by three different Directorates-General. In Fair these programmes were brought together into one single programme managed by the three DGs (Research, Fisheries and Agriculture). The many joint actions were carried out on the initiative and under the direction of the DG in charge of the overall running of the programme (DG Research), which also provided coordination on horizontal activities. In the fifth framework programme (FWP) the management of agricultural research has been transferred from DG Agriculture to DG Research.
- (b) The Commission considers that in the fourth FWP it was intrinsically difficult to set quantitative objectives in a research programme, particularly in a programme like Fair dealing with aspects such as agricultural production, fisheries, forestry and food production. The independent experts who carried out the annual monitoring exercises of the Fair programme always considered that the programme successfully met the assigned objectives.
- (c) A common evaluation procedure was agreed by the three DGs at the start of Fair and this was uniformly applied in the evaluation of all research proposals submitted to the programme. Nevertheless, the Commission acknowledges that problems with the first call of Fair did occur, particularly in area 4 of the programme, which are mentioned in the Court's special report. These problems were resolved and did not occur again in subsequent calls.

- (d) With regard to the specific cases and situations mentioned by the Court, the Commission is taking the necessary steps to remedy them.

4.51. As regards relevant indicators, the problem-solving approach of the fifth FWP (Framework Programme) facilitates the setting of clear objectives and deliverables within each key action, which can be measured against results obtained and for future evaluations. As far as coordination is concerned, a group of directors of the political and research DGs has been established. The role of the lead DG is now more clearly defined and improved computerised tools and common databases put in place.

With the fifth FWP, the provisions of the standard contract have been improved. The Commission has (see paragraphs 4.20 and 4.38):

- introduced a procedure allowing more detailed negotiation,
- adopted, on the basis of the Council decision, an implementing regulation providing further information and details for the definition and eligibility of costs,
- provided a more detailed definition of these costs in the contracts and made changes to the three categories of costs represented by staff, overheads and subcontracting,
- drawn up documents to help participants with the financial arrangements relating to RTD contracts,
- laid down contractual penalties and simplified their application.

Moreover, strict criteria for selection of experts are now in force: competence and experience, impartiality, fair geographical distribution, varieties of backgrounds (types of organisations) of the candidates, references. In all cases the Commission made the greatest effort to avoid inviting experts from institutes involved in the proposals to be evaluated. When this was unavoidable, the expert had to abstain from evaluation of individual projects where a conflict of interest might exist.

TRANS-EUROPEAN TELECOMMUNICATIONS NETWORKS

4.52. Observations from this report have been taken into consideration in the current management of the action. They

will also be included in the proposal for revision of Annex I to the guidelines, which defines projects of common interest.

4.53.

- (a) The decision-making process is outside the control of the Commission. When the guidelines are adopted, the regular updating of the work programme and the definition of the calls introduce the necessary element of flexibility in the design process of the action.
- (c) TEN-telecom (trans-European telecommunications networks) starts from results of technological developments whose marketability is not yet clear. TEN-telecom was presented to the research audience as a follow-on action. Indeed there exist similarities with the research programme on telematics applications in 'areas of general interest' (such as education, environment, transport), since the guidelines were conceived originally as a follow-on action to research. TEN-telecom focuses on assessing the marketability and the business case for products which present sufficient technological maturity but require clarification for future market deployment and for establishing a convincing business plan to secure internal or external project financing by well-committed partners. These issues are marginally addressed by RTD projects in their exploitation plans, where the core of the action addresses the conditions of adoption of advanced technologies or methodologies in cooperation between users and suppliers, and not market- or financial-package assessment.

The Commission is to submit proposals for revisions of the guidelines on the basis of the evaluation of the action and technical developments. Critical points for revision could be the following:

- the action would be clearly differentiated from what is covered by the research,
- the action would be more focused; building on priority actions of the e-Europe initiative,
- the work programme would remain sufficiently general to reflect technology changes and new market trends in the definition of calls for proposals,
- the structuring of projects and related Community support would be made clearer,

— greater emphasis would need to be placed on the trans-European dimension of the action.

- (d) The TEN Financial Regulation stipulates that 'studies' can always be accompanied by 'technical support measures', which is reflected in the glossary of terms approved by the TEN Financial Committee and confirms a larger acceptance in the meaning of 'studies'.

In addition, Article 3 of the guidelines clearly states as a priority 'study and validation of the technical and commercial feasibility, followed by the deployment of applications supporting the development of a European information society, in particular applications of collective interest'. Studies have been carefully defined following this model, with a greater emphasis put on market feasibility and validation so that the action could be best differentiated from what is supported in the research.

- (e) The 1994 to 1999 Structural Funds' programming period coincided with a transition period from a monopolistic to an open market. The Commission opted for a case-by-case approach, which helped to solve many problems in compliance with the new regulatory framework, and in respect of regional-development objectives, and to accelerate the liberalisation process in Cohesion countries. For the new period 2000 to 2006, rules for ensuring transparency and compliance with competition rules have been established in the framework of the operations of the Funds.

4.54. An intermediate evaluation report of the Euro-ISDN (integrated services digital network) guidelines for the period 1993 to 1997 was communicated by the Commission to the Court in February 1999. It makes recommendations which have been taken into consideration in the continuation of the action. Furthermore, a report on the final results of the 1998 TEN-telecom call for proposals was made (COM(99) 153) and presented to Parliament on 8 April 1999.

Finally an in-depth evaluation of the action is taking place until November 2000 and the results will be communicated to Parliament and the Council. The Commission will then submit a proposal for revision of Annex I to the TEN-telecom guidelines, on the basis of such evaluation and technical developments.

CHAPTER 5 (*)

External aid

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(*) The Commission's replies are on page 150.

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INTRODUCTION

5.1. External aid groups together the operations entered under heading 4 of the financial perspectives. This comprises the traditional forms of aid and the operations adopted by the Council under the common foreign and security policy (CFSP). The aid that is provided through the European Development Funds⁽¹⁾ appears only as a token entry in the general budget, as it is financed separately. Apart from the budgetary implementation and the specific appraisal in the context of the Statement of Assurance, the chapter includes observations on the Phare public administration programmes, the refugee-return programme in Bosnia, sound financial management issues concerning non-governmental organisations and the agreement between the European Community and the United Nations. The chapter also contains a section on the follow-up to previous observations.

IMPLEMENTATION OF THE BUDGET

Changes in and use made of appropriations in 1999

5.2. **Table 5.1** gives an overview of how available appropriations were used during the financial year 1999.

⁽¹⁾ See separate observations in this report.

5.3. More than 300 pages of Volume I, Part II of the revenue and expenditure account are devoted to describing the implementation of subsection B7 (External action) of the budget. By dint of its length, this description ignores a criticism previously made by the Court⁽²⁾, which recommended that any reader of the accounts should be able to refer to an exhaustive and user-friendly description and analysis of the management of budget appropriations. There is no table which gives an overview of the implementation of the budget in this area. The analysis consists in a mere juxtaposition of disparate contributions from different departments, included in their original state, which would have benefited from being more concise and reduced to a summary.

Commitment appropriations

5.4. As in the previous year⁽³⁾ most of the commitments were made in the fourth quarter of the year, in December, for the budget headings specified in **Table 5.2** (which represent 61 % of the total External actions — Subsection B7). Such a concentration of financing proposals in a very short period, notably for the Asian, Latin American and MEDA programmes, does not allow for proper decision-making by the Commission or for a proper assessment by Advisory Committees.

5.5. 127,6 million euro were granted to Title B7-5 in the form of provisional appropriations. When they were

⁽²⁾ Paragraph 5.14 of the Annual Report 1998.

⁽³⁾ Paragraphs 5.3 and 5.4 of the Annual Report 1998 (OJ C 349, 3.12.1999).

Table 5.1 — Heading in the financial perspectives: External aid

(Mio EUR and %)

		Financial perspective ceiling	Budget changes		Implementation of the budget						
			Initial appropriations ⁽¹⁾	Final appropriations available ⁽²⁾	Appropriations used	% of final appropriations available	Appropriations carried over to 2000	% of final appropriations available	Cancelled appropriations	% of final appropriations available	
Humanitarian and food aid (B7-2)	CA		836	1 232	1 231	100	0	0	1	0	
	PA		711	1 087	955	88	121	11	11	1	
Cooperation with developing countries in Asia, Latin America and southern Africa, including South Africa (B7-3)	CA		876	866	686	79	81	9	99	11	
	PA		541	581	570	98	10	2	1	0	
Cooperation with Mediterranean third countries and the Middle East (B7-4)	CA		1 092	1 081	1 027	95	44	4	10	1	
	PA		546	370	334	90	2	0	35	9	
Cooperation with the countries of central and eastern Europe, the new independent States and Mongolia (B7-5)	CA		2 102	2 422	2 347	97	65	3	10	0	
	PA		1 316	2 086	1 908	91	95	5	83	4	
Other cooperation measures (B7-6)	CA		341	360	344	96	6	2	9	3	
	PA		278	334	302	90	20	6	12	4	
European initiative for democracy and human rights (B7-7)	CA		98	98	94	96	0	0	4	4	
	PA		77	63	46	73	15	25	1	2	
External aspects of certain Community policies (B7-8)	CA		310	378	354	94	0	0	24	6	
	PA		331	332	310	94	0	0	21	6	
Common foreign and security policy (B8)	CA		30	40	29	73	11	27	0	- 1	
	PA		23	37	27	73	10	27	0	1	
Heading total	CA		6 870	5 685	6 477	6 112	94	207	3	158	2
	PA			3 822	4 890	4 452	91	273	6	164	3
Emergency aid reserve (B7-9 1)	CA		346	346	0						
	PA			346	0						

⁽¹⁾ Budget finally adopted by the European Parliament on 17 December 1998 (OJ L 39, 12.02.1999).

⁽²⁾ Budget appropriations amended after taking into account the supplementary and amending budgets and transfers, but not including appropriations carried over from 1998, appropriations resulting from the reuse of revenue, revenue resulting from third-party contributions, and other revenue corresponding to a defined purpose and appropriations made available again. For further information on the implementation of the budget, please refer to Diagrams III and IV in Annex I to this report.

Source: 1999 revenue and expenditure account (after adjustments to take into account the audit findings).

Table 5.2 — 1999 External aid — Commitments by quarter

(Mio EUR)

Budget area		Commitments 1st quarter 1999		Commitments 2nd quarter 1999		Commitments 3rd quarter 1999		Commitments 4th quarter 1999		Total com- mitments 1999	(Commitments in Decem- ber 1999)	
		Amount	%	Amount	%	Amount	%	Amount	%		Amount	%
B7-3 0	Cooperation with Asian developing countries	0,2	0,1	28,1	8,0	26,8	7,7	294,7	84,2	349,8	294,6	84,2
B7-3 1	Cooperation with Latin American developing countries	1,0	0,5	0,9	0,4	7,5	3,6	199,1	95,5	208,5	187,2	89,8
B7-4 1	MEDA	3,4	0,4	25,6	2,8	106,8	11,7	773,3	85,1	909,1	626,5	68,9
B7-5 0	Cooperation with the countries of central and eastern Europe	16,2	1,1	148,8	10,1	130,6	8,9	1 170,5	79,8	1 466,1	837,0	57,1
B7-5 2	Cooperation with the new independent States and Mongolia		0,0	24,8	6,2	164,9	41,5	207,5	52,2	397,2	203,0	51,1
B7-5 4	Cooperation with the republics formerly part of Yugoslavia	12,9	3,6	41,9	11,6	119,8	33,3	185,3	51,5	359,9	147,1	40,9

Source: Commission accounts (Sincom).

mobilised, which for some of these appropriations happened very late, there was no corresponding commitment during the financial year for Articles B7-5 3 2 (Macrofinancial assistance to the countries of the western Balkans region) and B7-5 4 6 (Aid for the reconstruction of Kosovo). Even though carrying over to the following financial year appropriations that are still uncommitted at the end of the year is allowed under Article 7(2) of the Financial Regulation, making provisional appropriations in the sum of 55 million euro available for these two headings, without any likelihood that they will be used during the financial year for which they have been entered, is not in accord with the principle of the annual nature of the budget.

Payment appropriations

5.6. The rate of utilisation of payment appropriations for Article B7-4 2 0 (Community operations connected with the Israel/Palestine Liberation Organisation (PLO) peace agreement) was much lower than planned. Of the 50 million euro entered in the initial budget, only 9,8 million euro, or 20 %, was used for payments, the rest of the allocation having being transferred to other budget headings. No explanation for this discrepancy is given in Volume I, Part II of the revenue and expenditure account.

5.7. The budgetary authority granted a quantity of payment appropriations which was well below the Commission's initial requests for the Phare and Tacis programmes (288,4 million euro, or more than 20 % on average). It was necessary to increase appropriations for Chapter B7-5 (Cooperation with the CCEE, including the Phare programme) by 341,9 million euro. After several transfers of appropriations (94,9 million euro) and/or supplementary and amending budgets (247 million euro), actual payments turned out to be in close relation to the initial estimates. Increases were also made to the Tacis programme (185 million euro) and to aid accorded to Former Yugoslavia (195 million euro).

5.8. For a large part, namely about 100 million euro, the increase in payments can be explained by an increase in advances paid by the Commission to the Phare programme's intermediaries and/or recipients, pending utilisation. In 1999, the latter received 688 million euro in the form of advances, compared with 574 million euro in 1998. The introduction of a new administrative body (the 'National Fund') responsible for managing cash requirements at local level, however, is in line with the desire to reduce the level of unused funds. It is evident from the information provided by the Commission that, for the whole of the Phare programme, there were no

proofs of payments for programmes and/or projects amounting to 492,7 million euro when the financial year was closed.

5.9. With regard to the Phare programme, additional appropriations amounting to 172 million euro were allocated on 18 November 1999 in the framework of SAB No 5, to which should be added a transfer of 27,8 million euro of appropriations decided by the budgetary authority. The fact that funds were made available late caused temporary shortages of appropriations which led to transfers of funds to the final recipients responsible for managing the projects also being postponed. The implementation of Sincom 2, which was particularly difficult in Bosnia-Herzegovina, where local problems were encountered, in addition to those at central level, also explains some of the delays in making payments. For all these reasons, local managers faced temporary cash flow problems.

5.10. With regard to Article B7-5 3 6 (Contribution to the EBRD for the Chernobyl Shelter Fund), the transfer of 27,9 million euro of appropriations, which was only decided on 15 December, caused the corresponding payment appropriations to be cancelled, since the commitment appropriations had been carried over. In Volume I, Part II of the revenue and expenditure account, the Commission indicates that the aim was to make the contribution available in 1999, which was not the case.

5.11. For Article B7-5 4 6 (Aid for the reconstruction of Kosovo), very few of the payment appropriations obtained following the late adoption of SAB No 4/99 (50,9 million euro) were used in 1999 (10,5 million euro), but the Commission provided no explanation for this in Volume I, Part II of the revenue and expenditure account. More than a quarter of the unused commitment appropriations and half the unused payment appropriations were carried over. The other half were cancelled.

5.12. With regard to Chapters B7-21 (Humanitarian Aid) and B7-54 (Cooperation with the Republics formerly part of Yugoslavia), important decisions were taken to carry payment appropriations over to the financial year 2000, concerning 121 and 66,9 million euro respectively. In both of these cases, these decisions related to about a third of the additional finance obtained during the financial year. The sums allocated did not correspond to possible payments required by the execution of measures which had been started. The Court has criticised this practice in previous years ⁽⁴⁾.

⁽⁴⁾ Paragraph 13.4 of the Annual Report 1996 (OJ C 348, 18.11.1997).

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

payments under the Phare DIS was carried out in four beneficiary countries;

Description of the subject area

5.13. Subsection B7, which covers external measures, includes a variety of instruments:

- (a) the granting of food and humanitarian aid (Title B7-2);
- (b) the carrying out of cooperation programmes via budget headings devoted to specific geographical areas (Latin America, Asia, the Mediterranean, the Middle East, central and east European countries, the New Independent States and Mongolia) (Titles B7-3, B7-4 and B7-5);
- (c) co-financing measures taken by non-governmental organisations (NGOs) (the greater part of Title B7-6 and, where necessary, by also using budget headings corresponding to the abovementioned instruments), as well as:
- (d) other measures, the bulk of which concerns international fishing agreements (the rest of Title B7-6 Title B7-7 and Title B7-8).

- (b) the Phare and Tacis Special Funds, by means of which various tasks are carried out by contractors using a similar mechanism to that mentioned in (a) above. The audit was conducted only at Commission level on the basis of a preliminary list of 106 contracts concluded between 1996 and 1999 for a total sum of 470 million euro;
- (c) the co-financing of activities managed by non-governmental organisations (NGOs) in developing countries. Most expenditure of this kind is financed from budget heading B7-6 0 0 0 'Community contribution towards schemes concerning developing countries carried out by non-governmental organisations', for which total payments made in 1999 amounted to 173 million euro. Audits were carried out at the Commission and the headquarters of two selected NGOs from each of six Member States. A sample of the projects managed by these NGOs was audited on the spot, and;
- (d) expenditure for aid to Bosnia, for which financial and operational management was transferred ('deconcentrated') in 1998 from Commission headquarters in Brussels to the Commission Representation Office in Sarajevo. Total payments in 1999 amounted to some 108 million euro. The Court restricted its audit to a sample of payments authorised by the Commission's Representation Office. It did not examine the subsequent payment of these funds to final beneficiaries in cases where the Commission's payment represented a transfer to an intermediary organisation.

Scope and nature of the audit

5.14. In addition to the work performed for the global DAS and in order to provide the discharge authority with more focused information, the Court's 1999 financial audit of external aid concentrated on payments made in four areas where the management of the expenditure programmes involves partners or a degree of delegation. This type of management corresponds to the general tendency in recent years for the Commission to involve third parties to an increasing extent in the management of Community external aid. The areas concerned were the following:

- (a) the approximately one half of the Phare programme which is implemented in association with programme management units (PMUs), essentially partner country administrations, under the decentralised implementation system (DIS). The total amount of advance payments made by the Commission in this context up to the end of 1999 was 3 283,5 million euro. The Court's audit of a sample of

5.15. Because the specific audits described above covered only certain selected parts of the whole field of external aid, albeit in greater depth, the purpose is not to draw general conclusions about the legality and regularity of underlying transactions in that field, as was done for 1998. The objective, taking account of the limitations indicated at paragraph 5.14 above, is to determine whether there are significant problems regarding both the legality and regularity of the transactions verified, and the quality of the internal control systems set up to ensure legality and regularity.

Phare decentralised implementation system (DIS)

5.16. The manual covering the decentralised management system (DMS) forbids the disbursing of any funds for Phare programmes after the expiration of the financing agreement and requires a final audit to be carried out once they have been completed and before closure. The Court therefore considers that this audit ought to be carried out within two years of the last possible disbursement. According to this criterion, the value of Phare programmes managed locally, completed but not closed was 1 210,8 million euro at the end of 1999. As was also the case in 1998, the Commission did not start on a final audit during 1999.

5.17. The Phare programmes that were totally closed in 1999 were, in almost all cases, those that do not come under the decentralised management system or which result from the completion of final audits decided on in 1997. On the whole, the Commission managed to close the contracts that were managed in Brussels within a reasonable time and is in control of this process. On the other hand, attention needs to be paid quickly and specifically to the closure of locally managed programmes before this task becomes especially difficult to carry out.

5.18. The audit did not reveal any significant errors of legality and regularity in the transactions examined.

Special funds

5.19. The Phare and Tacis programmes include the possibility of concluding contracts for goods and/or services which allow advances called 'special funds' to be paid to the contracting party. The measures financed in this way are sometimes of an administrative nature, sometimes concern technical assistance and are sometimes a mixture of the two. These special funds allow payments to be made more quickly and, in going beyond what was originally intended, they also allow the budget to be implemented by reducing the workload of the Commission departments. They also make it possible to apply provisions other than those which either provide the framework for the management of the budget or aim to limit the level of administrative expenditure.

5.20. The Commission has not introduced a mechanism which allows the proper monitoring of the use of these funds which, in reality, represent a delegation of the budgetary implementation of a measure to third parties, in particular by means of an appropriate accounting procedure and final audits allowing agreed advance payments to be closed.

*Non-governmental organisations (NGOs)***Systems of internal control**

5.21. The European NGOs and also their local partners differ significantly in the nature and quality of their organisation and internal controls. The most effective type of control procedures identified were regular monitoring visits by European NGO staff, review and approval of original supporting documentation by the European NGO before the transfer of further funds and the independent audits of statements of expenditure sent to the Commission. These procedures were not applied systematically or consistently in the cases examined by the Court.

5.22. The monitoring of projects by the Commission is currently limited to the review of the reports sent by the European NGOs for the purpose of obtaining further payments. In the rare cases where the Commission wishes to follow up some matter, for example a request for a modification to a project, the Delegation in the country involved may be requested to visit the project on the spot and report back with its findings and recommendations. A greater role could be given to Delegations by involving them in monitoring missions and checks on the technical and financial information provided in the reports sent to the Commission.

5.23. The effectiveness of the external audits of project expenditure depends upon the drafting of comprehensive terms of reference for the work to be undertaken and the competence of the audit firm. Weaknesses in this respect were illustrated by the fact that audit reports on projects visited on the spot by the Court did not mention the evident lack of adequate supporting documentation.

5.24. The control system would be substantially strengthened if on-the-spot audits of NGOs and their projects were undertaken systematically by the Commission. This could be based on a sample selected each year, as ECHO does for humanitarian aid expenditure. The benefit would be a greater knowledge of the checks performed by the NGOs themselves and the opportunity to be able to directly check the expenditure and activities of projects.

Legality and regularity of the underlying transactions

5.25. On-the-spot audits of NGO operations identified a number of cases where there was a lack of sufficient

supporting documentation evidencing the goods or services provided and their relevance to the EU-funded project. For example, some costs claimed by beneficiaries were not supported by invoices or proper indication of the services provided for the project.

5.26. The valuation of contributions in kind provided by the local partner was often a problem for the projects selected for audit. The supporting documentation was weak, sometimes merely consisting of a declaration from the local partner which did not provide any verifiable or independent basis for the valuation. Fixed assets included as contributions in kind could have been previously financed by other donors and it was not always clearly proven whether the services or materials really were necessary for the project. In the case of one project involving the provision of health care, animals were declared as a contribution in kind even though they were not being directly used in the project.

Conclusion

5.27. The NGOs selected have internal control systems of varying sophistication. The lack of ongoing monitoring of some projects by the NGOs has allowed unsubstantiated expenditure to be included within the project financial reports. There is a lack of adequate systems at all levels which means that an audit trail showing the exact nature of the costs being claimed can often not be identified. At the same time as the Commission develops generally its management and control arrangements to focus to a greater extent on the results obtained from its interventions, more effective monitoring and auditing of NGO co-financing expenditure is needed, adapted to the particular circumstances of that expenditure. The new management instruments and procedures for the implementation of the NGOs' co-financing provide for this.

Bosnia deconcentrated implementation system

5.28. Under the deconcentrated implementation system all commitments, contracts and payments made under the Phare and Obnova programmes are authorised by the head of the Commission's Representation Office (ECRO) in Bosnia. An important part of the system is the role played by the Control and Finance Section which has to visa all transactions before they can be authorised. The Section was found by the audit to be

well organised and motivated with local staff making a significant contribution to the Section's work. The Section's independence within ECRO, which is necessary for it to be able to perform its function effectively, could be strengthened if it reported to the SCR rather than to DG RELEX, to which both it and the Operations Section currently report.

5.29. The audit showed that, in general, well-defined financial management procedures had been put in place. These were set out in a manual on implementation guidelines issued in July 1999 although at the end of 1999 the manual still only existed in draft form. A key area where procedures required further attention was the need to define the responsibilities of the technical assistance unit (TAU) ⁽⁵⁾ in such a way as to reduce as far as possible the administrative workload on ECRO arising from the contracting process while still ensuring that ECRO maintained adequate control over this area.

5.30. In addition, although in many cases the payments made by ECRO were advance payments to intermediaries, typically NGOs which then disbursed funds to Bosnian subcontractors, at the end of 1999 the Representation Office had still to establish a system for auditing payments made by intermediaries. It is essential that such audits are carried out before projects are closed.

5.31. The audit work carried out on the Bosnia deconcentrated implementation system did not reveal significant legality and regularity errors on payments made by ECRO. Although the systems of internal control are generally functioning satisfactorily there is a need to establish a system for auditing payments made by intermediaries.

Overall conclusion

5.32. The audit of payments in the four areas selected, the limitations of which are indicated in paragraph 5.14, did not reveal significant legality and regularity errors. However, it was found for expenditure managed by NGOs that unsubstantiated expenditure can too easily be included in the project financial reports. The audit also revealed the need for improvements in the systems of internal control, notably:

⁽⁵⁾ The TAU was set up in September 1998 to support ECRO in its management of the deconcentrated system, particularly in relation to contracting.

- (a) the need for effective systematic audit arrangements in all four areas;
- (b) the need to ensure an adequate audit trail showing the exact nature of costs being submitted for co-financed operations managed by NGOs.

The dispersal of actions and centralised procedures

5.36. The Special Report indicated that too many actions were spread over a wide number of sectors. The Community had not identified what role it should play in assisting the South African authorities to strengthen their institutional capacities. The Special Report also observed that the Commission had not made sufficient resources available to manage the programme which was aggravated by complex and centralised administrative controls.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

Introduction

5.33. The Court reviewed the information presented by the Commission on the action taken to deal with the most important of its past observations. This limited review, carried out on the basis of information presented by the Commission, has attempted to identify the areas within which such measures have been taken without making a detailed check of their implementation.

5.34. The Court's review deals with the following past observations:

- (a) Special Report No 7/98 on South Africa ⁽⁶⁾;
- (b) Annual Report 1996, *Fondo Especial de Promoción de los Exportaciones de Honduras y Nicaragua* (FEPEX);
- (c) evaluation procedures in the fields of Phare and Tacis dealt with in various reports of the Court (see paragraph 5.50).

Special Report No 7/98 on South Africa

5.35. The Special Report on South Africa dealt with the management and implementation of the aid provided in the 1993 to 1997 period. The Court observed the dispersion of the actions in relation to overly centralised procedures, the lack of coordination with other donors, in particular the Member States, and the weakness of the Commission's information systems.

5.37. Although the actions are still spread over a large number of sectors, an increasing part of the aid is now being used for institutional strengthening. Also the government departments are more intensively used as implementing agents. The new regulation on aid to South Africa focuses on fewer sectors and is more precise about achievement indicators. However, this regulation, presented to Parliament in May 1999, was still not adopted in April 2000 by the Council.

5.38. Since 1998 the Commission has strengthened the Delegation in Pretoria. From mid-1999 onwards also a process towards greater decentralisation has started for the Delegation in South Africa, which is one of the Commission's pilots for an overall decentralisation programme. In order to facilitate the application of procedures, the South African Delegation developed a procedure manual which is regularly updated to take account of changing circumstances.

Coordination with other donors

5.39. The Special Report noted that the Commission's coordination with Member States was weak and that the coordination with other major donors (United States, World Bank and United Nations Development Programme) was virtually absent.

5.40. The coordination with Member States has improved, in particular in connection with the preparation of the Country Strategy Paper. Also Member States' representatives were invited to attend the annual meeting between the Commission and the National Authorising Officer. Nevertheless, the coordination is still far from a common approach to and assessment of the aid. On the coordination with non-member States an

⁽⁶⁾ OJ C 241, 31.7.1998.

evaluation made by the Commission in 1999 ⁽⁷⁾ stated that important donors such as the World Bank and USAID are often unaware of activities of EU donors and vice versa and that there are no efficient systematic and structural mechanisms for coordination.

Financial information system

5.41. The Special Report pointed out that the ability of the Commission to monitor adequately the implementation of projects was weakened because of the poor state of its information systems. As a consequence projects remained unnecessarily opened in the Commission accounts, overstating outstanding liabilities.

5.42. The Commission introduced a new information tool in 1996 for South Africa. This system was abandoned, and a new information system is being introduced in the SCR ⁽⁸⁾. This system should include a link with the information system of the South African Ministry of Finance.

5.43. Despite the slow progress on the information system, in 1999 the Commission closed 107 projects of the period 1986 to 1994, leaving 19 projects to be closed as at 31 December 1999. All closures were based on audit reports. Amounts recovered have been placed in a bank account for South Africa which can be used to finance future actions.

5.44. The limited review has shown that the Commission has taken a number of steps to improve its management of aid to South Africa. However, coordination with other donors needs further improvement.

Annual Report 1996: Fondo Especial de Promoción de las Exportaciones de Honduras y Nicaragua (FEPEX)

5.45. The FEPEX project aimed mainly at stimulating growth in exports and increasing the flow of foreign exchange into the Nicaraguan and Honduran economies. The total project cost was 32 million ECU; of this

amount 30 million ECU was for the credit fund while the remaining 2 million ECU was to finance technical assistance services.

5.46. In its 1996 Annual Report the Court identified a number of weaknesses in the management of the Fund:

- (a) the *Banco Centroamericano de Integración Económica* (BCIE) ⁽⁹⁾ appropriated for itself higher remunerations at the expense of the project funds than foreseen in the Financing Agreement (FA);
- (b) BCIE provided the Commission with inadequate information;
- (c) monitoring by the Commission and the technical assistance was insufficient;
- (d) at the Commission's request, amounts unduly charged by the BCIE have been transferred to the project fund.

5.47. The Council in the 1998 discharge ⁽¹⁰⁾ called on the Commission to review its relations with the BCIE and to recover without delay the amounts unduly credited by the BCIE to its accounts.

5.48. The Commission took the following steps:

- (a) a firm was commissioned to recreate FEPEX's unreliable accounting records and subsequently an independent external annual audit of the fund's accounts was introduced. Three audits have now been carried out without finding major problems;
- (b) a study has been carried out to obtain a better understanding of the Central American banking system and to appraise the potential for financial and technical cooperation between the EU and other financial institutions in the region;
- (c) at the same time, another study assessed the agreements between the BCIE and the Commission, in order to look for new ways of cooperating with the

⁽⁷⁾ The Commission's evaluation of EC Country Strategy: South Africa 1996 to 1999, August 1999.

⁽⁸⁾ Common Service for External Relations.

⁽⁹⁾ A regional public financial institution which managed FEPEX as well as other funds.

⁽¹⁰⁾ Paragraph 3 of Chapter 13 of the 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 (ref: SN 2017/98-GD F II).

BCIE and to evaluate alternatives for the achievement of the European Union's objectives in the region ⁽¹¹⁾;

- (d) at the Commission's request, amounts unduly charged by the BCIE have been transferred to the project fund.

5.49. As a result of these studies, the Commission intends to design a new framework for cooperating with the BCIE which should lead to a new organisation created by the Commission, the BCIE and other partners.

Evaluation procedures for Phare and Tacis

5.50. The Court's Annual Reports concerning the financial years 1995, 1996, 1997 and the Court's Special Reports No 3/97, No 6/97, No 11/98, No 25/98 all contained observations on the inadequate evaluation procedures for Phare and Tacis programmes.

5.51. The follow-up review of the evaluation procedures for Phare and Tacis programmes identified a number of positive features since the establishment of a Phare and Tacis evaluation unit in the SCR in 1997. In particular, the backlog of evaluations for these two programmes has been largely caught up, the majority of sectors having now been subject to evaluation. All evaluation reports are made available on the website of the SCR and are frequently consulted. However, as discussed in the following paragraphs, despite the progress made, a number of improvements are still required.

5.52. The independence of the evaluation work should be further strengthened. The evaluation unit is currently placed at the same level as operational units in the SCR: its independence could be enhanced by ensuring that its reports are sent directly to a more senior level in the Commission. Several cases were noted where experts were found to be evaluating sectors where they had already been involved in the implementation. The Commission should more strictly apply its own rules to avoid such confusion of interests.

⁽¹¹⁾ 'Informe sobre los sistemas bancarios de Centroamérica', EP-CONSEIL, December 1997: the conclusion of this study was that taking into consideration the weakness of the Central American banking system, the cooperation with the BCIE was the only acceptable option.

5.53. The Commission ⁽¹²⁾ has identified three different objectives for evaluators (to improve the design and management of programmes, to enhance accountability and/or to support budgetary decision-making) but it is not always clearly spelled out which objective in particular is to be met by a given evaluation. The specific purpose of each evaluation should be more clearly identified in the terms of reference.

5.54. While the evaluation reports reviewed were generally of an acceptable standard, there was, nevertheless, considerable variation in the quality. Reports were often found to be excessively long and produced with significant delays. The evaluation unit itself has not formally assessed the quality of the reports.

5.55. The SCR evaluation unit has no procedures for monitoring the follow-up to reports by the operational units. One of its main tasks should be to monitor the use of evaluations by the operational services to ensure that recommendations are fed into the programming and implementation phases of the project cycle. Indeed, each evaluation report should be examined in such a way that an agreed plan can be prepared identifying what action should be taken, and by whom.

OTHER OBSERVATIONS

Phare public administration programmes

Introduction

5.56. The objectives of the public administration programmes, which started in 1990, were to contribute to the development of a modern public service to serve the needs of a democratic society based on a mixed economy and to contribute to the continuing process of economic transition. In view of the accession prospects, this objective was modified to also take into consideration the obligations connected with the adoption of the body of EU law by the candidate countries.

⁽¹²⁾ Communication to the Commission by the Directors-General of DG XIX and DG XX, SEC(96) 659 final.

Table 5.3 — Public administration programmes (Phare)**A — General public administration programmes**

(Mio EUR)

	National	Multicountry	Subtotal
1990-1997	331,24	23	354,24
1998-1999	431,74	12	443,74
Subtotal	762,98	35	797,98

B — Customs programmes

(Mio EUR)

	National	Multicountry	Subtotal
1990-1997	50,75	34,30	85,05
1998-1999	6,75	0	6,75
Subtotal	57,50	34,30	91,80

C — Statistical programmes

(Mio EUR)

	National	Multicountry	Subtotal
1990-1997	43,66	35,50	79,16
1998-1999	6	20	26
Subtotal	49,66	55,50	105,16

Total amount for programmes (A, B and C)

(Mio EUR)

	Total support	% of total Phare budget
1990-1997	518,45	6,65
1998-1999	476,49	17,55
Total	994,94	24,20

5.57. The Phare national and multicountry programmes in this field represented about 6,7 % ⁽¹³⁾ of the whole Phare budget between 1990 and 1997 and concentrated on three major aspects: general public administration

(354 million euro), the customs service (85 million euro) and statistical services (79 million euro) (see **Table 5.3**).

5.58. The Court's audit that was carried out in 1998 and 1999 focused on four beneficiary countries (Hungary, Czech Republic, Romania and Slovenia) and involved the review of 23 programmes in the 1990 to 1997 programme period.

Support to general public administrations

5.59. Between 1990 and 1997 Phare national programmes amounting to 331 million euro financed

⁽¹³⁾ Amount committed; only the Desiree database offers 'public administration programmes'. Indirect support by other programmes concerning agricultural restructuring, infrastructure, the financial sector, etc., can only be estimated in view of the limitations of the accounting tools available.

principally training courses, seminars, study tours, computer equipment, the drawing up of recommendations on the institutional reform needed and the implementation of such recommendations.

5.60. The majority of the programmes examined were designed in the absence of a strategy, which should have been adopted by the governments of the beneficiary countries despite the fact that the results were very much dependent on their political will to implement the planned reforms. In addition, most of the objectives formulated in the Financing Memoranda ⁽¹⁴⁾, as well as in the contracts ⁽¹⁵⁾, were excessively general. Furthermore, the lack of performance indicators made it very difficult to assess the achievements of the projects carried out.

5.61. The implementation of many programmes suffered from lack of commitment in the beneficiary countries and, on both sides, high staff turnover as well as heavy administrative procedures and finally, lack of central structures in the organisations concerned and poor coordination. As a result, projects were often launched late and with excessive haste, just before the expiry of the programme.

5.62. In contrast to the more specific programmes in the fields of statistics and customs (see paragraphs 5.64 to 5.72), no major progress was made. There was a tendency to launch expensive training activities without either a coherent strategic framework, stable and durable institutional coordination or reliable evaluation of needs.

5.63. In contrast to the rather general approach followed for the national programmes, the SIGMA secretariat ⁽¹⁶⁾, in implementing the Phare multicountry programmes (23 million euro), concentrated on specific actions designed to meet the needs of the beneficiaries, who appreciated this kind of support. These multicountry programmes contributed to making candidate countries aware of the importance of an efficient, independent and democratically accountable public administration.

⁽¹⁴⁾ Agreed between the Commission and the beneficiary country.

⁽¹⁵⁾ Agreed between the beneficiary country or the Commission and external consultants.

⁽¹⁶⁾ Support for improvement in governance and management in central and east European countries, a joint initiative by the OECD and the EU and 90 % financed by the Phare contracts. The Sigma secretariat is part of the OECD organisation.

Support to the customs services

5.64. Phare national programmes supporting customs services, amounting to 51 million euro between 1990 and 1997, focused on the computerisation and the supply of equipment supported by technical assistance. It was difficult to retain the staff who had been sufficiently well trained to maintain the new systems, which reduced the effectiveness of the programmes. Better results could have been achieved if the approach could have followed an EU-compatible legislation already in force and had been more harmonised, planned and coordinated.

5.65. Phare multicountry programmes in this field amounting to 34 million euro in the same period concentrated mainly on customs legislation and procedures, the efficiency of anti-fraud measures, the simplification of procedures applying to international trade and the international cooperation between the national customs services involved.

5.66. In 1997, the Commission's DG responsible for the Taxation and Customs Union ⁽¹⁷⁾, Eurocustoms ⁽¹⁸⁾ and the Customs PCU ⁽¹⁹⁾ together with the Member States and the candidate countries, developed a 'pre-accession strategy in the customs and taxation sector'. This strategy identified 12 key areas ('Blueprints') which needed to be addressed in establishing a customs service capable of implementing and applying EU customs and related legislation. In addition, 'Declarations of endorsement' were expressed at a high political level. In contrast to the general public administration programmes, there was a clear will for reform in the partner countries' customs and tax administrations including the commitment to make available the necessary resources.

5.67. An important achievement of the multicountry programmes was the Commission's success in motivating the Phare beneficiary countries to carry out 'gaps

⁽¹⁷⁾ Called DG XXI until 1999.

⁽¹⁸⁾ Created in November 1991 by the customs administrations of the Member States as a non-profit consortium upon an initiative of the Commission. Eurocustoms is financed up to 95 % by contracts with the Commission.

⁽¹⁹⁾ Programme coordination unit in Ljubljana, run by an external firm.

and needs analysis' ⁽²⁰⁾ on their way to accession to the EU. Concrete needs were identified and addressed in individual national action plans, which aimed to form the basis for future Phare assistance.

5.68. DG XXI as the European Union's expert in customs was — in contrast to Eurostat (see paragraph 5.70 below) — only partly involved in the design and implementation of the customs programmes, although their greater participation would have been desirable. They were used as technical experts, but they never took on the role of a coordinator for implementation, which was contracted to Eurocustoms (7, 8 million euro) and the PCU (5, 3 million euro) for the multi-country programmes.

Support to the statistical services

5.69. Phare national programmes supporting statistical services (amounting to 44 million euro between 1990 and 1997) provided the beneficiary countries with hardware and software together with technical assistance. This created or strengthened their capacity to run a survey-based modern statistical system. As in the customs sector, it was difficult to retain the staff who had been sufficiently well trained to maintain the new systems, which reduced the effectiveness of the programmes.

5.70. Phare multicountry programmes (amounting to 35 million euro between 1990 and 1997) financed regional pilot projects, study visits, training courses, seminars and working groups. They focused on cooperation between Eurostat ⁽²¹⁾, the statistical offices in the Member States and the corresponding bodies in the beneficiary countries. The objective of this cooperation

⁽²⁰⁾ Blueprints, laying down minimum requirements for candidate countries in customs key areas to be fulfilled in view of EU accession and to be reviewed and amended when necessary, formed the basis for identifying the gaps and needs between theory and what was in place in real terms in individual countries. This exercise started in March 1998 with five candidate countries (Czech Republic, Estonia, Hungary, Poland and Slovenia) and in December 1998 with all other Phare beneficiary countries.

⁽²¹⁾ The European Statistical Office.

was to ensure conformity of statistical data with EU requirements.

5.71. The candidate countries had already expressed their political commitment in 1994 and 1995. Subsequently they made considerable efforts, assisted by Phare statistical multicountry programmes, to strengthen their statistical systems by establishing accurate, reliable and timely data which complied with international standards and methods. As a result the candidate countries are now producing statistics in a number of areas according to EU principles, procedures and definitions.

5.72. The justification for employing CESD ⁽²²⁾ (15 million euro) as a technical assistance contractor through a direct agreement is open to question. The work required was such that it should have been allocated to a contractor selected on the basis of a call for tenders.

Conclusions

5.73. Due to the lack of commitment in the beneficiary countries together with the absence of clear national strategies and clearly defined objectives, Phare general public administration national programmes audited were not sufficiently efficient or effective. In contrast, the SIGMA multicountry programmes, which had a very limited scope and specific nature and wide dispersion of their actions, were more successful and could be one of the appropriate instruments for continuing with Phare support of general public administration reform. Furthermore, from 1998, as a result of the fundamental reorientation of Phare, twinning ⁽²³⁾ will be the main instrument to help candidate countries to develop their own institutions and training systems.

⁽²²⁾ The European Training Centre for statistical economists from developing countries.

⁽²³⁾ Long-term secondment (over one year) of Member State officials, known as pre-accession advisers, supplemented where appropriate with short-term expertise to tackle specific needs of candidate countries.

It is to be hoped that this new instrument for institution-building ⁽²⁴⁾ will be more conducive to the efficient and effective use of resources.

5.74. Since cooperation in the fields of customs and statistics is an issue affecting more than one country, Phare multicountry programmes proved, for the period reviewed, a more effective means to implement the assistance than Phare national programmes.

Refugee return programme in Bosnia

5.75. As part of its audit of the deconcentrated system in Bosnia, the Court also carried out a brief review of the overall Commission aid programme to Bosnia, focusing on the implementation of refugee return programmes financed from the 1998 budget ⁽²⁵⁾. Programmes of this type represent the largest area of EU expenditure in Bosnia, commitments for 1998 programmes amounting to 82 million euro.

5.76. The main component of each programme was the repair of houses: 6 255 houses were planned to be repaired at an average cost of 8 632 euro. A detailed review by the Court of eight of the 30 programmes concerned showed that in three cases actual unit costs were more than 20 % higher than those stated in the contract. In virtually all cases, the programmes took no account of the beneficiaries' capacity to finance repairs, programmes instead being totally grant funded.

5.77. Despite the fact that the original deadline for programme implementation was generally April 1999, at the end of 1999 only 79 % of the houses had been finished. This was mainly due to an underestimation of the difficult implementation conditions in Bosnia, but delays in payments by the Commission also slowed down projects (see paragraph 5.8). Although significant breakthroughs were achieved through the 1998 programmes in terms of minority returns ⁽²⁶⁾, overall, according to Commission monitors, a third of the 4 937 houses completed were unoccupied in early 2000. This

⁽²⁴⁾ Reinforcing of the institutional and administrative capacity of the applicant countries.

⁽²⁵⁾ The Court's Special Report No 5/98 on reconstruction in former Yugoslavia (1996/1997) covered the earlier return programmes (OJ C 241, 31.7.1998).

⁽²⁶⁾ The return of Bosnian Muslims and Croats to the Serb Republic and the return of Serbs to the Federation.

situation was partly the result of delays in restoring basic amenities such as electricity, but also often reflected a reluctance to return to rural areas, particularly given the poor employment prospects. Approximately three quarters of the beneficiaries of working age who had returned to their homes were unemployed.

5.78. Although the programmes generally included a job creation component, the percentage of programme funds allocated to this was only approximately 4 %. More fundamentally, in the absence of any economic conditionality to the EU aid, and despite the wide-ranging powers of the Office of the High Representative, job creation continued to be seriously hindered by administrative conditions in Bosnia which discouraged investment.

Observations on sound financial management issues deriving from the audit of NGOs

5.79. In parallel with the financial audit of the aid channelled through the NGOs, the overall management of this aid was examined. As most of the expenditure is financed from budget line B7-6 0 0 0 'Community contribution towards schemes concerning developing countries carried out by non-governmental organisations', the systems audit concentrated on this area.

Appraisal

5.80. Applications for funding are submitted to the Commission by the European NGOs responsible for the proposed projects. The Commission checks whether the NGOs and the proposed projects are eligible for co-financing and obtains an opinion from the delegation of the developing country in which the proposed project is to be carried out.

5.81. The Council Regulation ⁽²⁷⁾ governing the co-financing operation with NGOs states that in its Article 6, 'as a rule, the decision as to whether an operation is to be supported should be taken within six months of the date of receipt of the application. If, in examining the file, it emerges that the application is incomplete, the six-month period shall run from the date of receipt of the information required'. In the sample of projects audited, the average time taken between the

⁽²⁷⁾ Council Regulation (EC) No 1658/98 of 17 July 1998 (OJ L 213, 30.7.1998).

application and the receipt of the decision was 12 months. If the Commission requests for further information or modifications are taken into account, the average time taken was reduced to seven months.

5.82. Long delays can lead to a deterioration in the relationship between the European NGO and the local counterpart and can lead to practical management difficulties. For example, there can be staffing problems when people planned to work on a project are no longer available or local needs may change in which case modifications may have to be made to the project or it may no longer be as relevant.

5.83. During the Commission's assessment of the project applications, the NGOs did not receive any feedback on the progress of their applications nor did they know the criteria applied for the selection of projects other than the general ones laid down in the Council Regulation ⁽²⁸⁾. There should be greater transparency so that all parties are adequately informed.

Reporting

5.84. The General Conditions for the co-financing of projects undertaken in developing countries by non-governmental organisations require the budget and statements of expenditure to separately disclose the expenditure financed by the EU and that financed by other sources (the European NGO, the local partner and other organisations). In practice this means that cost items are individually allocated to donors rather than the total project costs simply being split on a pro rata basis.

5.85. This separation is artificial since the allocation of costs to individual donors is often done on the basis of the availability of unspent donor's cash advances rather than for operational reasons. A significant risk arising from this procedure is that costs which are ineligible for EU purposes are allocated to non-EU donors on the assumption that only the EU-funded costs need to be eligible. In fact, all expenditure relating to an EU co-financed project should meet the EU eligibility requirements. A further implication of this requirement is that the administrative effort and therefore cost is increased by the need to maintain separate accounting records for each donor.

⁽²⁸⁾ Council Regulation (EC) No 1658/98 of 17 July 1998 (OJ L 213, 30.7.1998).

5.86. The General Conditions provide that the administrative expenses of the European NGO may not exceed 6 % of the direct costs of the project. A similar provision should be included to limit the administrative expenses of the local NGOs. Furthermore, local partner administrative expenses should be clearly and separately disclosed in the project application and financial reports because at present they are included in the expenditure categories of the direct costs of the project.

5.87. A variety of methods used by the local partner to convert expenditure in the local currency to the currency of the statement of expenditure sent to the European NGO were observed during the audit and in some cases the NGO was unaware of the method that had been used. Clearer instructions should be provided by the Commission for the exchange rates to be used.

5.88. Guidelines to NGOs for the main NGO co-financing budget line B7-6 0 0 0 are provided by the Commission's General Conditions. However, there are a number of other budget lines involving NGOs which use different procedures and formats, which it would be desirable to harmonise. In particular, the standardisation of application and reporting formats would reduce confusion and risk of error, increase transparency of the operations and simplify the work of both the NGOs and the Commission.

Results

5.89. The Commission's contracts usually set a three-year period for the co-financing of projects. This rarely corresponds to the NGOs' activities, which are usually over a longer period of time. Thus the EU-funded project is part of a longer programme and the true impact, assuming that the NGO finds sufficient funds to continue its activities, is only apparent some time after the conclusion of the EU-funded project.

5.90. The objectives of projects as stated in the applications sent to the Commission are not always clearly defined and rarely is any attempt made at quantifying them or setting monitoring or performance indicators. This means that it is not easy to properly assess the ongoing management of projects or their final impact when completed. Such information is also of importance when assessing applications for future projects. It

appears that the Commission does not consider the provision of such information high priority. This is illustrated by the fact that in undertaking their review of activity reports the Commission does not normally request further information on indicators when this information is missing.

5.91. The Council Regulation ⁽²⁹⁾ stresses in Article 2 the importance of sustainable development and of sustainable impact in project design. The concept of sustainability is not always clearly understood and needs to be properly defined. For example it needs to be made clear whether it is the project itself that will continue to be able to function after the EU support ends or whether the impact of the project (training, etc.) on the individuals benefiting from the activities carried out is sustainable. The interpretation of the concept causes particular difficulty when considering projects concerned with institutional support rather than those directed towards capital investment.

5.92. In its contracts with NGOs, the Commission does not usually require independent evaluations of projects to be carried out. It is thus left to the NGOs themselves to decide whether an evaluation should be carried out and to finance the costs involved. Given the importance that the Commission attaches to the evaluation procedure and the fact that evaluations can be useful in assisting NGOs in improving their management of projects, the Commission should consider offering more financial assistance for them to be more systematically carried out. The evaluations should be made available to the Commission to help its own management, including to take into account such conclusions for the evaluation of future project applications.

Block grants

5.93. Block grants are proposed annually to NGOs which have been co-financed for at least three of the last five years. The funding, in the form of a single advance payment, covers up to 85 % of the cost of mini-projects (for a maximum amount of 20 000 euro) lasting up to 12 months. Block grants have the advantage of enabling European NGOs to make use of the money quickly and flexibly for the projects which they consider the most important. However, the grants are given in the absence of a clear framework setting the priorities in terms of the type of project or the beneficiary country and neither the Commission in Brussels nor the delegation of the developing country concerned

are aware of the mini-projects before they are carried out.

Agreement between the European Community and the United Nations

5.94. As from 9 August 1999 onwards an agreement between the European Community (EC) and the United Nations (UN) came into effect, which is intended to govern the terms and conditions set out in the clauses of financing agreements or contracts signed between the Commission and UN agencies, particularly in the fields of humanitarian aid and development cooperation.

5.95. Such an agreement was considered necessary to facilitate relationships in the context of the Commission's participation in programmes run by UN agencies.

5.96. However, instead of resolving the fundamental question of what the relationship should be between the UN and the Commission, the new agreement deals with detailed contractual arrangements at an operational level. Almost each time that it seeks to define the terms to be applied, exceptions are provided for. The fundamental incompatibilities between the approaches of the UN and the Commission are not addressed in the agreement. As a result it is likely that relations will remain strained and difficulties in monitoring and auditing by the Community of activities administered by UN agencies will persist.

5.97. Although in reality most of the Commission's financing is a participation in the co-financing of the general programmes of UN agencies (similar to other donors), the Commission formulates its financing as contracts for specific projects to be identified separately from the rest of the programmes (so-called 'earmarking').

5.98. On various occasions the Court has criticised this approach ⁽³⁰⁾, which does not in practice enable the Commission to obtain assurance that it is not financing — directly or indirectly — those expenses which it does not wish to be charged to its account. This is the inevitable consequence of the interchangeable nature (fungibility) of the funds contributed by various donors.

⁽²⁹⁾ Council Regulation (EC) No 1658/98 of 17 July 1998 (OJ L 213, 30.7.1998).

⁽³⁰⁾ Special Report No 2/97 on humanitarian aid (OJ C 143, 12.6.1997); Special Report No 5/98 on the reconstruction in former Yugoslavia (OJ C 241, 31.7.1998).

5.99. The different concepts of the Commission and the United Nations require different procedures and control arrangements, which an agreement such as the current one cannot reconcile. Under the present system, scarce management resources in the Commission and in the UN agencies will continue to be devoted to the largely unproductive administrative and procedural tasks that are necessary to deal with a large volume of fragmented contracts and their numerous modifications without real benefits being derived from such efforts.

5.100. Since November 1999, the authorised representatives of the Commission and the Court have held exchanges of views on the risk of deadlock that this situation creates from the point of view of financial control of the measures. However, these high-level contacts have not been enough to make the Commission aware of (or admit to) the fact that the approach selected was not practically viable. In fact, it is clear that the Commission believes that it is utterly obliged to provide a clear and complete justification, with evidence in support of its position, of all expenditure which it co-finances, even when, in actual fact, this financing only represents one part of a complex of payments which cannot be broken down by very reason of the way they were made.

5.101. However, in the prevailing context of co-financed operations, efficient financial control can only be achieved if the operation is considered in its entirety from the very start to the very end. Therefore, the Community should seek a much more global approach. It should start by deciding, based on proposals from the Commission, to which UN agencies and programmes it is prepared to provide funds, on the basis of criteria such as:

(a) the concordance of the mission of the entity with the objectives of the Community;

(b) the overall soundness of the management of the entity's programmes;

(c) its commitment to administrative and financial reform;

(d) its overall accountability;

(e) the quality of the information it provides on the actual result of its activities.

5.102. Once it has decided to support the operations of an agency or a programme, the Commission should then ensure that the objectives of the programme are met, and that the intended results are achieved. It should also make sure that the other co-financing contributions are actually received from the other donors, and that the UN agency takes the steps necessary not only for the implementation of the programme, but also for the correct reporting on physical and financial implementation to the main donors including the Commission. It could achieve this by some form of permanent representation in the programming and administrative organs of the UN agencies, and by involvement in the audit arrangements of such agencies. The UN should be prepared to agree to this in return for the large contributions from the Commission, which has the obligation to ascertain and demonstrate that it has managed its contributions in a sound and efficient manner.

5.103. The Community must also be prepared to reduce or even suspend its support to UN agencies which fail to perform to an acceptable standard. This would be a much more satisfactory approach to ensuring that value for money is being obtained than artificially concentrating on the details of implementation of individual contracts for projects arbitrarily selected for financing by the Community.

THE COMMISSION'S REPLIES

IMPLEMENTATION OF THE BUDGET

Changes in and use made of appropriations in 1999

5.3. The Commission provided detailed comments on the implementation of the majority of budgetary appropriations in response to the observations made by the Court in its 1998 Annual Report. The Commission's comments in its presentation of the accounts for 2000 will be more concise.

Commitment appropriations

5.4. The Commission is doing what it can, within the present legal framework, to avoid an excessive concentration of commitments at the end of the financial year. However there will inevitably be a build-up in the second half of the year because the budget is annual and the current statutory procedures for consultation and approval of financing decisions are complex.

The Commission has therefore proposed a reform of external aid management:

- focusing the role of management committees (with the Member States) on strategy rather than examination of individual projects,
- strengthening the multiannual programming approach,
- organising tasks more efficiently in Europe Aid,
- increasing resources.

If these proposals are adopted by the budgetary and legislative authority commitments should eventually be spread more evenly over the year.

The rate of commitment of appropriations under the other budget headings not listed in Table 5.2 presented by the Court appears to be satisfactory.

5.5. The carrying over of appropriations is an exception to the principle of annuality laid down by the Financial Regulation.

The provisional appropriations in Chapter BO-40 were released after a number of conditions had been met including the adoption of a legal basis. They were moved to the heading by transfer approved by the budgetary authority. In the wake of the Balkans crisis appropriations were entered under the headings in question by means of a supplementary and amending budget rather than a transfer. The budgetary authority therefore clearly considered the Commission's request in its preliminary supplementary and amending budgets Nos 4 and 5/99 to be justified.

Payment appropriations

5.6. The Commission had requested payment appropriations in view of the large volume of outstanding commitments under budget heading B7-4 2 0 0 (115 million). The Commission also decided in 1999 to clear the backlog of payments in the external relations field and to make use of outstanding commitments to close old projects and to reduce their volume under heading 4.

The political situation in the Middle East has meant that implementation of most of the Community projects financed under heading B7-4 2 0 0 has been delayed or even interrupted. This was why the Commission undertook transfers of appropriations which were approved by the budgetary authority.

5.8. The increase in advances paid in 1999 is a logical consequence of the increased decentralisation of Phare programme management. The phenomenon described by the Court is due largely to the payment of the first instalments to the National Funds in the latter half of the year. The figures given by the Court must be seen in relation to the number of programmes adopted as this is the only way to see what they represent. The total amount of advances in 1999 accounts for only 11 % of total appropriations allocated to Phare countries since 1995 (corresponding more or less to the programmes still under way) and advances which had not been used at the end of the year correspond to only 6 % of these amounts. Furthermore the percentage of funds which had not been used by the NF PMU by the end of the year was one point less than in 1998 demonstrating that, in relation to the volume of appropriations to be managed, these funds fell rather than increased as the Court suggested.

5.11. The delay in adopting supplementary and amending budget No 4/99 meant that a number of projects could not

be finalised for commitment or could not get under way as had been planned when the draft was submitted by the Commission before the end of the financial year.

5.12. In the case of Yugoslavia the payment estimates for the year proved to be correct throughout the whole of the year. The delegation in Sarajevo found itself in difficulties at the end of the year when it had to meet not only the commitments to which it had logically given priority but also payments. The appropriations carried over are required this year to clear the backlog in payments.

The carryover of EUR 121 million in payment appropriations for Chapter B7-21 is both exceptional and unforeseeable. In the two preceding years (1997 and 1998) ECHO used up virtually all the payment appropriations (initial and supplementary appropriations).

The relatively slow rate of implementation of payment appropriations in 1999 is due to the three increases (EUR 376 million) required to deal with the Kosovo crisis and the earthquake in Turkey. The same amount in commitment and payment appropriations were allocated at the same time. Some of these extra funds did not become available until the second half of 1999 and, although all commitment appropriations were used, some of the payments could not be made until this year when these operations were closed.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Phare decentralised implementation system (DIS)

5.16. Closures are systematically carried out on projects which are centrally managed (although delays in the work programme for audits have slowed this process to some extent), and audits are planned. Nevertheless, pending the results of the audits, the Commission has proceeded with issuing recovery orders and decommitments to the fullest extent possible at this stage. At the end of 1999, the Commission had issued, both for centralised and decentralised programmes, 625 recovery orders for a total of EUR 111 million and 711 decommitments for a total of EUR 225 million, and had closed 3492 contracts for an amount of EUR 69 million.

The procedure for closing decentralised programmes is more complicated, time-consuming and requires additional resources than for closing centralised programmes, as the former involves

audits to be carried out with the involvement of the local authorities.

Despite the problems encountered in setting up the SCR's audit service considerable progress on closing decentralised programmes was made in 1999. On the basis of available documentation financial analyses were carried out for programmes adopted up to 1995 for which disbursement ended in 1998/1999.

5.17. The Commission shares the Court's concerns. Efforts will be made to close local programmes by the end of the year and these will continue throughout 2001.

Special funds

5.19 and 5.20. Effective aid delivery requires adequate instruments. The use of procurement agents via a procurement contract is such an indispensable instrument. A procurement contract consists of two parts: a management fee and a special fund.

Establishment of special funds is provided for in Article 31 of the General Conditions for service contracts financed from Phare/Tacis funds. They can therefore, in theory, be requested by any contractor for a Tacis contract which includes a requirement for purchase of equipment or organisation of study tours where the cost, for one, the other or both, exceeds EUR 20 000.

5.20. Special funds, as part of contracts, are followed and audited like contracts, i.e. the expenses are verified at the latest on the occasion of the final invoice relating to that contract.

This is not simply a question of finding an appropriate accounting procedure but an efficient way of managing special funds.

Non-governmental organisations (NGOs)

Systems of internal control

5.21 to 5.24. When the RELEX Directorate-General were reformed and the SCR set up the Commission looked at the most appropriate way of monitoring the use of external aid funds moving towards simplified ex ante control and more detailed and more appropriate ex post control.

A number of measures have been adopted to allay the Court's concerns:

(a) an information memorandum of 22 July 1999 to the Commission on the financial security of NGO grants and external aid operations;

(b) use of a standard contract (obligatory since January this year) for external aid grants.

This contract sets out the monitoring arrangements for Articles 2 to 8, and article 6 of Annex I (audit/evaluation: this exercise may have different objectives according to the terms of reference adopted. However for budget heading B7-6 0 0 0 the Commission appraises projects on the basis of their results in the light of the needs expressed by recipients).

The budget annexed to the contract may only include the eligible costs listed in Article 14 of Annex II. It is clearly stated in this Article that any benefits in kind are not costs eligible for Community co-financing;

(c) the General Conditions came into effect on 1 January and do not contain any other Article on the obligations or rights relating to grants. These are set out in the standard contract;

(d) the call for proposals for co-financing of NGO projects states that projects must follow the project cycle. This is intended to clarify what results are expected and to improve the quality of projects undertaken by NGOs on the ground;

(e) provided the budgetary authority makes available the necessary appropriations, the Commission will continue its decentralisation exercise for the delegations and increase the number of staff in Brussels. Eventually, once they have more staff the delegations will be able to play a greater role in monitoring projects co-financed with NGOs.

The Commission would also point out that in addition to the four specialised evaluations it conducted five years ago it has embarked upon an overall evaluation of budget heading B7-6 0 0 0 and the results are expected by the end of the year.

As regards the Court's suggestion that delegations should have greater involvement in monitoring projects, it should be noted

that under the external aid reform process adopted by the Commission on 16 May there will be a substantive increase in human and financial resources for the delegations. This will enable them to play a greater role and participate in monitoring NGO projects co-financed by Community aid.

The selection criteria defined in the operational guide for handling projects drawn up in March explicitly include the applicant NGO's performance in internal monitoring of co-financed projects. By way of example, eligibility checklist 1b includes an assessment of a European NGO's ability to support projects proposed by local partners (paragraph 13) and the nature and extent of its links with similar organisations in developing countries (paragraph 14).

Legality and regularity of the underlying transactions

5.25 and 5.26. The department in question has requested additional information from the NGOs. If the information it receives is not satisfactory it will issue a recovery order.

Conclusion

5.27. With effect from 1 January improvements have been introduced in response to the need for an approach (three major changes: standard contract, call for proposal, accounting system) which takes into account the rapid growth in the number of NGO projects financed or co-financed from EU funds and the need to improve the quality and impact of the measures. New procedures for the selection, appraisal and management of projects and programmes have been introduced with a view to increasing accountability and transparency. A standard contract for subventions has been introduced, which provides for a standard reporting system more focused on results. The rules for accounting and audit have also been changed. The new rules will lead to a much more uniform and effective monitoring of these projects.

Bosnia deconcentrated implementation system

5.28. The current arrangements whereby Section Control and Finance in common with Section Operations reports to DG RELEX will be revised to take account of the Communication to the Commission on the reform of the management of external assistance (SEC(2000) 814). This provides for reunification of the project cycle from identification through full implementation under the responsibility of Europe Aid

replacing the SCR (*Service Commun Relex*). The relationship between the Delegations and Europe Aid's various services will be defined at the start of the new service.

5.29. The manual of July 1999, 'Guidelines for the implementation for Phare and Obnova programmes in Bosnia-Herzegovina' is being updated to take account of the manual of instructions adopted by the Commission in November 1999. A further updating of the manual to reflect the revisions of the Phare decentralised implementation system (DIS) manual, which is under revision, will be required. The manual will be adopted in definitive form following its revision after updating of the DIS.

The responsibilities of the technical assistance unit (TAU) are described in the terms of reference of the contract between the Commission and the contractor and refined in an internal 'Procedural reference manual'. These responsibilities have been defined so as to minimise the workload on the Delegation while maintaining the appropriate control over contracting. Changes in the operation of the TAU designed to enhance the delivery of assistance, including more efficient procurement assistance, are introduced on an ongoing basis.

5.30 and 5.31. An audit team composed of two members of staff was established in March. It is responsible for performing direct checks on the spot as well as contracting independent auditors for more substantial audits. The team has performed seven checks on NGO projects resulting in one recovery order. Other checks are under way on ongoing projects which include the verification of payments made by the NGOs as well as checks on the award of contracts by the NGOs.

The Delegation has also contracted independent auditors to carry out an in-depth audit of two sectors. A third audit is planned.

Overall conclusion

5.32. The systems which it examines have already been reinforced and improved, particularly through the introduction of a standard contract.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

Special Report No 7/98 on South Africa

The dispersal of actions and centralised procedures

5.37. The need to focus: this recommendation has been fully taken into account not only in the new legal basis which has

now been adopted by the Council and Parliament but also in the new MIP 2000 to 2002 signed in June and which specifically provides for greater focus and for a sectoral approach which means a maximum of one or two programmes for each focal area.

5.38. The decentralisation measures for the South African Delegation will become operational in 2001.

Coordination with other donors

5.39. Since February an informal donor consultation network has been put in place which includes UNDP, WB, USAID, Japan, Canada, EU Member States and the Commission. It has held at least four meetings. In addition the Department of International Cooperation (within the SA Department of Finance) launched in September 1998 a Development Cooperation Report to assess the extent and impact of donor assistance from 1994 to 2000. After a number of sectoral studies and workshops held during the last 24 months attended by representatives of all donors, a full report will be presented on 22 September to the donor community for comments and recommendations on how to increase effectiveness of future cooperation programmes.

5.40. Coordination with EU Member States has improved dramatically over the last year and a half. Efficient coordination mechanisms have been put in place not only for the preparation of the country strategy paper, but also for the MIP 2000 to 2002 which now contains specific paragraphs on complementarity with other donors and EU Member States in particular. It is now further translated into actual implementation of our new programmes in 2000. For at least two programmes in the focal areas of the MIP — water and sanitation, and support to justice — the programmes will be co-financed by the EC and EU Member States who have worked together under the leadership of the SA Department concerned at all stages of the preparation of those programmes.

Financial information system

5.43. The Commission welcomes the Court's generally positive assessment.

Evaluation procedures for Phare and Tacis

5.51. *The Commission welcomes the Court's comment that significant progress has been made.*

5.52. *Evaluation was and currently is separated from the operational services of the SCR; such separation is considerably more important for its impartiality than its 'level'.*

The Commissioners for external relations decided in May that evaluation would be given a 'higher profile' by their taking direct responsibility for programming evaluations and for feedback.

It is often inevitable that experts used to evaluate sectors will have worked for the Commission in those sectors — but what is important is that they do not evaluate projects in which they have any previous significant involvement. The Commission makes every effort to respect this principle.

5.53. *While terms of reference for evaluations do not necessarily state which of the three categories they belong to, it is normally clear from the stated purpose and scope of each. Nevertheless particular note is taken of this recommendation.*

5.54. *Quality variation is inevitable due to the nature of the obligatory procurement processes, and to the vicissitudes to which consultants are exposed in difficult contexts and often with limited data. Excessive length and delay are limited as much as possible, but the evaluation unit cannot fully avoid them, due to the need to respect the independence of evaluation teams — and sometimes to produce a report of 'just good enough' contracted quality rather than nothing at all.*

The quality of reports is a constant concern of the unit, and at least two if not three evaluators (staff) read each major draft. An external evaluation of the evaluation function and its work was done at the end of 1999.

5.55. *Following the 'evaluation of evaluation' mentioned above, the Commission is considering a proposal by the evaluation unit that the reply of the services concerned to each major evaluation be published together with the report, to facilitate such monitoring of the use of evaluations.*

OTHER OBSERVATIONS

*Phare public administration programmes***Support to the general public administration**

5.60. *The importance of public administration reform in the former communist countries was such that the Commission decided to go ahead with programmes despite the lack of well-defined strategies in this sector. (Indeed a major aim of these programmes was to push the authorities to develop such strategies.) Because detailed strategies were lacking, the objectives had to remain general and performance indicators were frequently less precise than would have been desirable.*

5.61. *The degree of commitment from (certain) partner countries is the primary issue. Other issues (staff turnover, complex procedures, poor coordination, inadequate central structures) are secondary and could have been addressed with adequate commitment from the partner country. The Commission now only accepts mature programmes that consist of projects ready for tendering. The risk of hasty tendering is therefore reduced.*

5.62. *The regular reports indicate progress — albeit inadequate — in most candidate countries in public administration reform. The need for training in the public administration of these countries was very widespread so that a quick start-up of training of a general nature was directly useful and effective — even if it would have been theoretically desirable to await fully developed human resource development strategies for the public sector to ensure the efficiency of the activity.*

5.63. *The high-quality technical expertise available from Sigma was very useful in raising awareness of the importance of an efficient, independent and democratically accountable public administration.*

Proceeding beyond the stage of awareness-raising to a fundamental and sustained reform of public administration requires an enormous commitment from the candidate countries. In this respect, more remains to be done in all of the countries.

Support to the customs services

5.64 and 5.65. *The lack of well-trained people in candidate countries to handle frequent equipment supplies was due*

to the very low salaries in Phare countries' administrations; this encouraged the movement of those people, once trained, to the private sector.

5.68. The Court correctly states that the role of coordination had been contracted to the PCU and Eurocustoms. Therefore DG TAXUD (Directorate-General for Taxation and Customs Union) had no specific role to play that went beyond the successful development of the 'pre-accession strategy'. After the finalisation of the gaps and needs analysis, the need for such increased coordination became apparent and consequently DG TAXUD was given, early this year, a more important role in the appraisal and coordination of projects. That role is also seen to be important and to be continued in the framework of twinning and projects under national programmes.

Support to the statistical services

5.72. In the early years of the design and implementation of the Phare multicountry statistics programme, it was necessary to respond effectively to a rapidly evolving situation. Consequently the decision was taken to engage CESD by direct agreement, to allow the mobilisation of the essential expertise of the statistical institutes of Member States. Following further analysis in 1997, it was decided, with effect from 1998, to redesign the nature and scope of the tasks outsourced and organise tendering in compliance with standard Phare procedures.

Conclusions

5.74. The reason for the deliberate policy of moving away from multicountry programmes is that these programmes generally failed to generate sufficient commitment and ownership from the candidate countries. The results of the programmes were therefore frequently not sustained. National programmes are based on project fiches written by the beneficiaries who must themselves design the projects. Moreover there is a general requirement for co-financing to reinforce the commitment and ownership of the beneficiary. This enhances — but of course does not guarantee — the sustainability of the project's outputs.

The Commission shares the Court's view that Phare multicountry programmes have proved, most specifically in the preparatory stages of customs programmes (preparation of blueprints and gap analyses), to be the most effective means to implement assistance in the field of customs.

Refugee return programme in Bosnia

5.76. In their project proposals, the NGOs assume the levels of damage to potential returnees' dwellings. However, in a number of cases, returns have been to more severely damaged dwellings. This is sometimes because communities originally targeted for aid received support from other donors in the period between the preparation of the proposal and the signing of the contract (this is a situation which is experienced by all donors). In these circumstances the implementing NGO will assist neighbouring communities or be obliged to reconstruct a larger number of badly damaged dwellings than originally planned.

With reference to the beneficiaries' capacity to finance repairs, it should be noted that unemployment in Bosnia-Herzegovina as a whole is running at over 40 % and amongst returnees the figure is higher (see paragraph 5.7). Returnee families have, in general, little or no material assets apart from the dwelling to which they hope to return. However, beneficiaries often contribute to the rehabilitation works by clearing debris and carrying out finishing works. The Commission does not exclude self-help projects.

5.77. It is correct to say that difficult implementation conditions slowed down implementation of the 1998 programme. This programme, which was designed in close cooperation with the other major actors in promoting refugee return, coordinated through the refugee and return task force, saw the first minority breakthrough returns happening. Creating these minority return movements involved the implementing NGOs in painstaking and time-consuming political and social preparation which resulted in delays. The Kosovo conflict also had a delaying influence on return movements, particularly those to Republika Srpska.

The occupancy rate improved from two thirds at the time of the Court's audit to 73 % by September for those houses funded under the 1998 programme. The occupancy rate for the houses funded under the 1996/1997 programmes is 88 %. The introduction of the property legislation implementation plan by the High Representative in October 1999, which is designed to facilitate the recovery of property by the rightful occupants, is expected to further facilitate returns and hence lead to higher occupancy rates in a shorter period.

5.78. By the end of 1997 it was understood that there would be a number of soft loan facilities for job-creation. The 1998 return budget was primarily allocated for physical reconstruction. The programme also provided funding for

limited job-creation activities. The type of activities that would be undertaken were the provision of advisory services to assist returnees to apply for loans and other employment generation finance which was available from other donors. An exception was made for the Drvar area, which was pivotal for key minority returns, and where large grant-aided job-creation packages were financed as part of the programme.

According to a recently produced report on the job-creation component of the 1998 programme, commissioned by the Delegation, employment prospects were not an incentive for beneficiaries to return. However, employment prospects will undoubtedly contribute to the sustainability of the returns. In this regard, in 1999 the quick impact facility was created to improve and coordinate all these activities.

Observations on sound financial management issues deriving from the audit of NGOs

Appraisal

5.81. The Commission recognises the problem of the time taken pointed out by the Court and has instituted procedures this year to address the issue.

5.83. The selection criteria are available to the public as they are listed in the Commission Regulation already referred to (Articles 1 and 2), the General Conditions which form an integral part of the contracts signed with NGOs and in the two operational guides published in March and September. The departments assessing applications ensure that these rules are observed.

A telephone helpline was set up in November 1999 to provide information on projects by e-mail, fax or telephone. All the basic administrative information was recently put on the NGO unit's website. Through its contacts with national development NGO networks in each Member State CLONG helps to pass on information to individual NGOs.

Reporting

5.86. The NGO General Conditions allow certain administrative costs. For European NGOs the limit in 1999 was 6 % of total eligible direct costs — this has since been increased. The Commission is currently examining the question of the administrative costs of local partners.

5.87. Article 15.7 of the standard contract sets out the arrangements for exchange rates since 1 January this year.

5.88. The Commission has introduced (as from 1 January 2000) a standard reporting system for all grant contracts. In addition, the call for proposals published in June standardises all project proposal formats.

Results

5.89 to 5.92. NGOs have been able to submit projects for five years rather than three years since 1988. They have all been able to introduce one or more phases provided they increase/extend the scope of activities already co-financed.

5.90. As regards the reference framework for projects the General Conditions drawn up in January clearly state that 'a block grant will be based on an outline presented by the NGO or network indicating how it intends to use the block grant, in particular the NGO's approach to the use of small funds, the sectors, type of activity to be financed and main countries concerned' (paragraph 7.1).

Provided it is sufficiently detailed this outline will be an appropriate source of information on projects to be undertaken by beneficiary NGOs. The latter are also required to inform the Commission on activities co-financed under a block grant at the reporting stage (paragraph 7.2).

5.91. The Commission shares these concerns regarding sustainability which it considers concerns both the activities of the project and its participants, and the capacities of the implementing structures to continue and sustain these activities. To this end support for capacity building of development structures has been reinforced in the new General Conditions for co-financing. Furthermore, the new formats developed for the presentation of projects contain an entire section on factors ensuring sustainability which requests information on this issue from project proposers.

5.92. In the past, the carrying out of an evaluation was optional and at the discretion of the NGO and the NGO had the option of either carrying it out itself or having it co-financed by the Commission. The Commission has always had the option of launching its own evaluations of NGO projects which it has exercised to some extent. NGOs have, however,

usually transmitted to the Commission any evaluation they have carried out whether or not they have been financed by us; this has always been used in the appraisal of projects.

However, in recent years the Commission has more actively required an evaluation to be included in many of the projects it has co-financed. In the future, evaluation will constitute an even more important form of ex post monitoring and control under the new General Conditions, particularly for programme contracts.

Block grants

5.93. The development of the block grant was designed to open up a funding window for small projects and simplify their management. Control was exercised on an ex post basis. Block grants were awarded to NGOs who had demonstrated a good track record in the implementation of projects and previous block grants co-financed by the Commission. Projects financed under block grants had to fully conform to the terms of the 1988 General Conditions for co-financing which provided the framework for type of project and beneficiary country. The ex post control ensured that projects which did not conform to the General Conditions were refused and funds reimbursed. Neither the Commission nor its Delegations has

the capacity to exercise ex ante control over small micro-projects and the block grant has been considered a very successful mechanism to allow NGOs to finance small projects rapidly and flexibly.

Under the new General Conditions, the block grants have been expanded from one to three years' duration and will now be based on an explicit request from the NGO and a presentation of how the NGO intends to use the block grant, its approach to the use of small funds, sectors and types of activity to be financed.

Agreement between the European community and the United Nations

5.94 to 5.103. In the Commission's view the Court underestimates both the usefulness of the Agreement of 9 August 1999 and the magnitude of the shift of approach to EC/UN relations which it recommends in terms which do not fully reflect the overall political and administrative situation. Moreover, the Commission is required to respect the Financial Regulation and Council Regulations covering specific areas (e.g. humanitarian aid). However, in the context of its reform of external aid and recasting of the Financial Regulation, the Commission is looking at new approaches which will take account of the Court's suggestions.

CHAPTER 6 (*)

Administrative expenditure

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(*) The Institutions' replies are on page 169.

THE ADMINISTRATIVE EXPENDITURE OF THE INSTITUTIONS AND COMMUNITY BODIES

Introduction

6.1. Heading 5 of the financial perspectives, 'Administrative expenditure', groups together the institutions' administrative appropriations (Part A of the budget in the case of the Commission). The situation at the end of the financial year is shown in **Table 6.1**. These appropriations are managed directly by the institutions and are used primarily 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 staff receiving these payments is given in **Tables 6.2** and **6.3**. These appropriations also allow, in the case of the Commission, subsidies to be given by the Commission to associations and bodies that assist in the implementation of various aspects of the European Union's activities.

Implementation of the budget

6.2. Overall, the utilisation rate (payments and carry-overs to the following financial year) of budget appropriations in 1999 was 99 %. The cancellation rate of appropriations was 1 %. There are no budget items which call for specific remarks concerning the implementation rate. With regard to the institutions, the only notable example of appropriations not being used concerns the Committees: only 14,3 million euro of their appropriations for 'investments in immovable property, rental of buildings and associated costs' (41,7 million euro under heading C-20 of the Joint Organisational Structure) were used. This is primarily due to delays in occupying the Belliard buildings, after they were vacated by the Parliament to move into its new set of buildings, the lease on which is due to expire at the end of 2007. The unused appropriations (27,4 million euro) were finally the subject of a non-automatic carry-over to financial year 2000. The Court notes that the aim of this carry-over is to pay in advance for major fitting-out work on offices with no guarantee that the institutions can one day become the owners of the offices concerned on economically acceptable terms.

6.3. Moreover, the Commission should improve the way in which it presents its own analysis of the implementation of the budget for administrative expenditure. As set out in Volume I, Tome 2 of the revenue and expenditure account ⁽¹⁾, this analysis concentrates, in a format which is not easy to understand, on marginal

items in heading 5. It should rather contain detailed and more consistent information on the implementation of the main categories of administrative expenditure: salaries, pensions, rents and property transactions.

Specific appraisal within the framework of the Statement of Assurance

6.4. The Court's audit dealt with all the accounts and transactions concerning administrative expenditure (heading 5 of the financial perspective). For the financial year 1998, the Court began by conducting a detailed audit of salary payments and acquisitions of immovable property. Overall, the results of this audit were satisfactory. For 1999, the same expenditure was subjected to analytical tests, the results of which, supported by some substantive tests, indicated that the situation had not changed. The Court put particular emphasis on expenditure in connection with the pension scheme for former officials and members of staff, as well as the scheme for former Members of the Commission, the Court of Justice and the Court of Auditors. A special review was also conducted of specific expenditure on seconded national experts (SNE).

Reliability of the accounts

6.5. The reliability of the budgetary accounts and the financial statements supporting the consolidated balance sheet for the administrative expenditure of the institutions and Community bodies is compromised by the understatement of tangible assets resulting from the events described in paragraphs 8.2 and 8.3.

6.6. **The off-balance sheet commitments** show a decrease in the future cost of pensions, from 15 000 million euro at the end of 1998 to 12 600 million euro at the end of 1999. This significant decrease is due to the substantial rise in interest rates between 1998 and 1999, which is the parameter taken into account in actuarial calculations. As the Commission indicated in the corresponding explanatory note, this practice is in conformity with IAS 19. All the same, the Court wonders whether this parameter ought not to be taken into account in the form of an average over several years, in order to ensure that the actuarial calculation is less sensitive to short-term changes.

6.7. The Court believes that the improvements made by the Commission with regard to the future costs associated with the pensions scheme (the inclusion, for example, as from 1999, of the cost of paying Commissioners' pensions) must be continued. The information

⁽¹⁾ SEC(2000) 537-EN-BUDG/C/2, p. 736 and following.

Table 6.1— Administrative expenditure 1999 ⁽¹⁾ (summarised by section)

(Mio EUR)

	Total	Section I	Section II	Section III — Part A (including the Publications Office)	Section IV	Section V	Section VI		
		Parliament	Council	Commission	Court of Jus- tice	Court of Audi- tors	ESC ⁽⁶⁾	COR	JOS
		CA/PA	CA/PA	CA/PA	CA/PA	CA/PA	CA/PA	CEN/CP	CA/PA
Financial perspective ceiling	4 723	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1999 Budget development									
Initial appropriations	4 502	927	337	2 923	122	66	27	15	86
Final available appropriations ⁽²⁾ ⁽³⁾	4 504	927	337	2 923	123	66	28	15	86
Implementation of the 1999 budget ⁽³⁾									
Appropriations used ⁽⁴⁾	4 418	918	333	2 884	123	64	25	14	57
% of final available appropriations	98	99	99	99	100	97	90	91	67
Appropriations carried over to 2000 ⁽⁵⁾	26	0	0	0	0	0	0	0	26
% of final available appropriations	1	0	0	0	0	0	0	0	31
Cancelled appropriations	62	10	3	41	0	2	3	1	2
% of final available appropriations	1	1	1	1	0	3	10	9	2

⁽¹⁾ Under the financial perspective.⁽²⁾ Budget appropriations amended after the taking into account of supplementary and amending budgets and transfers.⁽³⁾ Not including appropriations carried over from 1998, appropriations from the reuse of revenue, revenue resulting from third-party shareholdings and other revenue corresponding to a specific use and appropriations made available again.⁽⁴⁾ Sums committed which gave rise either to a payment during the financial year, or to an automatic carry-over to the financial year 2000.⁽⁵⁾ Non-automatic carry-overs.⁽⁶⁾ Including EUR 0,3 million of transactions on behalf of third parties financed from the EDF (for the expenses for ACP meetings) or from the general budget.

For further information concerning the implementation of the budget, please refer to Diagrams III and IV in the Annex to this report.

Source: 1999 revenue and expenditure account.

Table 6.2 — Staff numbers by institution and by category as at 31 December 1999

Institutions	Officials	Temporary staff	Auxiliaries	Local employees	DYE ⁽⁶⁾	SNO ⁽⁷⁾	Advisers	Total
European Parliament and Ombudsman ⁽¹⁾	3 309	539	195	34	—	—	1	4 078
Council	2 488	34	—	—	—	—	—	2 522
Commission ⁽²⁾								
— Administration (Brussels, Luxembourg ⁽³⁾ , Strasbourg)	15 229	553	1 034	—	—	680	12	17 508
— Joint Research Centre ⁽⁴⁾	1 032	2 071	634	—	—	—	—	3 737
— Representations in the EU and staff seconded to the satellite bodies	475	19	24	203	—	—	—	721
— External delegations, representations and offices	643	21	—	1 766	93	—	—	2 523
Court of Justice	722	237	6	—	—	—	1	966
Court of Auditors	410	121	21	—	—	—	1	553
ESC/COR ⁽⁵⁾	640	89	31	—	—	—	2	762
Total	24 948	3 684	1 945	2 003	93	680	17	33 370

⁽¹⁾ Ombudsman: 11 temporary and 4 auxiliary staff.

⁽²⁾ Commission total: 24 489 (17 379 official, 2 664 temporary staff, 1692 auxiliary staff, 1969 local employees, 93 delegated young experts, 680 seconded national officials and 12 special advisers).

⁽³⁾ Including EUR-OP.

⁽⁴⁾ JRC staff and Commission staff at the JRC.

⁽⁵⁾ Economic and Social Committee and Committee of the Regions (including the joint organisational structure).

⁽⁶⁾ Delegated young experts (DYE).

⁽⁷⁾ Seconded national officials (SNO).

Source: The relevant institutions.

now provided shows the present value of the pensions liability in respect of past service: in other words, the future pensions payable to people who have already retired, plus the value of the pension entitlements already earned by officials who have not yet reached pensionable age. The financial statements do not, however, show the full cost of the pension entitlement earned during the year. Only the cash contribution of employees (i.e. 8,25 % of total pensionable pay ⁽²⁾ at present) and the cash costs of pensions payable are disclosed in the financial statements.

⁽²⁾ Regulations and Rules applicable to officials and other servants of the European Communities, Article 83(2): 'Officials shall contribute one third of the cost of financing this pension scheme. The contribution shall be 8,25 % of the official's basic salary, the weightings provided for in Article 64 not being taken into account'.

6.8. A recent actuarial assessment ⁽³⁾ indicates that the full cost each year of funding acquired pension rights amounts to rather more than a third of total pensionable pay. This additional information would be necessary to appreciate the overall costs incurred by the Union in employing its officials. Furthermore it would be useful to indicate, as additional information, the expected increase in the number of pensioners and the costs of pension payments in the years immediately ahead.

Legality and regularity of the underlying transactions

6.9. The review of expenditure incurred by the **pension scheme** for former officials and members of staff

⁽³⁾ Assessment by KPMG, prepared at the request of the Council in December 1998.

and by the scheme for former Members of the institutions did not reveal any specific anomalies.

6.10. Neither the review of the **systems for paying** officials and other members of staff nor the audit of allowances paid to seconded national experts (SNE) uncovered any significant anomalies as regards the legality/regularity of the underlying transactions. Nevertheless, they did lead the Court to draw the attention of the relevant services to the vague nature of the regulations applicable to the definition of place of recruitment.

6.11. The Court considers that, as regards the main elements of administrative expenditure recently examined in detail at the various institutions (see also paragraph 6.4), the legality and regularity audit of the corresponding operations produced satisfactory results.

Follow-up to previous observations

6.12. On the basis of information provided by the institutions and Community bodies concerned, the Court followed up several of its previous observations concerning, in particular, allowances paid to MEPs and Members of the Economic and Social Committee (ESC) and the Committee of the Regions (COR), as well as the payment of subsidies entered in Title A3 of the Commission's budget.

Follow-up to the Special Report on MEPs' allowances

6.13. The Court's Special Report No 10/98 concerning the expenses and allowances of Members of the European Parliament ⁽⁴⁾ primarily contained remarks on the fact that travel and general expenses allowances are too often paid as a lump sum; the fact that Members may declare their place of residence and thus their point of departure at their discretion; the overuse of the imprest account system; the flimsy nature of proof of presence in Parliament provided by certain supporting documents; and the lack of control of contracts between Members and their assistants. In particular, the Court recommended that the system of allowances should be based on actual expenditure.

6.14. The review conducted by the Court shows that the Parliament has taken some interim action to put an

⁽⁴⁾ OJ C 243, 3.8.1998.

end to the most obvious anomalies, pending a future Members' 'statute'.

6.15. As from 18 June 1998, the Parliament decided in principle that the future regime would be based on actual expenditure, except for the subsistence allowance, which would remain as a lump sum for practical reasons. In reality, the travel and subsistence allowances were replaced by other lump-sum allowances which were closer to the reference costs (IATA prices for example). A procedure was introduced for identifying possible anomalies concerning the place of residence/point of departure. The new system is quite close to actual costs. It is sometimes more favourable to Members and at others, it is less favourable. Overall, according to the Parliament's first estimates, it will cost slightly less than the previous system.

6.16. Whilst it has maintained a system of advances to Members, the Parliament has taken action to prevent payment in advance for travel tickets for private use and, ultimately, to reduce cash payments.

6.17. The rules governing the checks on Members' presence, the scales of the lump-sum general expenses allowance, as well as the regulations concerning the secretarial allowance were not amended. On the other hand, with regard to the rules applicable to Members' assistants, proposed amendments to the Staff Regulations of officials of the European Communities were drafted and submitted to the Council by the Commission. A decision taken by the Bureau of the Parliament in April 2000 ensures greater transparency in the management of assistants' employment contracts.

Follow-up to the 1996 Annual Report's observations on the allowances of Members of the Economic and Social Committee and the Committee of the Regions

6.18. The Annual Report for the financial year 1996 (paragraphs 17.1 to 17.21) described, in particular, the results of a Court enquiry into the expenses and the travel and meeting allowances of Members of the ESC and the COR and noted that some Members of these bodies — proportionally far fewer from the COR than the ESC — had asked for reimbursement of tickets other than the ones actually used.

The ESC

6.19. As part of the 1996 discharge, the Council asked the Court to deliver an opinion on the effectiveness of the methods of recovery applied by the ESC and on the

new system introduced by the ESC for the administration and reimbursement of travel expenses. Opinion No 7/98, delivered by the Court on 7 October 1998, concluded that the ESC had recovered the amounts claimed, but that they had been established with a certain leniency. Moreover, the Court noted the efforts made by the ESC to reform its system of allowances, but pointed out that further improvements were still necessary.

6.20. The information provided by the ESC, following the Court's opinion, indicates that the ESC intended to implement the main recommendations (stamping of tickets, keeping the addresses of Members permanently up to date, making payments by bank transfers and no longer by cheques, changing the procedures for signing off payments). It also intended to consider more economic and effective procedures for paying allowances. The Court was able to confirm that, between the end of 1998 and the beginning of 2000, the ESC had gradually implemented the measures recommended.

The COR

6.21. In its decision of 4 May 1999, giving discharge in respect of the implementation of the budget for the financial year 1997, Parliament asked the Court of Auditors to 'investigate the appropriateness and effectiveness of the measures taken by the Committee of the Regions to ensure that the irregularities identified in the 1996 Annual Report do not recur'⁽⁵⁾. At the end of 1999, the Court conducted the review requested.

6.22. The COR had, on 1 April 1999, taken some action in response to the Court's report. However, the new provisions were not immediately applied rigorously. Several violations of the newly introduced regulations had, at the beginning, led the Financial Controller to delay granting his approval to the payment orders concerned. Since then, the rules seem to have been applied more rigorously.

6.23. However, the Court was not in a position to vouch for the effectiveness of the action taken by the COR in March 1999. Since then, the COR tightened its regulations again in February 2000.

⁽⁵⁾ Annual Report on financial year 1996 (paragraphs 17.1 to 17.21).

Follow-up to the 1996 Annual Report's observations on miscellaneous subsidies under Title A3⁽⁶⁾

6.24. The Annual Report on the financial year 1996 (paragraphs 15.1.1 to 15.1.24) recommended, following a review of the systems for managing and controlling general subsidies, that the Commission should define more precisely how the subsidies and activities eligible for Community financing may be allocated, and develop its machinery for both documentary and on-the-spot audits.

6.25. Whilst auditing the three organisations subsidised, the Court found that the quality of the management of subsidies had been significantly improved, thanks to:

(a) firstly, the introduction, in 1998, of a guide on how to manage subsidies, applicable to all Commission policy areas for which no specific sectoral rules exist;

(b) and, secondly, the creation of a subsidy-management network (Commission Decision of 24 November 1998), aiming in particular to promote a consistent and effective approach to granting subsidies.

6.26. The rules for publicising Community subsidy programmes which derive from these measures should make the allocation of funds more transparent. They provide for the setting of objectives, eligibility and selection criteria as well as the exact financial conditions.

6.27. Moreover, the Commission has established budgetary and financial units in its departments and DGs which also have audit responsibilities. As well as carrying out other tasks, these units should ensure that subsidies are checked and strictly monitored.

6.28. Nevertheless, improvements have still not been made to the central index of financial aid. The current system, based on bank account numbers only, does not eliminate the risk of making the same payment to the same recipient twice.

⁽⁶⁾ Operational or project subsidies for various organisations promoting Europe.

Other audit work concerning administrative appropriations entered in the budget

Expenditure on immovable property

6.29. The Court's adoption of Special Report No 5/2000 on the Court of Justice's expenditure on buildings ⁽⁷⁾ was an opportunity for the Court to deliver general recommendations of interest to all the institutions. The purchase of the Court of Justice's buildings illustrates the problems encountered by the European institutions in trying to carry out their building projects in accordance with the principles of legality and regularity and sound financial management.

6.30. At a time when a number of institutions are continuing to extend their buildings (Court of Justice, Court of Auditors, Council) and all the institutions will have to face the need to expand their premises to cope with the coming enlargements, the Court is keen to draw attention to the content of the recommendations it made in this report:

- (a) the institutions should always obtain the prior approval of the budgetary authority before embarking on a building project;
- (b) in order to plan their property policy in a transparent and efficient manner, the institutions require multiannual investment budgets;
- (c) where necessary, the Communities should be able to finance their building programmes by direct borrowing, by amending the relevant legislative framework;
- (d) the Communities should have complete administrative, technical and financial control over their building projects. This means they should either make use of highly qualified consultants or develop the appropriate expertise internally within an interinstitutional framework;
- (e) in the event that powers of overall control are delegated to third-party representatives, these representatives should comply with the same obligations, in particular in respect of complying with competition rules, as those to which the Communities are subject.

Expenditure by the European Parliament's political groups

6.31. The adoption of Special Report No 13/2000 on the expenditure of the European Parliament's political groups ⁽⁸⁾ was an opportunity for the Court to submit its recommendations on this type of expenditure.

6.32. The Court's main recommendations were as follows.

- (a) Eligibility criteria for this expenditure should be clarified and laid down in a single regulation and appropriations should be grouped under a single budget heading.
- (b) The rules applicable to financing political parties as well as the role and activities of the groups, which are internal Parliament bodies, should be transparently and clearly defined.
- (c) Whilst the groups should be allowed legitimate operational autonomy, the way expenditure is managed should allow an effective internal control system to be introduced which would allow the rules for implementing the Community budget to be fully applied.
- (d) Clear rules should be established with regard to the regime for the ownership and recording of items acquired using the appropriations in question to ensure the protection and optimal use of all the groups' equipment and material.
- (e) Each group's annual report should set out, in a sufficiently detailed and informative way, the objectives, nature and cost of the main activities financed and the groups' certified accounts, which have been in the public domain since 1999, should be published in the future.
- (f) The external audit of all the groups should be entrusted, for a defined period, to a single organisation chosen by competitive tendering. The auditor should be given a clearly defined mandate to allow him to cover explicitly the control of the regularity of transactions, including within the Member States, and should draw up an annual report on each group addressed directly to the President of the Parliament.

⁽⁷⁾ OJ C 109, 14.4.2000.

⁽⁸⁾ OJ C 181, 28.6.2000.

- (g) Consideration should be given, without delay, to clarifying the contractual relationships between the groups and their employees and contractors and to standardising the contracts under the supervision of the Parliament's services.

AUDIT OF THE COMMUNITY SATELLITE BODIES

Introduction

6.33. The Court's annual audits of the Community satellite bodies have been the subject of specific annual reports ⁽⁹⁾, which will be published in the *Official Journal of the European Communities*.

6.34. The satellite bodies may be divided into three categories:

- the 'first generation' satellite bodies, whose management boards are granted discharge by the Council and the European Parliament,
- the 'second generation' satellite bodies which are not self-financing and which receive a discharge from their own board of directors or management board,
- the 'second generation' satellite bodies which are wholly or partly self-financing and which receive a

discharge from their own board of directors.

6.35. In 1999 the total amount of the satellite bodies' budgets was 266,9 million euro as against 169,5 million euro in 1998, i.e. an increase of 97,4 million euro (see **Table 6.4**). The reason for this rise is that four bodies designed to be self-financing have contributed a total of 85 million euro as a result of the expansion of their activities. A similar trend has been observed for the satellite bodies' staff, which increased to 1 257 members of staff in 1999 as against 1 156 in 1998, i.e. 101 more staff, 75 of whom are employed in the bodies which were designed to be self-financing.

Accounting systems

6.36. By the end of 1999, virtually all the bodies had set up and, to varying degrees, started to use the SI2

⁽⁹⁾ To be published in the OJ.

budgetary accounting system, developed and run by the Commission. The switch to this system has been beset by difficulties, one of the reasons being the need to ensure a changeover that fitted in with the previous budgetary accounting systems and to safeguard its consistency with the general accounting systems, which in some cases are rather basic.

6.37. The bodies should make sure that their general accounting systems are complete and, in particular, enable accounts with third parties and fixed assets to be managed properly. Apart from these functions, the systems in question should include functions for internal control and for the periodic production of reports. This would enable the satellite bodies to draw up accounts which comply with generally accepted standards and ensure effective internal control. The choice of system to be used in the future should, in accordance with the principles of sound financial management, take account of expected developments in the regulations and of the volume of transactions handled.

Booking of VAT

6.38. Until December 1998, the general Financial Regulation stipulated that expenditure was to be booked inclusive of VAT, as the latter, once refunded, could be reused. Since then ⁽¹⁰⁾, the general Financial Regulation has laid down that expenditure must be charged exclusive of VAT. The Court invites the satellite bodies to incorporate these new provisions into their own internal rules.

Weighting

6.39. For the satellite bodies whose headquarters are not located in the capital city of a Member State, the weighting that is applied is the weighting fixed for the capital of that Member State. As it did for the Joint Research Centres, the Commission should ensure that, for these bodies, no excessive difference in the cost of living exists between their headquarters and the capital of the Member State in which they are located. In the contrary case, it should propose to the Council that a weighting be established for the cities concerned.

⁽¹⁰⁾ See Article 27(2a) of the Financial Regulation applicable to the general budget of the European Communities, as amended by Council Regulation (EC, ECSC, Euratom) No 2548/98 of 23 November 1998 (OJ L 320 of 28.11.1998, p. 1).

Table 6.4 — The Community satellite bodies: budget and staff for 1998 and 1999

Name	Headquarters	Year of creation	Budget (Mio EUR)		Permanent posts	
			1998	1999	1998	1999
I. First-generation satellite bodies						
European Centre for the Development of Vocational Training (Cedefop)	Thessaloniki	1975	12,6	15,3	81	81
European Foundation for the Improvement of Living and Working Conditions	Dublin	1975	13,6	14,8	83	84
II. Second-generation satellite bodies which are not self-financing						
European Environment Agency (EEA)	Copenhagen	1990	16,9	18,5	62	68
European Training Foundation (ETF)	Turin	1990	15,2	16,2	130	130
European Monitoring Centre for Drugs and Drug Addiction (EDMC)	Lisbon	1993	7,3	8,2	40	51
European Agency for Safety and Health at Work (EASHW)	Bilbao	1995	5,0	6,6	24	24
European Monitoring Centre for Racism and Xenophobia	Vienna	1997	0,5	3,9	11	19
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	42,6	184	203
Office for Harmonisation in the Internal Market (OHIM)	Alicante	1994	52,6	115,4	407	437
Community Plant Variety Office (CPVO)	Angers	1994	5,8	8,1	22	29
Translation Centre for Bodies of the European Union (TCBEU)	Luxembourg	1994	12,8	17,3	112	131
Total			169,5	266,9	1 156	1 257

Publication of the bodies' budgets

6.40. The Financial Regulations of all the satellite bodies stipulate that their budgets must be published in the *Official Journal of the European Communities*. However, only eight of the 11 bodies published their budget for 1999, seven of them on 3 December 1999⁽¹¹⁾ and one on 22 December 1999⁽¹²⁾. The fact that they published their budget late would seem to indicate that these bodies are merely carrying out a formality rather than acting out of a desire to inform the public at the appropriate time. Furthermore, the information supplied is in some cases rather short on quantity, quality and accuracy. There has been no improvement in the situation: by June 2000, only the Office for Harmonisation in the Internal Market's budget had been published in the *Official Journal of the European Communities*⁽¹³⁾.

⁽¹¹⁾ OJ L 309, 3.12.1999, p. 1.

⁽¹²⁾ OJ L 330, 22.12.1999, p. 1.

⁽¹³⁾ OJ L 330, 22.12.1999, p. 13.

Contributions to the Community pension scheme

6.41. For the institutions, benefits paid under the pension scheme are charged to the Community budget, pursuant to the provisions of Article 83 of the Staff Regulations applicable to officials. The institutions' share, or the 'employer's contribution', which is currently 16,5 %, (see paragraphs 6.7 and 6.8), is not shown in their respective budgets and therefore circumvents the intermediate budgetary operations which should be carried out, i.e. the employer's share should be debited from the budgets concerned and then credited to the Commission's budget as revenue.

6.42. This practice, which was common to the institutions, has spread to the satellite bodies which are wholly financed by a subsidy from the European Union budget. For the sake of transparency in the satellite bodies' salary costs, the amounts payable as the employer's contribution to the financing of the pension scheme should be shown either in the general budget or in their own budgets.

6.43. For the bodies which are partly or wholly self-financing, it has not seemed fair to make the Community budget bear the whole cost of the employer's contribution to the pension scheme, and so in June 1998 the Commission invited three of them — the Office for Harmonisation in the Internal Market, the European Agency for the Evaluation of Medicinal Products and the Community Plant Variety Office — to pay their employer's contributions retroactively for the period prior to the date on which they began to receive their own revenue.

6.44. Only the Office for Harmonisation in the Internal Market transfers monthly, as of December 1999, its employer's contribution to the pension scheme and paid the arrears dating back to 1997, this date having moreover been fixed arbitrarily. The Community Plant Variety Office formed a reserve to cover the contributions due. The European Agency for the Evaluation of Medicinal Products has not yet taken any action. The Translation Centre for the bodies of the European Union, which

has to a very great extent been self-financing since 1998, should also pay a contribution to the pension scheme.

6.45. The Commission should, in conjunction with the satellite bodies, put forward proposals to ensure a suitable legal framework for the payment of the employer's contributions.

AUDIT OF THE EUROPEAN SCHOOLS

6.46. The Court's audit of the European Schools is the subject of a specific annual report which is sent to the Board of Governors of the European Schools. The management relating to the financial year 1999 did not call for any significant comments.

THE EUROPEAN PARLIAMENT'S REPLIES

6.5. Overstatement of tangible assets

See replies under points 8.2 to 8.4.

Parliament is in process of negotiating a single statute for MEPs with the Council. If an agreement is reached with the Member States, it is expected that the existing arrangements for travel allowances will be modified on the basis of the principle of reimbursement of expenses actually incurred.

6.15. MEPs' allowances

On 17 July 1998 Parliament gave very detailed replies to the observations made by the Court in its Special Report No 10/98 concerning the allowances paid to Members of Parliament.

Parliament emphasises the changes made to the relevant rules in the light of the Court's observations: Members who ask Parliament's Travel Office to issue them with tickets for official Parliament journeys within the European Community which are covered by the flat-rate travel allowance are required to pay for those tickets when they pick them up.

Moreover, Parliament emphasises that checks are still carried out on Members' attendance at official meetings.

6.30. Expenditure on property

Parliament endorses the Court's recommendations concerning the institutions' buildings, and notably the proposal that the institutions should have the option of direct borrowing in order to purchase property.

6.31 Expenditure by Parliament's political groups

Parliament replied in detail on 22 May 2000 to the Court's observations on political group expenditure.

THE COMMISSION'S REPLIES

THE ADMINISTRATIVE EXPENDITURE OF THE INSTITUTIONS AND COMMUNITY BODIES

Implementation of the budget

6.3. The Commission will endeavour to improve the way in which it presents its analysis of marginal items in heading 5 and will also analyse implementation of the main categories of expenditure.

At all events, the Commission is to examine the whole presentation and contents of Volume I, Part 2 of the revenue and expenditure account and make improvements in time for the 2000 financial statements.

Specific appraisal within the framework of the Statement of Assurance

Reliability of the accounts

6.5. The understatement of tangible assets is due to the fact that not all the European institutions/departments have calculated depreciation and that the buildings which the European Parliament and the Court of Justice are acquiring under rental-purchase or similar arrangements have not been included.

For the purposes of transparency, the Commission has indicated in the explanatory notes which institutions have calculated depreciation and has presented detailed information on these assets.

The Regulation on the accounting management of the Community's assets will be approved in the final quarter of 2000 and will apply to all the institutions; this will definitely represent a step forward in this sector.

6.6. From 2000 onwards, the Commission will present, alongside the amount calculated in conformity with international standard IAS 19, two indicative evaluations of the future cost of pensions: the first will be calculated on the basis of the interest rate applied the previous year and the second will be based on a rate corresponding to the average over several years.

6.7. From 2000 onwards, the amount of pension rights acquired during the financial year will be specifically recorded in the financial statements on an actuarial basis.

6.8. Apart from the information already provided for the actuarial calculation of future pensions, the Commission will already be presenting in 2000 an indicative projection over two years of the number of pensioners and the corresponding cost to the budget on the basis of the data available at the time of this extrapolation.

Legality and regularity of the underlying transactions

6.10. The definition of the place of recruitment will be clarified in an amendment to the rules which the Commission should adopt in the near future.

Follow-up to the 1996 Annual Report's observations on miscellaneous subsidies under Title A3 ⁽¹⁾

6.28. The current central index of financial aid, which is designed to monitor payments, is not a suitable instrument for identifying possible cases of double payment. The Commission is considering a solution which would use the central register of contracts and contractors which it is planning to create.

In this respect, the Commission would point out that, with a view to simplifying and improving the regulatory framework, it intends to add a new title on grant management in the Financial Regulation. This title, together with its implementing provisions, will incorporate the current provisions of the *vade-mecum*.

Other audit work concerning administrative appropriations entered in the budget

Expenditure on immovable property

6.30. The Commission would make the following points concerning the Court's recommendations:

- (a) all major or sensitive building projects are already notified to the budgetary authority before any commitment is made;

⁽¹⁾ Operating or project grants for various organisations of European interest.

- (b) and (c) the proposal for the recasting of the Financial Regulation contains provisions of the type demanded by the Court for multiannual expenditure and the possibility of borrowing in the building sector;
- (d) the Commission shares the Court's opinion on control over building projects; this is one of the objectives pursued by the interinstitutional approach adopted on the Luxembourg site;
- (e) the Commission rents (or buys under a rental-purchase agreement) buildings fitted out to its requirements; the changes are made in advance by the owner acting in his own name.

AUDIT OF THE COMMUNITY SATELLITE BODIES

Accounting systems

6.36 and 6.37. While installation of SI2 (Sincom 2) has led to redundancy in the accounting systems of the satellite Community bodies, it is the heads of administration who are responsible for the decision to keep the old management systems. DG (Directorate-General) Budget has provided all the documentation available for the installation of SI2. In 2000, DG Budget took over all the support and maintenance tasks for the SI2 version for these agencies. As for alignment of SI2 with the general accounting system, the strategy chosen is entirely the responsibility of the bodies' accounting officers.

These bodies generally use accounting software packages for managing of fixed assets and accounts with third parties. If some of the agencies opt to use only the central accounts to avoid recoding the third parties already contained in SI2, this is a matter for the agency's accounting officer alone. To improve this situation, an interface is currently being established between SI2 and an accounting software package with the assistance of DG Budget which has also provided additional instruments for the production of reports. Finally, a specific module of the SAP (systems, applications and products in data processing) system is being developed for the bodies under the guidance of the Dublin Foundation and with the collaboration of DG Budget.

Weighting

6.39. In view of the considerable cost of the statistical surveys required for determining weightings outside the capitals of the Member States, the Commission will check the situation if it has objective evidence that there is a substantial difference in the cost of living between the place where the bodies are based and the capital of the Member State concerned.

Publication of the bodies' budgets

6.40. The Commission will remind the agencies of their obligation to publish their budgets as soon as they are adopted by their management board; it will urge the agencies to make a joint effort to harmonise the presentation and publication of their budgets in order to cut costs.

Contributions to the Community pension scheme

6.42 and 6.43. As regards the satellite bodies which are wholly or partly subsidised from the Community budget, the Commission considers that payment of the employer's contribution to the pension scheme would only increase the subsidies to the satellite bodies entered in the Community budget. In line with the practice adopted for the Community institutions, the Commission has therefore decided not to demand payment.

6.44. Accordingly, the European Agency for the Evaluation of Medicinal Products, which is partly subsidised, should not pay a contribution. However, self-financing bodies such as the Community Plant Variety Office or those which are no longer subsidised, such as the Office for Harmonisation in the Internal Market (since 1997), contribute to the scheme. As regards the Translation Centre, the Commission will try and persuade this body that it should pay its contribution.

6.45. The Commission considers that payment of the employer's contributions to the Community budget by the self-financing bodies derives implicitly from the Staff Regulations. It will examine, together with these satellite bodies, whether there is any need to improve the legal framework.

THE COURT OF JUSTICE'S REPLIES

Specific appraisal in the context of the Statement of Assurance

Reliability of the accounts

6.5. Consolidated balance sheet

Acquisitions of immovable property financed through leasing

The Court of Justice has signed an agreement with the Luxembourg Government, Article 8(4) of which provides that ownership of the annexes to the main Court building is to be automatically transferred to it once the purchase price, as defined in Article 8(1), has been paid. Until then, the Court of Justice is to be regarded as the lessee of the buildings (see Articles 1 and 11 to 14 of the agreement).

In its instructions to the accounting services of the various institutions concerning the close of the accounting year, the Commission's accounting officer adopts an economic approach to the lease contract. He states that three conditions must be fulfilled in order for assets subject to 'lease-purchase and similar arrangements' to be entered in the assets shown on the balance sheet:

- the substance of the risks and advantages offered by the asset must be transferred to the lessee,
- the letting cannot be terminated otherwise than on terms requiring the payment of a prohibitive termination premium,
- the letting must be on terms which enable the lessee to recover and pay for the capital sums invested.

It is apparent, from an economic standpoint, that those three conditions may be regarded as having been fulfilled.

In addition, with a view to bringing the presentation of its accounting information into line with the practice adopted by

the other institutions, the Court of Justice proposes, with effect from the financial year 2000, to enter the capitalised value of its buildings in the assets shown in its balance sheet.

Depreciation and inventories

First of all, the Court of Justice would like to point out, as, indeed, it previously stated in its replies concerning the financial year 1998, that the rules relating to the management for accounting purposes of the assets of the institutions of the European Communities, the draft of which lays down the rules on depreciation, have not yet been adopted.

Depreciation calculations form an integral part of the computerisation of the management of the inventory of the Court of Justice, which will be completed by the end of the current year. That computerisation, accompanied by a full physical inventory, will make it possible to remedy the shortcomings identified by the Court of Auditors.

Other audit work concerning administrative appropriations entered in the budget

Expenditure on immovable property

The Court of Justice would like to point out, as already stated by it in its replies to Special Report No 5/2000 of the Court of Auditors, that it endorses the finding made by the Court of Auditors that the budgetary and financial framework within which the European institutions have to meet their accommodation requirements is inappropriate and that it therefore fully concurs with the recommendations made by the Court of Auditors with a view to remedying the situation.

Nevertheless, it is within that framework that the Court of Justice, in collaboration with the Luxembourg authorities, has been constrained, over the last 20 years, to take steps to cope with its constantly and rapidly growing accommodation requirements, which have been determined by a substantial increase in its caseload, the creation of the Court of First Instance, the successive enlargements of the Community and the growth in the number of staff employed in the institution.

THE COMMITTEE OF THE REGIONS' REPLY

6.2. *In fact there will be no pre-financing before the two committees sign a long lease with an option to purchase; this will ensure financially acceptable conditions and at the same time provide (by virtue of the option to purchase) that the rights and obligations of the owner rest with the two committees.*

At the time of writing (13 October 2000) the two committees are on the point of signing the contract. The EUR 26,4 million will be used only when the contract has been signed and will be earmarked for the specific needs of the two committees.

CHAPTER 7 (*)

Financial Instruments and banking activities

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(*) The Commission's replies are on page 183.

GUARANTEE FUND FOR EXTERNAL ACTIONS

Introduction

7.1. The decision to set up the Guarantee Fund for External Actions was taken at the Edinburgh European Council of December 1992. The Fund was established on 31 October 1994 by Council Regulation (EC, Euratom)

No 2728/94 ⁽¹⁾, and is drawn on 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, the Fund reimburses the Community cash resources that were previously used to service the borrowing.

7.2. The Court audited the Fund for the financial year ended 31 December 1999, at the Commission as regards the administrative management and at the European

⁽¹⁾ OJ L 293, 12.11.1994, p.1.

Investment Bank (EIB) as regards the financial management. Without prejudice to the observation made in paragraph 7.8, the Court has no comments to make on the results of the audits.

Situation and development of the Fund

7.3. Since the Guarantee Fund was set up, it has received funds from the budget totalling 1 638,4 million euro as at 31 December 1999 (see **Table 7.1**). Calls on the resources of the Fund in its role as guarantor amounted to 441,6 million euro (including 14,8 million euro in default interest), while late recoveries from defaulting debtors totalled 327,0 million euro (including 41,3 million euro in default interest).

7.4. At 31 December 1999, the balance of defaults stood at 184,6 million euro (including 43,5 million euro in default interest). The details are given in **Table 7.2**.

7.5. In 1999, 300,1 million euro were transferred to the Fund from the reserve for guarantees, while a sum of 297,8 million euro was repaid. This represented the difference between the actual level of the Fund at 31 December 1998 prior to remuneration of the EIB (1 281,2 million euro) and the target amount of 983,4 million euro, or 10 % of the guarantees outstanding ⁽²⁾.

7.6. The ratio of the Fund's liquid assets (1 313,1 million euro) to its outstanding capital liabilities for loans and loan guarantees for third countries plus unpaid

interest due (12 052 million euro) was 10,9 % at 31 December 1999 (see **Table 7.1**).

7.7. During the financial year there were three calls on the resources of the Fund as guarantor, totalling 16,3 million euro (including 1,2 million euro in default interest), and the Fund received 5,3 million euro (including 2,0 million euro in default interest) in late repayments from beneficiaries.

7.8. Guarantee Fund activities generated 41,1 million euro in net interest revenue in 1999, representing an average overall yield of 3,43 %, excluding capital gains on securities, while the 0,05 % annual fee for 1999 payable to the EIB for its financial management of the Fund amounted to 0,6 million euro. This rate of remuneration has not changed since 1995 ⁽³⁾, whereas the Fund's total resources have increased more than fourfold over the same period. In the light of the financial management experience acquired and the Fund's level of resources, this annual fee should be reviewed.

Follow-up to previous observations

7.9. In 1998 the repayment to the budget of the Fund's 66 million ecus surplus at 31 December 1997 was shown under costs in the profit and loss account. The Court considered that this method of accounting was not only contrary to the true and fair principle but also generated a loss without any real foundation. The Commission took this into account in 1999 and included the repayment to the budget of the Fund's surplus of 297,8 million ecus at 31 December 1998 in the balance sheet only.

EUROPEAN INVESTMENT FUND

7.10. In accordance with the wishes of the Edinburgh European Council of December 1992, the European Investment Fund (EIF) was set up on 14 June 1994 in order to provide additional financing capacities in support of the development of trans-European networks

⁽²⁾ Article 3 of the Regulation stipulates that: "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.' Since 1997, this ratio has consistently exceeded the rate of 10 % set as the target amount. As of 1 January 2000, the target amount was lowered to 9 %. Council Regulation (EC, Euratom) No 1149/1999 of 25 May 1999 amending Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions (OJ L 139, 2.6.1999).

⁽³⁾ Since the Fund had reached 300 million ecus at 31 December 1995, the rate of remuneration to the EIB was reduced from 0,125 % to 0,05 % of the Fund's average monthly assets with retrospective effect to 31 December 1994. Since its inception, the Fund has paid the EIB 1,8 million euro in management fees.

Table 7.1 — Guarantee Fund operations and situation

(Mio EUR)

Financial year	Payments ⁽¹⁾	Activation of guarantees ⁽²⁾	Late repayments	Result ⁽³⁾	Remuneration to EIB	Repayments to budget	Total Fund resources at 31 December	Total guarantee outstanding ⁽⁸⁾	Coverage (%)
1994	293,7	—	—	0,5	—	—	294,2	6 017	4,9
1995	250,8	(303,1)	35,6	23,4	0,2	—	300,9	5 882	5,1
1996	235,4	(52,5)	55,7	18,0	0,2	—	557,4 ⁽⁴⁾	6 715	8,3
1997	286,1	(54,3)	45,0	27,5	0,3	—	861,8 ⁽⁵⁾	7 960	10,8
1998	272,4	(15,4)	185,3	42,6	0,5	66,0	1 280,7 ⁽⁶⁾	9 834	13,0
1999	300,1	(16,3)	5,3	41,1	0,6	297,8	1 313,1 ⁽⁷⁾	12 052	10,9
Total	1 638,4	(441,6)	327,0	153,1	1,8	363,8			

⁽¹⁾ Payments to Guarantee Fund pursuant to Regulation (EC, Euratom) No 2728/94 of 31 October 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 December 1996, namely EUR 0,1 million.⁽⁵⁾ After deduction of EIB fees not paid at 31 December 1997, namely EUR 0,3 million.⁽⁶⁾ After deduction of EIB fees not paid at 31 December 1998, namely EUR 0,5 million.⁽⁷⁾ After deduction of EIB fees not paid at 31 December 1999, namely EUR 0,6 million.⁽⁸⁾ 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 the default situation as at 31 December 1999

(Mio EUR)

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			3,5	54,5	8,7	11,3
Turkmenistan	44,9	1,0	0,8	44,9	1,0	2,7			
Ukraine	31,9		1,0	31,9		1,6			
Former Yugoslavia	37,7	60,0	8,7	6,2	13,6	7,2	31,5	46,4	32,2
Subtotal	339,9	86,9	14,8	253,9	31,8	41,3	86,0	55,1	43,5
Total		441,6			327,0			184,6	

⁽¹⁾ This column includes interest accrued between the date of the call on the Fund and the end of the financial year; comparison of the three 'default interest' columns is thus not possible.

Source: Commission.

(TENs) and small and medium-sized enterprises (SMEs). At 31 December 1999, the Community had subscribed 30 % of the Fund's capital of 2 000 million ecus and the remainder was subscribed by the EIB (40 %) and a consortium of financial institutions (19,95 %) (4). The Community's share was 20 % paid up, some 120 million ecus having been paid over between 1994 and 1997.

Budgetary management of measures under mandate

7.11. The EIF managed three measures financed by the Community budget in 1999: the Growth and environment pilot project (5), the European technological facility — start-up and the SME guarantee facility. The two latter measures, along with the European Joint Venture scheme, which is directly managed by the Commission, are the constituent parts of the programme of financial assistance for innovative and job-creating SMEs (6).

Budgetary implementation

7.12. Cumulative payments from the Community budget to the EIF for these measures stood at 145 million euro at the end of 1999, 60 million euro of which was for the European technological facility — start-up, 60 million euro for the SME guarantee facility and 25 million euro for the Growth and environment pilot project (see **Table 7.3**).

Follow-up to previous observations

7.13. The Court pointed out in its Annual Report for 1998 that a budgetary implementation rate of 100 % calculated on the basis of the Community budget alone might conceal an underutilisation of budgetary funds by the agent and, in practice, weak implementation of the programme financed. This was the case, in 1998, with the Growth and environment pilot project. This situation improved in 1999, a year for which the cumu-

lative total for the sums utilised stood at 5,8 million euro; this was equal to an actual cumulative implementation rate of 23 % for this pilot project, the budgetary implementation of which was completed two years ago (see **Table 7.4**).

7.14. As regards other measures managed under mandate, the EIF had, at 31 December 1999, utilised a total of 14,3 million euro for the European technological facility — start-up, 12 million euro of which was in investments, out of 60 million euro disbursed; this was equal to an actual implementation rate of 24 % (see **Table 7.5**).

7.15. The time lag between budgetary implementation and the actual implementation of these programmes, which to a certain extent is inevitable, is not always clearly shown in the Community accounts, which presents a problem as regards the principles of transparency and annuality. The 'notes to the balance sheet of the Community' ought therefore to include an explanation of the fact that the balance of the accounts into which the budgetary funds are paid and the interest earned on these accounts over the last financial year appear on the EIF balance sheet under the heading 'Assets held on behalf of third parties'.

Management of own funds

7.16. The Court was unable, despite its prior efforts, to obtain full access to the necessary information on actions financed from the own funds, owing to the nature of the Fund's capital (see paragraph 7.10). Discussions are currently in progress with a view to defining audit procedures which are acceptable to all the parties concerned.

FINANCIAL MECHANISM OF THE EUROPEAN ECONOMIC AREA

Creation

7.17. Under Protocol 38 to the Agreement on the European Economic Area (EEA), which was signed on 2 May 1992 and entered into force on 1 January 1994, the Member States of the European Free Trade Association (EFTA) created the EEA Financial Mechanism (FM-EEA). The Mechanism is intended to contribute to the reduction of the economic and social disparities between the regions of the EEA. The Mechanism provides non-reimbursable grants as well as interest rebates on loans

(4) 10,05 % was still to be subscribed.

(5) Parliament Amendment No 0233 to the draft Community budget for 1995 (OJ C 18, 23.1.1995, p. 317).

(6) Council Decision 98/347/EC of 19 May 1998 on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs).

Table 7.3 — Measures managed by the EIF under a mandate from and for the account of the Community

(EUR 1 000)

Heading	Budget heading	1995			1996			1997			1998			1999			Total payments end 1999	2000		2001		Following years		Total budget 1995 to 2001		
		Appropriation commitments	Appropriation payments	Payments		Appropriation commitments	Appropriation payments	Appropriation commitments	Appropriation payments	Appropriation commitments	Appropriation payments															
Growth and environment	B5-3 2 3	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
European technological facility start-up	B5-5 1 0												25 000			35 000 ⁽¹⁾	60 000									
Guarantee facility													25 000			35 000 ⁽¹⁾	60 000	118 000	35 000			73 000		108 000	336 000	336 000
Total																	145 000							361 000	361 000	

⁽¹⁾ The spread of payments between the two measures is not given in the figures for the financial year.

Source: Commission.

Table 7.4 — Budgetary progress of the 'Growth and environment' pilot project

(EUR 1 000)

Heading	1995		1996		1997		1998		1999		Total	
	Commitments	Payments										
Total available appropriations	9 000	6 000	12 500	11 500	5 000	7 500	- 1 500	—	—	—	25 000	25 000
Budget outturn	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	—	—	—	—	—	141	—	1 325	—	4 326	—	5 792
Cumulative implementation rate (%)	—	—	—	—	—	0,56	—	5,86	—	23,17	—	23,17

Source: Commission (revised data for 1997 and 1998).

Table 7.5 — Implementation of budget heading B-5 5 1 0 'Technological facility for SMEs' (for the 'Technological — start-up facility')

(EUR 1 000)

Heading	1998		1999		Total	
	Commitments	Payments	Commitments	Payments	Commitments	Payments
Total appropriations available under heading B-5 5 1 0	100 000	50 000	118 000	70 000	218 000	120 000
Budget outturn	100 000	50 000	118 000	70 000	218 000	120 000
Implementation rate (%)	100	100	100	100	100	100
Utilisation by EIF for the 'start-up' measure						
Appropriations paid into the trust account	—	25 000	—	35 000	—	60 000
Appropriations used by the EIF	—	—	—	—	—	14 300
Implementation rate (%)	—	—	—	—	—	23,83

Source: Commission.

from the EIB, obtained directly or indirectly (i.e. via financial intermediaries) in the beneficiary countries. Financial assistance is provided in support of public and private initiatives with priority given to the fields of environmental protection, transport, training and education. The eligible regions are Greece, the island of Ireland, Portugal and certain regions of Spain.

Participants and contributions

7.18. The countries participating in the FM-EEA are Austria, Finland, Iceland, Liechtenstein, Norway and Sweden. Following the joint declaration of the EFTA States and in accordance with the principle of proportionality expressed in Article 82 of the Agreement on the EEA, the contributions are based on the gross domestic product (GDP) (for the three most recent years) of each country and will not be affected in the event that the State accedes to the European Community. According to the Acts (7) concerning the accession of Austria, Finland and Sweden to the European Union, the contributions of these countries have been borne, since they joined the Community on 1 January 1995, by the Community budget. Consequently, some 80 % of the contributions to the Mechanism have been paid through the Community budget in the period after 1994, the first year of the existence of the Mechanism.

Decision-taking powers and management

7.19. By Decision No 4/94/SC of the EFTA States, a Financial Mechanism Committee was established to manage the FM-EEA. Since 1995, the European Communities have been represented on this Committee by

a member nominated by the Commission. The other members of the Committee are nominated by Iceland, Liechtenstein and Norway. The decisions of the Committee have to be taken unanimously.

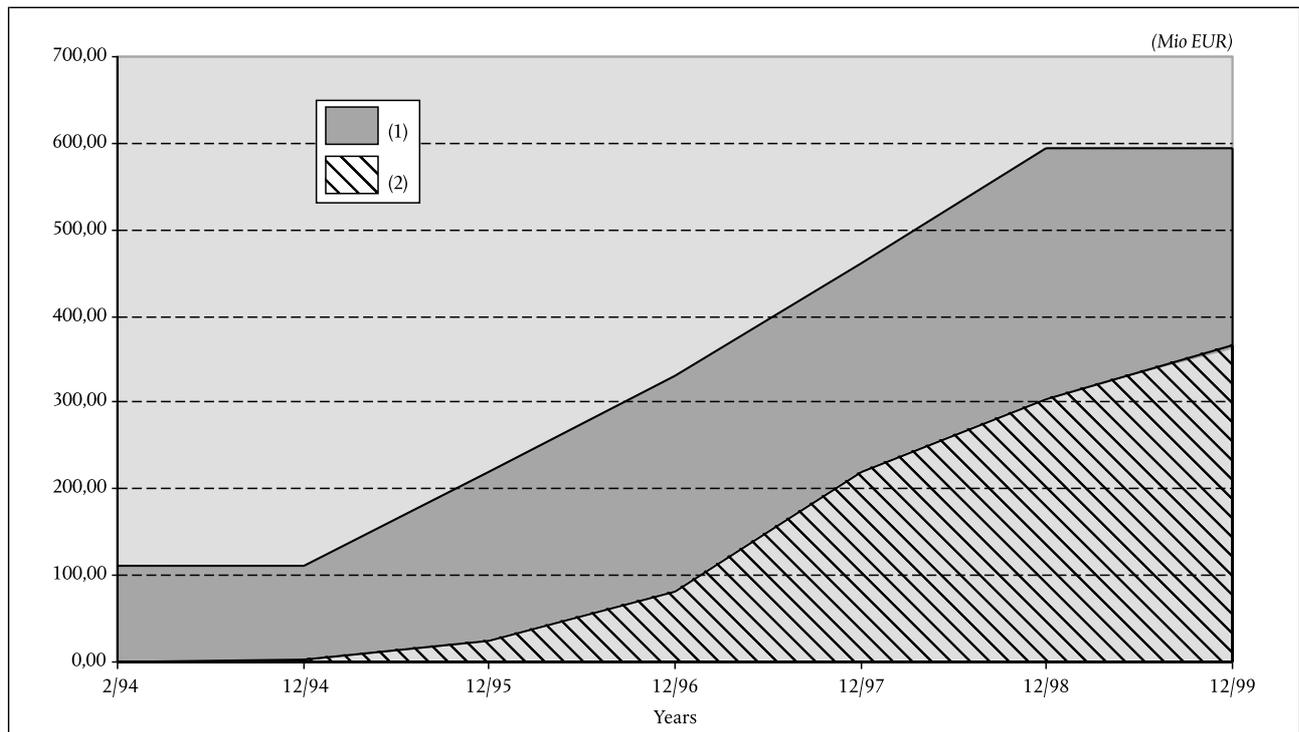
7.20. Management of the grants and interest subsidies was delegated to the EIB by the Cooperation Agreement signed on 30 June 1992 by the EFTA States and the EIB.

Budgetary management

7.21. The Community participation is charged to budget heading B2-4 0 1 0. Between 1995 and 1998, the Commission transferred a total of 385 million ecus to the EEA Financial Mechanism account held by the EIB. Between 1994 and July 1999 the available funds (i.e. the balance of contributions plus interest less disbursements and expenses) of the Mechanism were kept in that account. In July 1999, the Financial Mechanism Committee decided to commence active liquidity management and the mandate for this was given to the Commission. Since then, the available funds have been invested in money-market instruments (i.e. deposits and short-term bonds).

7.22. As shown in **Table 7.6**, absorption of the Mechanism's funds, especially in the first years, developed more slowly than the transfers to the Mechanism's account. The cumulative grant and interest rebate payments made up to 31 December 1999 totalled 366 million euro, which corresponds to 61,5 % of the cumulative transfers to the account (595 million euro).

(7) OJ C 241, 29.8.1994, p. 37.

Table 7.6 — Comparison between transfers to EEA Financial Mechanism account and their utilisation

(1) Transfers to FM account (cumulative, Commission 80 %, EFTA States 20 %).

(2) Payments of grants and interest rebates (cumulative).

Source: Commission.

The Court's audit

7.23. As at 31 December 1999, there were 56 grant projects with a total of 484,7 million euro. 37 loans for a total of 1 500 million euro were benefiting from interest rebates. The audit in 1999 consisted of a documentary review and an on-the-spot audit of selected projects. For this purpose, relevant information for 12 (out of 84) projects was requested from the EIB.

Access to project information

7.24. In October 1999, the EIB refused to give access to the documentation requested for four projects. On the basis of the situation as described in paragraph 7.18, the Court, however, considers that these projects fall within its audit mandate.

Observations on the on-the-spot audits

7.25. Of the eight projects for which documentation was received, four were selected for on-the-spot audit : a grant of 22,5 million euro (4,6 % of the total) and three loans of 79,8 million euro (5,3 % of the total), representing interest rebates of 7,5 million euro. They gave rise to the following comments.

Project descriptions submitted to the Financial Mechanism Committee

7.26. The FM Committee depends on information provided by the EIB when taking its decisions on interest rebates and grants. The main vehicle for information transfer is the project proposal. The operational

guidelines for the implementation of the Financial Mechanism stipulate that this document should describe and analyse, *inter alia*, the project investment cost, the financing plan and project implementation.

7.27. The project description submitted by the EIB to the Financial Mechanism Committee for one project failed to give complete and accurate information on the project and its financing. The flaws included:

- (a) a non-subsidised EIB loan had been given to one project at its initial stage in 1993. At the end of 1996 extensive modifications were made to the scope of the project. The project appraisal sent in at the end of 1997 to support the request for the interest subsidy did not take account of these modifications and was identical to the initial project description of 1990;
- (b) the loan benefiting from the rebate was used to refinance the first EIB loan disbursed in 1993. This loan was repaid early on the same day that the rebated loan was disbursed. The actual use of the loan was not disclosed to the FM Committee when the proposal was submitted;
- (c) the interest-rebate request states that works relating to the final stages of the investment plan will be tendered according to EC directives and will be open to suppliers from the European Economic Area. In fact there was no international public tender procedure for the project element, which was financed by the EEA.

Monitoring of cost

7.28. The monitoring of progress and expenditure should provide assurance of the reality of the operations underlying the payments from the Financial Mechanism.

7.29. At the request of the EIB, an effective control system had been designed for progress- and cost-monitoring of one project. Under this system, technical completion was systematically controlled by an independent consultancy firm, which monitored the progress of the project against the project specifications and gave a detailed monthly report thereon. The contractors invoiced the works on the basis of these reports and thus these reports constituted the substantive evidence for the invoices paid by the beneficiary and eventually reimbursed by the Financial Mechanism.

7.30. Unfortunately, in practice, the control system was not effective. The contractual agreement for the project made no provision for the EIB to receive the reports. The EIB made no direct use of the independent reports. Instead the Bank relied on information provided by the beneficiary, which sometimes differed from the independent progress reports. This practice undermined the operation of the control system and meant that there was no reliable audit trail from the underlying transaction (receipt and acceptance of the works) to the subsidy payment.

COMMISSION'S REPLIES

GUARANTEE FUND FOR EXTERNAL ACTIONS

Situation and development of the Fund

7.8. Under the terms of the Convention between the European Union and the EIB (European Investment Bank) concerning the management of the assets of the Guarantee Fund, both parties may decide to review the level of the management fee at the end of each financial year. The EIB's remuneration is based on the principle of matching its costs with fees received so as to produce neither a profit nor a loss. Given the considerable increase in the EIB's remuneration over the last three years, the Commission will ask the EIB at the end of the financial year 2000 to present an overview of the costs incurred. If appropriate, the Commission will then negotiate a revision of the remuneration structure.

EUROPEAN INVESTMENT FUND

Follow-up to previous observations

7.13. As regards the utilisation under the 'Growth and environment' programme, the Commission stresses that there is a time lag between the granting of guarantees and the actual debiting to the Commission account of the related fees. There has been a considerable increase in the Growth and environment project's take-up following the technical adjustments introduced on the basis of a thorough internal review in 1998. The Commission is of the opinion that the programme's relaunch has been successful.

7.15. The Commission is aware of the problem of the time lag between budgetary implementation and actual implementation; as part of its reappraisal of the presentation of the revenue and expenditure account it will try to find ways of making the information more accessible. The Commission will include an explanatory note in the balance sheet so that the amounts corresponding to funds held by the EIF can be identified.

Management of own funds

7.16. The EIF is in the process of being restructured in so far as the EIB will become the majority shareholder.

The Commission will remain an important and active partner in the EIF.

With respect to the audit rights of the Court of Auditors, the Commission continues its efforts to find a pragmatic solution.

FINANCIAL MECHANISM OF THE EUROPEAN ECONOMIC AREA

Access to project information

7.24. The Commission notes the observation of the Court to the effect that it was refused access to the documentation on four projects. However, in this respect, it has to be underlined that the Commission made available all the information at its disposal.

The EIB's comment on this lack of access is that the projects in question fell under the previous financing regime, namely by EEA (European Economic Area) funds alone, and were paid out in 1994, before these countries' accession.

Observations of the on-the-spot audits

Project descriptions submitted to the Financial Mechanism Committee

7.27. The Commission takes note of the fact that a request for the interest subsidy for a particular project did not take into account previous modifications to the project and the fact that the use of the loan benefiting from the rebate was not disclosed to the FM (Financial Mechanism) Committee, when the proposal was submitted.

As regards the request for the interest subsidy, the missing piece of information was not essential and was due to an administrative oversight. The refinancing may be considered as normal financial practice. The EIB states that the additional works covered by the EIB-EEA subsidised financing will be the subject of an international public tender, in accordance with the EU directive by the end of 2000.

The Commission considers that particular attention should be paid in future to oversights, reimbursement and tender procedures. The FM Committee will be informed of these points in order to take appropriate measures.

Monitoring of cost

7.30. The Commission points out that the control system the Court of Auditors is referring to was introduced at the EIB's request, in order to improve the management of this project.

CHAPTER 8 (*)

The Statement of Assurance and supporting information

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(*) The Commission's replies are on page 196.

STATEMENT OF ASSURANCE CONCERNING THE GENERAL BUDGET FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 1999

I. The European Court of Auditors ('the Court') has examined the consolidated accounts of the European Communities for the financial year ended 31 December 1999. 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 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. Except for the effects of the matters summarised below, the Court is of the opinion that the accounts for the financial year ended 31 December 1999 reflect reliably the Communities' revenue and expenditure for the year and the financial situation at the end of the year:

- (a) a net understatement of fixed assets by around 240 million euro (see paragraphs 8.2 to 8.4);
- (b) a material understatement of short-term amounts receivable from Member States (see paragraphs 8.5 to 8.7);
- (c) a material understatement of sundry debtors (see paragraph 8.8);
- (d) a lack of information on advances and payments on account at the year end (see paragraphs 8.11 to 8.13);
- (e) an understatement of commitments by some 2 600 million euro (see paragraphs 8.17 and 8.18);
- (f) an overstatement of commitments still to be settled by some 1 270 million euro (see paragraph 8.15);
- (g) a material overstatement of potential receivable amounts (see paragraphs 8.9 and 8.10).

⁽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 343, 1.12.2000).

⁽²⁾ Article 248 EC, Article 160c EAEC and Article 45c ECSC with regard to the ECSC's former administrative budget, which was incorporated into the general budget by the Merger Treaty of 8 April 1965.

Legality and regularity of underlying transactions

IV. In respect of revenue, the audit did not reveal a material incidence of error in own resources, within the limits described in paragraphs 1.7 to 1.10.

In respect of commitments, the audit revealed that legal obligations entered into were 390 million euro in excess of available appropriations for international fishery agreements, Structural Operations and External Action (see paragraph 8.18).

In respect of payments, the audit revealed an unacceptable incidence of error which affected their amount, or the reality or eligibility of the transactions underlying them (see paragraphs 8.21 and 8.22). Numerous other failures to comply with regulations (see paragraphs 8.23 and 8.24) and systems weaknesses (see paragraphs 8.25 and 8.30) were found for which the effect on payments cannot be directly evaluated.

In view of these findings, the Court declines to provide an assurance that the transactions underlying the financial statements are legal and regular except in respect of own resources, other commitments and the institutions' staff expenditure.

12 October 2000

Jan O. Karlsson
President

European Court of Auditors
12, rue Alcide De Gasperi, L-1615 Luxembourg

INFORMATION SUPPORTING THE STATEMENT OF ASSURANCE

Reliability of the accounts

8.1. Paragraphs 8.2 to 8.19 contain the Court's comments on the reliability of the accounts.

Fixed assets and stocks

8.2. The balance sheet presents a total value of tangible fixed assets of 3 019,1 million euro. This figure is understated as it does not include buildings being purchased through leases or similar arrangements by the European Parliament and the European Court of Justice with a value of approximately 668 million euro, despite this being necessary in order to ensure that the financial statements comply with International Accounting Standard No 17.

8.3. In addition, not all institutions implemented the Commission's instructions on the presentation of the balance sheet, with the result that assets are inconsistently identified, valued and classified. Only the Commission, the Court of Auditors and the European Ombudsman have calculated depreciation with the net book value of the assets in question being reflected in the balance sheet. In the absence of an adequate analysis by the other institutions, the Court estimates the impact on the financial statements as an understatement of depreciation of some 430 million euro. Inconsistencies were also noted in the treatment and calculation of depreciation between, and even within, different Commission directorates-general.

8.4. The Court identified weaknesses in the management of fixed assets in various institutions including: regulatory physical inventory checks not being undertaken; problems in physically locating assets when checks were undertaken; problems in implementing fixed-asset control systems; and non-capitalisation of certain computer hardware and software expenditure. These weaknesses mean that the reliability of the amounts recorded in the balance sheet cannot be assured.

Debtors and potential receivables

8.5. The balance sheet presents short-term amounts receivable from Member States as a net amount of 188,4 million euro. As can be seen from the notes to

the accounts, the Commission has made a 100 % provision for amounts receivable in respect of own resources (1 951,9 million euro — see paragraph 1.9) and EAGGF-Guarantee debtors (1 041,9 million euro). This approach, applied for the first time in 1999, recognises the accounting concept of prudence but, in not taking into account any rate of recoverability of the amounts due, does not provide an indication of their realistic value to the Community. While it is not realistic to assume that no funds will be recovered at all, this is an improvement on previous years when the balance sheet greatly overvalued these assets of the Community. Within this context, it should be noted that, except for amounts owed as a result of Guarantee Fund operations, the Commission makes no provision whatsoever against its sundry debtors totalling 2 370,3 million-euro.

8.6. In the case of own resources, the procedures for compiling the separate accounts (B accounts) maintained by the Member States supporting receivable amounts under litigation are not, in certain cases, reliable. This means that the Commission cannot be assured that the amounts recorded are accurate (see paragraph 1.14). As explained further in paragraphs 1.15 and 1.16, the nature of, and circumstances behind, the transactions recorded in these accounts means that it is very difficult to estimate their rate of recovery. Such an estimation is hampered by a lack of information as there is no requirement for Member States to provide a detailed analysis of the amounts recorded.

8.7. In the case of the EAGGF area the gross amount of 1 041,9 million euro represents those amounts due to be recovered from farmers, other agricultural enterprises and exporters who have received payments to which they were not entitled. It comprises amounts declared by paying agencies as due at the end of the EAGGF-Guarantee financial year on 15 October 1999. The Court's work shows that the balance is incomplete due to the omission of certain data, notably from one Member State, which could be of the order of several hundred million euro.

8.8. In 1999 the Commission, for the first time, made a significant attempt to record in the balance sheet, under sundry debtors, sums paid to various intermediate bodies, but not yet transferred to final recipients. The amount of 622,4 million euro comprises transfers to technical assistance offices, project management units, national funds, and other intermediaries acting on behalf

of the Communities, which had previously only been disclosed as definitive payments charged to the budget. By including the amounts in the balance sheet the Commission is providing important information on expenditure which remains to be implemented. The Court's audit work has shown that the identification of the transfers recorded in the balance sheet is incomplete and that the process used by the Accounting Officer to obtain the information does not include sufficient checks to ensure its reliability. For example, 327,5 million euro of the balance sheet amount relates to the Phare programme. There is however a difference of 165,2 million euro between this amount, which is based on the balances on bank accounts maintained by local managers, and the comparable amounts recorded in the Commission's own management reporting system (492,7 million euro). The Court has been unable to obtain explanations from the Commission's services. For other measures, the Court estimates that the value of the transfers not yet paid to final recipients but not included in the balance sheet, may be of the order of several hundred million euro.

8.9. The net potential profit from selling off agricultural stocks (104,8 million euro), which is listed among potential liabilities under off-balance sheet commitments, is understated by 178,5 million euro. This understatement is due to the use of an estimated sales price which is too low in comparison with the actual sales prices of stocks of butter and and skimmed-milk powder. Furthermore, the additional depreciation on all kinds of agricultural stocks, which is entered as expenditure, is overstated by 80 million euro on account of the forecasting problems in respect of the quantities held in stocks on 30 September, on the one hand, and, on the other, with the sales price forecast for the same date. This practice has recurrently led to profits in one financial year on sales of stocks from another.

8.10. Included within the off-balance sheet potential receivable account on fraud and irregularities in the area of EAGGF-Guarantee are balances under dispute which are also included in the balance sheet as short-term amounts receivable due from Member States in respect of EAGGF-Guarantee debtors and covered by a 100 % provision. As a result, these balances, which are estimated at several hundred million euro, are included twice in the financial statements and overstate the off-balance sheet potential receivable amount.

Advances and payments on account

8.11. In contrast to previous years, the financial statements for 1999 do not distinguish intermediate payments (payments on account and advances) from definitive payments. This information is not included in 1999 due to too many inaccuracies being found in the figures whilst obtaining them for previous years, and as a result of technical problems linked to the introduction of a new central accounting system. The lack of accurate information about the extent to which payments are definitive significantly reduces the value of the financial statements.

8.12. Furthermore, the financial statements continue to provide no indication of the extent to which the majority of budgetary payments representing intermediate payments have been utilised. The exception to this observation is the limited information presented in the balance sheet in the specific case of transfers to intermediate bodies described at paragraph 8.8 above. Most of the remainder of the transfers concerned 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 is not shown.

8.13. Information on the utilisation of intermediate payments 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 recipients. In general, defining the distinction between intermediate and final payments has not been satisfactorily tackled by the relevant Commission services. The Commission's Accounting Officer should undertake consultation with managing services to establish detailed rules for each budgetary area taking into account the different issues and problems faced. This would then provide a framework for developing an appropriate reporting tool to allow complete and reliable recording of the pertinent information for inclusion in the financial statements.

Commitments and potential liabilities

8.14. At 31 December 1999, commitments against differentiated appropriations totalling 70 931,5 million euro remained to be settled, 4 442,8 million euro of which were covered by payment appropriations carried over from 1999 to 2000.

8.15. At the year end the sums relating to the commitments outstanding from before 1998 are around 17 200 million euro, of which some 7 300 million euro were not subject to any payment during 1998 and 1999. Of this latter amount, the Court estimates that some 940 million euro (13 %) no longer represent an obligation to make payments.

8.16. In the area of the Structural Funds, the Commission's legal commitments (multiannual obligations) extend to the whole amount outstanding in each successive programming period, but, in accordance with the regulations of this budgetary area ⁽³⁾, 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. For all other areas of expenditure, the applicable regulations do not make any distinction between legal commitments and the commitments recorded in the accounts. These differing regulatory definitions of budgetary commitments result in inconsistent figures being provided in the financial statements on budgetary implementation.

8.17. In 1999, the last financial year of the 1994 to 1999 planning period for the Structural Funds, the Commission drew up an ad hoc inventory of aid which had been planned but not committed. This aid, covered by decisions taken prior to 31 December and which should have been the subject of budgetary commitments as stipulated in Regulation (EEC) No 4253/88 (see paragraph 3.41), was included in the off-balance sheet commitments ⁽⁴⁾. In order to avoid cancellation, the Commission carried over 2 196,3 million euro in available appropriations. In addition, the examination revealed a shortfall in appropriations of 179 million euro in the case of the Structural Funds.

8.18. For budget headings relating to international fisheries agreements the Commission has entered into legal obligations which exceed available appropriations

by 129 million euro. This amount, together with 179 million euro relating to Structural Funds (see paragraph 8.17) and 82 million euro in respect of External Action, means that the legal obligations entered into by the Commission exceed available appropriations for a total of 390 million euro. Together with commitments decided, but not booked in 1999, relating to Structural Operations (see paragraph 8.17), commitments for the year are understated by a total of some 2 600 million euro. The amounts concerned are, however, disclosed as potential liabilities.

8.19. Decisions were taken at the Berlin Summit to establish financial reference amounts for various multiannual programmes (e.g. ISPA, Socrates, etc.) for the programming period 2000 to 2006 whose amounts are not disclosed in the financial statements, in contrast to the treatment of decisions taken in respect of Structural Operations representing aid planned but not programmed. The amounts to be entered in the financial statements depend, in reality, on the existence and type of the Commission's obligations. The Commission should draw up a typology of these obligations in order to avoid any differing interpretations, in future, of the amounts to be entered in the financial statements and, in particular, in the off-balance sheet items and the explanatory notes.

Legality and regularity of underlying transactions

8.20. Paragraphs 8.21 to 8.31 present further information on the result of the Court's audit work on the legality and regularity of underlying transactions.

Substantive legality and regularity errors concerning payments and the transactions underlying them

8.21. The Court's audit showed an unacceptable incidence of error affecting the amount of payments made or the reality or eligibility of transactions underlying them and so financed by the Community budget. 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 the general budget.

8.22. The main types of substantive errors found included: actions or costs being co-financed not meeting Community eligibility requirements; overclaiming

⁽³⁾ 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.

⁽⁴⁾ 2 375 million euro for the Structural Funds and 2,7 million euro for the Cohesion Funds.

of quantities, surface area or costs for Community support; insufficient justification proving reality of costs claimed or link with Community supported action; and errors in calculations resulting in definitive overpayments from the Community budget.

Formal legality and regularity errors concerning payments and the transactions underlying them

8.23. Formal errors were noted across most areas of the budget. These errors do not have a 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 comprise failures to correctly apply the systems of control established by Community regulations to administer Community programmes.

8.24. The main types of formal errors found included: failure to comply with requirements of control procedures such as those included in the integrated administration and control system for agriculture; failure to maintain sufficiently detailed documentation on costs or activities claimed for Community support; and failure to comply properly with tender procedures.

Summary of detailed findings for areas of activity

8.25. The different areas of activity within the Community budget are characterised by differing transaction types and management approaches. This diversity has an impact not only on the type and frequency of irregularities that may occur, but also on the nature and extent of audit work and the accompanying results. Detailed observations in the form of specific appraisals for each of the main areas of activity can be found in the relevant chapters of this Annual Report. The following paragraphs provide an overview of some of the important issues arising from each area.

8.26. Traditional own resources are collected by the customs authorities of Member States. The audit in this area covered the legality and regularity of duties that are

established and entered into the accounts of Member States on the basis of declarations submitted to customs authorities. No material incidence of error was detected based on this work. The Court takes into account the specific risks of amounts that are due, but not established, within work undertaken outside the context of the DAS. In contrast to traditional own resources, VAT and GNP resources (which represent 80 % of total income) are determined by the Commission mainly on the basis of statistical data. As such, the Court's audit involved checking the working of the system used by the Commission for collecting these resources and concluded that it had reasonable assurance as to its reliability.

8.27. The administration of the EU budget in the EAGGF-Guarantee field is mostly performed by Member States. Much of the expenditure comprises a very large number of relatively low value payments based on declarations by individual farmers of eligible physical events such as surface areas sown to a particular crop type, or number of animals held. As can be expected from such a system, the majority of errors occur in inaccuracies of the beneficiaries' declarations which result in overpayments from the Community budget. Over the past few years the Community has made a significant attempt at improving the control procedures by establishing the integrated administration and control system covering much of the EAGGF-Guarantee budget. The Court's audit has shown that the Commission should continue its efforts to ensure the full implementation of this system so as to achieve all the expected benefits.

8.28. In respect of Structural Operations, management of Community expenditure programmes is also undertaken by Member States' administrations. However, in contrast with most expenditure in the EAGGF-Guarantee field, claims are based on costs incurred by final recipients in undertaking eligible activities against which the Community co-finances a defined proportion up to an upper limit. Additionally, and again in contrast with EAGGF-Guarantee, there is no general system of clearance of accounts or penalties for incorrect declarations. The Court's audit revealed a high incidence of error due, for example, to costs or actions not meeting eligibility criteria, costs declared exceeding those actually incurred or insufficient supporting documentation. Whilst these errors do not always have an impact on the regularity of the advance Community payments through which the programmes are financed, the Court's work has

shown that many of them are likely to have a definitive impact on the Community budget when the programmes are closed. The Commission, in previously acknowledging the unacceptable level of irregularity, secured the enactment of Regulation (EC) No 2064/97 which provides for a greater degree of verification of costs claimed by final beneficiaries. It is now up to the Member States to implement these measures effectively.

8.29. The Internal Policies expenditure is mainly managed directly by the Commission through contracts made between itself and public or private third parties. Generally these contracts cover the Community contributions, which, as for Structural Operations, cover a fixed proportion of eligible costs incurred by the contractors up to a defined upper limit. The Court concludes that the Commission's control over cost claims submitted by beneficiaries must be intensified and improved which, together with the nature of the expenditure and the absence of contractual penalties for incorrect declaration, indicates a significant risk of overcharging. This is borne out by the significant incidence of overpayments revealed by the Court's audit, including costs or activities not meeting eligibility criteria, costs claimed in excess of those actually incurred, and costs for which no documentary evidence could be provided.

8.30. External Action expenditure largely comprises contributions to a relatively large number of small development projects with a very wide geographical dispersion. Again the contributions are often based on a defined proportion of costs incurred by the final recipients, subject to a ceiling. Not only does this geographical dispersion hinder effective control procedures by the Commission, but also limits the possibilities for the Court to undertake audit work on the spot. The bulk of the expenditure is managed directly by the Commission, but increasing emphasis is being placed on the use of intermediaries which is intended to take advantage of the control procedures they use to protect their own interests. As such, the Court's 1999 audit in the External Action field was targeted towards areas of shared management and included some on-the-spot visits to beneficiaries. The work revealed only limited errors but highlighted the need for the Commission to improve monitoring and control systems, particularly in introducing systematic audit arrangements.

8.31. Administrative expenditure, which represents 5,6 % of the general budget, comprises a large proportion of routine transactions and is directly managed by

the Commission and the other institutions. By nature, the transactions are for the most part relatively straightforward, and information is readily available to allow detailed checking. The Court's audit in the administrative expenditure field has focused on the main budgetary areas forming the major part of this expenditure. The systems of procedures and controls were found to be generally satisfactory and there was no evidence of a material incidence of error.

ACCOUNTING FRAMEWORK AND PRACTICES

Drafting of consolidated financial statements

8.32. For the second year in succession, the Commission only met the 1 May deadline set in the regulations for forwarding the consolidated financial statements ⁽⁵⁾ in a purely formal sense. The fact is that the documents sent out officially on this date contained considerable errors which were pointed out to the Commission. A corrected version was sent out on 15 May 2000 and gave rise to further comments by the Court's auditors. This version was therefore subject to successive corrections in the course of the following months. For this reason, the DAS is based on the amended version of the financial statements which was sent to the Court by the Commission on 2 October 2000.

8.33. This situation cannot be attributed solely to problems resulting from the introduction at the beginning of 1999 of the new Sincom 2 accounting system (see paragraphs 8.41 to 8.56). The inability to produce proper financial statements by the stipulated deadlines highlights the lack of appropriate procedures for drawing up these statements, in particular the lack of adequate supervision, rational checks and checks in respect of the plausibility of the data produced.

8.34. The fact that intermediate financial statements are not drawn up at regular intervals also prevents anomalies from being discovered in good time and corrective measures from being taken as soon as a problem arises. The Court considers that the Commission, even in the absence of more restrictive legislation, should be able to provide functional financial statements well before the stipulated deadline of 1 May and draw up intermediate financial statements during the year.

⁽⁵⁾ Articles 78, 81 and 82 of the Financial Regulation.

Keeping of the accounts

8.35. Pursuant to the provisions of the Financial Regulation and of the corresponding implementing rules ⁽⁶⁾, the Accounting Officer is required to keep budgetary accounts using the cash-accounting method for drawing up the consolidated revenue and expenditure account and general accounts for drawing up the consolidated financial balance sheet. In practice, the implication is that transactions are first charged to the budget heading concerned and then, in the case of transactions to be included in the balance sheet, recorded in the general accounts and in the consolidated financial balance sheet, on the basis of periodic non-accounting inventories.

8.36. These non-accounting inventories, in particular as regards tangible and intangible assets, loan transactions and purchases of participations using budgetary funds, and stocks or advances paid to middlemen, are drawn up by management departments without any comparison being made with the corresponding amounts charged to the budget on the revenue or expenditure side. This lack of checks, even in respect of plausibility, is detrimental to proper accounting and, therefore, to the drawing-up of the financial statements.

8.37. In addition to the detrimental consequences for internal control and for the exhaustiveness of the data contained in the balance sheet, the lack of continuous, detailed entries in the general accounts makes it impossible to close accounts at regular intervals as a significant proportion of the necessary information is lacking from the central accounting system. Thus, for many balance sheet items, the interim accounting statements drawn up in accordance with the Regulations ⁽⁷⁾ at the end of June and November 1999, when the Accounting Officer stopped work, include only the figures for 31 December 1998.

8.38. Since the amendments introduced in November 1998, the Financial Regulation has made provision for a distinction between budgetary and non-budgetary expenditure and revenue accounts; the aim of the latter was to make it possible to obtain an 'extended set of accounts' ⁽⁸⁾. At the end of 1999, the Commission had not yet implemented this provision of the Financial Regulation.

⁽⁶⁾ Articles 6, 69, 70 and 72 of the Financial Regulation. Articles 133 to 136 of the detailed rules for the implementation of certain provisions of the Financial Regulation.

⁽⁷⁾ Article 18 of the detailed rules for the implementation of certain provisions of the Financial Regulation.

⁽⁸⁾ Article 70 of the Financial Regulation.

The Court's reservations

8.39. The Court is obliged to qualify its statement as to the reliability of the accounts by a disquieting number of significant, repeated reservations, the causes of which are often identical to those of previous years. The Commission should take the necessary steps without delay so as to rectify inadequate accounting practices and to put an end to the other shortcomings observed. It should give itself the necessary human and technical resources so as to introduce an effective accounting system based on the principles of accruals-based accounting and containing reliable, comprehensive and more informative data. The revision of the Financial Regulation should afford an opportunity to introduce the necessary arrangements and to increase the Accounting Officer's authority.

OTHER MATTERS

Treatment of amounts to be recovered

8.40. The legislation governing traditional own resources ⁽⁹⁾ lays down that they shall be made available after established entitlements have been recovered or guaranteed. Consequently, entitlements which are disputed are entered in a separate account and are made available, depending on the outcome of the dispute, only after the sums concerned have actually been recovered. However, in the case of agricultural expenditure, the amounts which were paid in error to final beneficiaries and disputed have already been transferred to the Member States by means of monthly advances. They are recovered only after a period which may last several years, depending on the length of the administrative or legal procedures. A double claim is thus made on Community funds: through the advance of the disputed amounts in the context of the EAGGF-Guarantee and the failure to make disputed amounts available in the field of own resources. In order to improve protection of the European Union's financial interest, the Commission should look at ways of putting an end to this situation, at regulation level, for example by providing for the recovery by the Commission of the EAGGF-Guarantee disputed amounts, by offsetting against subsequent monthly advances, pending a definitive decision concerning recoveries in the Member States.

⁽⁹⁾ Article 6(2)(b) of Council Regulation (EEC) No 1552/89 of 29 May 1989.

Introduction of a new accounting system

Concept and implementation

8.41. During 1999 the Commission put into operation its new accounting system known as Sincom 2. After a crossover period of parallel processing with the superseded Sincom 1 system at the end of the 1998 budgetary year, the new system officially took over the budgetary accounting from the start of the 1999 budgetary year.

8.42. The development of the system has been protracted, taking five years to complete. Whilst the implementation of such a complex system is difficult to achieve on target, some of the choices made by the Commission in defining and developing the system have undoubtedly added to the time required.

8.43. The functional conception of the system is very complicated in order to enable it to implement the requirements of the Financial Regulation, which, as the Court has said on many occasions, are overly and unnecessarily complex. It is regrettable that the Commission was not able to take advantage of a simplified and more relevant Financial Regulation when conceiving the new system. In respect of the recasting of the Financial Regulation currently being undertaken, the Sincom 2 system may not be easily adaptable to the significant changes that could arise from that process. Furthermore there is a risk that the depth of reform of the Financial Regulation may be constrained by the need to use Sincom 2.

8.44. The technical conception of the Sincom 2 system is complex as there are three main subsystems. The multisystem structure has caused problems particularly in terms of ensuring coherence of data between the different subsystems due to technical issues involved in linking the systems as well as differences in functioning between the systems.

8.45. For a number of reasons, major elements of the budgetary and accounting information and function only became fully operational during the course of 1999. For instance, major expenditure (EAGGF transactions) as well as income (only functioning from July/August 1999) areas were not accounted for in the budgetary accounts until the second half of 1999. This rendered the budgetary accounts incomplete and meant that it was impossible to produce a full set of intermediate accounts as at 30 June 1999. The absence of the

accounting information for own resources had the further implication that the Commission was unable to control the payments received effectively. As a result, certain errors in Member State contributions remained undetected for a number of months.

8.46. In its conception of the Sincom 2 system the Commission chose not to include some basic accounting functions which could have provided the basis for efficient control procedures. Features such as accounts receivable and accounts payable, control accounts and fixed-asset accounting were available as standard packages from the software supplier, and their inclusion would have incurred little extra expense.

Data-handling and reporting

8.47. A critical aspect of the changeover to the new system involved the transfer of closing account balances from Sincom 1 to opening account balances of Sincom 2. The data involved include the amounts used to establish the amounts carried over to the financial year 1999 and are therefore a critical aspect of the budgetary process. The transfer should have been accompanied by careful checking and reconciliation to ensure that it was both complete and accurate. This was not done at the time of the transfer and was only started as a formal exercise in April 2000, at the request of the Court, and completed in August 2000.

8.48. Another aspect of data-transfer is the ongoing reconciliation of financial data between various local systems maintained by directorates-general with Sincom 2. Each DG is responsible for its own data and for correct management information and should ensure that the transactions agree with those in the official accounting system. Furthermore, such reconciliations can help identify potential errors or inaccuracies in the information contained within Sincom 2 which is of particular importance at this early stage of implementation. These processes are not always performed on a systematic and regular basis, which increases the risk of inaccurate or incomplete data being retained in both Sincom 2 and the local systems used for management purposes.

8.49. The introduction of Sincom 2 was hampered by problems with the reporting tool which meant that the Commission DGs could not always provide complete, reliable reports during the financial year 1999. As such,

management may not have had sufficiently adequate information to support its decision-making process, which increased the risk of inefficient management of Community funds.

8.50. The main subsystem used by the DGs contains many inadequacies in terms of its informational and reporting capabilities. To counteract the reporting deficiency the Commission has chosen to implement an additional reporting tool known as Datawarehouse, which only became operational in April 2000.

8.51. The complexity of the structure of the data is causing difficulties with the Datawarehouse in that information is taken from different sources. Furthermore, significant differences in the presentation of information between the main budgetary accounting system and the reporting tool result in uncertainty as to which represents the definitive presentation.

8.52. To date, the revenue and expenditure account has been established on the basis of the data contained in the Datawarehouse, which is intended to reflect the accounting information in another two subsystems. However, reconciliation between the various sets of data contained in the three systems has only been partially performed. To ensure full integrity of the data, complete reconciliations should be performed between the subsystems.

Operational shortcomings

8.53. Some operational difficulties are caused by shortcomings in some basic principles and definitions. For example, there is an inadequate definition and function for handling dates and periods in the Sincom 2 system. This causes problems in presenting the budgetary situation for dates in the past with the consequent difficulties in closing accounting/budget periods.

8.54. A further example is the technical treatment of modifications to existing commitments (e.g. decommitments or supplementary commitments) by overwriting the existing values, which means that the audit trail can only be established by an extremely cumbersome procedure of on-screen consultation of historical records.

8.55. Since the introduction of Sincom 2, and in contrast to the situation for Sincom 1, there has been no complete, validated and tested business continuation plan in the event of complete failure of the system through natural or other disaster. This means that the Commission is not in a position to carry out back-up-based recovery and to continue ongoing functions in the event of a major incident.

8.56. Normal minimum-access security procedures are not being applied to Sincom 2. Some users have access to budget lines outside their scope of responsibility. A large number of users can act both as Accounting Officer and as Financial Controller, duties which are mutually incompatible according to the terms of the Financial Regulation (Article 21(4)). Moreover, as a consequence of technical adjustments to the programmes, transactions were validated automatically without any intervention by the Financial Controller. The number of users with system administrator rights or in a position to amend the databases is far too high. The Commission must rectify this situation with the utmost urgency by installing an efficient access control device. This is absolutely vital for a system dealing with such large and complex financial transactions.

CONCLUSION

8.57. The Court has produced an annual Statement of Assurance since the 1994 budgetary year. Each year the Court has expressed serious criticisms of the legality and regularity of the payments and the transactions underlying them. The discharge authority has naturally pressed the Commission to undertake corrective action. As the Court has pointed out in previous reports, a medium-term improvement requires a combination of general and specific measures, including the clarification and simplification of Community financial regulations and improvement of control procedures, particularly at the level of Member States.

8.58. Within the context of the discharge procedure for the 1998 budgetary year, the Commission has taken an important step in this process by presenting to the budgetary authority an action plan of procedures introduced, or to be introduced, in order to improve financial management. The Court can only welcome this initiative.

8.59. The Court of Auditors nevertheless wishes to draw attention to a potential ambiguity in the interpretation of its Statement of Assurance: it appears that the aim of corrective measures is to reduce established errors and for a commitment to be made with a view ultimately to obtaining a positive opinion. This is a source of confusion. The real objective of management must be to improve management and inspection procedures. This improvement, if it is effective and constant, will have an effect on the audit findings and, consequently, on the Court's conclusions. However, no one could undertake in advance to obtain or provide a preconceived opinion.

8.60. Care is also needed in considering the connection between the estimated incidence of error in agricultural guarantee expenditure as measured by the Court's audit, and the financial corrections administered by the Commission mainly in the context of the 'conformity' stage of the clearance of accounts (see paragraph 2.20). If, for any given year, the amounts in question in the two cases could be shown to be comparable, this might be seen as an indication that the

financial corrections were of the right order of magnitude. In practice, however, the Court's audit results cannot be directly compared to the conformity corrections, as the latter relate to a number of financial years at a time and include flat-rate corrections applied where no quantification of the impact of any resulting errors is possible (see paragraphs 2.27 to 2.35). It is the responsibility of the Commission, on the basis of its own, and others' audit work, together with other pertinent information, to take any necessary corrective action.

8.61. The Court of Auditors is endeavouring, with a view to contributing to the necessary reorganisation effort and as far as its resources permit, to develop its audit tools and the manner in which it drafts its Statement. The Court is endeavouring to develop its approach by incorporating into its Statement of Assurance the findings of appraisals which it is carrying out in respect of more specific management and inspection systems. The Court's audit can only serve as a diagnostic tool to be taken into account, among other tools, by the Commission.

THE COMMISSION'S REPLY

INFORMATION SUPPORTING THE STATEMENT OF ASSURANCE

Reliability of the accounts

Fixed assets and stocks

8.2 to 8.4. The Commission is always at pains to see that fixed assets are correctly entered in the accounts. The finishing touches are now being put to the Regulation on the accounting management of the Community's assets, which will be adopted by the Commission towards the end of October 2000 and will be applicable to all the institutions when the financial year 2000 closes.

Not all the institutions have followed up the instructions sent to them by the Commission's accounting officer. For the purposes of transparency, the Commission has stated what information is missing in the explanatory notes to the balance sheet.

The Commission will ask the other institutions to take appropriate measures for inventory management to ensure that their accounting officers send the Commission's accounting officer full and reliable information for consolidation of the financial balance sheets for 2000.

Debtors and potential receivables

8.5. As stated in the notes to the balance sheet, the Commission is aware that actual receivables from the Member States have been overestimated: it is unable to give a precise evaluation of doubtful debts since the rules in force do not oblige the Member States to provide information about the possibility of recovery.

As regards EAGGF Guarantee, from 2001 onwards the Member States, in addition to providing information relating to the debtors ledger, will have to estimate the likelihood of recovering the amounts declared. This requirement has been introduced by Commission Decision C(2000) 1992 of 14 July 2000 which determines the layout of the tables to be pre-

sented by the Member States for their monthly declarations. Several Member States were strongly opposed to this new requirement.

As regards the calculation of the provision for debtors in the separate own resources account to be included in the balance sheet, the Commission, while considering that a provision of 100 % is an acceptable solution as information now stands, will, when drawing up the accounts for 2000, apply a method of calculation which will take account of the recovery figure for previous years.

For sundry debtors the accounts must first be given the technical means of applying standard evaluation rules for debtors to the financial statements for 2000.

8.6. The Commission can confirm that the separate accounts contain errors which may be either one-off or structural in nature. For the past four years the Commission has made the separate account one of the main subjects of its controls in all the Member States and will continue to do so in future. Whenever an anomaly is detected, the Commission takes appropriate steps against the Member State and will even initiate an infringement procedure when this proves necessary.

The Commission is aware of the difficulties connected with the centralisation of data in the separate account (the 'B account') in some Member States. It would point out that this centralisation is based on a large number of accounting ledgers kept at local level (customs offices) which are not computerised in all Member States. The Commission regularly checks the entries in the separate account during its inspections and corrections are made whenever anomalies are found.

8.7. In Regulation (EC) No 2761/1999, amending Regulation (EC) No 296/96, the Commission has made it compulsory for the Member States to forward information on the amounts owed by individual operators in the EAGGF Guarantee sector. In future, the information which the Commission will be able to provide should be complete.

8.8. The Commission is aware of the risks involved in applying this type of operation and undertakes to adopt the following measures to step up controls on funds granted to intermediaries:

- it will compile a list of financial intermediaries managing Community funds (2000 accounts),
- it will lay down minimum rules which the authorising officers must observe in the management and control of these funds and cut excessive advances, contractual arrangements, (2001 accounts),
- it will provide relevant information on this type of activity in the explanatory notes (2000 accounts).

The EUR 327,5 million which the Court mentions in connection with the Phare programme corresponds to the sum of the bank balances at 31 December 1999 of the local management bodies which replied to the Commission's request for information. The difference between the figure in the balance sheet and the data from the internal monitoring system could be due to the time lag between the date of payment by the local management bodies, the date on which these payments are coded and the date on which they are transferred to the local management system.

However, the Commission will endeavour to improve its management procedures to produce complete and reliable information.

8.9. The estimated sales price is not the only determining factor for estimating potential assets deriving from the potential profit from selling off agricultural stocks on erratic agricultural markets. Changes in the dollar rate and the volume of purchases also have a considerable effect on the financial outturn of the management of agricultural stocks. The Court's findings as regards the profits repeatedly made on sales of agricultural stocks reflect the careful management to avoid transferring potential losses as well as the unpredictable factors which every year affect one sector or another.

Furthermore, Article 8(5) of Regulation (EC) No 1883/78 on the additional depreciation of agricultural stocks can apply only when appropriations are still available at the end of the year.

8.10. The recent Commission Decision C(2000) 1992 of 14 July 2000 determining the layout of the tables to be used to supply information on EAGGF Guarantee Section expenditure makes a distinction between entitlements to be recovered as a result of irregularities and fraud (Regulation (EC)

No 595/91) and other entitlements. This distinction should avoid any duplication in the accounts in future.

Advances and payments on account

8.11 to 8.13. The Commission stated in the explanatory notes to the revenue and expenditure account why this information was not included in the consolidated financial statements. The current rules do not make any distinction between the various types of payment made by the Commission. To be able to provide clear and transparent information, the Commission has, in recasting the Financial Regulation, listed four types of payment which should make it easier to monitor this sort of operation.

The Commission will consult the administering departments to lay down detailed rules for each sector of activity and will apply this classification in 2001 before the revision of the Financial Regulation is approved.

Commitments and potential liabilities

8.15. The Commission will ensure that management measures are taken to reduce outstanding commitments to the level commensurate with legal obligations.

8.16. The Commission would point out that the method of budget commitment is consistent with the rules, which may vary according to sector; the financial statements are presented in compliance with these rules.

8.17. The year 1999 was the last one of the previous programming period (1994 to 1999). Therefore, the financial plans of the programmes had to be adapted to actual implementation in order to commit the overall Edinburgh allocation. Mainly because of delays in the reprogramming by Member States, Structural Funds DGs did not have sufficient time to make the commitments before the end of 1999. In consequence, the under-implementation of appropriations was very high. The main part of these remaining needs could be covered by a carryover of appropriations from 1999 to 2000. The rest of the needs could not be covered due to a mismatch, on budget lines and chapters, between appropriations which were available for carryover and the remaining need for

commitments. As well, due to late reprogramming by Member States, the Commission was not able to proceed with the necessary transfers to avoid this mismatch.

To sum up, under-implementation was fairly high at the end of 1999 and a large proportion of the appropriations available were carried over to 2000 to allow commitment of pending Structural Fund operations; the budgetary authority was informed.

8.18. The fisheries agreements and various agreements in the field of external relations constitute legal frameworks which extend over a number of years and define each party's (Community, third country) obligations for each year. The Community's financial obligations are thus clearly divided into annual tranches in the basic text (financial protocol). That is why the Commission commits only the appropriate individual tranche in the year in question. The Commission, mindful of the Court's repeated observations, has included specific provisions in its proposal for the recasting of the Financial Regulation to take account of this situation.

As regards the Structural Funds, the Commission would refer to the explanations given above in its reply to paragraph 8.17.

However, for the purposes of transparency, the Commission includes with off-balance-sheet commitments every year all the amounts which have not yet been committed under the legal obligations deriving from the agreements in force.

8.19. For the 2000 financial statements, the Commission will analyse the features of the various allocations adopted at the Berlin Summit to identify the extent to which they are expenditure targets to be included with off-balance-sheet commitments.

Legality and regularity of underlying transactions

Summary of detailed findings for areas of activity

8.27. As regards EAGGF Guarantee, the Commission continues to monitor the implementation of the integrated administration and control system, IACS. Detected deficiencies have over the years led to financial corrections imposed on some Member States and/or reductions in the monthly advances.

Considerable efforts made by Member States in collaboration with the Commission departments have resulted in significant improvements in the implementation of the IACS.

8.28. The Structural Funds are implemented principally under multiannual programmes in the Member States and the Community legislation applicable does not provide for an annual clearance procedure, such as that applied for EAGGF Guarantee expenditure; however, for the period 1994 to 1999, financial corrections were possible under Article 24 of Regulation (EEC) No 2082/93 in the event of irregularities. For the new programming period (2000 to 2006), the Commission has approved a draft regulation to implement the reinforced provisions on financial corrections contained in Council Regulation (EC) No 1260/1999, which must be presented for consultation to the Structural Funds committees before it can be finally adopted.

The high incidence of errors found by the Court is not evidence that a significant proportion of the Community funds are being misspent, but rather that deficiencies exist in the Member States' financial control of the funds which are typical of the management of any complex programme. The principal effort required is to maintain progress in improving the financial management and control systems.

The strengthening of procedures relating to the control of operations and to the closure of programmes laid down in Commission Regulation (EC) No 2064/97 should result in a better capacity to ensure the regularity of Community expenditure. The Commission will continue to monitor the full implementation of the provisions of this regulation by Member States.

8.29. In the field of internal policies, the Commission set up a working party which produced in February 2000 a report proposing a number of improvements and simplification in the management of research programmes. Some of the main conclusions were that two pilot actions should be undertaken: use of a flat rate, and use of audit certificates with cost statements.

In addition, to reinforce the effect of the administrative measures which exist already in the event of a financial irregularity of a serious nature, administrative sanctions could be introduced to prevent contractors who have committed serious financial irregularities or fraud from continuing to receive funding from Community programmes or actions. The introduction of such administrative sanctions requires a sectoral Council Regulation in the field of research, based on the general Council Regulation of 18 December 1995.

8.30. In the field of external action, and specifically in the area of shared management, improvements have been introduced, with effect from 1 January 2000, in response to the need for an approach (on three major points: standard contract, call for proposal, accounting system) which takes into account the rapid growth in the number of NGO (non-governmental organisation) projects financed or co-financed from EU funds and the need to improve the quality and impact of the measures.

New procedures for the selection, appraisal and management of projects and programmes have been introduced with a view to increasing accountability and transparency. A standard contract for grants has been introduced, which provides for a standard reporting system more focused on results. The rules for accounting and audit have also been changed. The new rules will lead to a much more uniform and effective monitoring of these projects.

ACCOUNTING FRAMEWORK AND PRACTICES

Drafting of consolidated financial statements

8.32 to 8.34. The Commission would point out that the transition to a new integrated computer system involved a substantial workload for all departments. The problems encountered with the 1999 closure have been analysed and corrective measures are now being developed. In addition, an intermediate closure is planned for 30 September 2000 so that any anomalies which still exist can be identified and corrected before the end of the year ready for the closure of the accounts for 2000.

Keeping of the accounts

8.35 to 8.38. The Commission is aware that it does not have an adequate accounting framework which complies with the basic standards and which could serve as a basis for drawing up the institutions' accounts in a harmonised and regular manner.

The Commission would point out, without detracting in any way from the relevance of the Court's observations, that the keeping of public accounts is now evolving at international level and considerable progress has been made in this respect in recent years. One typical feature of the international evolution of public accounts is the widespread introduction of basic reforms to most countries' public accounting systems. These reforms vary in scope and sometimes go so far as to affect the objectives of accounting data or the registration procedures applied.

The Commission has therefore started a methodological analysis of the accounting process to produce reliable, accurate and complete financial statements satisfying the accounting standards so that they will be generally understandable and useful for decision-making. To achieve this, the Commission has called on high-level external assistance to ensure that the financial statements comply with the standards and principles generally accepted by the public sector. A survey has been carried out in this connection and the conclusions are now being examined in detail by the Accounting Officer's departments.

However, these developments are a long-term exercise and it will not be possible to use the results in the 2000 accounts.

The Commission's plan of action would be:

- to examine all the changes proposed by the experts and decide whether they are feasible, and draw up a working plan,
- to incorporate the main changes in the recasting of the Financial Regulation and/or its implementing provisions,
- to introduce the necessary changes to the accounting procedures and the computerised system of accounts.

The Court's reservations

8.39. The Commission is aware of the problems raised by the Court. It commissioned a study on this matter from a senior group of experts, which presented its conclusions in July 2000. The Commission will draw up a plan of action on the basis of the experts' recommendations. Improvements could be made to the financial statements for 2000. It will not be possible to make other, more far-reaching improvements until 2001.

OTHER MATTERS

Treatment of amounts to be recovered

8.40. The Commission confirms the Court's assessment that entitlements relating to own resources and the EAGGF Guarantee Section are not credited to the Community budget

until they are recovered by the Member States from the third parties concerned. This is in accordance with Article 10(1) of Council Regulation (EC) No 1150/2000 in the case of own resources and Article 8(2) of Council Regulation (EC) No 1258/1999 in the case of EAGGF Guarantee.

To encourage the Member States to improve their recovery procedures, the possibility of amending the current rules should be considered so that any entitlement which they had not recovered could be credited to the Community budget on expiry of a reasonable time limit to be determined.

Introduction of a new accounting system

Concept and implementation

8.41 to 8.44. The design of Sincom2 could not anticipate the changes to the Financial Regulation. Adapting Sincom2 to the outcome of this recasting will not pose an obstacle, just as it did not hold back the recasting exercise.

The Commission will shortly be considering whether budget accounting should be managed through a single application, so eliminating the risk of inconsistency between data noted by the Court.

8.45. As regards the EAGGF Guarantee transactions, there is a problem of interface with the local AGREX system which still provides information in the format of the old application, Sincom1. The transactions are now transmitted direct under the new application, Sincom2.

Concerning revenue, as the beginning of 1999 was entirely devoted to making the expenditure side of budget accounting operational, the revenue accounting could not be converted from Sincom1 to Sincom2 until later. This situation has now been resolved.

8.46. The Court's comment is fair; however, the Commission has not ruled out making use of these functions: the introduction of an invoice management utility (Action 11 of the White Paper) will offer the opportunity for a complete

review of procedures with a view to asset accounting. The Commission will also examine the possibility of integrated asset management. This approach is linked to setting up the study on accounting principles.

Data-handling and reporting

8.47. The following controls were carried out when Sincom2 was introduced:

- for the budgetary accounts, the differences between the closing balances in Sincom1 and the opening balances in Sincom2 were noted. Some of them are due to the differences in processing methods between the old and the new application. Controls were carried out after Sincom2 was introduced,
- for the general accounts, the closing and new opening balances were checked. The data in the general accounts were entered after the opening of the budgetary accounts.

8.48. The authorising officers will be instructed to conduct regular controls of differences between the local systems and Sincom2.

8.49 to 8.52. The reporting tool could not be brought on stream until the accounting application was properly stable.

Reports on the monitoring of budget implementation sent to the budget authority are based on data drawn from the current accounting system; reports to Directorates-General are based on data drawn from the authorising officers' management module. While it is true that the existence of two sources may sometimes lead to inconsistencies, by bringing budget accounting under a single application, the Accounting Officer's services will improve the consistency and unity of data. The new architecture will be chosen in December 2000.

Operational shortcomings

8.53. The Commission is aware of the problems mentioned by the Court and has asked the software supplier to resolve these issues by the end of 2000.

8.54. The Commission would point out that in Sincom2 the commitment transactions are identified by a single key and the audit trail is thus guaranteed. By the end of 2000 the database for monitoring implementation (Datawarehouse) will allow users to obtain this information for commitments which have not been cleared more easily.

8.55. The Commission has established an emergency plan which will be tested before the end of 2000.

8.56. Steps to tighten access security are being taken. The interventions by the development teams in the place of authorising officers and the Financial Controller were solely intended to unblock transactions in the workflow: these were purely technical operations.

The Commission would reiterate the following: when Sincom2 was brought on stream on 1 January 1999, the emphasis was on allowing users access to the application. Although the emphasis was not placed on a regulatory approach to security and although broad access profiles were granted, they are in practice restricted by the rules on the validation of transactions.

The systems administrators' rights of access have also been considerably cut back to the strict minimum. In future, specific profiles will be introduced for this type of transaction.

CONCLUSION

8.58. In 1999 the Commission presented a plan of action setting out the measures which it intended to implement under

each heading of the financial perspective and which it had already announced in its replies to the annual report for 1998. It updated this plan of action in its report on the follow-up to the discharge for 1998.

For the common agricultural policy, for example, the Commission has introduced a system to penalise forecasts for rural development which are significantly wrong. In the case of structural operations, the recasting of the Financial Regulation and the introduction of financial corrections will improve the financial management of the funds. As regards external action, the Commission has announced that the technical assistance offices are to be wound up. For internal policies, the Commission has improved the management of recovery orders and placed particular emphasis on the monitoring of dormant commitments.

8.59. The Commission shares the Court's view that the real objective of Commission action should be to improve the management and control procedures.

8.60. The Commission agrees with the Court on the difficulties in comparing the DAS results and the clearance of accounts decisions (see also the Commission's answer to Chapter 2).

However, the Commission is of the view that it is of interest to make a qualitative comparison between, on the one hand, the DAS results and, on the other hand, amounts recovered by the Community budget as a result of Commission decisions and Member States' corrections.

THE INSTITUTIONS' REPLIES TO PARAGRAPHS 8.2 TO 8.4

THE EUROPEAN PARLIAMENT'S REPLIES

8.2. Tangible assets and leases

The Court's observation to the effect that Parliament has not followed the instructions of the Commission's accounting officer is incorrect. The instructions issued by the Commission's accounting officer on 22 December 1999 for the harmonisation of the institutions' balance sheets set out three conditions which must be met if leases are to be included under the 'tangible assets' heading of the balance sheet.

Parliament did not include an entry for the Strasbourg building in its balance sheet, as it considers that one of the technical conditions laid down by the Commission's accounting officer has not been met.

Nevertheless, prior to establishing the balance sheet as at 31 December 2000 Parliament will give further consideration to the Court's legal and accounting arguments.

8.3. Harmonisation of the identification, estimation and classification of assets by the institutions

Article 70a of the Financial Regulation, which provides for the depreciation of asset elements to be taken into account,

states that 'the rules for the entry in the accounts of depreciation (...) shall be determined by the implementation rules'. No implementing rule has been adopted to date on this point. In addition, the Commission has still not adopted, pursuant to Article 21 of the implementing rules, a regulation on the accounting management of the institutions' property.

The estimation of the depreciation total indicated in the observations merely reflects the suppositions of the Court of Auditors' services.

8.4. Weaknesses in the management of fixed assets

Parliament is introducing a new inventory management system (ELS), designed to remedy the weaknesses identified. Parliament's objective is to submit a much more reliable estimate of the balance sheet as at 31 December 2000, as requested by the Court of Auditors; it will also endeavour to apply the depreciation calculation for the first time. The implementation of the action plan forwarded to the Court at the end of 1998 is being pursued in line with the agreed timetable. It should be borne in mind that Parliament has property with a total surface area of some 900 000 m², covering 26 buildings in 15 Member States.

THE INSTITUTIONS' REPLIES TO PARAGRAPHS 8.2 TO 8.4THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

8.3. *A complete, standardised method of presenting depreciation data is to be discussed at interinstitutional level by the auditors. The Economic and Social Committee will apply the conclusions resulting from this joint consultation.*

year, the Economic and Social Committee plans to carry out an audit of the physical inventory early in 2001,

None the less, the depreciation figures should be presented on an indicative basis at the close of 2000 financial year.

— *the last audit of the physical inventory was unable to trace a number of items of property. The depreciation period of these items had expired and hence they had no value for accounting purposes. The process of clearing the inventory is currently under way and should be completed at the end of October 2000,*

8.4. *On the shortcomings identified by the Court in respect of inventory management by the EU institutions, the Economic and Social Committee's situation can be summed up as follows:*

— *the last audit made of the physical inventory was in 1998. After the move, scheduled for November/December this*

— *in the balance sheet for 1999, IT software and hardware have been capitalised as agreed at interinstitutional level.*

