

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 762/2001 of 9 April 2001 and the Financial Regulation of 16 June 1998 applicable to development finance cooperation under the fourth ACP-EC Convention, the Court of Auditors of the European Communities, at the meeting on 10 October 2002, adopted its

ANNUAL REPORT

concerning the financial year 2001

(2002/C 295/01)

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. The structure and format of this Annual Report are similar to those of recent years, although more concise than last year's report. Separate chapters deal with revenue and each of the expenditure areas that fall under the headings of the financial perspective. The concluding chapter (Chapter 9) contains the Court's Statement of Assurance. The Court's observations concerning the European Development Funds are presented separately. The Commission's replies and, where appropriate, those of the other institutions, are published alongside the observations of the Court.

0.2. Since the last Annual Report, the Court has published seven special reports, summaries of which are included in the relevant chapters of this report. The Court also adopted 10 opinions, including a second one concerning the recasting of the Financial Regulation (Opinion No 2/2002 ⁽¹⁾).

0.3. This general introduction focusses on key matters concerning the financial management of the European Union budget in 2001. These were the Commission's programme of reform of its administration, in particular its financial management, which included the adoption of a new Financial Regulation, and the significant surplus, for the second year running, of revenue over expenditure.

Statements of Assurance

0.4. With regard to the general budget, in the Court's opinion, except for the effect of certain matters mentioned in the Statement of Assurance the accounts for the financial year ended 31 December 2001, as published in the Official Journal, reliably reflect the Communities' revenue and expenditure for the financial year and their financial situation at the end of the year. The Court draws attention to the fact that most of its observations and the matters mentioned are recurrent. To a large extent the weaknesses highlighted are due to the nature of the Community accounting system, which was not designed to provide a complete record of the assets.

0.5. These weaknesses in the Commission's accounting system are highlighted in paragraphs 9.6 and 9.7 of this report. The Court has repeatedly drawn attention to this issue in its previous Annual Reports, in particular those of 1999 and 2000 where it highlighted significant prob-

lems with the Sincom 2 accounting system concerning control and security over the system and the completeness of the data contained therein. Some of the problems have still not been resolved ⁽²⁾. The Court has been concerned that, while in the past the Commission has recognised at least some of the deficiencies pointed out by the Court, it has not given sufficient priority or devoted sufficient reflection and appropriate resources to overcoming them within a reasonable timescale. The Commission has stated in its reply to paragraphs 9.6 to 9.8 of this report its commitment to the modernisation and improvement of the accounting system. It now needs to develop urgently a detailed action plan with the necessary resources and a timetable that is both realistic and reasonable. The action plan should clearly distinguish between those measures required to solve current operational deficiencies and to enhance the informative value of the current cash-based accounts, and those necessary to move towards full accruals accounting.

0.6. With regard to the legality and the regularity of the transactions underlying the financial statements, in view of the results of the audit the Court is of the opinion that the transactions are, taken as a whole, legal and regular in respect of revenue, commitments and administrative expenditure; it still cannot provide this assurance in respect of all the other payments.

0.7. With regard to the Statement of Assurance concerning the European Development Funds, the Court is of the opinion that, except for certain items set out in the statement, the financial statements at 31 December 2001 and the revenue and expenditure accounts for the financial year 2001 reliably reflect the revenue and expenditure relating to the sixth, seventh and eighth EDFs for the financial year and their financial situation at the end of the year.

0.8. As far as the legality and regularity of the underlying transactions are concerned, the Court is of the opinion that the revenue entered in the accounts, the amounts allocated to the EDF's commitments and payments for the year are, taken as a whole, legal and regular. However, the Court is not in a position to provide assurance regarding the reality of work, supplies and services underlying the payments at the level of the local beneficiaries.

⁽¹⁾ OJ C 92, 17.4.2002. See also paragraph 0.17. A full list of the reports and opinions adopted by the Court in each of the last five years appears in Annex II to the report.

⁽²⁾ Annual report concerning the financial year 1999, paragraphs 8.41 to 8.56 (OJ C 342, 1.12.2000); Annual Report concerning the financial year 2000, paragraphs 9.38 to 9.43 (OJ C 359, 15.12.2001).

Reform of the Commission : 2001 was a year of transition

0.9. 2001 was an important transitional year in what is a profound reform of the administration of the Commission as a whole, and particularly concerning the reform of financial management. Paragraphs 9.48 to 9.100 set out a number of observations concerning the reform of the Commission's internal control system.

0.10. The Court notes in paragraphs 9.63 to 9.70 that delays have been experienced and that a number of deadlines in the Action Plan of the Reform White Paper have been put back from end-2001 to end-2002. The Court considers that such delays were inevitable as the original timetable of the White Paper was over-ambitious. The wide-reaching and ambitious nature of the reform programme means that it requires time for its effective implementation.

0.11. The annual activity reports and the declarations made by the Directors-General, which are a key element in the reform, provide a good illustration of this point. The Court concludes from its review of these annual activity reports and declarations, plus the conclusions of the Internal Audit Service and the summary report of the Commission addressed to the Council and the European Parliament ⁽³⁾, that it is too early to draw any conclusions from the reports and declarations on the level of assurance that can be obtained about the legality and regularity of operations carried out and the sound financial use of resources: in this matter the Commission acknowledges that much still needs to be done to improve the methodology and ensure consistent application and reporting (see paragraphs 9.71 to 9.100).

0.12. The nature of the declarations varies considerably, there are problems of coherence between the declaration and the report of some Directors-General, as well as between the approaches adopted. It is difficult to assess the significance of the reserves and observations included by the Directors-General, in particular concerning expenditure under shared management with the Member States, which accounts for the vast bulk of the budget. The overall conclusions drawn by the Commission in its summary report are themselves ambiguous. The report concludes that the result reflects a 'globally positive situation' despite the multiple risks and weaknesses identified in most areas.

⁽³⁾ Synthesis of the annual activity reports and declarations of the Directors-General and heads of service, COM(2002) 426 final of 24 July 2002.

0.13. The Commission has, however, taken important steps to clarify responsibility and accountability for the management of Community funds. Furthermore, the Commission has shown its commitment to build on the results of this first year by presenting an 18-point action plan to address the weaknesses identified. This shows that it is aware that much remains to be done to improve the quality of its financial management on a permanent, long lasting basis. The reports provide much useful information on the areas where further action is needed to further develop and improve internal control mechanisms.

0.14. The principal aim of the annual activity reports and declarations is to increase the accountability of the Directors-General for the financial management of the resources they spend. They also have to be taken into account by the Court in its audit work. Improving the quality of the annual activity reports and declarations of the Directors-General as foreseen in the 18-point action plan of the Commission is essential if the Court is to be able in the future to obtain from them any of the assurance it needs for its Statement of Assurance. These reports and declarations are intended to be one of the cornerstones of the system of internal control over Community expenditure currently being developed at the level of the Commission and in Member States. As the chapters of this report show, there is, however, a great deal of work which needs to be done to develop a proper Community system of internal control and audit which will enable the Court to obtain assurance from these sources.

0.15. Thus, while in the different financial perspective areas monitoring and control systems are being developed and greater attention is being paid by the managing services of the Commission to the audit of actions financed from Community funds, the systems in place do not yet ensure that the information available to the Commission, or to the Court, on the legality and regularity of the underlying transactions is sufficiently reliable. For example, in Chapter 2 (common agricultural policy) the certification process for paying agencies does not provide assurance that the facts declared by beneficiaries in claims for payment reflect reality. In the area of structural measures (Chapter 3) it is concluded that, despite progressive strengthening and improvements in the control systems applicable to the different programming periods, the control systems still do not ensure that the checks on final declarations of expenditure are rigorous and reliable enough, and for the current period (2000 to 2006) the structures are not all operational

and independent auditing of the operations has not yet begun. Chapter 4 (Internal policies) shows that significant errors resulting from overdeclaration of expenditure by contractors for indirect research actions persist, despite a significant increase in financial audits by the Commission in 2001. With regard to external action (Chapter 5, and the part of the report dealing with the European Development Funds) the Court concludes that it cannot yet rely on the Commission's internal control and monitoring systems for part of its assurance.

0.16. Concerted action will be needed over a number of years to develop an effective Community system of internal control and audit from which the Court will be able to obtain assurance.

Financial Regulation

0.17. Since the last Annual Report the Council has adopted a new Financial Regulation which will be applied from 1 January 2003. Thus a process that in many respects started with the Court's Opinion No 4/97 ⁽⁴⁾ is complete. In the general introduction to the Annual Report concerning the financial year 2000 the Court, while welcoming many of the changes being introduced, pointed out several areas where its Opinion No 2/2001 ⁽⁵⁾ on the Commission's initial proposal for recasting the Financial Regulation had not been followed in its revised proposal. Indeed, the Court found it necessary to issue a further Opinion ⁽⁶⁾ on the revised proposal dealing with the timetable and procedure for the adoption of Court reports, and for the presentation and approval of the financial statements.

0.18. Although the Court supports the general thrust of the new Financial Regulation it still contains elements the Court considers unsatisfactory. These include artificial annual instalments for commitments, unnecessary derogations in specific fields and marginal items (for instance, carry-over of appropriations) which render management and accounting systems unnecessarily complex with very little financial effect. This last point is significant in the light of the problems referred to in paragraph 0.5 above. It is regrettable that the opportunity was not taken to be more radical in the revision.

The budget surplus in 2001 was even larger than the surplus of the previous year

0.19. For the second year running there was a significant surplus of revenue over expenditure amounting to 15 013 million euro (16 % of the final budget). The corresponding figures for 2000 were 11 619 million euro and 14 %.

0.20. There is no valid reason to call on own resources which are significantly in excess of the needs for the year. The Commission in its replies to paragraph 1.11 of this report dismisses the Court's argument that the mechanism of the supplementary and amending budget should be used to avoid excessive budget surpluses. However, the reasons given by the Commission are insufficient to avoid the criticism that its budgetary management lacks adequate rigour.

0.21. A significant factor contributing to the emergence of the budget surplus is the overbudgeting of payment appropriations, not only for structural measures but also for the enlargement programmes ⁽⁷⁾; on structural measures almost one third of payment appropriations were not needed. The Court considers that the Commission's and Member States' past experience of spending programmes should have enabled the Commission to make more realistic budget estimates in these areas.

Concluding remark

0.22. The Court celebrates its 25th anniversary in November 2002. Anyone reading the Court's reports since it began its work will be struck by how frequently the Court has had to repeat similar observations concerning the need for improvements in the management of Community funds, at all levels, and in all areas of the budget. The Commission has now made formal commitments to correct deficiencies, through, for example, the 98 Actions in the Reform White Paper ⁽⁸⁾, and now the 18-point action plan in connection with the annual activity reports and declarations of the Directors-General. Progress is indeed being made in implementing these various action points. However, as this report shows in the individual chapters, there remains a great deal to be done. The Court urges the Commission to reinforce its efforts, in order that improvements are made as soon as feasible.

⁽⁴⁾ OJ C 57, 23.2.1998.

⁽⁵⁾ OJ C 162, 5.6.2001.

⁽⁶⁾ Opinion No 2/2002 (OJ C 92, 17.4.2002).

⁽⁷⁾ See paragraphs 6.4-6.6 of this report.

⁽⁸⁾ COM(2000) 200 final of 5 April 2000.

REPORT ON THE ACTIVITIES FINANCED
FROM THE GENERAL BUDGET

CHAPTER 1

Own resources

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INTRODUCTION

1.1. In the area of traditional own resources, the Court's audit concentrated on the systems for recording duties established and for making them available, as required by Community legislation, as well as on the correct presentation of the amounts in the Commission's accounts. In this context, particular attention was paid to the system of private customs warehouses.

1.2. For the VAT and GNP own resources, the Court's audit concentrated on the drafting of the budget and its implementation in respect of these resources, the balances, and adjustments to balances, deriving from these resources and refunds to Member States. The audit included as a specific issue the calculation of the UK correction and its financing in 2001.

1.3. Observations related to the implementation of the budget, in particular the very high budget surplus, to administrative cooperation for the safeguarding of VAT revenue and the follow-up to earlier audit observations are also presented, in addition to the SOA (Statement of Assurance) specific appraisal.

ANALYSIS OF BUDGETARY MANAGEMENT

Actual revenue

1.4. **Table 1.1** summarises the Community's revenue for the financial year 2001 and **Graph 1.1** shows the distribution of the different types of revenue. **Graph 1.2** illustrates the evolution of actual revenue over the period 1989 to 2001.

1.5. As part of its analytical review procedures, the Court compared the amounts of own resources made available by each Member State with those of previous years.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

1.6. The total amount of customs and agricultural duties received in 2001, 15 370,2 million euro, was 2,5 % lower than the amount actually received in 2000, but 5,9 % lower than the final budgeted figure of 16 327,5 million euro. The budget total was in fact increased by 10 % by supplementary and amending budget No 3 (adopted on 5 July 2001), reflecting the fact that in most Member States the revenue trend in the first part of 2001 was running above that of the previous year. This remained true up to September, but revenue decreased in the last quarter as world trade declined. In Greece, Luxembourg, Ireland and Austria (which together collect about 4 % of import duties) revenue ran at a lower rate throughout the year.

Table 1.1 — Revenue for the financial years 2000 and 2001

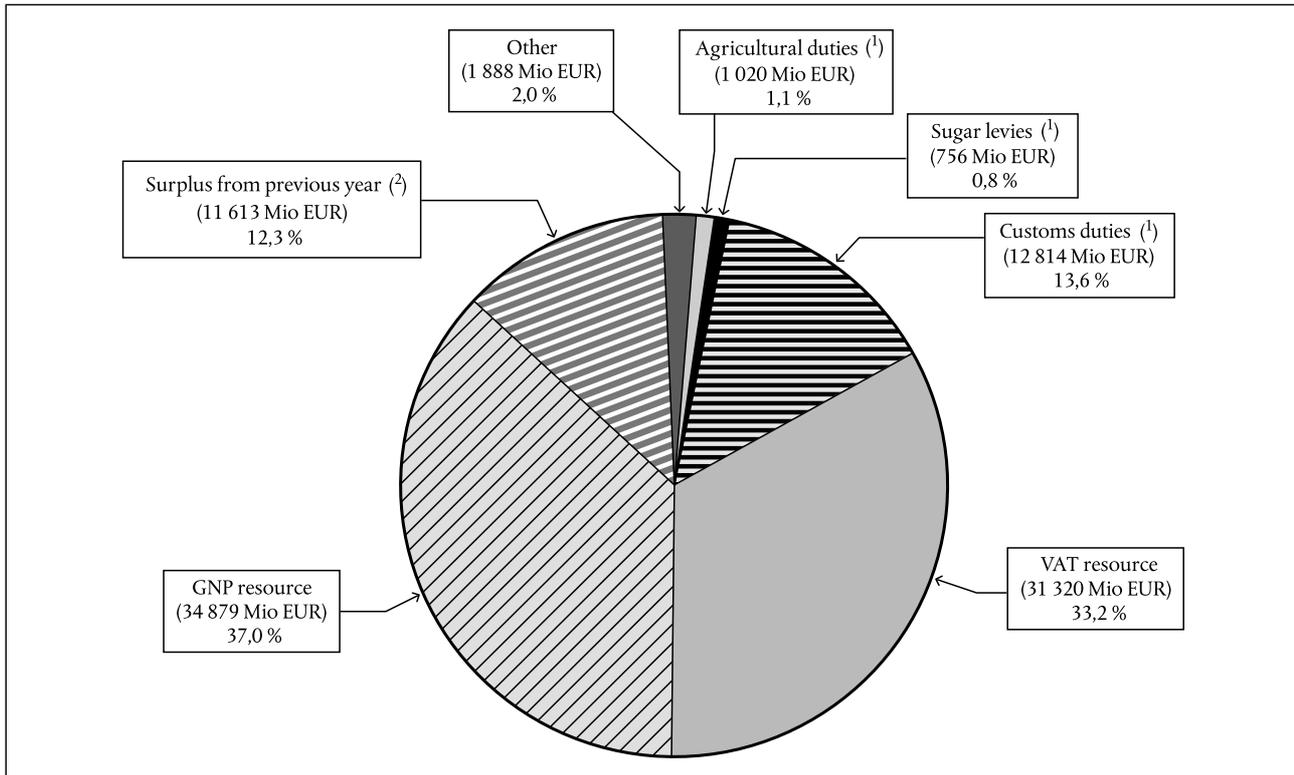
(Mio EUR)

Type of revenue and corresponding budget heading	Actual revenue in 2000	Development of the 2001 budget		Actual revenue in 2001	% change (2000 to 2001)
		Initial budget	Final budget		
	(a)	(b)	(c)	(d)	(e) = [(d)-(a)]/(a)
1. Traditional own resources	15 267,1	14 259,4	15 600,4	14 589,2	- 4,4 %
— Agricultural duties (Chapter 1 0)	1 198,4	1 180,0	1 180,0	1 132,9	- 5,5 %
— Sugar and isoglucose levies (Chapter 1 1)	1 196,8	1 006,3	1 006,3	840,0	- 29,8 %
— Customs duties (Chapter 1 2)	14 568,3	13 657,5	15 147,5	14 237,4	- 2,3 %
— Collection expenses (Chapter 1 9)	- 1 696,3	- 1 584,4	- 1 733,4	- 1 621,0	- 4,4 %
2. VAT resources	35 192,5	33 467,2	30 691,4	31 320,3	- 11,0 %
— VAT resource from the current financial year (Chapter 1 3)	34 187,6	33 467,2	30 691,4	30 695,4	
— Balances from previous years (Chapter 3 1)	1 004,9	p.m.	0,0	624,9	
3. GNP resource	37 580,5	43 245,5	35 177,8	34 878,8	- 7,2 %
— GNP resource from the current financial year (Chapter 1 4)	37 253,2	43 245,5	35 177,9	34 460,2	
— Balances from previous years (Chapter 3 2)	327,3	p.m.	0,0	418,6	
4. Budgetary imbalances	- 70,9	0,0	0,0	- 70,3	- 0,9 %
— UK correction (Chapter 1 5)	- 70,8	0,0	0,0	- 72,5	
— Final calculation of UK correction (Chapter 3 5)	- 0,1	p.m.	0,0	2,2	
5. Other revenue	4 755,3	1 597,3	12 664,9	13 571,2	185,4 %
— Surplus from previous financial year (Chapter 3 0)	3 209,1	900,0	11 612,7	11 612,7 ⁽¹⁾	261,9 %
— Refunds to Member States (Chapter 3 3)	0,0	p.m.	0,0	0,0	
— Miscellaneous revenue (Titles 4 to 9)	1 546,1	697,3	1 052,2	1 958,5	26,7 %
Grand total	92 724,4	92 569,4	94 134,6	94 289,3	1,7 %

⁽¹⁾ Exclusive of an amount of 6,3 million euro attributed to EEA/EFTA countries which is included under miscellaneous revenue.

Source: Budget 2001, and 2000 and 2001 revenue and expenditure accounts.

Graph 1.1 — Breakdown of actual revenue (2001)

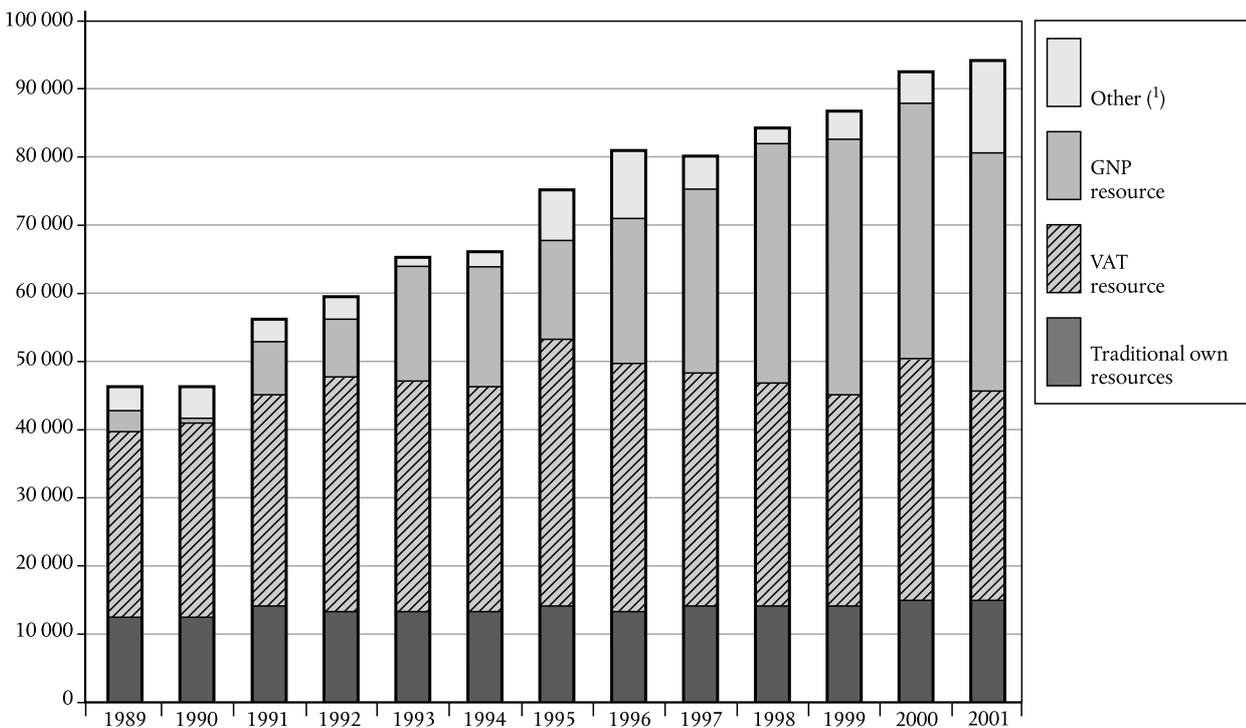


⁽¹⁾ After deduction of 10 % for collection expenses incurred by Member States.

⁽²⁾ Exclusive of an amount of 6,3 Mio EUR attributed to EEA/EFTA countries which is included in 'Other'.

Source: 2001 revenue and expenditure accounts.

Graph 1.2 — Evolution of sources of actual revenue 1989 to 2001 (Mio EUR)



⁽¹⁾ Surplus from previous financial year and miscellaneous.

Source: 2001 revenue and expenditure accounts.

THE COURT'S OBSERVATIONS

1.7. The monthly amounts of agricultural duties made available by France averaged 4,7 million euro from January to April 2001, but increased sharply to 10,3 million euro in May 2001 and remained thereafter at the higher level. For the whole of 2001 this represented an increase over 2000 of 74 %, contrary to the general trend of import duties.

1.8. Portugal was late in paying part of its VAT and GNP twelfths. The sum owed was 5 million euro and it was paid on 28 December 2001 instead of 3 December 2001. The whole of its VAT and GNP balances, and adjustments to balances, amounted to 59,5 million euro and this was paid on 11 January 2002 instead of 3 December 2001.

1.9. **Graph 1.2** illustrates how the GNP resource has grown in importance since 1990 and amounts to more than 36 % of the revenue in 2001, though it decreased by 7,2 % compared to 2000 due to the extraordinary budgetary surplus for the year 2001. Though it has been rather stable since 1998 it will continue to grow as a result of the decrease in the VAT call-up rate specified in the new own resources Decision ⁽¹⁾.

Surplus for the year 2001

1.10. The financial year 2000 was closed with a high surplus of 11 619,1 million euro (13 % of final budget), the origin and consequences of which were commented on by the Court in its Annual Report concerning the financial year 2000 (paragraphs 1.4 to 1.7). The budgetary management in the year 2001 produced a further increase of the surplus to 15 013,5 million euro (16 % of final budget), the origin being very large cancellations of appropriations, principally for structural measures (10 538,9 million euro), but also for other areas of expenditure (for instance: agriculture, 1 857,2 million euro; preaccession aid, 876,6 million euro; reserves, 668,8 million euro).

THE COMMISSION'S REPLIES

1.7. *The Commission will contact the French authorities to discover the underlying reason for the change and take any action that might be required to protect the Community's financial interests.*

1.8. *The Commission sent a letter demanding payment of interest (337 107 euro) from the Portuguese authorities on 12 June 2002.*

⁽¹⁾ Council Decision No 2000/597/EC, Euratom of 29 September 2000 on the system of the European Communities' own resources (OJ L 253, 7.10.2000, p. 42).

THE COURT'S OBSERVATIONS

1.11. In order to keep the surplus within reasonable limits, the Commission should have used the SAB procedure to adapt the final appropriations for the corresponding expenditure domains to realistic expectations of financial needs ⁽²⁾. In this way the demands on Member States for GNP resources (35 177,9 million euro in total) could have been reduced by a rate of 30 % to 40 %, depending on the areas and amounts of forecasted expenditure cancellation taken into account.

Supplementary and amending budgets

1.12. Article 10 of the Financial Regulation states that supplementary and amending budgets should normally be published one month after adoption. Supplementary and amending budget No 3/2001 was published on 19 December 2001, five months after its adoption on 5 July. In the meantime the Commission corrected errors in the calculation of the financing of the UK correction through a corrigendum dated 31 October 2001 ⁽³⁾.

1.13. Supplementary and amending budget No 4/2001 was adopted on 11 December, increasing expenditure by 24,8 million euro. The published version ⁽⁴⁾ made no

THE COMMISSION'S REPLIES

1.11. *The Commission acted in accordance with the financial rules, which provide that the balance at the end of each financial year is entered in the budget for the following year. A supplementary and amending budget can be presented towards the end of the budgetary year but only in exceptional circumstances, for example to address one-off needs and for a limited amount. At this period of the year, when the budgetary procedure for the following year is on the point of completion, it is difficult to discuss and decide on adjustments of appropriations for the budgetary year under way in the light of expected underutilisation.*

A provisional estimate of the budget surplus for 2001 was introduced in the amending letter No 2 to the PDB 2002, adopted by the Commission on 5 November 2001. This was integrated by the Council into its second reading of the draft budget, for an amount of 1,2 billion euro. This procedure followed the Council's request, stated in a declaration on revenue attached to the Council's first reading of the draft budget 2002.

1.12-1.14. *The Commission has redoubled its efforts in terms of providing technical assistance to the European Parliament so that the latter can ensure publication as soon as possible.*

⁽²⁾ See also Chapter 3, paragraph 3.20.

⁽³⁾ Member States paid initial amounts on 1 August 2001 following the adoption on 5 July 2001 of supplementary and amending budget No 3/2001. They paid revised amounts on 2 January 2002 after publication of the corrected SAB on 19 December 2001. The differences per Member State ranged from an overpayment of 38,9 million euro to an underpayment of 31,8 million euro.

⁽⁴⁾ OJ L 14, 16.1.2002, p. 1.

THE COURT'S OBSERVATIONS

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mention of the amount of GNP own resources required from each Member State to finance this extra expenditure.

1.14. In its Annual Report concerning the financial year 2000 (paragraph 1.9), the Court drew attention to the late publication of supplementary and amending budgets and the omission of pertinent information. The Commission replied that it would ensure timely publication.

Costs of collecting traditional own resources

1.15. The own resources Decision ⁽⁵⁾ of 29 September 2000 entered into force, following ratification by all Member States, on 1 March 2002. Under this decision, the amount that Member States retain by way of collection costs is raised from 10 % of traditional own resources to 25 %, effective for duties established after 31 December 2000.

1.16. The decision affects the great majority of the traditional own resources made available in 2001. During 2001, pending ratification of the decision, Member States continued to retain 10 %. There is thus a repayment now due to them which is provided for in supplementary and amending budget No 2 to the 2002 budget. This liability is referred to in a note to the Commission's balance sheet as at 31 December 2001 ⁽⁶⁾. The Court considers that the note should indicate the estimated amount of the repayment, namely 2 038,6 million euro ⁽⁷⁾.

Presentation of the revenue in the revenue and expenditure account

Clarifying the presentation of the revenue

1.17. The introductory sections of the Financial Statements (volume I, tome 1, and volume IV) contain a table of prime importance entitled 'Budget outturn'. This table omits a lot of interesting data, whereas other data

1.17. *In volume IV for 2001, the Commission substantially improved the presentation of the implementation of revenue and expenditure and the link with the outturn table. It is considering expanding the revenue*

⁽⁵⁾ Council Decision 2000/597/EC, Euratom.

⁽⁶⁾ Annex 3 — explanatory notes to the balance sheet — Comments on the balance sheet at 31 December 2001, point 3.

⁽⁷⁾ In supplementary and amending budget No 3/2002 this figure was adjusted to 2 037,9 million euro.

THE COURT'S OBSERVATIONS

such as the balance for the financial year, are pointlessly duplicated elsewhere. It should be replaced with a more detailed presentation that includes the following considerations:

- (a) the development of the budgetary revenue and appropriations ⁽⁸⁾ (initial and final budget) as a total and by principal categories, demonstrating the budgetary balance laid down in Article 268 of the Treaty;
- (b) observance of the ceiling on the own resources entered in the budget ⁽⁹⁾ and an indication of the margin still available;
- (c) the budgetary implementation for the various categories of revenue and expenditure, with an indication of the implementation rate;
- (d) the balance for the financial year and its breakdown in terms of revenue collected in excess or revenue shortfalls and appropriations not used.

1.18. The 'revenue' part of the Financial Statements (implementation of the budget, volume II, part 1) should also be made clearer, as regards structure and content. In particular the detailed budgetary headings should be observed, the headings should be indexed, the terminology in the regulations should be used, the figures for forecast and actual revenue should be presented in parallel and, more generally, there should be harmonisation of the various parts of the revenue and expenditure account and the general budget.

VAT/GNP resources and the UK correction

1.19. The actual data for the VAT and GNP bases used to calculate the balances and the adjustments of the balances are now entered in the revenue and expenditure-account, just like the forecast data concerning these

THE COMMISSION'S REPLIES

table to include data relating to implementation for the year n - 1 and implementation rates compared with forecasts.

It intends to continue to work towards greater transparency in the sense desired by the Court. To this end, the outturn table in volume II will be amended in order to present, by title or financial heading, the extent of implementation in revenue and expenditure compared with the budget.

1.18. *The 'Budget revenue' heading contained in volume II, tome I, part A of the Financial Statements describes the implementation of the budget. However, the Commission will ensure that the link between the budget and the revenue and expenditure account is made clearer.*

1.19. *The Commission shares the Court's view on the calculation of the burdens on the Member States in respect of the balances. It intends to present such calculations in the next accounting report.*

⁽⁸⁾ See the Financial Regulation, Article 78.

⁽⁹⁾ Article 19(3) of Council Decision 94/728/CE, Euratom of 31 October 1994 on the system of the Communities' own resources (OJ L 293, 12.11.1994, p. 62).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

items. However, the calculation operations concerning the burdens on the Member States in respect of these resources should also be set out.

1.20. A special table should be drawn up for the UK correction (Chapters 1 5 and 3 5) and the essential information given concerning the basic data and the calculation operations on which the overall amount of the UK correction and its financing are based.

Budgetary nomenclature for revenue

1.21. The Financial Regulation ⁽¹⁰⁾ stipulates that the budgetary nomenclature in the context of the budgetary procedure must be set out in titles, chapters and articles. The form of classification used, which must accommodate the very disparate characteristics of the different types of revenue, is uneven. Traditional own resources, VAT and GNP resources, and the UK correction are now concentrated under Title I. The surplus available from the previous financial year (Chapter 3 0) should come under a separate title as it has nothing in common with the balances, corrections and refunds concerning the VAT and GNP resources and the UK correction included under the same title (Chapters 3 1, 3 2, 3 3 and 3 5).

1.20. *The Commission will look at whether or not it is appropriate to include in the revenue and expenditure account tables on the basic data for the definitive calculation of the UK correction and its financing.*

1.21. *The Commission considers that the structure of the budgetary nomenclature must not be based only on quantitative principles.*

It will examine the possibilities of adapting, if need be, the budgetary nomenclature for revenue.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE*Traditional own resources***Accounting for traditional own resources**

1.22. Import duties are established by Member States' customs authorities and are first entered in national accounting systems. They are then allocated to the 'A' account or while the debt remains unpaid and is not

⁽¹⁰⁾ Article 19(3).

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secured or is under appeal, to the 'B' account⁽¹¹⁾. Amounts in the A account must be made available to the Commission in the prescribed time limit.

Audit work done

1.23. The Court has examined the Commission's accounts for traditional own resources and has audited, through an examination of monthly statements submitted to the Commission by the Member States' customs authorities, a statistical sample of entries of import duty receipts in these accounts. In addition, the underlying national accounting systems in nine Member States, responsible together for 93 % of the import duties collected in 2001, were examined. However, the Court recalls that its audit does not cover imports which are not declared or which have escaped customs surveillance.

Making available of own resources

1.24. In Germany, more than one third of the import duties collected during 2001 (8,0 % of total European Union import duties) were accounted for by the deferred-payment system. Although a new computer system has since been introduced, the system in use for the own resources of 2001 was, as highlighted in the past⁽¹²⁾, not transparent. It did not provide systematic accounting evidence that the correct total amounts of own resources were being made available to the Commission: documentation directly supporting the totals, and thus representing a full audit trail, could not be provided. Internal control procedures were not sufficient to give assurance against misclassification of transactions or the omission of some of the amounts due.

Amounts established but not yet made available to the Commission (B accounts)

1.25. Established entitlements for which no security has been provided, and those which have been challenged and might be subject to change, need not be made available but must then be entered instead by the

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1.24. *The Commission also welcomes the German authorities' introduction of a new computerised system, which is intended to remedy the shortcomings highlighted over some years by both the Court and the Commission. The Commission plans to test the performance of this new system as a part of its 2003 control programme. Appropriate measures including charging interest will be taken if it is found that amounts due have not been made available completely and promptly.*

⁽¹¹⁾ Article 6 of Council Regulation (EC, Euratom) No 1150/00 of 22 May 2000 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources (OJ L 130, 31.5.2000, p. 1).

⁽¹²⁾ See Annual Report concerning the financial year 2000, paragraph 1.14.

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Member States in separate accounts (the B accounts). Each Member State provides a quarterly statement of its B accounts to the Commission. The balances are included in the balance sheet under 'Amounts owed by Member States'.

1.26. The total balance standing in the B accounts increased by 3,7 %, from 2 035,4 million euro at 31 December 2000 to 2 119,4 million euro at 31 December 2001 ⁽¹³⁾. For the year 2000 the balances in the B accounts increased by 4,3 %. The balance includes some long-standing entries for which full recovery must now be regarded as very doubtful (see also Chapter 9, paragraph 9.23). The Court said in its Annual Report concerning the financial year 2000, in paragraph 1.19, that no useful purpose is served by maintaining items in the B accounts indefinitely if they are not likely to be recovered, and that amendments to the regulation, already proposed by the Commission ⁽¹⁴⁾, should be made accordingly. As long as the Council does not adopt such amendments, the B account balance will continue to contain many amounts which are de facto irrecoverable.

1.27. In 2001, as in previous years, problems were found with the maintenance of the B accounts in several Member States. In Germany, it is not at present possible to confirm the B account balance, because the database does not allow a breakdown into single entries. The management of the B accounts in Italy is not yet uniform and calculation errors can occur at local and regional level without being detected by controls. Errors in entries in the B accounts were also found in Belgium and France, and inspection reports by the Commission referred to B account errors in Ireland, Sweden and Finland. These errors, though minor in terms of the amounts, reflect a weakness in the accounting for own resources under the Community transit system.

THE COMMISSION'S REPLIES

1.26. *The Court has highlighted precisely the arguments advanced by the Commission in proposing its amendments. The Commission will continue to pursue this issue.*

1.27. *In its response to the Annual Report for 2000 the Commission expressed the opinion that the current separate accounting system can lead to both systematic and one-off errors. Hence the Commission's efforts to improve the structure of the system as highlighted in the previous paragraph and the close attention it pays to the subject during its own inspections in Member States. Action is already under way to resolve any financial consequences arising from the Court's observations in France and Italy. Appropriate action will be initiated on the Court's further observations once all the relevant information from Member States has been received.*

⁽¹³⁾ Figures given are after deduction of costs of collection (10 %) as prescribed by Article 2(3) of Council Decision 94/728/EC, Euratom.

⁽¹⁴⁾ Amended proposal for a Council regulation (EC, Euratom) amending Council Regulation (EEC, Euratom) No 1552/89 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources (OJ C 150, 16.5.1998, p. 20).

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Customs warehouses

1.28. The customs warehousing procedure is provided for by the Community Customs Code and its implementing provisions ⁽¹⁵⁾. It permits indefinite suspension of the payment of import duties while goods are stored in premises or under an inventory system authorised as a customs warehouse.

1.29. The Court examined the systems in place in nine Member States to authorise and control private customs warehouses, as well as a sample of exit declarations from these warehouses. In all the Member States visited, the rules concerning authorisation and operation of warehouses prescribed by the Customs Code and the implementing provisions had been transposed into national instructions and procedures.

1.30. The Community regulations do not prescribe either particular methods of working or the level of customs control that should be exercised, this being a matter left to the discretion of the Member States' customs administrations. Control strategies for warehouses need to take account of the risks to revenue arising from the fact that goods under the warehousing procedure are removed from the areas at ports under continuous customs control, balanced by the assurance available from the quality of the internal controls and of record-keeping by the warehouse-keeper. Customs control work for warehouses usually therefore includes careful assessment of the application for authorisation, and of the quality of the operator's accounting and internal control system. This is then a basis for deciding on the level and type of subsequent controls, usually a mix of physical spot checks on entry and exit of goods, review of inventory and stock records, post-clearance accounting controls, and checks on declarations.

1.28-1.33. *As far as the Community dimension of this question is concerned, the Commission shares the Court's opinion on the primordial role of techniques based on risk analysis in implementing customs controls. As part of the implementation of the Customs 2002 programme, it ensures that the best practices implemented in this field are disseminated and applied in all the Member States and, on this basis, is developing a shared model for risk management.*

1.30. *Under the Customs 2002 programme a document is currently being drafted entitled 'Inventory on control areas'. The document provides customs administrations with an exhaustive list of control areas and subareas as well as common definitions of control methods.*

⁽¹⁵⁾ Articles 84 to 90 and 98 to 113 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L 302, 19.10.1992, p. 1), as last amended by Regulation (EC) No 2700/2000 of the European Parliament and of the Council. Articles 496 to 516 and 524 to 535 of Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code (OJ L 253, 11.10.1993, p. 1), as last amended by Regulation (EC) No 444/2002 (OJ L 68, 12.3.2002, p. 11).

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1.31. There are considerable variations in national practices and instructions both as to the type of control mix that is required, and on where the responsibility lies for deciding on the control strategy for each operator. Particularly if there is a resource problem, the decisions on the control mix — whether made at national or local level — need to be based on adequate risk-analysis methods and reviewed by management to ensure that the customs administration as a whole is carrying out an efficient and effective mix of controls in relation to the risks to the revenue. Several Member States do not make detailed prescriptions in national instructions, but allow decentralised decision-making, case by case, by officers responsible for particular operators. The Court found an uneven picture in practice.

1.32. For a number of the warehouses examined, the frequency of physical controls carried out did not reach the levels prescribed by national guidance. This applied to one warehouse in France, where the reason was lack of staff. At one customs office in Italy, the frequency of controls required by national legislation was not respected for all warehouses, while in another only documentary controls had been carried out. In Spain inventory controls were insufficiently documented and the rules of the warehouse authorisation were not complied with by the warehouse keeper at the two warehouses visited. In Germany, an important part of the control mix consists of ex post controls at traders by specific trader control units. However, due to limited staffing, some of these control units did not carry out their control plans as prescribed by national guidance. In the United Kingdom, following reorganisation of customs offices, one of the largest warehouses had had no routine physical controls for more than a year. In Sweden, there had been no physical controls upon exit at either of the warehouses visited since 1999.

1.33. Minor errors reflecting certain weaknesses in the control systems were found in the exit declarations, on the basis of which duty is paid, at several warehouses (France, Sweden).

THE COMMISSION'S REPLIES

1.31. *The Commission recognises that the picture in relation to controls is uneven. Within the Customs 2002 programme, project groups of customs experts and Commission representatives are working on the development of a common risk management model, standard formats for exchange of control information and selection of risk categories.*

1.32-1.33. *As far as the financial aspects are concerned the Commission is already taking action to recover any amounts of own resources or interest due from France, while for Italy, Sweden and Spain the relevant replies from the Member States are undergoing analysis. Action will be taken for the remaining Member States once all the relevant information has been provided.*

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Customs duties on seized goods

1.34. The Court has found that in the United Kingdom, for goods seized by customs and subsequently brought into free circulation, customs duties are not brought to account and made available as own resources. Up to now, United Kingdom Customs have not been able to quantify the amounts of own resources involved. The Court calls upon the Commission to take appropriate action to ensure that such duties are properly accounted for and made available as own resources.

Conclusions and recommendations

1.35. In the Court's opinion, taking into account the limitation of the scope of the audit (see paragraph 1.23), the checks and systems analysis carried out gave satisfactory overall results concerning the reliability of the accounts, with the exception of the deferred-payment system operated in Germany, in respect of which the Court does not express an opinion for the reasons mentioned in paragraph 1.24.

1.36. The audit work carried out on the systems and related transactions which underly the accounts has allowed the Court to obtain reasonable assurance that the underlying transactions taken as a whole are legal and regular. However there is scope for Member States to improve the national instructions in respect of the control regime for Customs warehouses so that type, scope and frequency of controls are clearly set out. Instructions should also indicate at which level of the customs service decisions about the control modalities should be taken. Finally Member States should ensure that scheduled controls are carried out. In addition, the issue of import duties on the sale of seized goods in the United Kingdom needs to be regularised.

VAT/GNP own resource

1.37. In contrast to the EU's revenue from traditional own resources, the scope of the audit for the VAT and GNP own resources is limited because the EU's receipts reflect macroeconomic statistics whose underlying data cannot be tested directly. Therefore, the VAT/GNP audit takes as its starting point the receipt by the Commission from the Member States of the macroeconomic aggregates (either as forecasts or as real figures) and seeks to assess the Commission's system for handling the data until they are ultimately reflected in the final

1.34. *The Commission is aware that the United Kingdom has initiated action to remedy the systemic faults. Quantification of the own resources unaccounted for is continuing. Action will then be taken to recover that amount together with interest on the delay in making it available.*

1.35-1.36. *The Commission will continue to seek assurance that Member States' procedures in the field of traditional own resources comply with Community rules. The Commission is also engaged in ensuring that any non-conformity with Community regulations highlighted by reports of the Court are pursued and that action is taken where necessary to collect amounts of own resources or interest due.*

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accounts. The Court looks at the difficult question of quality of the macroeconomic data separately in special reports, such as Special Report No 17/2000⁽¹⁶⁾.

Financing the UK correction

1.38. In 2001 the United Kingdom correction amounted to 7 300 million euro. As outlined by the Court on previous occasions⁽¹⁷⁾ the mechanisms for the calculation of the financing of the United Kingdom correction are highly complex and sometimes cumbersome. They will be further complicated under the new decision on own resources, giving rise to increased inherent risks.

1.39. Every year the Commission prepares a working document which explains in some detail the calculation and financing of the definitive correction concerning the year $n - 4$ ⁽¹⁸⁾. This explanatory document does not form part of the budgetary procedure for fixing the amount of the UK correction and its financing, but is only provided to the Council for information purposes, after the adoption of the supplementary and amending budget. In 2001 this document was presented to Council on 5 September, after the adoption of SAB No 3/2001. Considering the relevance of the document mentioned before, it would be appropriate to make it available to the two arms of the budgetary authority in due time.

Conclusions and recommendations

1.40. Taking into account the limitation to the scope of the audit, the Court obtained a reasonable assurance that the VAT and GNP resources were correctly assessed and collected. However, the Commission should put forward proposals for the simplification of the final calculation of the financing of the United Kingdom correction.

1.39. *The main purpose of the working document on the result of the final calculation of the UK correction and its financing is to explain the method of calculation, while using the latest available figures. It is not always possible to submit this document in advance of the adoption of the relevant SAB, although this was done in 2002. The final calculation is explained in the explanatory memorandum to the SAB itself. The Commission will examine the possibility of including further details of the calculation of the final correction in the relevant SAB.*

1.40. *The new Own Resources Decision and its accompanying working document on the calculation of the UK correction ('the calculation method') does give some scope for simplifying for budgeting the result of the final calculation of the UK correction. This in turn could simplify the final calculation for the financing of the correction. The Commission intends to pursue this opportunity for the year 2001 calculation, to be budgeted in 2005.*

⁽¹⁶⁾ Special Report No 17/2000 on the Commission's control of the reliability and comparability of the Member States' GNP data (OJ C 336, 27.11.2000).

⁽¹⁷⁾ Most recently in 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).

⁽¹⁸⁾ Final calculation of the 1997 correction of the United Kingdom's budgetary imbalance and of its financing, distributed to the Budgetary Committee of the Council on 5 September 2001.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

Outward-processing arrangement

1.41. In its Annual Report concerning the financial year 1999 ⁽¹⁹⁾ the Court proposed that the outward-processing arrangement be simplified as regards the application of economic conditions, granting of authorisations and the calculation of the duty relief. Such changes are incorporated in a new regulation ⁽²⁰⁾ issued by the Commission, rationalising all the customs procedures that have an economic impact.

Use of statistics to combat fraud

1.42. As part of the Annual Report concerning the financial year 1999 ⁽²¹⁾, the Court recommended that a method of comparing tax sources with statistical sources, tested by both France and Italy, be extended to other Member States and used as a possible means of combating fraud. In its reply the Commission committed itself to discussing this method with the Member States.

1.43. In its recommendation ⁽²²⁾ on the discharge to be given to the Commission in respect of the implementation of the general budget for the European Communities for the financial year 1999, the Council welcomes with interest the Court's recommendation and suggests that this matter should be examined by the Advisory Committee on Own Resources.

1.44. Although the Commission has taken adequate steps in carrying out this commitment, the Member States have been unable to come to an agreement. The Court again recommends that the Commission should continue its efforts in this very important area.

1.42. *Following the Court's recommendation, the Commission asked the national administration of every Member State to provide information about any studies made of the gap between VAT actually collected and the theoretical amount of VAT due on the basis of economic statistics.*

1.43-1.44. *This item was discussed at both meetings of the Advisory Committee on Own Resources (ACOR) held in 2001. The conclusion, shared by Italy and France, was that, regrettably, statistical information about theoretical VAT receipts requires such extensive disaggregation to be useful in targeting tax controls that other risk indicators are more readily accessible, more reliable and easier to use. In addition, Member States concluded that ACOR was not the most suitable forum for any further development. However, the findings remain available for use wherever Member States consider that they may prove useful input for their risk analysis systems. Furthermore, the Commission systematically raises this matter on VAT own resources' control missions, in order to ensure that national authorities give full consideration to the implications of discrepancies between theoretical and actual VAT.*

⁽¹⁹⁾ Paragraphs 1.43 to 1.56.

⁽²⁰⁾ Commission Regulation (EC) No 993/2001 of 4 May 2001 amending Regulation (EEC) No 2454/93 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code (OJ L 141, 28.5.2001 p. 1).

⁽²¹⁾ Paragraphs 1.63 to 1.70.

⁽²²⁾ Document SN 2088/01 — DGF II.

ADMINISTRATIVE COOPERATION FOR THE PROTECTION OF VAT REVENUE

The Court's audit

1.45. The Court has previously examined the adequacy and the functioning of arrangements for administrative cooperation between the Member States and the Commission in respect of the safeguarding of VAT revenue. The observations arising from these audits, together with the Commission's responses and proposals for remedial action, are mentioned in several of the Court's reports ⁽²³⁾.

1.46. The Court has reviewed the arrangements and the Commission's proposal ⁽²⁴⁾ for remedial action particularly in relation to 'roundabout' fraud which constitutes an important threat to the proper collection of VAT revenue (see paragraph 1.50), with the objective of assessing how these arrangements are being applied and whether they are effective.

1.47. The examination was limited to the Commission and focused on the elements related to a number of weaknesses in administrative cooperation previously identified by both the Court and the Commission. Particular attention was paid to the report by the Council ad hoc group on fiscal fraud and its recommendations.

Main features of administrative cooperation

1.48. The essential elements of administrative cooperation between the Member States and the Commission are laid down in Council Regulation (EEC) No 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation (VAT) ⁽²⁵⁾

⁽²³⁾ Annual Report concerning the financial year 1997, paragraphs 1.30 to 1.36;
Special Report No 9/98 concerning the protection of the financial interests of the European Union in the field of VAT on intra-Community trade, paragraphs 3.32 to 3.37;
Annual Report concerning the financial year 2000, paragraph 1.79.

⁽²⁴⁾ In particular the proposal for a regulation of the European Parliament and of the Council on administrative cooperation in the field of value added tax (COM(2001) 294 final, 18.6.2001), which is at present under discussion in the Council.

⁽²⁵⁾ OJ L 24, 1.2.1992, p. 1.

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and Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and VAT ⁽²⁶⁾ as amended. They concern:

- (a) the value added tax information exchange system (VIES), comprising the operation of an electronic database by each Member State which contains information to be submitted by taxable persons and a register of persons identified for VAT purposes;
- (b) the provision by Member States of further information in relation to VAT-liable transactions, the pooling by the Commission and the further dissemination of such information;
- (c) the Standing Committee on Administrative Cooperation (SCAC), which adopts the measures required for the application of the exchange of information;
- (d) direct communication between Member States on matters of bilateral interest, exchanges of information under Directive 77/799/EEC and communication by the Commission to each Member State of any information which it receives and which it is able to supply.

1.49. The Member States are, therefore, primarily concerned with the exchange of information while the Commission's role is limited to evaluating and stimulating administrative cooperation.

Roundabout fraud

1.50. 'Roundabout' fraud consists of a series of commercial operations with the same goods over a relatively short period, which constitute an abuse of certain characteristics of the VAT collection system. Though different, sometimes complex forms of roundabout fraud exist, the basic structure of a roundabout can be described as follows: trader A 'sells' goods to trader B, charging VAT but not submitting a tax return or return

⁽²⁶⁾ Directive 77/799/EEC (OJ L 336, 27.12.1977, p. 15), as amended by Directive 79/1070/EEC (OJ L 331, 27.12.1979, p. 8).

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ing any amount to the State. Trader B 'sells' the goods to trader C without charging VAT, but claims a refund of the VAT paid to trader A, pretending that the goods are to be supplied to another Member State (or exported outside the EU). The goods are in fact transferred again to A, and then resold by A to B and then to C several times (hence the expression 'roundabout'). In fact, the goods may even exist on paper only.

1.51. The amounts defrauded in this manner are not known. According to a Commission document, cross-border fraud, which constitutes the greater part of roundabout fraud, cannot be countered without rapid and intensive administrative cooperation. However, the existing instruments seem too inflexible and ineffective to achieve this.

Findings

1.52. The Commission's proposal in respect of administrative cooperation in the domain of value added tax (see footnote 24) closely follows the recommendations of the Council ad-hoc group on fiscal fraud and contains a number of clear improvements in administrative cooperation, such as:

- (a) the possibility of direct contacts between operational services in Member States as well as the possibility for officials of a Member State of participating in investigations in another Member State;
- (b) the possibility for Member States of requesting other Member States to carry out administrative investigations and to carry out simultaneous controls.

1.53. However, a number of problems, most of which have been discussed for some years in the framework of the SCAC and the Standing Anti-fraud Sub-Committee (SCAF), persist, and continue to hamper the effectiveness of administrative cooperation in the fight against the evasion of VAT revenue and roundabout fraud in particular:

- (a) it has still not been decided if and how use can be made of VIES as a means of an integrated approach for analysing risk factors and performing controls in the fight against fraud;

1.53.

- (a) *The VAT information exchange system (VIES) aims to ensure compliance by taxable persons by means of ex post controls; it was not designed as an instrument to tackle fraud. The Commission has proposed exchanging information to tackle carousel fraud outside VIES, thereby:*

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- ensuring quicker exchange of data, and
- not increasing disproportionately the administrative burden on compliant traders.

As concerns risk analysis, the Commission takes the view that it should not be decided at Community level how the VIES data should be integrated in the Member States' systems for risk analysis, as all have different legal and administrative structures. However, the Commission has undertaken several actions offering Member States the facility to pool experiences in this area, such as Fiscalis seminars, exchange of officials and risk analysis presentations by Member States in the Standing Committee on administrative cooperation in the field of indirect taxation (SCAC). Moreover, an ad hoc group has been created to draft common principles on how to build risk indicators.

(b) there is still scope for improvement in the information of both the Member States and the Commission in the case of suspected and detected cases of fraud. In this context the consultative and investigative role of OLAF in fraud matters needs clarification;

(b) The Commission shares the view of the Court and underlines that agreement has been reached recently in SCAC whereby Member States report all cases of roundabout fraud detected on a systematic basis.

As far as OLAF's operational competence in the field of VAT is concerned, the Commission included in both its action plan for 2001 to 2003 on protecting the Communities' financial interests and the fight against fraud ⁽¹⁾ and its work programme 2001 ⁽²⁾ a proposal for a regulation of the European Parliament and of the Council establishing a system for cooperation between the Member States' authorities and the Commission with a view to protecting the financial interests of the Communities against illegal activities, including VAT-related activities and money laundering.

(c) the absence of remedial actions for not providing timely information, operational weaknesses in the SCAF subcommittee ⁽²⁷⁾, and differences in the operational capabilities of central liaison offices (CLOs) which are responsible for maintaining contacts with other Member States constitute other areas where improvements should be made;

(c) The Commission shares the view of the Court and notes that its proposal on administrative cooperation deals with the problem of providing timely information. The Commission has recently reorganised the Committee structure in order to shorten the decision-making process (by having SCAC dealing directly with anti-fraud issues rather than in a specialised subcommittee). Although action, as pointed out by the Court, is primarily required at national level the weakness of the CLOs has been addressed in several Commission reports.

⁽²⁷⁾ Such as the length of the decision-making process and unequal contribution by Member States to the work of the Committee.

⁽¹⁾ COM(2001) 254 final, 15.5.2001.

⁽²⁾ See sheet 2001/098.

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- (d) the effectiveness of actions organised under the Fiscalis programme ⁽²⁸⁾, though they have led, according to the Commission, to an increased awareness of roundabout fraud in Member States, could be increased by taking follow-up action, coordinated at Community level by the Commission, for example in the form of more frequent multilateral controls.

Recommendations and conclusion

1.54. Although the Member States are primarily responsible for the safeguarding of VAT revenue and the related administrative cooperation, the following measures could be taken in order to increase the effectiveness of administrative cooperation between Member States and the Commission:

- (a) the SCAC and SCAF Committees, as the major forums for the exchange of information between Member States could, under the guidance of the Commission, develop best practice in respect of the development of an anti-fraud strategy;
- (b) exchange of information between Member States could be facilitated by the further development of the VIES to combat fraud, of bi- or multilateral agreements as well as by the introduction of corrective actions in cases where Member States do not provide timely information;

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- (d) *The Commission follows up the actions organised under the Fiscalis programme, within the legal framework in force. The Commission cannot coordinate specific follow-up by means of multilateral controls which are in any case initiated and organised by Member States. The Commission has, however, recently held a special meeting of the SCAC aimed at improving the use of such controls (see also point 1.55 below).*

1.54. *The Commission agrees with the Court's recommendations. However, improvements in this regard fall solely within the competence of the Member States, and therefore require action at national level.*

Under the current legal framework for administrative cooperation in the field of VAT, the role of the Commission is limited to evaluating the functioning of the arrangements and offering Member States the facility to pool experience.

In addition, the Commission services are preparing a separate proposal under Article 280 of the EC Treaty, laying down specific provisions which confer a role on the Commission in coordinating administrative cooperation.

- (a) *The Commission agrees that SCAC should develop best practice in respect of the development of an anti-fraud strategy. Therefore it has organised follow-up in SCAC to the recommendation of the Council ad hoc group on fiscal fraud. In this context, SCAC has set up an ad hoc group with the aim of pooling best practice in preventing and tackling roundabout fraud.*
- (b) *These problems are dealt with in the Commission proposal for administrative cooperation, although the Commission takes the view that anti-fraud information should be exchanged outside the VIES.*

⁽²⁸⁾ Programme adopted for the period 1998 to 2002, which has grouped several actions previously financed under different budgetary chapters. Its three elements consist of seminars in which officials from national administrations and from the Commission and OLAF participate, exchanges of officials between national administrations and multilateral controls. One of the programme's objectives is to ensure efficient and extensive cooperation between Member States and Commission.

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- (c) special control units to tackle specific VAT fraud cases could be set up to give Member States better opportunities to fight fraud on the condition that these units are integrated in, or work closely with, the CLOs and with the assistance of OLAF;
- (d) the scope of the information exchange mentioned in Articles 11 and 12 of Council Regulation (EEC) No 218/92 should be clarified and made more explicit; information exchanges between Member States could be made more efficient by harmonising the competences and capabilities of CLOs in Member States.

1.55. In conclusion, though the field of application of administrative cooperation between Member States and Commission is wider than the fight against (roundabout) fraud in Community trade, this constitutes an important element, as is also acknowledged by the Commission in its communication to the European Parliament and to the Council — A strategy to improve the operation of the VAT system within the context of the internal market ⁽²⁹⁾. Member States are the main actors in administrative cooperation and the fight against fraud but the Commission should play a more effective coordinating role given the existence of a single market and the cross-frontier aspects of fraudulent operations ⁽³⁰⁾. The Commission's proposal in respect of administrative cooperation contains clear improvements but leaves a number of issues unaddressed. Finally the Court would like to draw attention to the fact that roundabout fraud is facilitated by the existing transitional VAT system itself. The entry into force of the proposed definitive system, with taxation at the origin of the commercial transactions, would considerably reduce the scope for committing this type of fraud.

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- (c) *The Commission endorses this recommendation. The need for special control units to tackle specific VAT fraud has been addressed in several Commission working papers and reports.*
- (d) *The Commission endorses this recommendation and points out that the Council is currently discussing a new draft of Articles 11 and 12 of Council Regulation (EEC) No 218/92 on the basis of the Commission proposal on administrative cooperation. The weakness of the CLOs has been addressed in several Commission reports, but again primarily requires action at national level.*

1.55. *The Commission agrees with the Court, although this proposal only deals with those issues which require a legislative initiative under Article 95 of the EC Treaty. The Commission emphasises that it has undertaken a considerable number of other actions to prevent and tackle fraud in the VAT area.*

On 28 January 2000 the Commission produced a report to the European Parliament and to the Council ⁽³⁾ on VAT control. This report has been taken up by the Council's ad hoc Working Party on Tax Fraud which has made recommendations to tackle fiscal fraud. These recommendations have been taken on board by the Commission in three ways:

- those recommendations which fall within the legislative competence of the Commission are covered by the proposal on administrative cooperation,*
- for those recommendations which require Community action other than legislative action, the Commission has taken the necessary initiatives in SCAC,*
- for those recommendations that fall solely within the competence of the Member States, the Commission has organised follow-up and an evaluation of progress. The action taken at national level has been examined on the basis of Member States' contributions. The Commission will present its conclusions in a report to the European Parliament and to the Council under Article 14 of Regulation (EEC) No 218/92.*

In addition, the Commission will make a separate proposal under Article 280 of the EC Treaty, to lay down specific provisions to confer a role on the Commission in coordinating administrative cooperation.

Finally, the Commission shares the opinion of the Court about a system of taxation in the Member State of origin. However, since it is unlikely that significant progress will be made in the immediate future, the Commission considers this to be a longer-term goal.

⁽²⁹⁾ COM(2000) 348 final, 7.6.2000.

⁽³⁰⁾ See also Special Report No 9/98, paragraphs 4.1 to 4.11.

⁽³⁾ COM(2000) 28 final of 28.1.2000.

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 B2-5 1 ⁽¹⁾ (Controls and other operations in the agricultural sector).

2.2. Virtually all this expenditure is handled by the paying agencies in the Member States. Before paying the aid to the recipients, the national authorities have to subject the claims to checks laid down by the regulations. For two thirds of the aid distributed, this process includes cross-checking the claims against national databases set up under the integrated administration and control system ⁽²⁾ (IACS) or the system for the identification and registration of bovine animals ⁽³⁾ (SIRB). These cross-checks are intended to detect any errors in the declaration of the areas cultivated or the animals kept.

⁽¹⁾ The figures given under the Analysis of budgetary management section (paragraphs 2.5-2.8) relate only to subsection B1 of the budget. With regard to Chapter B2-5 1, the initial budget in respect of commitment appropriations was 54 million euro. In the course of the year, these appropriations were increased by 22 million euro, and the commitments for the financial year totalled 50 million euro (94 %).

⁽²⁾ IACS was introduced by Council Regulation (EEC) No 3508/92 of 27 November 1992 (OJ L 355, 5.12.1992, p. 1) and implemented by Commission Regulation (EEC) No 3887/92 of 23 December 1992 (OJ L 391, 31.12.1992, p. 36).

Since 1992, the common agricultural policy has basically consisted of direct aid to farmers. The amount of aid paid depends on the eligible surface area (for arable crops) and the eligible animals (for animal premiums) declared by farmers. In order to reduce the risk of errors and irregularities, a control system, IACS, was set up. It includes the recording of claims for aid, a system for identifying agricultural parcels, a system for the identification and registration of animals, and the use of administrative checks and a minimum number of on-the-spot checks (5 % for surface areas and 10 % for animals). The Court has recently published a special report on IACS (Special Report No 4/2001 (OJ C 214, 31.7.2001, p. 1)).

⁽³⁾ Regulation (EC) No 1760/2000 of the European Parliament and of the Council of 17 July 2000 establishing a system for the identification and registration of bovine animals and regarding the labelling of beef and beef products, and repealing Council Regulation (EC) No 820/97 (OJ L 204, 11.8.2000, p. 1).

THE COURT'S OBSERVATIONS

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2.3. Every month the Commission advances the Member States an amount based on the payments declared in the previous month. These payments are booked monthly to the expenditure accounts, subject to any corrections that may be necessary when the accounts are cleared at the end of the financial year.

2.4. This chapter consists of five parts:

- (a) the analysis of the budgetary management for the financial year 2001;
- (b) the Statement of Assurance for the financial year 2001;
- (c) the clearance of the accounts;
- (d) the follow-up to previous observations;
- (e) the principal observations in the Special Reports adopted by the Court since the last Annual Report ⁽⁴⁾.

ANALYSIS OF BUDGETARY MANAGEMENT

A supplementary and amending budget far in excess of needs

2.5. The initial appropriations of the EAGGF-Guarantee budget ⁽⁵⁾ were 43 798 million euro (including 100 million euro in provisional appropriations and the monetary reserve ⁽⁶⁾ of 500 million euro) (see **Table 2.1**), i.e.

⁽⁴⁾ Since 1997 there have been many special reports or opinions on the subject of the common agricultural policy. These are listed in full at Annex II.

⁽⁵⁾ Final adoption of the general budget of the European Union for the financial year 2001 (OJ L 56, 26.2.2001).

⁽⁶⁾ The monetary reserve is intended to cover (in respect of amounts above 200 million euro) adverse 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.

THE COURT'S OBSERVATIONS

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47 % of the entire budget. These appropriations were amended by a supplementary and amending budget (SAB) (7).

2.6. This SAB added 971 million euro (8) to meet the extra costs arising from the bovine spongiform encephalopathy (BSE) crisis, partly offset by a 245 million euro reduction due to a favourable change in the euro/dollar parity. These needs were greatly overstated: expenditure on the purchase and culling of cattle amounted to only 212 million euro.

Table 2.1 - EAGGF-Guarantee 2001: Analysis of the budgetary management

(Mio EUR)

Financial perspective heading: 1. Subsection B1: EAGGF-Guarantee (1)						
	Total heading	Of which:				
		B1-1	B1-2	B1-3	B1-4	B1-6
		Plant products	Animal products	Ancillary expenditure	Rural development	Monetary reserve
Financial perspective ceiling	44 530					
Budget changes						
Initial appropriations (2)	43 798	27 595	10 159	1 049	4 495	500
Final appropriations available	44 484	27 404	10 466	1 619	4 495	500
Implementation of the budget						
Appropriations used (3)	42 083	26 714	9 558	1 448	4 363	0
% of final available appropriations	95	97	91	89	97	0
Appropriations carried over to 2002	99	0	0	0	99	0
% of final available appropriations	0	0	0	0	2	0
Appropriations lapsing	2 301	690	908	171	32	500
% of final available appropriations	5	3	9	11	1	100

(1) Non-differentiated appropriations.

(2) Including provisional appropriations of 100 Mio EUR (B0-4 0) and the monetary reserve of 500 Mio EUR.

(3) In commitments.

Source: 2001 revenue and expenditure account.

(7) Final adoption of supplementary and amending budget No 1 of the European Union for the financial year 2001 (OJ L 218, 13.8.2001).

(8) 700 million euro for the purchase and culling of cattle aged over 30 months not intended for human consumption, 33 million euro for the cost of tests for cattle aged over 30 months intended for human consumption and 238 million euro for storage costs for beef/veal.

THE COURT'S OBSERVATIONS

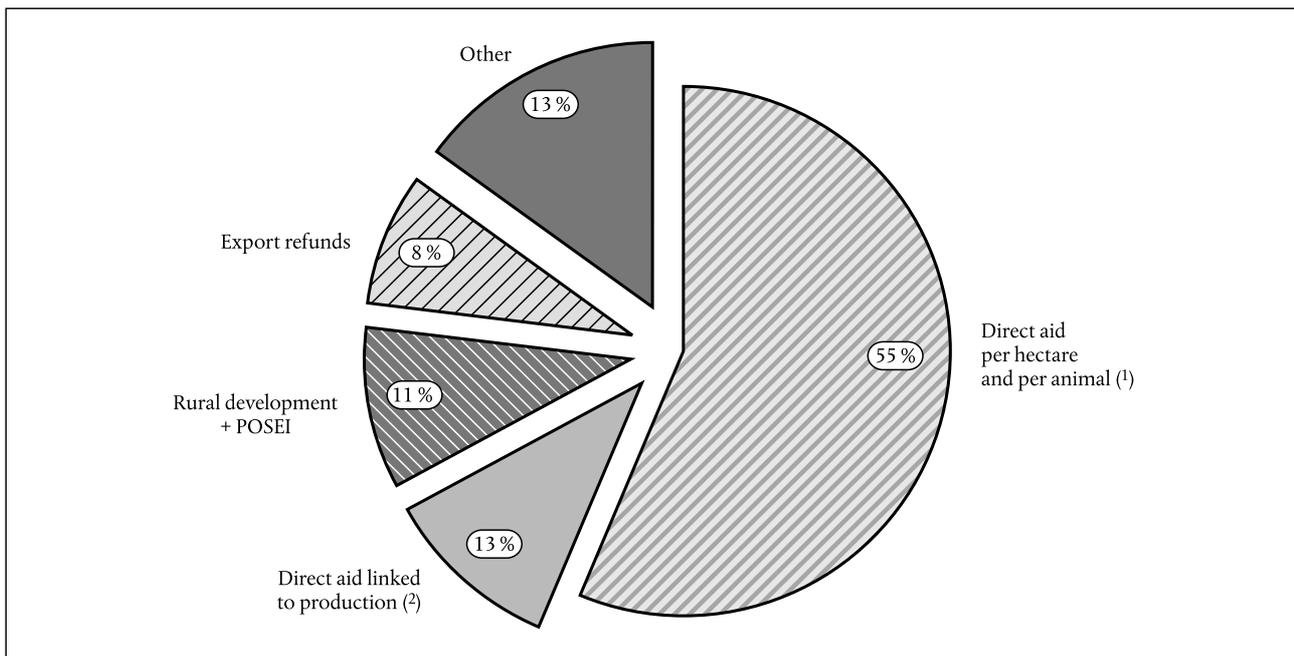
In the end, expenditure totalled 95 % of the appropriations

2.7. The final appropriations were 44 484 million euro and expenditure was 42 083 million euro, i.e. 95 % of the total available appropriations (see **Table 2.1**). Excluding appropriations for the monetary reserve, which was not used in 2001, the outturn on the budget amounts to nearly 96 %.

2.8. This 42 083 million euro in expenditure was divided up as follows:

- see **Graph 2.1** for the breakdown of expenditure by type,
- see **Graph 2.2** for the breakdown of expenditure by sector.

Graph 2.1 — Breakdown of expenditure by type

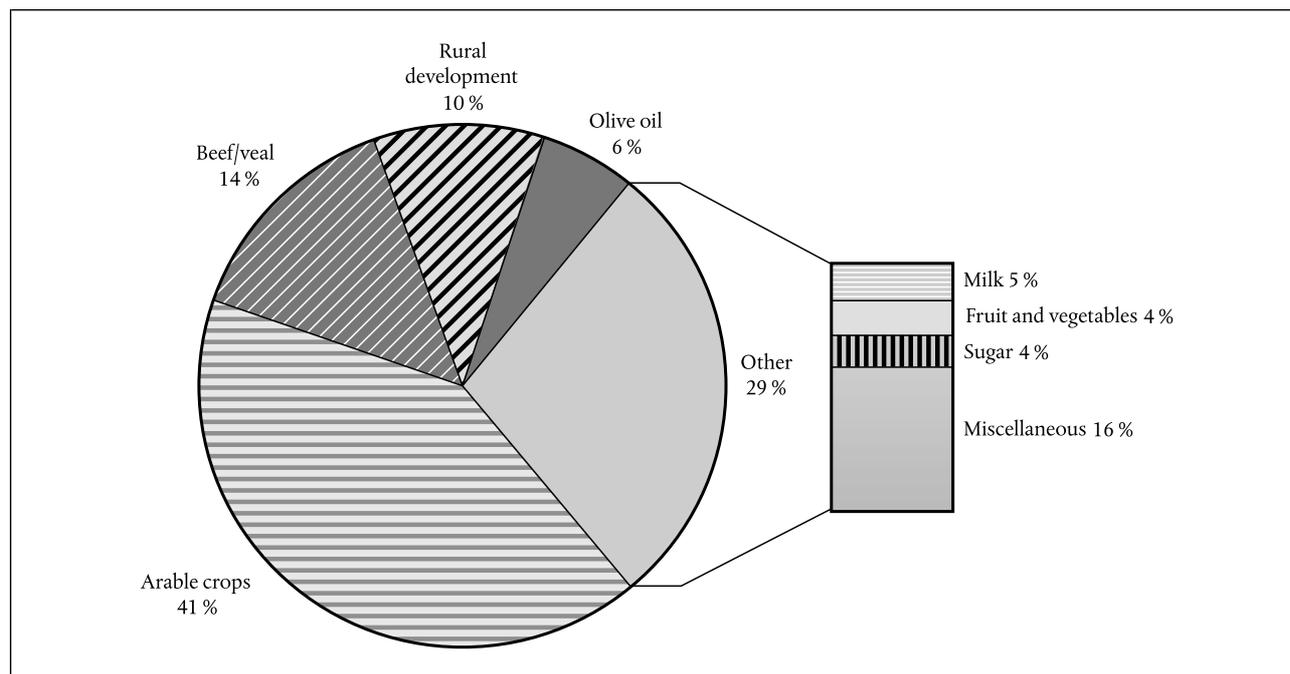


Source: The Court of Auditors, on the basis of the Commission's accounts for 2001.

The classification of expenditure used here differs from that of the Commission (Table 10 of volume I) in the following respects:

- (1) The Court of Auditors has considered expenditure on Article B1-1 0 6 'Set aside' as a part of the cost of support for arable crops, increasing expenditure under this heading by 3 % and reducing that under 'Other' by the same amount.
- (2) The Court of Auditors has considered expenditure on Item B1-1 2 1 1 'Schemes related to production' and Article B1-1 3 0 'Production aid for dried fodder' as part of the cost of support for direct aid linked to production, increasing expenditure under this heading by 1 % and reducing that from 'Other' by the same amount.

THE COURT'S OBSERVATIONS

Graph 2.2 — Breakdown of expenditure by sector

Source: The Commission's accounts for 2001.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE**2.9. The Court:**

- (a) took a representative sample of 156 transactions from the Commission's accounts and, for these transactions, examined both the reliability of the accounts and the legality and regularity of the underlying transactions. The Court examined each transaction on the premises of the paying agency and the final beneficiary;
- (b) reviewed the control systems for a number of common agricultural policy (CAP) schemes;
- (c) compared the results of its work with the results of physical checks carried out by Member States, in particular under the integrated administrative and control system (IACS);
- (d) took account of the declaration of the Commission's Director-General for Agriculture.

THE COURT'S OBSERVATIONS

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2.10. The observations on the reliability of the accounts have been grouped together in Chapter 9, paragraphs 9.6 to 9.35. Those concerning the legality and regularity of the underlying transactions are set out and described below.

2.11. The Court found CAP expenditure was materially affected by errors in the declarations made by farmers and other recipients of subsidy rather than at the level of paying agencies. The audit did not provide evidence of significant improvement in the overall situation previously remarked on. The following text groups the Court's findings under the headings: 'Area aid schemes', 'Animal premium schemes', 'Olive oil', 'Rural development' and 'Other expenditure'.

Area aid schemes

2.12. Area aid payments to producers of arable crops amounted to 16 847 million euro in 2001, 40 % of CAP expenditure. The greater part of this aid is paid to cereal growers.

2.13. Payments under these schemes result from the multiplication of the following three figures:

- (a) the subsidy rate, laid down in Community legislation;
- (b) the yield per hectare, calculated by the Member States (on a regional basis) and approved by the Commission; and
- (c) the area of the parcels devoted to the production of cereals, as declared by the producer.

Control system

2.14. Under IACS, Member States make administrative checks on all declarations and physical checks in the field on a sample of beneficiaries.

Findings of the Court

2.15. In previous reports the Court has criticised several aspects of the support scheme for arable crops. Aid

2.11. For this financial year, the Commission would point out that 82,9 % of the substantial errors detected at the level of management by Member States' paying agencies relate to situations of which the Commission is aware and which have been or will be corrected in the context of the various recent and future EAGGF-Guarantee account-clearance decisions.

THE COURT'S OBSERVATIONS

payments have generally exceeded the loss to producers resulting from the 1992 reform. The approved regional yields are too high in some Member States, for example in the case of oilseed crops (see paragraph 2.122) ⁽⁹⁾.

2.16. The audit performed in 2001 found a material incidence of error affecting these subsidies. Most of the errors involved discrepancies between the arable area declared by farmers and the area found when parcels were measured in the presence of auditors. Approximately half of the discrepancies were of less than 3 % of the declared area. (If such discrepancies are found in the course of an IACS field inspection, paying agencies are required to correct the claim, but not to impose penalties.) A similar number of discrepancies related to errors of between 3 % and 20 % of the area declared. (Such discrepancies, under the relevant regulations, should result in the imposition of penalties and are unlikely to be explained by simple error on the part of the farmer.)

2.17. The audit identified two payments based upon declarations which were largely or completely unfounded. The first case involved an unjustified payment of a subsidy for the production of protein crops in Italy. The second case involved payment of a subsidy for the production of maize in Greece, where, due to the inaccurate information provided by the beneficiary, and the deficiencies of the control systems of the paying agency, it was not possible to verify the area cultivated. Cases of this nature appear to have a greater impact on expenditure than the measurement errors described above (paragraph 2.16).

Results of checks performed by Member States

2.18. Comparison between the results of the Court's audit and the inspections carried out under IACS is difficult. Transactions checked by Member States under IACS include both declarations identified as presenting particular risks and declarations selected on a purely random basis. Community legislation did not require paying agencies to present the two sets of results separately.

THE COMMISSION'S REPLIES

2.16. *For each Statement of Assurance (SOA) case the specific knowledge resides with the authorities of the Member State. The Commission will continue to review the detailed findings with the Member States.*

Apart from auditing the expenditure declared by Member States and applying financial corrections, where appropriate, the Commission also plays an active role in improving the systems implemented by the Member States. For example, Member States will have to adopt, at the latest by 1 January 2005, geographical identification systems in order to reduce human error in claims submitted and to generally improve their control systems.

2.17. *As regards Italy and Greece, to which the Court refers specifically, the Commission services have proposed or are proposing flat-rate financial corrections as a consequence of deficient control systems for the marketing year involved.*

2.18. *The Member States are required under Article 17(3) of Regulation 3887/92 and Article 52 of 2419/2001 to send to the Commission, by no later than 31 March each year, a report covering the previous calendar year. This report shall among other things give the result of the checks carried out. For this purpose the Commission services have created a questionnaire in respect of the arable crops sector in which Member States are required to report separately the results of cases selected on a risk and random basis with effect from 2000.*

Furthermore, Article 19(1) of Regulation No 2419/2001, applicable as from 1 January 2002, provides that Member States 'shall select randomly between 20 % and 25 % of the minimum number of farmers to be subject to on-the-spot checks'.

⁽⁹⁾ Special Report No 6/2002.

THE COURT'S OBSERVATIONS

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2.19. Nevertheless, so far as comparison is possible, the Court's audit suggests that the IACS inspection results may understate overall error. The Court's audit, based on random sampling, indicated a higher incidence of error than do the IACS results, though the latter are drawn from a mixture of random and risk-based tests. For 2000, the relevant year for most payments made in the 2001 EAGGF year, physical IACS checks on nearly 300 000 farmers showed that they had overstated arable areas by 2,3 % (see **Table 2.2** and **Graphs 2.3** and **2.4**). This figure is heavily influenced by the results for Italy, where 43 % of the total number of IACS inspections were performed, covering 13 % of the total area checked, and as a result many false declarations were identified. In the claims examined in Italy the total area claimed was overstated by 8 %. No results were provided by Greece. The Court's audit work also included the re-performance of some field inspections carried out under IACS. In some cases this brought to light errors not identified in the original examination.

Table 2.2 – Area aid – Results of IACS field inspection and remote sensing

Member State	Applications submitted		Applications checked				Applications with errors			
	Number	Area (ha)	Number	as %	Area (ha)	as %	Number	%	Area (ha)	%
Belgium	43 058	996 646	5 255	12,20	159 584	16,01	1 084	20,60	1 376	0,90
Denmark	56 229	2 295 566	3 146	5,59	141 613	6,17	569	18,10	1 727	1,20
Germany	339 555	14 072 879	24 211	7,13	1 325 883	9,42	7 254	30,00	7 677	0,60
Greece	(¹)	(¹)	(¹)		(¹)		(¹)		(¹)	
Spain	453 215	17 158 323	45 682	10,08	2 311 284	13,47	12 546	27,50	52 666	2,30
France	441 404	23 376 044	28 589	6,48	1 988 947	8,51	10 247	35,80	16 105	0,80
Ireland	130 052	4 613 819	7 086	5,45	313 336	6,79	907	12,80	8 993	2,90
Italy	604 332	7 007 936	124 239	20,56	1 459 266	20,82	20 687	16,70	120 537	8,30
Luxembourg	2 128	121 845	188	8,83	18 692	15,34	161	85,50	271	1,40
Netherlands	48 993	592 692	3 971	8,11	71 856	12,12	781	19,70	1 504	2,10
Austria	131 381	2 092 652	10 810	8,23	242 305	11,58	3 899	36,10	2 028	0,80
Portugal	151 327	2 785 028	15 483	10,23	1 482 606	53,23	8 467	54,70	30 141	2,00
Finland	72 529	2 061 292	4 791	6,61	167 753	8,14	1 056	22,00	1 132	0,70
Sweden	63 456	2 720 038	5 389	8,49	308 588	11,34	2 422	44,90	6 138	2,00
United Kingdom	142 536	13 666 049	9 443	6,62	1 009 134	7,38	4 537	48,00	7 194	0,70
Total	2 680 195	93 560 809	288 283	10,76	11 000 847	11,76	74 617	25,90	257 489	2,30

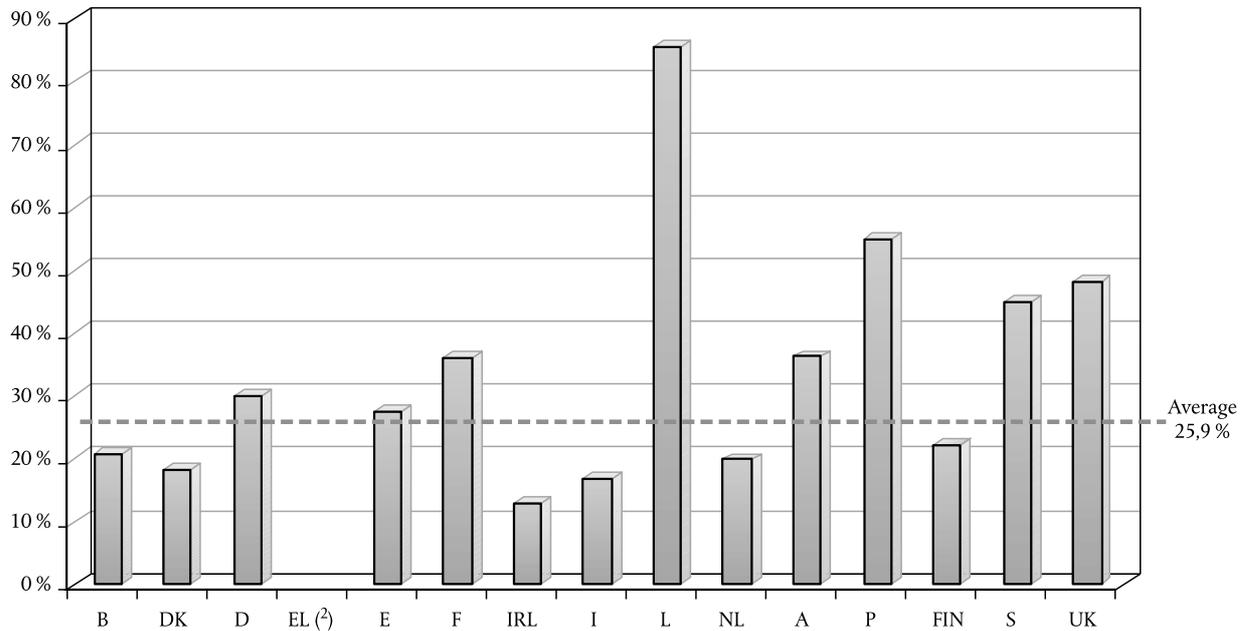
(¹) Data not sent to the Commission.

NB 1: Remote sensing involves the use of satellite or aerial photography to check IACS application.

NB 2: Differences in percentage of errors detected may be explained both by differences in the number of inaccurate claims submitted and differences in the efficiency of detection.

Source: DG AGRI – IACS 2000 Statistics.

Graph 2.3 — Area aid — Result of IACS field inspections: percentage of applications inspected which were overstated ⁽¹⁾

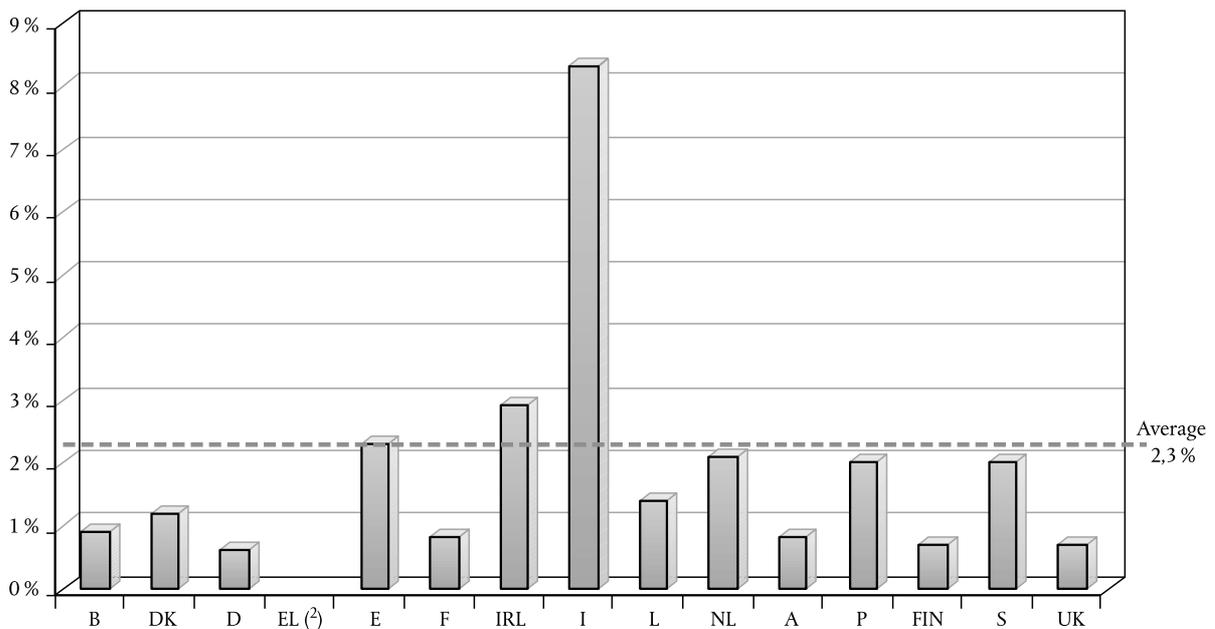


⁽¹⁾ 74 617 applications were overstated, i.e. 25,9 % of the total number of applications inspected by Member States.

⁽²⁾ Greece: data not sent to the Commission.

Source: DG AGRI — IACS 2000 Statistics.

Graph 2.4 — Area aid — Results of IACS field inspections: average overstatement ⁽¹⁾ in claims inspected



⁽¹⁾ Total overstatement amounted to 257 489 ha, i.e. 2,3 % of the total area checked by the Member States.

⁽²⁾ Greece: data not sent to the Commission.

Source: DG AGRI — IACS 2000 Statistics.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Animal premium schemes

2.20. Aid to livestock producers amounted to 6 824 million euro in 2001, 16 % of CAP expenditure. Nearly four fifths of this sum subsidises beef producers, the remainder subsidising the rearing of sheep and goats ⁽¹⁰⁾.

2.21. These schemes typically pay producers a fixed amount of subsidy per animal. The amount of subsidy depends on the animal concerned (bulls or steers, suckler cows, etc.). Certain schemes require farmers to observe stocking density limits, notably the extensification payment scheme.

Control system

2.22. In the framework of IACS, producers must maintain extensive records of animal movements and must tag cattle. Member States must perform administrative checks and selective on-farm inspections. As with area aid, results of on-farm inspections presented by the paying agencies do not distinguish between random and risk-based checks.

Findings of the Court

2.23. The errors found by the Court in its sample chiefly involved discrepancies between, on the one hand, records kept by the farmer and, on the other hand, the declaration on which premiums had been paid. The largest errors of this kind related to payments made in the Netherlands and the United Kingdom. Expenditure on animal premium schemes appears to be materially affected by error.

2.22. *Although Member States are not required to report their inspection results in the way proposed by the Court, the breakdown between random and risk-based checks has indeed been examined regularly, as appropriate in the context of audits of agricultural expenditure conducted by the Commission services; the aim being to ensure that the selection of farmers for on-the-spot checks is representative as provided by Regulation EEC No 3887/92. Furthermore, IACS legislation has been strengthened in this respect by Article 19(1) of Regulation (EC) No 2419/2001, applicable as from 1 January 2002, which provides that Member States 'shall select randomly between 20 % and 25 % of the minimum number of farmers to be subject to on-the-spot checks.' This regulatory requirement will adequately ensure the properly based audit conclusions implied by the Court's remark.*

2.23. *The Commission services' audits of agricultural expenditure have also established that the quality of record-keeping by farmers, including those in the Member States mentioned by the Court, is less than satisfactory. IACS Regulations lay down the means to control and proportionately sanction such occurrences. Member States' failings in this respect are duly considered in the Commission's clearance of accounts procedure.*

⁽¹⁰⁾ Certain livestock producers also receive subsidies from Chapter B1-4 'Rural Development'.

THE COURT'S OBSERVATIONS

2.24. The 2001 audit also involved a specific examination of the extensification payment scheme ⁽¹¹⁾, which cost 913 million euro in 2001 and accounted for some 2 % of CAP expenditure. Payments are made to producers who keep the number of animals per hectare within limits laid down in Community legislation. The results of the audit in 2001 and in previous years suggest that overall underlying payments were not materially affected by errors of legality and regularity. Most producers paid under this scheme fall well within the applicable ceiling for stocking density. Administrative checks are performed on all beneficiaries. However, an examination of control systems in six Member States found that most failed to focus selective physical checks on applicants close to the eligibility limit and that only one had adopted an integrated approach to checking both criteria (existence of animals and area devoted to pasture and the production of fodder crops).

2.25. Specific weaknesses in systems were found in two Member States. In Austria, the extent of eligible alpine pasture was overestimated by more than 60 % in some areas, on the basis of information in the land register. The introduction of aerial photography in 1998 brought this difference to light, but had only been applied in some areas of Austria, such as the Salzburg region, in the 2001 application year. In France, inaccuracies in the cattle database used to calculate the stocking density increased the risk of error and were compounded by weaknesses in the forage area inspections. Producers were paid the premium on the basis of this unreliable database, regardless of whether they had specifically requested the aid.

THE COMMISSION'S REPLIES

2.24. *As a consequence of the Commission services' audit findings, the new IACS Regulation (EC) No 2419/2001 explicitly requires the risk analysis factor suggested by the Court with effect from 2002.*

As concerns checks on applicants close to the eligibility limit, this was not a regulatory requirement prior to 2002 although the Commission has recommended it as good control procedure. Likewise, the integrated approach suggested by the Court has always been recommended by IACS legislation.

2.25. *The matters raised by the Court in respect of Austria and France are the subject of enquiries by the Commission services in the context of the clearance of accounts procedure.*

⁽¹¹⁾ Council Regulation (EC) No 1254/1999 of 17 May 1999 establishing the common organisation of the market in beef and veal (OJ L 160, 26.6.1999, p. 21); Commission Regulation (EC) No 2342/1999 of 28 October 1999 laying down rules for the implementation of Regulation (EC) No 1254/1999 (OJ L 281, 4.11.1999, p. 30).

THE COURT'S OBSERVATIONS

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Results of checks performed by Member States

2.26. Since January 2000, Member States have been required to operate a system for the identification and registration of bovine animals, enabling the paying agencies to cross-check applications for payment of animal premiums. Although around half of the Member States failed to meet this timetable, this new tool is beginning to bring to light higher levels of inaccurate declarations in this scheme. **Table 2.3** and **Graph 2.5** summarise the results of on-farm inspections for the most expensive scheme, the suckler cow premium. This shows, for example, that, in 2000, authorities in the Netherlands reduced 18 % of claims selected for IACS checks and rejected a further 2 % outright.

2.26. Whilst some Member States did not have in place their bovine identification and registration database by the due date of 1 January 2000, several were nevertheless able to perform computerised cross-checks to a high degree prior to payment (in 2001) of the bovine premiums relating to aid applications lodged during 2000.

The Commission services have also noted the improved control facility offered in a majority of Member States by a properly functioning database. It is also recalled that the CAP reform of 2000 introduced several new, or greatly modified, bovine premium schemes, whose controllability has been enhanced by the new tool, which is also central to the control provisions laid down in the IACS Regulations.

As regards the Dutch authorities' actions in reducing claims during 2000, this was possibly the result of the Commission services' on-the-spot audit of agricultural expenditure in September 1999.

Table 2.3 – IACS inspections for suckler cow premium – Results of on-the-spot checks in 2000

Member State	Total number of claims submitted	Claims inspected (CI)		Claims partially rejected		Claims fully rejected	
		Number	%	Number	%	Number	%
Austria	90 224	13 188	14,62	1 021	7,74	37	0,28
Belgium	17 493	1 952	11,16	67	3,43	4	0,20
Denmark ⁽¹⁾	9 732	⁽¹⁾		⁽¹⁾		⁽¹⁾	
Germany ⁽¹⁾	35 626	⁽¹⁾		⁽¹⁾		⁽¹⁾	
Greece ⁽²⁾	⁽²⁾	⁽²⁾		⁽²⁾		⁽²⁾	
Spain	74 208	8 395	11,31	633	7,54	58	0,69
France ⁽¹⁾	138 303	⁽¹⁾		⁽¹⁾		⁽¹⁾	
Ireland	70 591	8 612	12,20	621	7,21	47	0,55
Italy ⁽³⁾	60 900	26 552	43,60	2 502	9,42	549	2,07
Luxembourg	515	60	11,65	5	8,33	0	0,00
Netherlands	5 496	520	9,46	94	18,08	11	2,12
Portugal	31 413	3 770	12,00	579	15,36	23	0,61
Finland	1 431	173	12,09	31	17,92	2	1,16
Sweden	10 816	1 274	11,78	67	5,26	9	0,71
United Kingdom	49 400	3 026	6,13	235	7,77	16	0,53
Total	596 148	67 522	11,33	5 855	8,67	756	1,12

⁽¹⁾ Denmark, Germany and France: data sent to the Commission in incompatible format.

⁽²⁾ Greece: data not sent to the Commission.

⁽³⁾ Italy: incomplete data sent to the Commission.

NB 1: Differences in percentage of errors detected may be explained both by differences in the number of inaccurate claims submitted and differences in the efficiency of detection.

NB 2: A claim is fully rejected when a difference higher than 20 % is found between the number of animals declared and that determined to be eligible or when the difference is the result of irregularities committed intentionally.

Source: DG AGRI – IACS 2000 Statistics.

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THE COMMISSION'S REPLIES

Olive oil

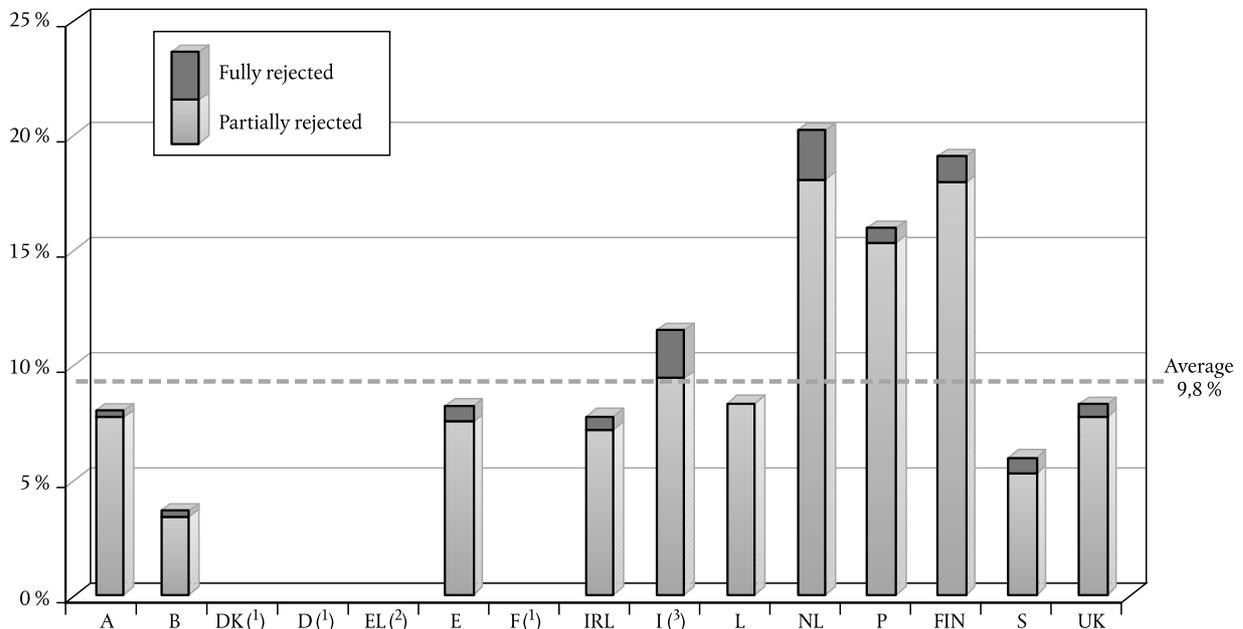
2.27. The cost to the budget of aid for the olive oil producers amounted to 2 505 million euro in 2001, 6 % of total CAP expenditure. This subsidy is paid to producers on the basis of the amount of oil produced, as certified by approved pressing mills.

Control system

2.28. Member States' olive oil control agencies must inspect 30 % of approved mills each year. The Member States are also required to set up a geographical information system for olive cultivation. Producer organisations must check claims and ensure that, *inter alia*, they agree with mill records.

2.28. The Commission services are monitoring the introduction and effectiveness of the new control tools referred to by the Court.

Graph 2.5 — Suckler cow premium — Percentage of claims inspected with errors



⁽¹⁾ Denmark, Germany and France: data sent to the Commission in incompatible format.

⁽²⁾ Greece: data not sent to the Commission.

⁽³⁾ Italy: incomplete data sent to the Commission.

NB 1: Differences in percentage of errors detected may be explained both by differences in the number of inaccurate claims submitted and differences in the efficiency of detection.

NB 2: A claim is fully rejected when a difference higher than 20 % is found between the number of animals declared and that determined to be eligible or when the difference is the result of irregularities committed intentionally.

Source: DG AGRI — IACS 2000 Statistics.

THE COURT'S OBSERVATIONS

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Findings of the Court

2.29. Where aid is payable on the basis of quantities produced, the reliability of the control system is particularly important. Evidence as to the accuracy of information produced by an olive mill can only be obtained at the time of milling. The audit of olive oil subsidies must therefore take account of the extent to which the control system ensures the accuracy of this information. Weaknesses noted in 2001 included the absence of an olive register in Greece and, in Spain, instances of mills pressing olives without giving the relevant agency the opportunity to be present, no olive cultivation geographical information system and a failure to inspect the required number of olive mills.

Rural development

2.30. Rural development expenditure amounted to 4 364 million euro in 2001, 10 % of total CAP expenditure. The most expensive schemes involve support for agri-environmental measures, the less-favoured areas (which now include more than 50 % of the agricultural area of the EU) and forestry. Expenditure is based upon rural development plans drawn up by the Member States and approved by the Commission.

Control system

2.31. There is no common control system for rural development expenditure. Frequent conditions include adherence to 'good farming practices', and minimum standards for environmental impact, hygiene and animal welfare. Member States, however, have significant discretion in the choice of areas to fund and in the design of appropriate control systems. Several certifying bodies express concerns about this expenditure, with the certifying bodies for the French, Portuguese and Bavarian paying agencies primarily concerned with rural development payments qualifying their audit opinions.

2.29. *The weaknesses noted by the Court in 2001 are being, or will be, followed up in the context of the clearance of accounts procedure. It should, however, be pointed out that as from 1 November 1998, the olive register has been replaced by the geographical information system for olives, for which the deadline for completion is 1 November 2003. In the intervening period until the 'Oligis' is completed, Member States are required to conduct an increasing number of on-the-spot inspections. The Commission services are closely monitoring progress in this domain.*

2.31. *The Community rules provide a general framework for the system of management, control and sanctions for rural development measures. However, considering the great diversity of measures and administrative organisations in the Member States, the detailed implementing rules are laid down by the Member States themselves in accordance with the principle of subsidiarity. The Commission department have nevertheless striven to ensure a degree of harmonisation between the Member States by issuing recommendations in a guidelines paper. The conclusions of certifying bodies are also taken into account in the clearance of EAGGF-Guarantee accounts.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Findings of the Court

2.32. In 2001 the audit incorporated a specific examination of aid for less favoured areas. This concluded that significant weaknesses in accounting and control systems exist. A particular problem is that standards for 'good farming practice' are poorly defined or are unverifiable.

2.33. Payments are generally based on arable areas. All of the types of error discussed under area aid schemes also occur in payments in this area, with the additional risk that farmers are failing to respect the conditions mentioned in paragraph 2.32.

Other expenditure

2.34. Expenditure not covered in paragraphs 2.12 to 2.33 amounted to 11 543 million euro, 27 % of CAP expenditure in 2001. This includes expenditure on activities such as cotton production, processing of agricultural products, export refunds and other forms of market intervention.

Findings of the Court: aid for cotton

2.35. The Court undertook a specific examination of aid for cotton, which amounted to 733 million euro in 2001, 2 % of CAP expenditure. It is paid to ginning undertakings in Greece and Spain on condition that a minimum price has been paid to the producers for the quantities of cotton delivered. National authorities must have in place controls designed to ensure that aid is paid on the correct quantity.

2.36. One key control is a check on the existence of producers and the reasonableness of the quantities delivered. Producers are required to submit an area declaration. National authorities use data from the area declarations to calculate, for each producer, the yield per hectare of unginned cotton, allowing yields exceeding acceptable thresholds to be investigated. Such checks, together with the cross-checks in the context of IACS and the on-the-spot checks, address the risk that

2.32. *The conclusions of the Court's examination of aid to less favoured areas will be carefully assessed by the Commission departments. The Commission departments are well aware of the issue of the control of good agricultural practices. Specific recommendations on this subject were included in the guidelines paper referred to at paragraph 2.31 above.*

2.33. *Area-related errors are also being evaluated in the context of compliance clearance, both in general enquiries concerning the IACS and in specific enquiries concerning rural development measures.*

2.36-2.37. *The incompatibility of parcel identification for cotton in Greece, and the consequent difficulty in confirming the areas of cotton parcels, is the subject of an ongoing enquiry by the Commission services in the context of the clearance of accounts procedure. However, regulatory provisions have already been put in place.*

Articles 9a(1) and 13(1)(d) of Council Regulation (EEC) No 3508/92 require, at the latest by 1 January 2003, the

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producers understate the area devoted to cotton in order to overstate claims for crops on which area aid is payable.

2.37. In Greece, around 30 % of parcels declared use references which are incompatible with the IACS references. This renders it impossible to confirm the area of these parcels. In addition, computerised systems allow multiple entry of reference numbers for individual registration of parcels.

2.38. Also in Greece there were no clear comprehensive instructions as to the selection, timing and methodology to be applied to on-the-spot checks of area declarations submitted by cotton producers. As a consequence, for the 2000/2001 marketing year, declarations were selected randomly rather than on the basis of risk; inspections were undertaken after harvesting had taken place and often after the parcels concerned had been ploughed; exceptionally large numbers of inspections were undertaken on the same day and the reporting mechanism lacked detail as to the plots examined, the methodology applied and the bases of the findings. Due to these weaknesses very few discrepancies were reported (0,05 % of the number examined). The frequency of error of 0,05 % contrasts with the results of the Court's audit testing on the accuracy of the area declarations for 2001/2002. In 16,7 % of the declarations checked, significant differences were found (exceeding national tolerances) between the areas declared and those cultivated with cotton.

Casein

2.39. The 2001 audit included a specific examination of aid for skimmed milk processed into casein, which amounted to 263 million euro, 0,6 % of CAP expenditure. This included examination of a sample of 107 payments, which were found to be without error.

THE COMMISSION'S REPLIES

administration and control systems applied to certain Community aid schemes to be set up so as to allow, without any problems or conflicts, a common functioning of, or the exchange of data between them and the integrated system. The Community aid schemes concerned, which include production aid for cotton, are set out in the Annex attached to Commission Regulation (EC) No 495/2001, amending the Annex to Council Regulation (EEC) No 3508/92. All Member States were reminded of these obligations by letter dated 8 March 2002, and requested to provide an update of the situation for each product sector involved.

2.38. *The Commission services note the Court's critical observations regarding Greece, and have established similar deficiencies in the context of their audits of agricultural expenditure. Any such failings in the national authorities' administration or control systems would be duly considered in the context of the clearance of accounts procedure.*

Nevertheless, whilst fully recognising the serious shortcomings established by the Court in respect of on-the-spot checks of land parcels used for cultivating cotton, especially given that they broadly reflect those regularly reported by the Commission services, it must be borne in mind that aid for cotton is paid on the basis of actual deliveries to the factories and not on the basis of areas declared. Therefore, when assessing any risk to the Fund with a view to attaching financial consequences with regard to the deficient checking of parcels, the Commission services would take account of the possible impact of such weaknesses on the overall outcome, other controls and procedures probably having a greater bearing.

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Other significant findings

2.40. The most significant finding in this area was that in Germany subsidies for grubbing-up vineyards were being paid for vineyards planted fewer than 10 years ago. Such expenditure is ineligible. In France, a payment of subsidy for tobacco was found to exceed the maximum quota.

2.40. In its reply to the Court's observation, Germany contests and claims that there would in addition be a linguistic problem in the German version of the relevant regulation. The Commission services will therefore further examine this question.

As for tobacco and the maximum quota, the Member States may, under certain conditions, carry out transfers. This matter needs to be examined in more detail before a final judgment can be made.

*Horizontal findings***Deductions**

2.41. Community regulations normally insist that the full amount of aid be paid directly to the farmer, exporter or enterprise concerned. As in previous years, the audit showed that deductions are still made⁽¹²⁾ which go beyond the exceptions allowed by the regulations and case-law. This does not involve an additional cost to the budget.

2.41. The Commission has followed up with due attention the respect of the integral payment clause. That is why already in the past corrections have and are still being made within the clearance of accounts procedure.

From the financial year 2002, Greece will no longer make such deductions from CAP aid and premiums in the sectors referred to by the Court.

The clearance audit trail system (CATS)

2.42. The Commission has a database containing all the information on EAGGF-Guarantee payments that have been made in the 15 Member States in the course of the previous financial year⁽¹³⁾. The Court tested the data for the financial year 2000 in order to check whether they were reliable and plausible, the payment date and the financial year were consistent and the aid paid was accurate. The results of these tests showed that:

2.42. It should be underlined that the CATS database contains 30 million records for the financial year 2000, with each record containing up to 128 potential fields. Even with unlimited resources, it is almost impossible to check every individual value. The Commission accepts that a further quality control of the CATS data is desirable. However, the need for this control must be seen in the context of all the priorities of the Commission. The opinion of the Court will be taken into account in the risk analysis of the Directorate responsible.

⁽¹²⁾ Annual Report of the Court of Auditors concerning the financial year 2000, paragraphs 2.37 and 2.40.

⁽¹³⁾ These data are made available to the Commission by the Member States pursuant to Commission Regulation (EC) No 1663/95 of 7 July 1995 (OJ L 158, 8.7.1995, p. 6) and Commission Regulation (EC) No 2390/1999 of 25 October 1999 (OJ L 295, 16.11.1999, p. 1).

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- (a) Greece had not supplied the detailed data requested;
- (b) most of the data from the other Member States (with the notable exception of Luxembourg) had many shortcomings.

Overall conclusions on common agricultural policy (CAP) expenditure

2.43. The audit showed that declarations made by farmers and other recipients of subsidies are materially affected by error; although the IACS control system picks up many errors, a material level of error is still present in the payments made by the paying agencies. The implementation of IACS is still incomplete and bovine identification systems, due in January 2000, were not introduced on time (see paragraphs 2.18 to 2.19 and 2.26).

2.44. Reporting of IACS inspection results needs to be improved, in particular to distinguish between the results of risk-based and random checks. The Commission should reperform and verify a selection of IACS inspections on an annual and representative basis.

2.45. Rural development is affected by the same types of error as area aid schemes, with the additional risk that farmers fail to apply standards of good farming practice required for these schemes. Standards for good farming practice are often poorly defined or unverifiable.

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- (a) *In May 2002, Greece started sending the required detailed information (financial year 2000) to the Commission. It should be noted that the accounts of Greece for financial year 2000 have not been financially cleared yet.*
- (b) *The financial year 2000 was the first year for which the CATS database was fully operational. The following quality controls have centrally undertaken on the CATS data:*
- *completeness of the data in respect of the budget items,*
 - *reconciliation with the annual accounts,*
 - *completeness of the data in respect of the X table,*
 - *respect of code lists.*

2.43. *The Commission considers that IACS allows the limitation to a large extent of the incidence of errors. Furthermore, the Commission is continuously improving the control system by amending the relevant regulations and by encouraging their full implementation and development in Member States; this is the case for example for the implementation of the bovine identification system or the introduction at the latest by 1 January 2005 of a geographical identification system (see point 2.16).*

2.45. *The Commission departments are well aware of the issue of the control of good agricultural practices. Specific recommendations on this subject were included in the guidelines paper referred to at paragraph 2.31 above.*

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2.46. Aid paid on quantities produced which cannot be verified *ex post* demand a strong control system. However, the largest schemes of this kind (olive oil and cotton) show particular weaknesses in terms of the implementation of checks by the Member States (paragraphs 2.28 and 2.29 and 2.36 to 2.40).

2.47. The Commission should take the necessary steps to make the CATS database more reliable and useful.

THE COMMISSION'S REPLIES

2.46. *Reference is made to responses given at points 2.29. and 2.38. The Commission services have also detected control deficiencies, which are routinely and systematically treated in the Commission's clearance of accounts procedure.*

2.47. *For the future, the quality controls on the CATS data will be enhanced by using a series of checks, similar to those undertaken by the Court; in addition stricter quality controls (e.g. on the use of code lists) will be built in the program used by the Member States for sending the computer data to the Commission.*

CLEARANCE OF ACCOUNTS

Introduction

2.48. Under the clearance of accounts procedure the Commission decides whether expenditure to implement the CAP undertaken by paying agencies should be definitively charged to the Community budget. Since 1996 the Commission has taken:

- (a) an annual financial clearance decision based on the certification of paying agencies' accounts by certifying bodies appointed by the Member States. These certifying bodies have to give an assurance as to whether the accounts are true, complete and accurate;
- (b) conformity decisions, whereby the Commission decides to exclude expenditure from Community financing because it does not comply with Community rules. Such decisions may relate to several EAGGF years.

A conciliation body is responsible for trying to reconcile the positions of the Commission and Member States on any proposed corrections referred to it. Corrections may also be referred to the European Court of Justice.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

2.49. The following paragraphs consider:

- (a) the financial decision for the EAGGF year 2001 ⁽¹⁴⁾,
- (b) three conformity decisions in respect of 1996 to 2000 ⁽¹⁵⁾.

2.50. The Court's examination aims to answer the following questions:

- (a) in respect of financial clearance:
 - (i) does the work of the certifying bodies, as reflected in their reports, provide an adequate basis for the certificate they give?
 - (ii) did the paying agencies meet the accreditation criteria (including information technology (IT) security)?
 - (iii) does the Commission's financial decision reflect the conclusions of the certifying bodies (where their work is deemed satisfactory)?
- (b) in respect of conformity decisions:
 - (i) are the corrections in the conformity decisions adequate and well founded?

Financial clearance

2.51. The Court has examined the reports of the 10 largest paying agencies by expenditure and all those whose certificates are qualified in any way (see **Table 2.4**). The Court has also reviewed the work of the Commission in preparing the financial decision.

⁽¹⁴⁾ Commission Decision 2002/461/EC of 12 June 2002 (OJ L 160, 18.6.2002, p. 28).

⁽¹⁵⁾ Commission Decision 2001/137/EC of 5 February 2001 (OJ L 50, 21.2.2001, p. 9), Commission Decision 2001/557/EC of 11 July 2001 (OJ L 200, 25.7.2001, p. 28) and Commission Decision 2001/889/EC of 12 December 2001 (OJ L 329, 14.12.2001, p. 68).

Table 2.4 — Paying agencies by expenditure declared in 2001

No	Member States	Paying agency	Amounts declared in Mio EUR	% of total	Qualified accounts ⁽¹⁾	Corrected accounts	Disjoined accounts ⁽²⁾
1	Italy	AGEA	5 111,74	12,19	✓	✓	
2	France	ONIC	4 147,32	9,89			
3	Greece	Opekepe (previously known as Gedidagep)	2 605,78	6,22	✓	✓	✓
4	United Kingdom	DEFRA (previously known as MAFF)	2 137,21	5,10		✓	
5	Spain	Andalucia	1 614,06	3,85	✓		
6	Ireland	DAF	1 533,45	3,66			
7	France	ONIOL	1 261,37	3,01			
8	Denmark	EU-direktoratet	1 111,73	2,65			
9	Germany	Bayern, Landwirtschaft	943,63	2,25			
10	Austria	AMA	939,09	2,24			
			21 405,38	51,05			
11	Spain	Castilla-Léon	888,73	2,12			
12	Spain	Castilla-La Mancha	876,00	2,09		✓	
13	France	ACCT/SDE	849,67	2,03	✓		
14	France	Ofival	847,25	2,02	✓		
15	Finland	MMM	815,35	1,94			
16	Sweden	SJV	779,66	1,86			
17	United Kingdom	IBEA	740,23	1,77			
18	Portugal	INGA	720,83	1,72		✓	
19	Spain	FEGA	710,38	1,69			✓
20	Germany	Niedersachsen	698,01	1,66			
21	Spain	Extremadura	590,96	1,41	✓		
22	France	CNASEA	584,57	1,39	✓		
23	Belgium	BIRB	583,46	1,39			
24	United Kingdom	SERAD	573,02	1,37			
25	France	Onilait	559,66	1,33	✓		
26	Germany	Hamburg-Jonas	549,24	1,31			
27	Germany	BLE	504,93	1,20			
28	Spain	Aragón	458,85	1,09			
29	Germany	Mecklenburg-Vorpommern	401,06	0,96			
30	Germany	Baden-Württemberg	393,67	0,94			
31	Germany	Brandenburg	362,87	0,87			
32	Netherlands	PZ	362,15	0,86			
33	Spain	Cataluña	359,60	0,86	✓		
34	France	FIRS	359,13	0,86	✓		
35	Germany	Sachsen-Anhalt	358,17	0,85	✓		
36	Belgium	Min. of Agr. — DG3	330,08	0,79			
37	Netherlands	LASER	318,20	0,76			
38	Germany	Sachsen	302,80	0,72			
39	Netherlands	HPA	297,45	0,71			
40	Germany	Nordrhein-Westfalen LWK Müntst	295,11	0,70			
41	Germany	Schleswig-Holstein	282,82	0,67			
42	United Kingdom	DARD	260,91	0,62			
43	Germany	Thüringen	260,19	0,62			
44	United Kingdom	NAWAD	258,72	0,62			
45	France	Oniflhor	253,84	0,61	✓		
46	Italy	SAISA (previously known as DCCC)	249,49	0,60			
47	France	Onivins	222,22	0,53	✓		
48	Germany	Hessen	195,96	0,47			
49	Spain	Canarias	195,06	0,47			
50	Germany	Rheinland-Pfalz	172,30	0,41			
51	France	Odeadom	166,61	0,40	✓		
52	Portugal	Ifadap	154,14	0,37	✓	✓	
53	Spain	Valencia	139,37	0,33			
54	Spain	Navarra	128,95	0,31	✓	✓	
55	Spain	Galicia	119,71	0,29			
56	Germany	Nordrhein-Westfalen LWK Bonn	103,24	0,25			
57	Italy	ENR	97,48	0,23			
58	Spain	Murcia	85,13	0,20	✓		
59	Austria	BMLFUW Präs B10	64,83	0,15			
60	Spain	País Vasco	60,92	0,15		✓	✓
61	Spain	Asturias	57,99	0,14			
62	Spain	Madrid	52,66	0,13	✓		
63	Spain	La Rioja	50,32	0,12			
64	Austria	ZA Salzburg	48,60	0,12			
65	Ireland	DMNR	48,60	0,12			
66	Netherlands	DLG	44,23	0,11			
67	Netherlands	PT	42,03	0,10			
68	Netherlands	PVVE	39,23	0,09			
69	Luxembourg	Min. Agric.	29,27	0,07	✓		
70	Spain	Cantabria	27,46	0,07			
71	Spain	Baleares	21,93	0,05	✓		
72	Germany	Bayern, Umwelt	21,38	0,05	✓	✓	
73	United Kingdom	FC	20,55	0,05			
74	Germany	Saarland	16,38	0,04			
75	Belgium	Vlaamse Gemeenschap	12,08	0,03			
76	Germany	Hamburg	11,26	0,03			
77	Belgium	Région wallonne	9,07	0,02	✓	✓	
78	France	Ofimer	7,48	0,02			
79	Spain	FROM	6,33	0,02			
80	Germany	Nordrhein-Westfalen LfEJ	6,12	0,01			
81	Germany	Bremen	1,75	0,00			
82	United Kingdom	CCW	1,72	0,00			
83	Germany	Berlin	1,60	0,00			
		TOTAL	41 926,40	100,00			

⁽¹⁾ Accounts qualified by the certifying bodies because of financial errors, scope restrictions or other reserves.

⁽²⁾ Disjoined from the financial decision of April/May 2002.

NB: Exchange rates for Member States outside euro zone:

Denmark: 7,45508, Sweden: 8,98170, United Kingdom: 0,621063.

Source: Summary report of the Commission on the financial clearance of the EAGGF Guarantee Section accounts for 2001.

Financial decision for 2001

2.52. The Commission took its financial clearance decision on 12 June 2002, after the 30 April deadline laid down in the Regulation. The Commission accepted the accounts of the paying agencies, subject to the following exceptions and conditions:

- (a) the Commission excluded (disjoined) the accounts of four paying agencies from the decision, accounting for 3 391 million euro (8 %) of the total expenditure declared. The accounts of Greece and the Flemish Community (Belgium) were not cleared because they had not provided the Commission with adequate computer payment data. For FEAGA and Basque Country (Spain), the Commission requested further information;
- (b) as a sanction against late payments, overshooting expenditure ceilings and failure to collect the milk super levy on time, the Commission decided that the advances paid to Member States in 2001 were 131,4 million euro too high, but that Portugal was entitled to reimbursement of 20,6 million euro following the grant of an additional milk quota to the Azores;
- (c) the Commission adjusted the amounts of expenditure declared by 10 paying agencies by a total of 9,2 million euro on the basis of findings by the certifying bodies.

The certifying bodies

Late appointment of certifying bodies

2.53. Two certifying bodies were appointed late: for the Greek paying agency (the third largest in the Community) on 14 October 2001, one day before the end of the financial year; for the largest paying agency in the Community (AGEA, Italy) not until 12 December 2001. Final reports and certificates had to be provided by 10 February 2002.

2.53. *The Commission strongly regrets that the certifying bodies for Italy and Greece were not appointed earlier in the year and will insist that this is done for 2002.*

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Findings by the certifying bodies

2.54. The certifying bodies' reports indicate that the level of error in the paying agency accounts in terms of their truth, completeness and accuracy does not exceed 1 % of the total expenditure declared. The certifying bodies' certificates, however, do not provide assurance that the facts declared by beneficiaries in claims for payment reflect reality; it is at this level that the Court's audits have shown that errors are most likely to occur. The certifying bodies are required only to certify whether the paying agencies' management and information systems are capable of ensuring that payments are properly made.

2.54. *The purpose of the certificate is not to provide assurance that the facts declared by beneficiaries in claims for payment reflect reality. In accordance with Article 3 of Commission Regulation (EC) No 1663/95, the certificate by the certifying body covers compliance of payments with the Community rules only as regards the capability of the paying agency's administrative structures to ensure that such compliance has been checked before payment is made. However, the Commission would like to underline that the reasonable assurance that expenditure incurred is in conformity with the rules derives not only from the financial audit. Indeed, with the financial audit decision the Commission accepts the accounts on the basis of the certificates and reports of the certifying body but without prejudice to subsequent compliance decisions to recover expenditure that is found not to have complied with Community rules. Under the reform of the clearance procedure, Member States are required not only to accredit paying agencies and nominate delegated bodies in charge of controls but also to install internal audit functions. Therefore, the reasonable assurance is designed to be given by the totality of the described measures put into place by the reform of the clearance procedure in 1995.*

The paying agencies

Some paying agencies do not meet the accreditation criteria

2.55. In Greece the former paying agency (Gedidagep) was replaced by Opekepe in October 2001. The accreditation of the new paying agency on 3 September 2001 was provisional for one year. Full accreditation is dependent upon improvements in the structure and organisation of the paying agency.

2.56. The certifying body for two of the French paying agencies (Odeadom and SDE) considers that they do not meet the accreditation criteria. The main scheme for which SDE is responsible (suckler cow premium) will be transferred to another French paying agency (Ofival) with effect from the EAGGF year 2003. However, it will continue to be responsible for two very small schemes, whereas the certifying body, the Commission and the Court are of the opinion that it should cease to be a paying agency.

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2.57. The certifying body for Ifadap (Portugal) considers that the paying agency failed to meet a wide range of accreditation criteria. According to the certifying body and the Commission, the Flemish Community paying agency (Belgium) does not meet the accreditation criteria. The Commission has not yet taken any corrective measures in either case. If the Commission considers that a Member State is not doing enough to improve the situation it can reduce the monthly advances ⁽¹⁶⁾.

Qualified audit certificates

2.58. The certificates for 23 paying agencies were qualified because of doubts about the eligibility of expenditure, inadequate internal controls (Greece, Italy (AGEA) and Luxembourg) and the level of financial error found by the certifying bodies. In most cases the Commission has proposed corrections or will consider the points at issue in a conformity decision. However, it has not proposed corrections for the extrapolated error found by the certifying bodies for three French paying agencies (totalling 51,5 million euro) and for one Spanish paying agency (0,1 million euro).

Information technology (IT) security in paying agencies

2.59. The accreditation criteria for paying agencies include the protection and control of computer systems ⁽¹⁷⁾. At the end of 1999 the Commission launched a series of IT audits of paying agencies, drawing on earlier work by the agencies and certifying bodies. Eight private audit firms examined compliance with the computer security guidelines at 49 paying agencies (which

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2.57. *In order to reduce the monthly advances the Commission has to respect the requirements of Article 14 of Regulation (EC) No 2040/2000, that is that monthly advances may only be reduced in cases of 'manifest non-compliance with the rules and a clear misuse of Community funds'.*

As part of the follow-up to the 2001 clearance process the Commission services have informed the Portuguese authorities that a financial correction of 2 % of Ifadap expenditure is proposed (EUR 2,8 million).

In view of the further regionalisation of EAGGF competencies in Belgium the services of the Commission are monitoring the accreditation process for the enlarged paying agencies closely.

2.58. *For one French paying agency (Cnasea) a correction (of EUR 1 million) was unfortunately overlooked in the financial decision. It will be made in the conformity process.*

For the other two French paying agencies (Ofival and SDE) and the Spanish paying agency, the Commission does not consider that they are in a position to make the corrections mentioned at the moment. These corrections will be proposed in the conformity process and fully examined in this process.

⁽¹⁶⁾ Council Decision 94/729/EC of 31 October 1994 on budgetary discipline (OJ L 293, 12.11.1994, p. 14).

⁽¹⁷⁾ Paragraph 6(vi) of the Annex to Regulation (EC) No 1663/95 of 7 July 1995 (OJ L 158, 8.7.1995, p. 6).

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together account for some 90 % of total expenditure declared) at a cost of 1,1 million euro. Application systems were not reviewed as such; the audit scope was limited to a general description of the controls over the input and processing of accounting and analytical data. The audit firms scored current performance and planned changes on a scale of 0 to 5⁽¹⁸⁾ for 16 aspects of IT security. The Court reviewed one report produced by each of five companies⁽¹⁹⁾. On the whole the reports are of good quality.

2.60. By the end of 2001, 35 reports had been submitted and finalised. They indicate that, for the most part, paying agencies have failed to meet the accreditation criterion. None of the paying agencies reviewed achieved a 'very good' (overall 5) rating and only one was assessed as 'good' (overall 4). The most common failings were absence of or inadequate contingency plans (18 paying agencies), unsatisfactory logical security systems (15 paying agencies), poor policies, standards and procedures (12 paying agencies) and personnel policy that does not address information security aspects (10 paying agencies).

2.61. Many certifying body reports indicate that these observations have been followed up. On the other hand, according to the reports, only nine of the 49 paying agencies reviewed plan to reach compliance in the short term (a score of 4 or higher). The Commission does not intend to impose corrections on the basis of the IT audit findings because it has not identified any risk to the Fund.

Inspection levels and foot-and-mouth disease

2.62. Because of foot-and-mouth disease (FMD) most of the inspections required under IACS could not be carried out in the United Kingdom and Ireland and many animals were slaughtered during the scheme retention periods. The Commission issued a regulation⁽²⁰⁾ providing for alternative controls, for example cross-checks between premium claims and the number of animals culled.

2.61. *The Commission will follow up the weaknesses in order to improve the systems.*

2.62-2.63. *In respect of the foot-and-mouth outbreak, having introduced Regulation No 882/2001 derogating from the normal control rules laid down in IACS Regulation (EEC) No 3887/92, the Commission services are keeping themselves fully informed of the dossiers mentioned by the Court with regard to Ireland and the United Kingdom. In principle, since the Member States concerned detected the erroneous nature of the claims prior to payment, the claims have been rejected in line with IACS requirements. Exclusion for a second year is also foreseen under IACS rules.*

⁽¹⁸⁾ 0 = not existing; 1 = inadequate; 2 = weak; 3 = to be improved; 4 = good; 5 = very good.

⁽¹⁹⁾ DT-AGEA; MS-IBEA; PWC-INGA; E & Y-Ofival and AA-FEGA.

⁽²⁰⁾ Commission Regulation (EC) No 882/2001 of 3 May 2001 (OJ L 123, 4.5.2001, p. 20).

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2.63. In Northern Ireland investigations based on these cross-checks revealed that 103 farmers had claimed for more sheep than were culled and 17 of them had no sheep on farm when the cull took place. The certifying body concludes that the livestock inspection quality control procedures should be re-evaluated. A similar situation was found in the Republic of Ireland (106 farmers had claimed more sheep than they had at the time of the cull and 16 of them had no sheep on farm when the cull took place). For those found to have no sheep the only sanction provided for in the relevant regulations is a ban on claiming the premium for two years.

Conclusion on financial clearance

2.64. In general, the work of the certifying bodies provides an adequate basis for their certificates, though it is a matter of concern that the certifying bodies for the largest and third largest paying agencies were appointed very late in the day (see paragraph 2.53). The overall level of error identified from the records of the paying agencies by the certifying bodies does not exceed 1 % (see paragraph 2.54); however, this figure does not represent a judgement on the facts declared by beneficiaries giving rise to payments. The Commission's financial clearance decision takes into account the findings of the certifying bodies with the exceptions noted in paragraph 2.58. Most of the concerns expressed by the certifying bodies will be followed up in the conformity context (see paragraph 2.58). Compliance with the IT security accreditation criterion leaves much to be desired, and there are paying agencies which fall seriously short of the general accreditation requirements (see paragraphs 2.56 to 2.58).

Conformity decisions

2.65. In its conformity decisions the Commission makes use of one-off and flat-rate corrections. One-off corrections are typically made for 'errors' which can be precisely quantified, payments after deadlines, advance payments not followed by settlements, overclaims, etc. The Commission uses flat-rate corrections when systems' weaknesses have a financial impact on the Fund that cannot be precisely quantified. The rate applied

2.64. *The Commission agrees with the general conclusion of the Court that the work of the certifying bodies provides an adequate basis for their certificates.*

The Commission will insist that certifying bodies are appointed in time. The low rate of error confirms that administrative structures in the paying agencies are generally satisfactory.

Those paying agencies falling short of fully meeting all general accreditation criteria are closely monitored on the implementation of measures to improve the situation. Nevertheless, continued compliance with the accreditation criteria is mainly a concern for the competent authorities of the Member States which issue and withdraw accreditation of paying agencies (Article 4(7) of Council Regulation (EC) No 1258/1999 and Article 1 of Commission Regulation (EC) No 1663/95).

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depends on the Commission's judgement of the severity of the failure of controls. Flat-rate corrections, which make up nearly 90 % of all corrections by value, are thus more controversial and are often referred by Member States to the conciliation body.

Key and ancillary controls

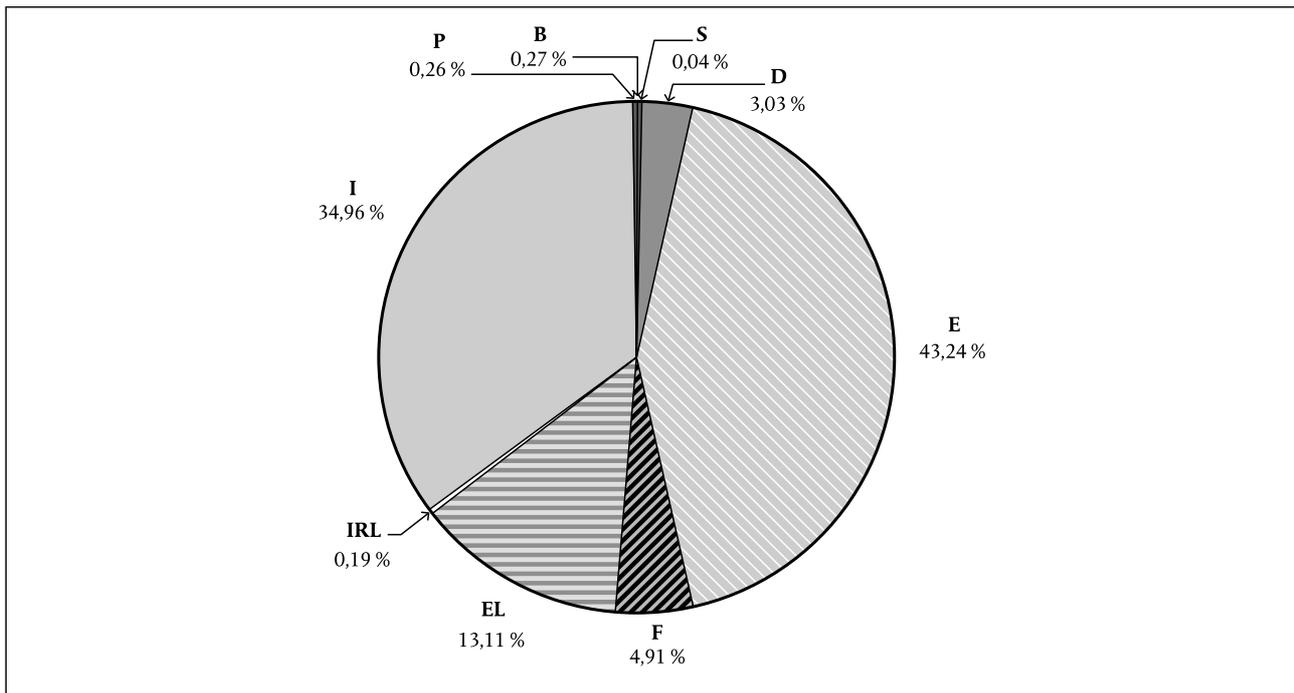
2.66. Key control failures normally attract at least a 5 % flat-rate correction whereas ancillary control failures attract a 2 % flat-rate correction (unless the risk to the Fund is demonstrably lower). In order to make the relationship between systems weaknesses and flat-rate corrections clearer, the Agriculture DG's clearance unit has started to develop definitions of key and ancillary controls. By the end of 2001 eight areas of the CAP, accounting for the great majority of expenditure, had been covered (export refunds, arable crops, animal premiums, rural development, public storage, dried fodder, olive oil and the over-30-months scheme ⁽²¹⁾). The Court welcomes this initiative by the Commission.

2.66. *In accordance with legislation and guidelines governing the clearance of accounts procedure, the Commission may correct expenditure only to the extent that there is a risk to the Community budget. If, after taking all elements into consideration (e.g. viable alternative controls) the risk is deemed to be reduced, then a lower flat-rate correction, or even no financial correction at all, is applicable.*

Analysis of the corrections made in 2001

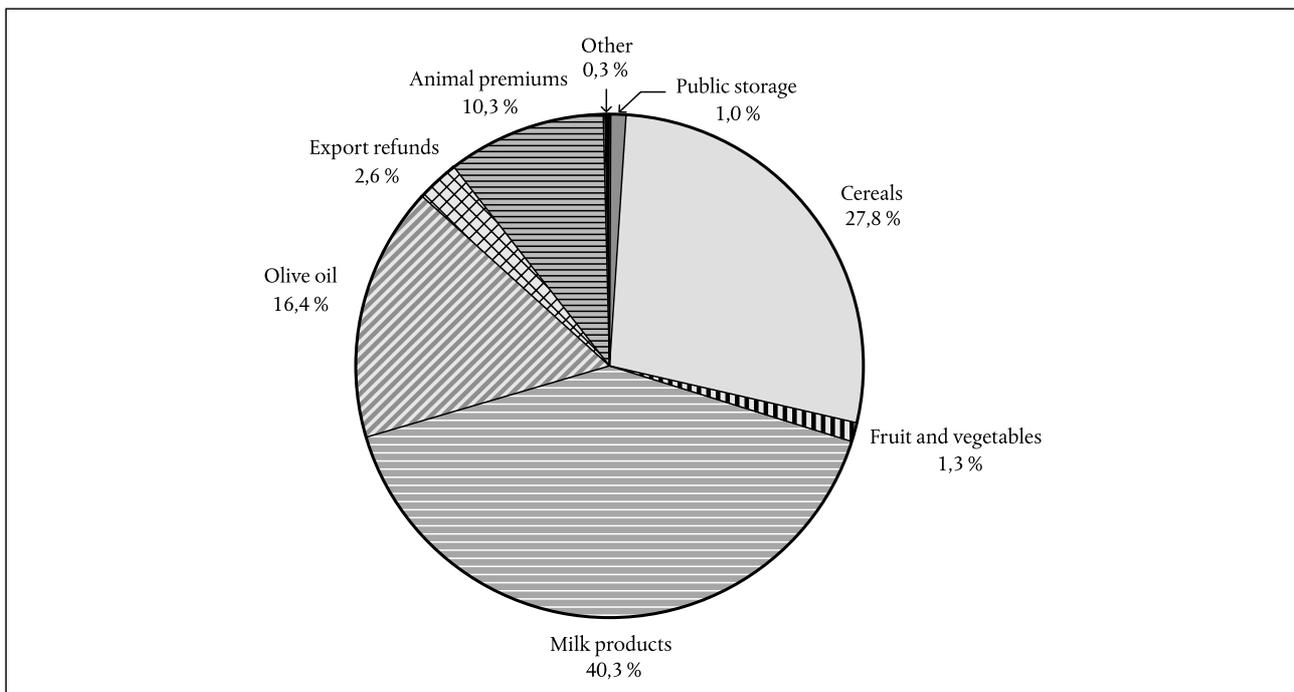
2.67. **Graphs 2.6 and 2.7** show the distribution of expenditure excluded from Community financing per Member State and per market as a result of decisions taken in 2001, for the EAGGF years 1996 to 2000, and totalling 807,2 million euro. Of this total, the Court has examined corrections amounting to 783 million euro and concluded that corrections relating to 629,3 million euro were soundly based. Areas of concern are discussed below.

⁽²¹⁾ These definitions are set out in Commission document AGRI 17933/2000.

Graph 2.6 — Corrections in conformity decisions 6, 7 and 8 per Member State

NB: For the United Kingdom the correction is in fact a reimbursement of 13,2 million euro.

Source: Commission Decision 2001/137/EC of 5 February 2001 (OJ L 50, 21.2.2001, p. 9),
 Commission Decision 2001/557/EC of 11 July 2001 (OJ L 200, 25.7.2001, p. 28),
 Commission Decision 2001/889/EC of 12 December 2001 (OJ L 329, 14.12.2001, p. 68).

Graph 2.7 — Corrections in conformity decisions 6, 7 and 8 per market

Source: Commission Decision 2001/137/EC of 5 February 2001 (OJ L 50, 21.2.2001, p. 9),
 Commission Decision 2001/557/EC of 11 July 2001 (OJ L 200, 25.7.2001, p. 28),
 Commission Decision 2001/889/EC of 12 December 2001 (OJ L 329, 14.12.2001, p. 68).

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Inadequate corrections — olive oil production aid

2.68. The Court has examined corrections, in respect of the EAGGF years 1997 and 1998, of 121,9 million euro for olive oil out of a total of 132,3 million euro (Greece: 50,8 million euro, Spain: 71,1 million euro).

2.69. The Commission has identified three key controls for olive oil production aid: operational olive oil registers, computerised files of declarations and claims, and controls of olive oil mills. The reports of audit missions carried out by the Commission in 1998, 1999 and 2000 in Greece and Spain indicate that the olive oil register and the computerised files were either not operational or not used as control tools. The Commission applied a 5 % flat-rate correction for both Member States for the EAGGF years 1997 and 1998 as it had done for 1994 to 1996.

2.70. In the Court's view, as two key controls are still missing (they should have been implemented 10 years ago at least), the risk to the Fund is high, and a 10 % or higher flat-rate correction should have been applied. The Court criticised the Commission's position for the EAGGF years 1994 to 1996 in its Annual Reports for 1998 and 1999.

Failure to make corrections

Milk levy

2.71. Although the Commission has identified numerous problems in the management of the milk quota system (mainly in Greece, Italy and Spain), no corrections for systems' weaknesses have been made. The Court reiterates ⁽²²⁾ that the Commission should take action to ensure that corrections are applied for systems weaknesses which pose a financial risk to the EAGGF.

2.69-2.70. *The situation for both Greece and Spain has not fundamentally changed since a financial correction was first applied at a flat rate of 5 % for the financial year 1994. The factors then taken into account when evaluating the risk to the Fund (i.e. that the Control Agency OEEE in Greece was operating satisfactorily and, for Spain, that all the oil was sold through the olive oil mills) also remain valid for the subsequent years to which the Court refers. Therefore, given that the Commission services' audits have not established a high risk to the Fund, it is still considered, as previously, that these two aspects significantly limit the risk to the Fund of over declaration.*

2.71. *The Commission would point out that many of the weaknesses detected in the application of the milk quota system are mostly related to the collection of the levy. Such weaknesses have no direct relation to the quantity of milk declared to the Member State and reported to the Commission, and as such do not affect the amount of levy due to the Community. In any event, as the Court had pointed out earlier itself, the reductions in advances which result from the Member States' failure to collect the levy have an immediate and direct impact on reducing the financial risk to the fund. Also, with regard to the incomplete implementation of the milk quota regime the Commission has opened infringement procedures against Italy (Reasoned Opinion 97/2228) and Spain (Reasoned Opinion 97/2227) for incorrect application of the regime and failure to collect the levy.*

⁽²²⁾ Annual Report concerning the financial year 1999, paragraph 2.58.

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Delays in making corrections

Olive oil consumption aid

2.72. A correction for Spain (5 million euro) was made more than four years after the end of the relevant EAGGF year, even though it was notified to Spain in July 1999. The correction for Greece for 1996 to 1999 is still under consideration.

2.72. *The administrative oversight referred to by the Court in respect of Spain is acknowledged. However, it is emphasised that the Commission's legal position was not at risk and neither was there a risk that the correction would not be applied. Internal procedures have now been improved to guard against recurrence.*

As regards Greece, financial corrections are pending receipt of data requested from the national authorities.

Cotton

2.73. The corrections relating to expenditure made during the EAGGF years 1996 and 1997 took place in July 2001.

2.73. *The delays in the application of financial corrections for cotton expenditure were due to the Greek authorities' failure to provide additional information. The corrections had initially been scheduled for inclusion in a much earlier ad hoc clearance of accounts Decision.*

Financial consequence of the 24-month rule

2.74. Corrections can only be applied retrospectively for a maximum of two years preceding a written notification to the Member State concerned. In June 1997 the Commission carried out an inspection concerning proofs of arrival provided by authorised supervisory companies ⁽²³⁾ in the EAGGF years 1994 to 1996. Proofs of arrival are documents required as evidence that agricultural goods attracting export refunds have been placed on the market in a non-EU country. The inspection concentrated on Germany, the main user of supervisory company proofs.

⁽²³⁾ Amongst other functions, supervisory companies perform services on behalf of either buyers or sellers of goods to ensure that the contractual specifications regarding the quantity and quality of the goods in question have been respected. In the context of export refunds they certify on behalf of the claimant that the goods have been placed on the market in a non-EU country corresponding to the description, quantity and quality declared in the refund claim.

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2.75. Investigations carried out by the German authorities led the Commission to conclude that the system was 'gravely deficient' and that there was widespread evidence of irregularity. A 25 % flat-rate correction was applied (20,9 million euro). This correction was notified in September 1997, and under the present Council Regulation it could only cover the preceding 24 months. Without this limitation, the Commission would have been able to correct for a longer period. A 25 % correction, for example, for the period 1994 to 1996 would have amounted to 93,7 million euro. The Commission has recently submitted a proposal to extend this period to 36 months.

Clearance of accounts decisions since 1991

2.76. **Table 2.5** shows the results of the Commission's clearance decisions for 1991 and subsequent years. Clearance has been completed for the years up to and including 1996 but some conformity decisions remain to be taken for subsequent years. The total amounts disallowed represent the Commission's view of the amount of expenditure declared by Member States which, because of specific identified irregularities or system's weaknesses, should not be borne by the Community budget.

Conclusion on conformity decisions

2.77. The corrections made in recent conformity decisions are well founded, with the exceptions mentioned in paragraphs 2.69 to 2.74.

Table 2.5 – Clearance of accounts corrections in conformity decisions (1996 to 2001)

(Mio EUR)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Expenditure declared (including B1-3 7 0)	31 255,9	30 480,2	34 008,0	33 592,8	35 654,4	39 062,5	40 884,3	38 857,4	40 726,2	40 410,6	41 593,8
Corrections in clearance decisions	- 1504,1	- 788,2	- 754,7	- 307,8	- 591,9						
Corrections in the conformity decisions	0,0	0,0	0,3	0,0	1,4	- 807,0	- 443,6	- 278,8	- 43,9	- 0,1	0,0
Total amount of corrections	- 1 504,1	- 788,2	- 754,4	- 307,8	- 590,5	- 807,0	- 443,6	- 278,8	- 43,9	- 0,1	0,0
of which:											
(a) Corrections for late payments	- 10,6	- 5,6	- 20,4	- 21,1	- 14,8	- 25,2	- 27,2	- 16,3	- 15,6	0,0	0,0
(b) Milk super levies	- 979,2	- 419,7	- 265,4	0,0	- 31,4	- 215	- 110,2	0,0	0,0	0,0	0,0
(c) Corrections resulting from Clearance of accounts unit activity	- 514,3	- 362,9	- 469,2	- 286,7	- 547,1	- 566,8	- 306,2	- 262,5	- 28,3	- 0,1	0,0
Clearance of accounts unit corrections as a percentage of expenditure declared	1,6 %	1,2 %	1,4 %	0,9 %	1,5 %	1,5 %	0,7 %	0,7 %	0,1 %	0,0 %	0,0 %

NB: Exchange rates:

Those used by the Commission in its summary reports.

Total amount of corrections per EAGGF year:

The amounts in italic are still provisional.

There are still conformity decisions to be taken to clear the expenditure of these EAGGF years.

In order to make comparisons between the level of corrections for EAGGF years, milk super levies and penalties on late payments have been deducted because they are not corrections as a result of Clearance of Accounts Unit enquiries.

Corrections made in conformity decisions for 1993 and 1995:

These positive amounts correspond to corrections cancelled by the Court of Justice (in Conformity Decision 2001/557/EC).

Source: All the Commission's clearance of accounts decisions covering the EAGGF years 1991 to 2001 taken from 1996 to 2002.

FOLLOW-UP TO PREVIOUS OBSERVATIONS

2.78. The Court has reviewed the information presented by the Commission on the action taken to deal with the most important of its past observations. This limited review, based on information presented by the Commission, sought to identify the areas within which such measures have been taken (or not), without making a detailed check of their implementation.

2.79. This year's follow-up deals with observations on the support scheme for durum wheat published in the Court's Annual Report concerning the financial year 1997⁽²⁴⁾ and with observations contained in the Court's Special Report No 20/2000 concerning the management of the common organisation of the market (CMO) for sugar⁽²⁵⁾.

*Durum wheat***Main conclusions of the Court's report**

2.80. When this scheme first started, the special aid to durum wheat was based on actual production of this cereal and on objective criteria. Over the years, the way in which the criteria governing entitlement to this aid have been applied has been eased and broadened, leading to a marked increase in budgetary expenditure: it rose from 15,4 million euro in 1971 to 425,9 million euro in 1993, and by 1997 had reached 1 745,6 million euro⁽²⁶⁾. Total expenditure (supplementary aid and compensatory aid) has since remained stable at around 1 700 million euro per annum.

2.81. If the aid to durum wheat producers had been determined on the basis of the same principles as were being followed at the time for establishing the aid for maize and oilseeds⁽²⁷⁾, the total amount of this aid (supplementary aid and compensatory aid) would have worked out at about 250 euro per hectare, instead of

⁽²⁴⁾ Chapter 2, Title II.

⁽²⁵⁾ OJ C 50, 15.2.2001.

⁽²⁶⁾ This figure can be broken down as follows:

— supplement granted to the traditional zones and to the non-traditional zones: 1 080,6 million euro,

— normal per-hectare aid (estimate): 665 million euro.

⁽²⁷⁾ These forms of aid were calculated on the basis of historical average yields and a specific reference amount, and were capped according to maximum base areas.

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530 euro per hectare. Had this method been applied from 1993 onwards, expenditure from the EU budget would have been reduced by over 3 000 million euro for the four-year period 1994 to 1997.

The position of the discharge authority

2.82. In its recommendations on the discharge in respect of the implementation of the budget for the financial year 1997, the Council observed ⁽²⁸⁾ that the Court's report contained a critical assessment of the justification for the regulations in force, but did not mention any irregularities in implementing the budget for the regulations concerned in the financial year 1997. Lastly, the Council welcomed the assessment of the scheme embarked on by the Commission (see paragraphs 2.86 to 2.88) and thought that this was a practice which should be made more widespread.

2.83. In its resolution informing the Commission of the reasons for the postponement of the decision giving discharge in respect of the financial year 1997 ⁽²⁹⁾, the European Parliament expressed its agreement with the Council's observations, whilst nevertheless noting that it would be appropriate for the legislative and budgetary authorities to give thought to changing the legislation in respect of the durum wheat aid scheme in order to make it more equitable.

Action taken by the Commission

2.84. In its 'Agenda 2000' published in March 1998 ⁽³⁰⁾, the Commission proposed that the scheme set up in 1997 be continued unchanged. Following the publication of the Court's report in November 1998, the Commission did not submit any amended proposals for the Berlin Summit, which took place in March 1999. In the absence of any specific proposal from the Commission, the overall agreement reached in Berlin on 26 March 1999 on Agenda 2000's political and financial guidelines thus, amongst other things, doubled the base area granted to Portugal for growing durum wheat, from 59 000 to 118 000 hectares ⁽³¹⁾.

⁽²⁸⁾ Council document of 19 February 1999 (reference 5911/99).

⁽²⁹⁾ Resolution informing the Commission of the reasons for the postponement of the decision giving discharge in respect of the implementation of the general budget of the European Union for the financial year 1997, paragraph 28 of the Annex (OJ C 279, 1.10.1999, p. 125).

⁽³⁰⁾ COM(1998) 158 final, 18.3.1998, p. 35.

⁽³¹⁾ Council Regulation (EC) No 1251/1999 of 17 May 1999 (OJ L 160, 26.6.1999, p. 1).

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The extra cost to the Community is put at 20 million euro per year ⁽³²⁾.

2.85. In 1998, the Commission ordered a study assessing the Community policy on durum wheat since the 1992 reform of the common agricultural policy. The final report was sent to the Commission in December 1999 ⁽³³⁾.

2.86. This report's main conclusion was that the objectives concerning durum wheat laid down by the agricultural policy at the time of the 1992 reform had, in the main, been achieved, but the report pointed out the following:

- (a) the 1992 reform had not enabled the budgetary cost of the Community's durum wheat policy to be reduced;
- (b) the internal durum wheat market had been restabilised, but quality was declining and an increasing share of the production was being used for animal feed. Since the latter could be provided using other, far less subsidised cereals, some 150 million euro in Community aid was thus being 'wasted' every year;
- (c) in 1999, the international price of European durum wheat was close to the world rate, but prices within the EU fluctuated quite considerably;
- (d) the objective of compensation for the foreseeable loss of income had been largely achieved; producers' incomes would still have been maintained if total aid per hectare had been reduced by over 100 euro/hectare; the potential saving would have been over 300 million euro per year.

2.87. The main recommendations made in the evaluation report were to:

- (a) lower the aid rate used to calculate the durum wheat supplement;

⁽³²⁾ In 2000/2001, claims were submitted for only 52 917 hectares of the supplementary 59 000 hectares allocated, thus leading to extra expenditure of 18,2 million euro. In 2001/2002, claims were made for all the additional areas allocated.

⁽³³⁾ This report is available on the Commission's Internet site at the following address:
[http://europa.eu.int/comm/agriculture/eval/reports/bledur/full %5Ffr.pdf](http://europa.eu.int/comm/agriculture/eval/reports/bledur/full%5Ffr.pdf).

THE COURT'S OBSERVATIONS

- (b) improve the quality of the durum wheat produced in the EU;
- (c) allow Community durum wheat production to be adjusted to demand;
- (d) bring the durum wheat aid scheme into line with the aid schemes for the other arable crops.

2.88. Since the publication of the Court's report in 1998, the durum wheat aid scheme has remained unchanged.

Conclusion

2.89. The Commission's evaluation report confirmed the Court's main conclusion, namely that the durum wheat supplement greatly exceeds the amount needed to maintain producers' incomes. The Community institutions' previous conclusions and recommendations remain valid. The Court considers that, for the four-year period 1998 to 2001, considerable savings could once again have been made, had the scheme been changed.

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2.89. *As part of the mid-term review, the Commission sent recommendations for a new common agricultural policy to Parliament and to the Council in July 2002. In the case of durum wheat the Commission proposes reducing the specific additional payment to EUR 250/ha in traditional areas and abolishing the aid scheme altogether in non-traditional areas, in line with the Court of Auditors' analysis of this sector and the evaluation by independent experts.*

In order to increase the production of high-quality durum wheat there is a proposal to introduce a special payment of EUR 15/t for durum wheat sold to the industry under contracts guaranteeing fulfilment of certain quality criteria.

The Commission's management of the CMO for sugar

Main observations of the Court

2.90. In its Special Report No 20/2000 ⁽³⁴⁾ the Court concluded that strategic weaknesses existed in the quality of the Commission's proposals, decisions and actions in respect of sugar, and that the continuing high cost to consumers and overproduction in the EU had not been tackled in successive renewals of the common market for sugar. The Court observed that a number of

⁽³⁴⁾ Special Report No 20/2000 concerning the management of the common organisation of the market for sugar (OJ C 50, 15.2.2001).

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alternatives existed which the Commission should address in its forthcoming proposal for the reform of the regime.

The Court's follow-up

2.91. Although the report was discussed in Parliament's Land-use and Food Policy Intergroup and in the Council's Working Group on Agricultural Finance (Agri-fin), there was no reference to the report in the context of the discharge procedure. Since the Court's report, the Council has adopted a new regulation ⁽³⁵⁾ for the quota arrangements to be applied from July 2001, based on a proposal by the Commission ⁽³⁶⁾.

2.92. In view of the observations formulated in the Special Report on the Commission's preparation of previous legislative proposals, the Court's aim in this follow-up is to assess the soundness of the Commission's proposal and, in particular, the explanations given by the Commission to the legislator and to the public regarding the basis for and justification of its proposal.

Action taken by the Commission

Significant uncertainties on technical issues

2.93. In March 1999 the Commission launched an external evaluation study in preparation for its proposals for the 2001 renewal of the sugar quotas. The evaluation was due to be completed in January 2000 but was not finally published until February 2001. Although the Commission had established the terms of reference, it judged the report's quality to be poor in several key aspects: design of the evaluation, analysis, validity of conclusions and usefulness of recommendations; and said that the report was of 'very limited use for the services concerned'.

2.94. The Commission acknowledged in the explanatory memorandum to the proposal that: 'At this stage significant uncertainties remain on technical issues that would affect any radical change in the sugar regime. In addition, the present regime and any changes to it

2.93-2.94. *When preparing its proposal COM(2000) 604, the Commission drew on three sources of information:*

- *the results of the evaluation it started at the beginning of 1999,*
- *smaller-scale studies it had already carried out,*
- *numerous independent studies of the sugar sector and the special report of the Court of Auditors.*

Despite its preparatory work for the proposal, the amount of information available was not completely satisfactory. The preparation of the evaluation requested by the Commission ran into difficulties, and the results, though considerable, fell short of expectations. In particular, the evaluation did not produce the requisite synthesis of the information available which is scattered between different sources and sometimes contradictory.

⁽³⁵⁾ Council Regulation (EC) No 1260/2001 of 19 June 2001 (OJ L 178, 30.6.2001, p. 1).

⁽³⁶⁾ COM(2000) 604 final, 4.10.2000.

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should be carefully examined in terms of their impact (...). Fundamental reform (...) will require both a review of the quota system, as well as of the level of intervention prices.' Given that it was decided in 1995 ⁽³⁷⁾ that the sugar regime would expire in June 2001, the Commission should have ensured that this basic information was available in time to prepare its October 2000 proposals.

Incomplete presentation of the EU market

2.95. In the explanatory memorandum, the Commission presented a table headed 'The Community sugar market' which showed the EU's supply in the marketing year 1999/2000 as just 14,3 million tonnes. This represents only the sugar produced from EU-grown sugar beet and cane and ignores the 1,8 million tonnes of sugar produced in the EU from raw cane sugar, which is imported mainly from the ACP States.

2.96. However, these imports are part of the EU's sugar supply as the EU has indefinite legal obligations, notably the 1975 Sugar Protocol, to purchase this sugar, and the imports benefit from the same intervention and export-refund guarantees in the common market organisation as sugar from EU-grown beet and cane. Excluding these imports gives the false impression that the imported sugar is not part of the EU's supply. In fact, most of the imported sugar is consumed in the EU, continuing the traditional supply arrangements of the United Kingdom, Portugal and Finland before accession, and an equivalent quantity of sugar from EU-grown beet and cane is exported with subsidies.

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2.95-2.96. *The Commission felt that the surplus in Community sugar production should be treated separately from the preferential imports from ACP States and India. Being subject to different constraints they warrant separate treatment. Any change in Community production quotas has an impact on European producers without affecting the obligation to import preferential sugar. Given the objectives assigned to the CMO for sugar the first priority is to analyse the impact of any reform on Community producers. Moreover, 1,6 million tonnes of sugar, equivalent to the imports from ACP countries and India, can be exported without WTO restriction. The Commission does not, therefore, include these in the Community's supply balance.*

Under these circumstances the Commission presented the situation objectively and focused its analysis on the quantities of sugar that pose a problem for the Community market. It should be stressed here that the relevant information about preferential sugar imports clearly features in the proposal: the explanatory memorandum explains the legal provisions governing them and the fact that the Community funds the export of an equivalent quantity of white sugar. Similarly, the financial statement annexed to the proposal clearly mentions the tonnage involved and the cost to the budget of such exports.

⁽³⁷⁾ Article 23(5) of Council Regulation (EEC) No 1785/81 of 30 June 1981 (OJ L 177, 1.7.1981, p. 4), as amended by Council Regulation (EC) No 1101/95 of 24 April 1995 (OJ L 110, 17.5.1995, p. 1).

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2.97. The table compared this *partial* supply figure (i.e. excluding the supply from imports) to the *total* EU consumption (*including* the consumption of imports) and thereby arrived at a figure of 1,5 million tonnes by which EU production exceeded internal consumption. In the main text of the explanatory memorandum, however, the Commission only referred to a 'structural surplus' of 0,23 million tonnes, this being the amount by which the EU's surplus production was likely to exceed the World Trade Organisation (WTO) limits on subsidised exports.

2.98. In reality, the EU common market organisation guarantees the supply every year of over 3 million tonnes more sugar than it consumes, a figure confirmed by the Commission in its reply to the Court's Special Report. Most of this surplus is disposed of by exporting it with subsidies, which cost the EU agriculture budget a net 700 million euro in 2000 ⁽³⁸⁾. Because of this impact on the EU budget, the existence and magnitude of the surplus are important elements in any decision on the renewal of sugar quotas. Nowhere in the information presented by the Commission was it made clear that reducing quotas to 11 million tonnes would still be sufficient to meet the EU's internal needs, with a consequent budgetary saving of some 700 million euro in export refunds.

Incomplete information

2.99. The Commission stated that the proposed abolition of storage aid 'would lower expenditure by 300 million euro'. Neither in the main text nor in the Annex relating to storage costs did the Commission mention that this proposal would also result in an equivalent loss of income from the storage levy. There was also no assessment of the likely effect of this measure on the sugar industry. The importance of such an analysis is

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2.97. *The table does not take account of either imports or exports.*

2.98. *The cost of preferential imports has to be considered from a broader perspective that embraces international relations as a whole.*

2.99. *The Commission prepared the financial statement accompanying the proposal to amend the common organisation of the markets in the sugar sector in accordance with the properly established method. The detailed information on the likely changes in expenditure and own resources is given in the abovementioned Annex and includes the changes directly resulting from the abolition of the compensation system for storage costs.*

⁽³⁸⁾ The sugar CMO pays for the export refunds for the first 1,6 million tonnes of the surplus. This corresponds to the export of a quantity of white sugar equivalent to the cane sugar imported under preferential agreements. Above this amount, the cost of export refunds is recovered from the sugar industry in the form of a production levy.

THE COURT'S OBSERVATIONS

confirmed by the comments of the European Parliament's Agriculture Committee ⁽³⁹⁾ and the Economic and Social Committee ⁽⁴⁰⁾ on this subject.

2.100. Calculations by the Commission of the net savings of the proposals in relation to the existing regime included elements that were not related to the proposals. Instead of the Commission's net 241 million euro, the Court calculates the annual net saving to be 134 million euro. Several Member States pointed out these errors to the Commission in November 2000 ⁽⁴¹⁾. The magnitude of the errors should have prompted the Commission to issue a corrigendum to the explanatory memorandum and financial statement.

THE COMMISSION'S REPLIES

In view of the questions that have been raised, the Commission accepts that the explanations provided in document COM(2000) 604 should have been more detailed. It supplied additional explanations in the course of the debates with the European Parliament and the Economic and Social Committee to which the Court referred.

2.100. *The Commission and the Court have different approaches to calculating net costs. In the interests of transparency, the Commission set out in the Annex to the financial statement the method used to estimate the expenditure and revenue associated with the various instruments of the new regime in 2002 and 2003, aligning itself with the provisions laid down in the preliminary draft budget 2001 for the current regime. In its calculation, which produces savings estimated at EUR 130 million, the Court compares predicted expenditure and/or revenue for the years 2002 and 2003 with and without amendments to the regime.*

It should be noted that the proposed measures would in any case have been necessary. The Court's calculations show that despite everything these measures generate considerable annual savings.

⁽³⁹⁾ Report of the Committee on Agriculture and Rural Development, PE 286.396 of 28 February 2001: '(...) it is inconceivable to abolish a key mechanism for the stabilisation of the sugar market which has proved its value over 30 years without providing any evidence that it is ineffective and without having calculated the effects of its abolition on the various parties involved.'

⁽⁴⁰⁾ Opinion of the Economic and Social Committee, CES 1423/2000 of 30 November 2000: '(...) the Committee regrets to note that the amendments proposed by the Commission regarding storage have not been subject to an impact study. It is also surprised that arrangements which have been considered most valuable in previous regulations are now suddenly described as unnecessary without the Commission making the effort to justify its change of opinion.'

⁽⁴¹⁾ Council Document 8270/01 of 10 May 2001: Report of the Agrifin meeting of 16 November 2000 on the proposal for a Council Regulation on the common organisation of the markets in the sugar sector — financial implications, Section II.4 Specific observations.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Insufficient consideration of alternatives

2.101. Only brief consideration was given to reform options in the explanatory memorandum. Three simple options were put forward, all of which assumed the continuation of the existing quota and export-refund systems. These were a one-off 25 % cut in prices (the Agenda 2000 model); a progressive reduction in prices; and the continuation of the existing prices. The first two were dismissed on the basis of the budgetary costs, estimated at 1 125 million euro a year.

2.102. The Court has examined the Commission's calculation of this 1 125 million euro cost of compensation and found that it was based on the intervention price for white sugar, not on the prices paid to farmers for sugar beet and cane. Moreover, it did not take into account the effects on production levies nor the budgetary savings on export refunds that would directly follow any price cuts. The Commission has since informed the Court that this figure should be seen as only giving an idea of the magnitude of the global loss to the whole sugar sector. It should not, therefore, have been presented as an estimate of the budgetary cost, in terms of compensation to producers, of applying the Agenda 2000 model.

Conclusion

2.103. The Commission failed to prepare the necessary studies for its October 2000 proposals in time and the supporting information provided was in places incomplete and did not show the real Community surplus of sugar. There was no assessment of the likely impact on the sugar industry of the proposal to end storage reimbursements. Alternatives to the current arrangements were not properly considered and the costs given for the Agenda 2000 model were calculated on an incorrect basis and therefore overstated.

2.101-2.102. *The quota system expired in June 2001 and had to be renewed. But as the Commission clearly pointed out, there were numerous uncertainties. Some were connected with the Commission's need for further information, others were beyond the Commission's control (new negotiations on agriculture in the WTO, forthcoming enlargement). Although unable to carry out thorough analyses, the Commission wanted to single out certain characteristics and immediate consequences of some of the options being put forward most frequently.*

In this connection, the figure of EUR 1 125 million mentioned in the explanatory memorandum was simply meant to show that the budgetary cost of a reduction in the intervention price could be considerable in terms of compensation for the sector as whole. A more detailed study would have been based on hypotheses that, if they were to be credible, required the sort of information the Commission wanted for planning a more far-reaching reform. Undoubtedly the Commission should have been more clear, by explicitly pointing out that the figure of EUR 1 125 million quoted was only an indication of the order of magnitude, equivalent to 50 % of the possible losses for the entire sugar sector.

2.103. *The Commission provided the legislator with all of the relevant and useful information for the decision. This information came from the evaluation undertaken in early 1999 and its monitoring of market trends (see points 2.93 and 2.94). Furthermore, the financial statement, drawn up in the proper manner in support of the proposal, gave the requisite budgetary details. The estimates of revenue and expenditure associated with the various instruments of the regime in 2002 and 2003 (see points 2.100 to 2.102.) were supplied in an Annex to the financial statement accompanying the proposal. The Commission believes that the Council adopted the Regulation on the basis of a full knowledge of the facts.*

On the specific question of the sugar surplus on the Community market, it separated the problem of sugar produced within the EU from that imported under the preferential system. Finally, it was not possible to explore the alternatives to the current regime without making assumptions which it would have been difficult to justify without additional information.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

PRINCIPAL OBSERVATIONS IN SPECIAL REPORTS

2.104. The following paragraphs contain a summary of the principal observations contained in the Special Reports on EAGGF-Guarantee subjects adopted by the Court since the Annual Report 2000 which should be taken into account during the discharge procedure.

The sound financial management of the common organisation of markets in the banana sector ⁽⁴²⁾

2.105. The banana market is the world's second largest fruit market after citrus fruits. A common organisation of the market (CMO) for bananas was introduced in this sector in 1993. Its main objective was to harmonise and stabilise this market by means of various aid measures and to limit imports by means of a tariff quota system.

2.106. The main objective of the audit was to examine the way in which the objectives of the CMO were defined by the Council and implemented by the Commission and how the implementing measures were managed by the Member States and monitored by the Commission.

Measures financed by the EU

2.107. The lack of precision of some of the basic implementing texts led to difficulties in the implementation of the CMO, e.g. deficiencies in the information required to calculate aid, non-compliance with the rules applicable to producer organisations, applications for compensatory aid in respect of quantities presented for marketing by the producers which were not accepted subsequently by the purchasers.

2.108. Some producers benefited from additional national financial support which was not notified to the Commission in advance. Furthermore, shortcomings were revealed in the documents provided in support of aid payments.

2.107. *The level of detail in the definition and quantification of objectives is similar to the other market organisations and will be reviewed in depth when the market organisation is evaluated under Article 32 of Regulation (EEC) No 404/93 (evaluation planned for 2004).*

The Commission finds that the method for calculating the compensatory aid is clearly defined in Article 12 of Regulation (EEC) No 404/93.

The Commission considers that it solved the management problems that arose in the Member States effectively, by taking immediate corrective action.

2.108. *The Commission will be drawing the attention of the relevant national authorities to the State aid scheme cited by the Court with a view to ruling on whether it is compatible with the common market under Article 87 of the Treaty.*

The Commission had already identified the shortcomings in the documents supplied in support of compensatory aid payments as mentioned by the Court. These are being followed up under the clearance of accounts procedure.

⁽⁴²⁾ Special Report No 7/2002 (OJ C 294, 28.11.2002).

THE COURT'S OBSERVATIONS

2.109. The premium for final cessation of banana production had only limited impact.

Measures to regulate the market

2.110. The difference between the world prices and Community prices leads to a situation known as 'quota rents'.

2.111. The system of tariff quotas originally introduced by the CMO has led to a complex system for the importation of bananas and also to continued non-compliance with the World Trade Organisation's rules (WTO).

2.112. In Member States, poor customs practices and fraudulent imports have given rise to risks for the effective management of the quota.

THE COMMISSION'S REPLIES

2.109. *The grubbing-up aid was a limited measure (1993 and 1994) connected with the transition to the common organisation of the market. The main purpose of the measure was to enable a very specific and limited category of producers to leave the sector.*

2.110. *The difference vis-à-vis other representative markets (such as the USA) is not due to the quota rent alone, but also to other factors such as the distance from the production areas, distribution costs, product quality and customs duties.*

Moreover, a tariff-only system will be introduced on 1 January 2006 at the latest (Article 16(1) of Regulation (EEC) No 404/93, as amended by Regulation (EC) No 216/2001), and quota rents are part of all tariff-quota regimes.

2.111. *The import arrangements introduced in 1993 replaced a situation which was extremely diverse, given the existence of 12 different national import regimes. The new arrangements were designed to ensure fair access to the Community market for many different types of operators and bananas from many different origins, taking account of the situations of the various players in the import system (e.g. ACP producer States with close ties to particular Member States of the Community).*

The current system has achieved a remarkable stability. It is widely appreciated for its simplicity by producer third countries and the Community's other trading partners.

2.112. *The Commission is aware of the Member States' shortcomings in applying the Community legislation on physical checks on the net quantity of imported bananas. At the meeting of the Customs Code Committee of 17 May 2002, the Commission departments reminded the Member States of their obligations under the Community rules and stressed the importance of those obligations. The Commission will monitor this matter within the Customs Committee in order to achieve full and correct application of the Community rules.*

The fraudulent imports were detected by the Commission. It should be noted that this discovery was possible because imports are subject to a licensing scheme. The Commission immediately adopted Regulation (EC) No 1632/2000 to introduce a procedure for cross-checks on the issuing and use of licences so that such fraud can no longer occur.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Developments and evaluation

2.113. After putting in place an interim arrangement, the Commission decided in favour of a system based solely on tariffs to be introduced by 2006. The Commission's intention was to maintain adequate protection for producers in the EU and ACP (African, Caribbean and Pacific) States without affecting the volume of imports and with minimal impact on prices.

2.114. The Commission is expected to produce a general evaluation of the CMO at the end of 2004. This should allow an overall assessment to be made of the consequences of the introduction of the CMO and the degree to which its initial objectives have been achieved.

Conclusions and recommendations

2.115. There have been shortcomings in the implementation of the CMO's objectives, some of which have not been achieved, and some of the measures taken have had unforeseen and undesired results. Little or no use has been made of grubbing-up premiums and opportunities to develop alternative crops. Shortcomings in the methods used to calculate reference prices and prices for producers have led to overpayment of compensation aid and corrective financial measures. The quota rent advantage derived from the tariff quota system by the multinationals operating in the market is approximately two to three times as great as the support given to EU and ACP growers ⁽⁴³⁾.

2.113. *The transitional arrangements currently in force are indeed designed to maintain fair market access for EU and ACP producers before a tariff-only system is introduced, no later than 1 January 2006. However, with regard to import volumes, 100 000 tonnes was transferred from the C quota (ACP bananas) to the B quota (open to all origins) as of 1 January 2002 following the entry into force of Regulation (EC) No 2587/2001.*

2.114. *The Commission attaches the same importance as the Court to the evaluation of the different aspects of the market organisation and its objectives planned for 2004.*

2.115. *The Commission takes the view that:*

- (a) *the fundamental objectives of the market organisation have in the main been achieved, in particular the fusion of several national markets into a single market, the quantitative balance in market supply, fair prices for consumers and for Community and ACP producers. In the context of a world market dominated by multinationals, the Community market has remained diversified and pluralist, in terms of both the origins of bananas and types of traders;*
- (b) *the grubbing-up premium was a limited measure (1993 and 1994) connected with the transition to the common organisation of the market. The main purpose of the measure was to enable a very specific and limited category of producers to leave the sector;*
- (c) *the method for calculating the compensatory aid is clearly defined by the Community legislation in force (Article 12 of Regulation (EEC) No 404/93 and Regulation (EEC) No 1858/93). The Commission has identified the shortcomings in the application of the Community rules and these are being followed up under the clearance of accounts procedure;*

⁽⁴³⁾ The figures quoted by the Commission in its reply relate to the rate of quota rent of 200 euro per tonne estimated by it, compared to the rate of income compensation aid of 383 euro per tonne for the year 2000. The Court's calculations are based on the total value of the quota rent in relation to the quota of 2 553 000 tonnes, which is some 511 million euro. This is around two to three times the expenditure for income compensation aid in 1999 and 2000.

THE COURT'S OBSERVATIONS

2.116. The vulnerability of producers within their producer organisations should be given more attention. In addition, the import arrangements under the CMO have proved susceptible to irregularities, and significant weaknesses were found in import controls.

2.117. As the Commission has committed itself to conducting its first major evaluation around 2004, it should ensure that it keeps to this timetable and that, in particular, it includes an evaluation of the synergies developed by the various types of support for the banana sector.

THE COMMISSION'S REPLIES

(d) *lastly, concerning the comparison between the quota rent and the support given to Community and ACP growers, the Commission notes that:*

- *there are 3,5 times more 'dollar bananas' than bananas produced in the Community (the same applies for ACP bananas),*
- *the compensatory aid received by Community producers in 2000 was 1,9 times the theoretical quota rent estimated for dollar bananas,*
- *the producers of bananas in the ACP States enjoy not only technical assistance but also particularly advantageous preferential treatment (an exclusively reserved tariff quota, zero import duty inside all the quotas and a duty reduced by EUR 300 outside the quotas),*
- *the existence of tariff quotas, and therefore, inevitably, a quota rent, also makes it easier to sell Community and ACP bananas and indirectly benefits Community and ACP producers.*

2.116. *The Commission has identified the shortcomings in the way the Member States apply the rules applicable to producer organisations and the matter is being followed up under the accounts clearance procedure.*

The Commission has also adopted a number of measures to improve the cash-flow situation of producers.

The Member States' customs procedures on import have yet to be improved and the Commission stressed this point to the Member States at the meeting of the Customs Code Committee on 17 May 2002. The Commission will continue to insist that the Member States find a permanent solution to the problem.

2.117. *The Commission attaches the same importance as the Court to the evaluation of the different aspects of the market organisation planned for 2004. It will ensure that it keeps to this timetable.*

THE COURT'S OBSERVATIONS

The Commission's management of the Community oilseed support scheme

2.118. In its Special Report No 6/2002 ⁽⁴⁴⁾, the Court examined the management of the common organisation of the market (CMO) in oilseeds and the implementation of the aid scheme for oilseeds produced on set-aside land.

2.119. During the period 1993 to 1999, annual budgetary expenditure on oilseeds was about 2 700 million euro, or around 15 % of the Community expenditure devoted to arable crops.

2.120. In 1991, the Community radically reformed the CMO by replacing the aid paid to the oilseed crushers with area-based aid paid direct to the oilseed producers. The level of the aid was based on the historical yield of the region concerned and was subject to changes in world prices.

2.121. Under the Agenda 2000 reform, the same level of aid was introduced for cereals, oilseeds and set-aside land, as of the marketing year 2002/2003.

2.122. Despite the high level of budgetary expenditure, the Commission has not carried out an evaluation of the 1991 reform. It has accepted regionalisation plans containing overstated historical yields. For the period 1992/1993 to 1999/2000, the irrecoverable aid ⁽⁴⁵⁾ paid out as a result of this exceeded that laid down in the Community regulations by 474,7 million euro. The Commission's annual calculations of aid levels resulted in 366 million euro in additional irrecoverable budgetary expenditure for the period 1992/1993 to 1999/2000. In two of the five Member States visited, the prescribed penalties for failing to comply with the conditions stipulated in the industrial set-aside scheme were incorrectly applied.

THE COMMISSION'S REPLIES

2.122. *A detailed evaluation by an independent consulting firm was carried out only recently because it was necessary to view the oilseeds sector in conjunction with the cereals sector, where the CAP reform of 1992 has only applied fully since 1995.*

The Commission does not intend to ask the Member States concerned to change their regionalisation plans, because after discussions at Council level these plans formed a key element in the conclusion of Agenda 2000. The Commission acted in conformity with the rules laid down by the Council.

The Commission does not agree with the Court's conclusions on the cases relating to the method of calculating aid. It believes that it did comply with the rules laid down by the Council. Consequently it cannot share the Court's conclusion regarding the extra cost to the budget calculated on the basis of the alleged incorrect application of the rules. The system criticised by the Court was replaced by Agenda 2000.

The Commission is aware of the shortcomings of the penalty system described by the Court and takes appropriate measures under the clearance of accounts procedure.

⁽⁴⁴⁾ OJ C 254, 22.10.2002.

⁽⁴⁵⁾ Given that the additional expenditure referred to results from Commission decisions, its recovery from Member States or beneficiaries is no longer possible, bearing in mind that the protection of legitimate expectation and the principle of legal certainty are principles of law.

THE COURT'S OBSERVATIONS

2.123. The Commission should give consideration to the advisability of adjusting the overstated historical average yields in certain regionalisation plans and should examine to what extent unduly paid Community aid can be recovered. The Court recommends that clear and quantified objectives be defined and that the Commission should reassess the support given to products which may be grown instead of oilseeds.

Extensification premium and payment schemes (EPS) in the CMO for beef and veal

2.124. In Special Report No 5/2002 ⁽⁴⁶⁾ the Court examined the extensification payment scheme (EPS), a direct beef payment scheme under the common organisation of the market for beef and veal aimed at encouraging extensive beef production in an environmentally sustainable way and reducing surplus production. The aims of the audit were to consider the extent to which the EPS had encouraged extensive cattle production in the European Union and to examine the implementation of the scheme as reformed under Agenda 2000. The EPS co-exists with agri-environmental and compensatory allowance schemes with similar stocking density requirements for qualification.

2.125. The Court found that the EPS had had little influence on encouraging extensive and environmentally sustainable beef farming, particularly before the 2000 reforms, and that the Commission had little information on the effectiveness and efficiency of the scheme. One important effect of the EPS was to support the incomes of farmers who farmed extensively. EPS premiums paid on a per head basis encourage producers to maximise their subsidy revenue by maximising production within the given stocking density limits.

2.126. Weaknesses in the implementation of the scheme were found in all the Member States visited (Spain, France, Ireland, Austria and the United Kingdom).

2.127. The Court recommends that the Commission should assess the effectiveness and the efficiency of the EPS and its consistency with other schemes such as agri-environmental and compensatory schemes.

THE COMMISSION'S REPLIES

2.123. *The Commission does not intend to ask the Member States concerned to change their regionalisation plans, because after discussions at Council level these plans were included in Agenda 2000. The Commission has acted in conformity with the rules laid down by the Council.*

The objective of market equilibrium is a familiar concept, the exact nature of which changes according to the state of the market (equilibrium between demand and supply). The question of reassessing the support given to other sectors will be examined in the mid-term review of Agenda 2000.

2.125-2.127. *The Commission has planned and will carry out the assessment of the common organisation of the market in beef and veal in 2004/2005 and will analyse the impact of the various instruments planned in this sector, particularly the new extensification premium introduced by Agenda 2000.*

More generally, the questions raised by the Court are examined in the study carried out for the purposes of the proposal for a mid-term review of Agenda 2000 which is intended partly to limit the obligation to produce in order to benefit from premiums and partly to reinforce cross-compliance.

Consistency between agri-environment measures, compensatory allowances and the EPS is ensured by clear provisions in Council Regulation (EC) No 1257/99, implementing rules of which address explicitly the extensification payment. Consistency is also ensured by the fact that the implementing bodies in the Member States are using the same control tools.

⁽⁴⁶⁾ OJ C 290, 25.11.2002.

CHAPTER 3

Structural measures

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INTRODUCTION

3.1. This chapter is devoted to structural measures. It deals with the implementation of the Cohesion Fund and of the four Structural Funds (SFs): the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agricultural Guidance and Guarantee Fund, 'Guidance' section, (EAGGF-Guidance) and the Financial Instrument for Fisheries Guidance (FIFG).

3.2. These measures are listed under heading 2 of the financial perspectives. For the 2000 to 2006 period, this heading accounted for appropriations totalling 213 000 million euro ⁽¹⁾.

ANALYSIS OF BUDGETARY MANAGEMENT

Introduction

3.3. Structural measures are managed on the basis of multi-annual programmes. Each intervention ⁽²⁾ is accompanied by an indicative financing plan which specifies the amount of Community aid and the Member State's contribution. Contributions for structural measures are committed in annual instalments and are paid in the form of advances, payments on account, and intermediate and final payments.

Implementation of appropriations

3.4. As a proportion of the entire Community budget, the implementation of the structural measures accounted for 40,5 % of the commitments entered into (41 166,0 million euro) and 28,7 % of the payments made (22 455,8 million euro).

3.5. **Table 3.1** shows the implementation of the appropriations for structural measures. **Tables 3.2** and **3.3** present 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') ⁽³⁾.

⁽¹⁾ i.e. 195 000 million euro for the Structural Funds and 18 000 million euro for the Cohesion Fund.

⁽²⁾ Project in the case of the Cohesion Fund and programme or single programming document (SPD) in the case of the Structural Funds.

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

Table 3.1. — Evolution and implementation of the 2001 budget

(Mio EUR)

Heading in the financial perspectives: 2. Structural measures						
	Total for heading		Structural Funds		Cohesion Fund	
	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations
Ceiling in the financial perspectives	32 720,0		30 005,0		2 715,0	
Evolution of the budget						
Initial appropriations ⁽¹⁾	32 720,0	31 572,4	30 005,0	28 712,4	2 715,0	2 860,0
Available final appropriations ⁽²⁾	41 362,5	32 994,8	38 233,9	29 834,8	3 128,5	3 160,0
Implementation of the budget						
Appropriations utilised	41 166,0	22 455,8	38 040,7	20 472,4	3 125,2	1 983,4
% of available final appropriations	99,5	68,1	99,5	68,6	99,9	62,8
Appropriations carried over to 2002	175,2	0,1	171,9	0,1	3,3	0,0
% of available final appropriations	0,4	0,0	0,4	0,0	0,1	0,0
Appropriations cancelled	21,3	10 538,9	21,3	9 362,3	0,0	1 176,6
% of available final appropriations	0,1	31,9	0,1	31,4	0,0	37,2

⁽¹⁾ Budget definitively adopted by the European Parliament on 14 December 2000 (OJ L 56, 26.2.2001).⁽²⁾ Budgetary appropriations amended taking account of supplementary and amending budgets and of transfers, including appropriations carried over from 2000, appropriations from revenue resulting from contributions by third parties and other revenue for a specific purpose and appropriations made available again. For more detailed information on budgetary implementation, see graphs III and IV of Annex I to this report.

Source: 2001 Revenue and expenditure account.

Table 3.2. — Budgetary implementation for measures and the Structural Funds in the financial year 2001

(Mio EUR)

	Budget reference	Appropriations				Total available appropriations (c) + (d) + (e)	Implementation of available appropriations	Rate of implementation of available appropriations (%)	Appropriations carried over to the financial year 2002	Appropriations cancelled at the end of the financial year		
		Initial budget	Final budget after SABs and transfers	Carry-overs from the previous financial year	Other additional appropriations					Amount (f) - (g) - (i)	% (j)/(f)	
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h) = (g)/(f)	(i)	(j)	(k)	
C	Objective 1	B2-1 0	20 832,0	20 832,0	5 374,8	0,2	26 207,0	26 202,9	100,0	3,9	0,1	0,0
	Objective 2	B2-1 1	3 613,0	3 613,0	2 648,7	3,4	6 265,1	6 263,6	100,0	1,5	0,0	0,0
	Objective 3	B2-1 2	3 575,0	3 575,0	187,8		3 762,8	3 762,3	100,0		0,5	0,0
	Other structural measures (excluding O1)	B2-1 3	164,0	164,0	14,0		178,0	173,4	97,4	4,6	0,0	0,0
	Community initiatives	B2-1 4	1 683,0	1 607,3			1 607,3	1 433,8	89,2	161,8	11,6	0,7
	Innovative and technical assistance measures	B2-1 6	138,0	213,7		0,1	213,8	204,7	95,7	0,1	9,1	4,2
	Sub-total 'Structural Funds'	B2-1	30 005,0	30 005,0	8 225,3	3,6	38 233,9	38 040,7	99,5	171,9	21,3	0,1
	Cohesion Fund	B2-3	2 715,0	2 715,0	413,5		3 128,5	3 125,2	99,9	3,3	0,0	0,0
	Total		32 720,0	32 720,0	8 638,8	3,6	41 362,5	41 166,0	99,5	175,2	21,3	0,1
	P	Objective 1	B2-1 0	18 745,2	18 535,5	1 020,0	0,1	19 555,6	13 789,4	70,5	0,1	5 766,1
Objective 2		B2-1 1	4 323,2	4 323,2	150,0		4 473,2	3 137,9	70,1		1 335,3	29,9
Objective 3		B2-1 2	3 205,4	3 205,4			3 205,4	1 630,3	50,9		1 575,1	49,1
Other structural measures (excluding O1)		B2-1 3	463,5	463,5			463,5	115,6	24,9		347,9	75,1
Community initiatives		B2-1 4	1 745,4	1 907,4			1 907,4	1 701,4	89,2		206,0	10,8
Innovative and technical assistance measures		B2-1 6	229,7	229,7		0,1	229,8	97,9	42,6	0,1	131,9	57,4
Sub-total 'Structural Funds'		B2-1	28 712,4	28 664,7	1 170,0	0,1	29 834,8	20 472,4	68,6	0,1	9 362,3	31,4
Cohesion Fund		B2-3	2 860,0	2 860,0	300,0		3 160,0	1 983,4	62,8		1 176,6	37,2
Total			31 572,4	31 524,7	1 470,0	0,1	32 994,8	22 455,8	68,1	0,1	10 538,9	31,9

Source: Sincom and revenue and expenditure account.

NB: C = Commitments; P = payments.

Table 3.3. — Detail of budgetary implementation for the Structural Funds in the financial year 2001

(Mio EUR)

Budget item	Description	Commitments			Payments		
		Available appropriations	Implementation	%	Available appropriations	Implementation	%
B2-1 0 0	Objective 1 — EAGGF-Guidance	3 220,0	3 219,8	100,0	1 822,5	1 273,8	69,9
B2-1 0 1	Objective 1 — FIFG	385,2	385,1	100,0	306,8	154,9	50,5
B2-1 0 2	Objective 1 — ERDF	15 684,8	15 682,9	100,0	9 554,4	6 934,7	72,6
B2-1 0 3	Objective 1 — ESF	6 710,9	6 709,1	100,0	3 360,6	2 707,8	80,6
B2-1 0 4	Objective 1 — PEACE	206,0	206,0	100,0	104,0	37,2	35,7
B2-1 0 5	Objective 1 — Completion of previous programmes	0,2	0,0	0,0	4 407,2	2 681,1	60,8
Total Chapter B2-1 0: Objective 1		26 207,0	26 202,9	100,0	19 555,6	13 789,4	70,5
B2-1 1 0	Objective 2 — ERDF	5 598,3	5 596,7	100,0	2 164,1	1 562,0	72,2
B2-1 1 1	Objective 2 — ESF	663,5	663,5	100,0	445,1	168,2	37,8
B2-1 1 2	Objective 2 — Completion of previous programmes	3,4	3,4	100,0	1 864,0	1 407,6	75,5
Total Chapter B2-1 1: Objective 2		6 265,1	6 263,6	100,0	4 473,2	3 137,9	70,1
B2-1 2 0	Objective 3 — ESF	3 762,8	3 762,3	100,0	2 447,1	1 346,5	55,0
B2-1 2 1	Objective 3 — Completion of previous programmes	0,0	0,0	0,0	758,3	283,8	37,4
Total Chapter B2-1 2: Objective 3		3 762,8	3 762,3	100,0	3 205,4	1 630,3	50,9
B2-1 3 0	FIFG (excluding Objective 1)	178,0	173,4	97,4	112,4	37,0	32,9
B2-1 3 1	Completion of previous programmes — FIFG	0,0	0,0	0,0	20,0	9,2	46,1
B2-1 3 2	Completion of previous programmes — EAGGF-Guidance	0,0	0,0	0,0	331,1	69,4	21,0
Total Chapter B2-1 3: other structural measures (excl. Objective 1)		178,0	173,4	97,4	463,5	115,6	24,9
B2-1 4 0	Leader	329,6	271,3	82,3	132,5	82,0	61,8
B2-1 4 1	Interreg	703,7	594,3	84,5	200,9	82,9	41,3
B2-1 4 2	EQUAL	464,6	458,8	98,8	208,2	208,1	100,0
B2-1 4 3	URBAN	109,4	109,4	100,0	50,9	43,0	84,5
B2-1 4 4	Completion of previous programmes	0,0	0,0	0,0	1 314,8	1 285,4	97,8
Total Chapter B2-1 4: Community initiatives		1 607,3	1 433,8	89,2	1 907,4	1 701,4	89,2
B2-1 6 0	Innovative and technical assistance measures — EAGGF-Guidance	0,0	0,0	0,0	4,6	0,0	0,0
B2-1 6 1	Innovative and technical assistance measures — FIFG	1,1	1,1	99,9	2,2	0,8	34,2
B2-1 6 2	Innovative and technical assistance measures — ERDF	171,0	166,6	97,4	60,9	10,5	17,2
B2-1 6 3	Innovative and technical assistance measures — ESF	40,3	35,8	88,9	30,0	7,6	25,4
B2-1 6 4	Completion of previous programmes	1,4	1,2	84,3	132,0	79,0	59,8
Total Chapter B2-1 6: innovative and technical assistance measures		213,8	204,7	95,7	229,8	97,9	42,6
Total 'Structural Funds'		38 233,9	38 040,7	99,5	29 834,8	20 472,4	68,6

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THE COMMISSION'S REPLIES

Commitment appropriations: almost 100 % utilisation

3.6. The financial year 2000 was characterised by a rate of implementation of 58 % of available appropriations, and by considerable recourse to carry-overs of appropriations (8 639 million euro). In 2001, this tendency was reversed. Almost 100 % of the available appropriations were used (38 234 million euro in the case of the Structural Funds and 3 129 million euro in the case of the Cohesion Fund). Consequently, the carry-over of appropriations to the financial year 2002 (175 million euro) was appreciably lower than the appropriations carried over to the financial year 2001.

3.7. Maximum budgetary implementation was a particular concern in 2001 as, from the financial year 2001 onwards, no unused appropriation could be carried over to subsequent financial years ⁽⁴⁾. Consequently, for certain programmes ⁽⁵⁾ where commitment proved impossible during the financial year, the appropriations were used for other interventions ⁽⁶⁾. In addition, in the case of certain interventions concerned by carry-overs of appropriations from 2000 to 2001 two annual instalments were committed from the appropriations for a single financial year.

3.8. As a result of very late decisions, certain commitments had to be carried over to the following financial year (see paragraph 3.73). Others could be entered into only in the very last days of the year. For example, seven Interreg III interventions were adopted on 31 December 2001. In the case of the Cohesion Fund, the majority of the projects were approved by the Commission in December, as was the case in 2000. In fact, the approval procedure took much more than the three weeks allowed by Regulation (EC) No 116/94 (Article 10.6).

3.7. The decisions to amend the programmes were taken with the agreement of the Member State concerned. The Commission would point out that the indicative distribution of appropriations was made by Member State and not by programme. This distribution makes it possible to allocate or reallocate appropriations, the only constraint being the need to comply with the national profile.

As regards the commitment of two annual instalments from the appropriations for a single financial year, these carry-overs were decided within the framework of the Financial Regulation and relate to an instalment from the previous year added to the instalment for the current year.

3.8. Considering the late presentation of these Interreg programmes, their approval at the end of the year was satisfactory. For the Cohesion Fund projects, some proposals ready for adoption were received as late as the last quarter, although the Commission had asked the Member States to bring forward their application submission schedules as far as possible.

⁽⁴⁾ Interinstitutional agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and the improvement of the budgetary procedure (OJ C 172, 18.6.1999, p. 1).

⁽⁵⁾ In particular, Interreg and Urban to promote innovative and technical assistance measures.

⁽⁶⁾ For example, the 2001 instalments of the Greece-Italy Interreg (9,96 million euro) and Archimed (6,8 million) programmes were used temporarily for the Italy-Slovenia (1,5 million) Western Mediterranean (6,92 million) and Greece-Bulgaria (8,34 million) programmes.

THE COURT'S OBSERVATIONS

3.9. The Court also wishes to draw attention ⁽⁷⁾ once again to the consequences for the management of commitments of a system which is modelled on the annual breakdown of the appropriations specified in the financial perspectives. That means that the legal obligations entered into by the Commission are not all entered in the accounts when the interventions are decided on, but gradually, in annual tranches (see paragraph 9.14). It follows that the financing plans for each intervention must also be made compatible with the annual tranches of the financial perspectives. For this reason, some 240 financing plans for interventions for the 2000 to 2006 period had to be updated, with the administrative cost that that entails.

3.10. The result is a situation where the accounting entry is later in time than the legal obligation, just as the financing plans are not representative of actual forecasts of interventions, either by measure or globally. Moreover these forecasts are not available from other sources either.

Payment appropriations: a rate of implementation which has been falling for three years

3.11. The payment appropriations available, which totalled 29 835 million euro for the Structural Funds and 3 160 million euro for the Cohesion Fund, were used up to the extent of 69 % ⁽⁸⁾ and 63 % respectively. This rate of implementation is the lowest since 1999 and confirms the downward trend observed to date.

3.12. The low rate of implementation of the payment appropriations is explained by delays in implementing the 2000 to 2006 programmes and in presenting and settling expenditure for the previous programming

THE COMMISSION'S REPLIES

3.9. *As in previous years, the Court questions the system of commitments by annual instalments laid down in the financial provisions of the general Structural Fund Regulation. In its reply to the Court's 1999 report (paragraphs 3.21 and 3.22), the Commission already pointed to the advantages offered by commitments made in this way. As that Regulation was approved by the Council in 1999, after endorsement by the European Parliament, it will cover all the 2000 to 2006 period and commitments will have to be made by means of annual instalments during the forthcoming period in accordance with the financial perspectives laid down by the two arms of the budget authority.*

The financing plans were updated under the Interinstitutional Agreement (paragraph 17).

3.10. *The timelag between the accounting entry and the legal obligation is a direct result of the regulatory and financial framework. The progress of interventions in the field can be measured for each programme by means of monitoring indicators. The Member States take these evaluation components into account in the annual report. It must also be pointed out that the financing plans for assistance do not include financial programming at individual measure level and that these are given in the programming complements with a multiannual allocation.*

3.11 to 3.15. *In 2001 the Commission honoured virtually all the payment requests submitted to it by the Member States.*

The years 2000 and 2001 were not only the first two years of the new programming period, but also the last two years of financial implementation of the 1994 to 1999 period. In addition to an amount outstanding under the Community budget of about 10 % of the allocation for this period, at the end of 1999 there was a 'hidden' amount outstanding, consisting of the difference between the advances paid to the Member States and the expenditure actually incurred by them up to that date. The authorities at all the various levels of the Member States concentrated their efforts on completion of the programmes under the old period and were slow in launching programmes covered by the new period.

⁽⁷⁾ See, in this connection, paragraph 4.5 of Special Report No 16/98 and paragraph 3.132 of the Annual Report concerning the financial year 2000.

⁽⁸⁾ Of which almost three quarters for 2000 to 2006.

THE COURT'S OBSERVATIONS

periods. This under-implementation concerns almost all budget headings relating to the structural measures, both for the 2000 to 2006 programming period and for the completion of previous programmes.

3.13. The low utilisation of the appropriations is responsible for the cancellation of all of the unexpended balance, i.e. 10 539 million euro ⁽⁹⁾, including 1 470 million euro ⁽¹⁰⁾ carried over from the previous financial year. For this reason, the Commission decided not to carry over any appropriations to the financial year 2002 ⁽¹¹⁾.

3.14. Despite the introduction, in cooperation with the Member States, of a system for forecasting payment requests ⁽¹²⁾, the estimates of the necessary payment appropriations needed are still not very reliable. Moreover, in cases where the available information is such as to modify these estimates no account is taken of it for the purpose of updating budget forecasts (amending letter, supplementary and amending budget) ⁽¹³⁾. Under these circumstances, as in the case of commitment appropriations, budgetary estimates of payment appropriations continue to be unrelated to the process for adopting interventions and to the progress of the interventions themselves.

3.15. As regards the staggering of payments throughout the financial year, payments in respect of the Structural Funds and the Cohesion Fund made in December account for almost 30 % of the total, an appreciable increase when compared with the previous financial year (when the rate was almost 20 %). For the 2000 to 2006 programming period alone, these percentages were considerably higher, in particular for Objective 1 interventions and the Community Initiatives, where more than 40 % and 51 % of payments respectively were made in December.

⁽⁹⁾ i.e. 9 362,4 million euro (31 % of the available appropriations) for the Structural Funds and 1 176,6 million euro for the Cohesion Fund (37 % of available appropriations).

⁽¹⁰⁾ Of which almost 80 % was for the Structural Funds.

⁽¹¹⁾ The amount of 0,1 million euro in Tables 3.1 and 3.2 refers to appropriations for reuse (Article 27 of the Financial Regulation). See also the revenue and expenditure account, Volume 11, page 687.

⁽¹²⁾ The Commission's reply to paragraph 3.13 of the Annual Report concerning the financial year 1999.

⁽¹³⁾ In addition, the working documents drafted by the Commission within the framework of the preliminary draft budgets provide no indication as to how these estimates are reached.

THE COMMISSION'S REPLIES

The low utilisation referred to by the Court is also explained by a particularly wide gap between the Member States' forecasts and their implementation, while the Commission and the budget authority allocated lower appropriations than the total amount requested by the Member States.

For example, under the ERDF (with a difference of EUR 7,8 billion between forecast and implementation), just three Member States account for 84 % of this difference, and two Member States account for two-thirds of it. In the case of the Cohesion Fund (with a difference of EUR 1,7 billion between forecast and implementation), one Member State accounts for two-thirds of the difference.

The Commission did not submit any preliminary draft amending budget to avoid needlessly calling up own resources when it observed that payment appropriations were under-utilised because it relied on the Member States' forecasts, all the more so as the latter even suggested that appropriations would be insufficient.

The Commission points to the difficulty of forecasting despite the introduction of a system by which the Member States send in forecasts of their payment requests. At Member State level, the host of decentralised agencies involved comes on top of the fact that the rate of payments on the ground is subject to a considerable degree of uncertainty since they are made on the basis of expenditure statements submitted by recipients, for projects whose progress is dependent on a range of external factors. The Commission itself does not yet have historical information on the rate of payments under the new payment arrangements, which are now based on the reimbursement of actual expenditure instead of making advance payments. Consequently, it is no easy task to predict the budget implementation of payment appropriations.

The Commission will look closely into the causes of the differences between actual and forecast payments. It has requested the Member States to improve the quality of their forecasts by drawing them up programme by programme and sending them by e-mail.

To avoid a build-up of appropriations uptake at the end of the year, Regulation (EC) No 1260/1999 makes it compulsory to group payment requests together and submit them on three dates in the course of the year, the last being 31 October, but the Member States were not yet complying with this new rule in 2001.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Review of the Commission's comments on financial management

3.16. The information provided by the Commission on the analysis of the financial management is more comprehensive than in previous years but improvements in the 2001 revenue and expenditure account ⁽¹⁴⁾ compared with the objectives set are still called for. In particular, the Commission provides no information on the actual results of expenditure on the structural measures in relation to the latter's objectives either for the current period or for previous periods, whereas the Financial Regulation states that the revenue and expenditure account should supply detailed information on compliance with the principles of sound financial management ⁽¹⁵⁾. Nor, with regard to outstanding commitments in respect of periods prior to 1994, does the Commission provide figures for each type of problem which would have prevented these files from being closed (in particular concerning cases of suspension for legal reasons and the corresponding amounts).

3.17. As regards interventions for the 1994 to 1999 period, no details are provided of outstanding commitments. The Commission indicates the number of closed files which are jointly financed by the Social Fund only in the case of Objective 2 interventions for the 1994 to 1996 period, even though almost all of these interventions (72 out of 73) involve more than one Fund (ERDF-ESF).

3.18. The Commission has discontinued the 'lessons to be learnt' sections, which were a feature of the previous financial year. This is despite the fact that the structural shortcomings observed in recent years would have required much more detailed analysis with a view to suggesting at the right time improvements to be made in the future to the financial and budgetary frameworks (i.e. the financial perspectives and the procedures for drawing up estimates of appropriations) as well as the programming and management provisions contained in the regulations governing the structural measures.

3.19. It would also have been beneficial for the Commission to consider its own responsibility as regards delays in the programming procedure, shortcomings in the estimates of appropriations and the increase in transactions at the end of the financial year. Furthermore, the Commission does not provide a satisfactory

3.16. *The information referred to by the Court is not yet available for the periods 1994 to 1999 and 2000 to 2006. Nevertheless, some information is given in the annual reports on individual programmes, the annual Structural Funds report and the mid-term and ex post evaluations, and the report on the analysis of Structural Fund expenditure.*

The budget authority is regularly informed by means of these documents of the implementation, progress, results and impact of the measures taken.

3.18. *As regards the discontinuation of the 'lesson to be learnt' sections, the Commission takes the view that there is no loss of information because detailed analyses are always given in the revenue and expenditure accounts.*

3.19. *The Commission intends to submit more detailed information on appropriations forecasts and the build-up of transactions at the end of the financial year in the next revenue and expenditure accounts. The presentation of a supplementary and amending budget towards the end of the financial year can only be the exception, for example to cover*

⁽¹⁴⁾ Volume 1 of the 2001 Revenue and Expenditure Account, Analysis of the financial management.

⁽¹⁵⁾ Articles 2 and 80 of the Financial Regulation.

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explanation as to why, when it would appear already to have observed widespread non-utilisation of payment appropriations, it did not submit a preliminary draft for a supplementary and amending budget, which would have made it unnecessary to call up own resources totalling 15 000 million euro (the out-turn for the financial year).

Conclusions and recommendations

3.20. The accounting commitment is entered into long after the legal obligations have been contracted and the financing plans for the measures do not correspond to the actual forecasts for these measures (see paragraphs 3.9 and 3.10). The situation as reflected in the budgetary accounts thus continues to bear no relation to the status of the interventions.

3.21. Furthermore, the implementation of payment appropriations, which has been falling continually for three financial years now, is symptomatic of a forecasting system which is not very reliable, despite improvements to the legislative framework (see paragraphs 3.11 to 3.14).

3.22. The Court also notes an increase in transactions at the end of the year. In the case of commitments, it is Cohesion Fund projects which are concerned (see paragraph 3.8). This increase occurs across the board in the case of payment appropriations where the low level of implementation of appropriations in 2001 gives reason to fear a build-up of payment requests in the future (see paragraph 3.15).

3.23. The Court recommends that budgetary transactions should be more evenly spread out over the financial year. Such a step would provide an additional guarantee that the legislation is rigorously applied, thus ensuring that decisions are not adopted to meet very tight deadlines, at a time when the possibility of appropriations being cancelled may constitute a source of pressure.

THE COMMISSION'S REPLIES

specific needs of limited amount. At this time of the year, when the budgetary procedure for the following year is being completed, it is difficult to discuss and decide on adjustments of appropriations for the current financial year on the basis of a foreseeable under-utilisation.

3.20. *The time lag between the accounting entry and the legal obligation is a direct consequence of the regulatory and financial framework.*

3.21. *The under-utilisation is explained to a large extent by the delay in adoption of the programmes, spread out over 2000 and 2001. But it is also explained by a particularly wide gap between the Member States' forecasts and implementation. The Commission will look closely into the causes of these errors in forecasting. It has requested the Member States to improve the quality of their forecasts.*

3.22 and 3.23. *The increase in commitments in December is linked to the late adoption of decisions at the end of the year. To avoid a build-up of payments at the end of the year, Regulation (EC) No 1260/1999 makes it compulsory to group payment requests together and submit them on three dates in the course of the year, the last being 31 October, but the Member States were not yet complying with this new rule in 2001.*

THE COURT'S OBSERVATIONS

3.24. The Court also recommends that the Commission and the Member States should take appropriate action to ensure that actual requirements are more accurately reflected in budgetary forecasts.

IMPLEMENTATION OF THE PROGRAMMES

Introduction

3.25. The management of the structural measures is divided up between various programming periods which take the financial perspectives as their frame of reference. In addition, modifications have been made to the regulatory framework between the various periods.

3.26. The Court has carried out checks in respect of the new 2000 to 2006 programming period and will report on its findings in greater detail at a later date. However, it considers it beneficial to illustrate some of its observations in the present context.

Periods up to 1999: delays in closure and increases in requests for final payments

3.27. At the end of 2001, the amounts outstanding for the periods prior to 1994 totalled 532 million euro for all of the Structural Funds, i.e. approximately half the total as at 31 December 2000.

3.28. Delays in closure stem mainly from the fact that the Commission had not taken the necessary measures at the right time in response to its own findings and those of the Court. As a result, when the interventions were closed, it found itself faced, sometimes ten years after the checks, with many problems, the resolution of which may involve protracted discussions with the Member States. Examples include the need to provide fuller supporting documentation, to establish any errors or irregularities or precisely to identify transactions which have been suspended for legal reasons (see also paragraphs 3.48 to 3.52).

THE COMMISSION'S REPLIES

3.24. *Under the partnership and the principle of subsidiarity, the Member States are responsible for monitoring and managing their programmes. Expenditure cannot always be scheduled by the Commission since the Member States are given a great deal of latitude in their management. Nevertheless, the Commission is endeavouring to improve its forecasting (see reply to paragraphs 3.11 to 3.15).*

3.27 and 3.28. *Clearly measurable progress was made on the closure of files relating to periods prior to 1994. The Commission has assigned the major resources required for this task.*

As at 30 June 2002 the amounts outstanding totalled EUR 370 million, i.e. 0,6 % of the budget allocation for the period 1989 to 1993. By the end of 2002 this should be reduced to a small number of files which cannot be closed until legal procedures have been completed.

THE COURT'S OBSERVATIONS

3.29. As regards the 1994 to 1999 programming period, the amounts outstanding totalled 16 707 million euro at the end of the financial year. As the expenditure was eligible until 31 December 2001 ⁽¹⁶⁾, all interventions should, under normal circumstances, be closed in 2002 or 2003.

2000 to 2006 period: improvements which are limited when compared with the objectives

3.30. One of the main objectives of the new legislative framework ⁽¹⁷⁾ was to speed up and simplify programming procedures. However, the proper programming work, which took place in several successive stages ⁽¹⁸⁾, proved to be especially cumbersome and difficult to manage. It was typified by a lack of clarity in the division of responsibilities between the Commission and the Member States and by the absence of a precise pre-established programming framework. Long negotiations between the Member States and the Commission proved to be necessary ⁽¹⁹⁾ but in spite of that the

THE COMMISSION'S REPLIES

3.29. Starting from an amount outstanding for 1994 to 1999 of EUR 41,2 billion at the end of 1999, the Commission's efforts led to a reduction by almost EUR 17 billion at the end of 2001. In line with the regulations and the deadlines laid down, it is to be expected that approximately 50 % of this amount outstanding will be settled in 2002, followed by 45 % in 2003, leaving 5 % for cases where projects are suspended for legal reasons.

3.30. Programming was complicated by the added requirements designed to ensure that assistance measures comply with the rules and to improve their quality. Thus, as a precondition for programme approval, the Commission insisted on the lists and procedures required by the Natura 2000 Directives. It also had a list of the State aid schemes to be used together with information on the measures taken to check for any overlap in funding sources inserted in each programme. In addition to these regulatory requirements, the focus was on greater quality in programming, for example by means of closer incorporation of the results of ex ante evaluation, taking account of the Commission's horizontal priorities (employment, sustainable development, innovation and the information society, and equal opportunities) and, in the case of the ESF, of the European Employment Strategy, close attention to defining monitoring indicators backed up by quantified objectives, and establishing criteria for allocating the performance reserve. The Commission also paid close attention to the reliability of the structures introduced to manage assistance operations.

Of course, the large number of matters to be negotiated and their complexity represented a major workload for all the partners involved, including the Commission, despite its efforts to put it into a manageable framework. Thus, to help the Member States, the Commission published guidelines on the content of assistance measures, a vademecum on programming procedures, and working papers covering in particular ex ante evaluation, indicators and the performance reserve. It also drew up, for use by its own staff, guides on ESF programming, negotiating briefs, etc.

⁽¹⁶⁾ This deadline does not apply to 73 interventions concerning the 1994 to 1996 subperiod of Objective 2. Of these 73 interventions, nine had not been closed as of 31 December 2001 in the area of the ESF (35,2 million euro) and 44 were yet to be closed in the area of the ERDF (540,5 million euro).

⁽¹⁷⁾ Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds (OJ L 161 du 26.6.1999, p. 1). The new legislative framework for the 2000 to 2006 period stipulates, for each intervention, that:

- total Community assistance shall be broken down by year, on the basis of financing plans which are compatible with the applicable financial perspectives,
- the first commitment shall be made when the corresponding decision is adopted,
- subsequent instalments shall be committed automatically on 30 April of each year.

⁽¹⁸⁾ Plans, Community support framework, single programming document, operational programmes and additional programming.

⁽¹⁹⁾ In its opinion No 10/98 on certain proposals for regulations in the context of Agenda 2000 (the part concerning the Structural Funds, paragraphs 4.1 to 4.7, the programming procedure), the Court questioned the actual usefulness of the various programming stages, in which only the last document, the programming supplement, implements the strategy and main priorities of the intervention and contains details about the measures.

THE COURT'S OBSERVATIONS

operational framework for the intervention was still not completely defined.

3.31. The Commission specified its role in checking the compliance of additional programming only in October 2001. Consequently, it was possible to release intermediate payments to the Member States, but at the expense of an agreement restricting the Commission's checks to the form and consistency of the financing plans. In the end, instead of simplifying the programming of the Structural Funds, a new procedure was created which accentuated delays and led to problems of interpretation. The cumbersome nature of the procedures was also confirmed by the review of interventions which also proved to be drawn out.

3.32. In addition to these problems with programming procedures, the legislation governing expenditure proved to be complex, and uncertainty persisted as regards the interpretation of a number of basic questions such as the eligibility of certain items of expenditure, the rates at which revenue-yielding investments were jointly financed or the definition of the final beneficiary (see paragraphs 3.74 to 3.78).

THE COMMISSION'S REPLIES

At a practical level, a lack of clarity in the division of responsibilities became apparent when dealing with programming complements (see following paragraph). Otherwise, the negotiations took place on the basis of partnership. Without going into the details of the specific measures taken, the limit on the duration of negotiations at strategic level is laid down in the rules, although compliance proved difficult.

3.31. *The Regulation provides for programming complements to be forwarded to the Commission for information, but also as a precondition for meeting interim payment requests. The Commission recognises that it took some time to find the solution described by the Court in order to resolve the situation without creating legal uncertainty for subsequent implementation of the programmes.*

It is too early to draw conclusions as to whether the Commission's procedures for programming complements are more straightforward or not. The scope for amending programmes afforded by this new instrument should make it possible to speed up the adjustment of assistance measures to actual conditions on the ground.

3.32. *Commission Regulation (EC) No 1685/2000 of 28 July 2000 clarifies the eligibility of types of expenditure for which a common EU treatment is necessary. The sources of the expenditure and the timing of its inclusion in intermediate declarations of expenditure to the Commission for reimbursement were discussed with Member States in the Structural Fund management and advisory committees in 2001. In September 2001 the Commission sent a guidance note on these issues to the Member States. The guidance note makes it clear that payments by 'final beneficiaries' that administer aid schemes or multi-beneficiary programmes must be supported by expenditure on projects on the ground before the expenditure is declared to the Commission. This is to avoid the need to recover advance payments of aid to project promoters that are not used. In July 2002 DG REGIO presented a guidance note on the financing of revenue-generating infrastructure projects to the Committee on the Development and Conversion of Regions. This note, too, will be finalised shortly and sent to the Member States.*

THE COURT'S OBSERVATIONS

3.33. The establishment of the areas eligible for Objective 2 interventions is a specific example of difficulties in getting the programming phase off the ground. The list belatedly adopted by the Commission covers areas which do not necessarily correspond to the statistical or administrative categorisation of the regions concerned. The result was eligible areas which were artificial and very far away from one other, which led to practical difficulties in defining the measures. A further difficulty is geographical overlapping: Objective 2 interventions overlap with those of Objective 3, which led to subsequent delays in the definition and management of measures on the ground.

3.34. These various reasons explain the general and substantial exceeding of the maximum period laid down in the regulations for adopting a series of interventions, almost all of which could not be approved by the Commission until the end of the financial year 2001. What is more, it was during this same financial year that about a third of the Objective 1 interventions were approved, along with almost all the Objective 2 interventions and the first Community Initiatives ⁽²⁰⁾.

THE COMMISSION'S REPLIES

3.33. *The procedures laid down in the Regulation for determining which areas are eligible under Objective 2 consist of three stages: first, on the basis of the criteria laid down in the Regulation, the Commission establishes population ceilings. Then the Member State proposes a list of the national areas meeting the criteria, which are also defined in the Regulation. Lastly, the Commission draws up the final list in close cooperation with the Member State. This zoning method gives the Member States greater flexibility, in accordance with the principle of subsidiarity. But, coming on top of the complexity of negotiations on the content of programmes, it made programming for Objective 2 longer than desirable.*

The Commission already pointed to the fragmented nature of zoning for Objective 2 in its second report on economic and social cohesion. It also referred to the possibility of giving the Member States greater responsibility for Objective 2 zoning in future.

The side-by-side implementation of Objective 3 programmes in areas covered by Objective 2 is provided for in the Regulation, which requires integrated programmes covering all Structural Fund assistance only for Objective 1 regions.

3.34. *The amount of work to be covered in the negotiations meant that it was difficult to meet the five-month deadline. The regrettable overruns, especially for Objectives 1 and 2, were to some extent the price to be paid for improved quality in programming.*

The adoption of Community Initiative programmes in 2000 was practically ruled out owing to the obligation under the Regulation to consult Parliament and the Structural Fund committees on guidelines before launching the programming process. Given the preliminary stages required, the time taken for programming was not excessively long.

⁽²⁰⁾ The interventions adopted concern Interreg (54 interventions), Urban (70 interventions), Leader (56 interventions), and Equal (17 interventions).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Existing information on the Structural Funds: a lack of overall vision

3.35. In the past, the Court pointed out that it was difficult to monitor the implementation of the Structural Funds, owing to a lack of reliable, up-to-date information, both physical and financial, and at all levels of management (Community, national and regional) ⁽²¹⁾. Furthermore, it was this observation which led the Council, within the framework of the 1999 Discharge, to ask for a solution to be found to this problem ⁽²²⁾.

3.36. As regards financial information, the latest overall information available for the 1994 to 1999 period still concerns the implementation of the budget as at 31 December 1999 ⁽²³⁾. The 2000 annual report on the Structural Funds ⁽²⁴⁾ gives no figures for the period 1994 to 1999. All it contains are a few sporadic comments on the implementation of the interventions in the Member States. In the case of the 2000 to 2006 period, the 2000 Annual Reports restricts itself to providing information on the implementation of commitments and payments.

3.35. For earlier periods (before 2000) there was no common database for the Structural Funds as a whole.

However, at the end of 2001 a common database called SFC (Structural Funds Common System), became operational and was used by the four DGs responsible for the Structural Funds. It contains the tables in the Structural Funds vademecum with a breakdown of resources by Objective, Fund, Member State and Community Support Framework (CSF).

Also, in Regulation (EC) No 438/2001 the Commission has laid down what information the Member States must keep on individual operations.

As regards the actual progress of assistance measures on the ground, the annual reports will provide information on the physical indicators used.

3.36. Concerning the 1994 to 1999 period, since almost all the commitment appropriations and 75 % of the payment appropriations had been used by the end of 1999, the Commission does not think it necessary to provide detailed figures on this period. Annexed to the 2000 annual report covering the 2000 to 2006 period are details of financial implementation by Objective, Member State and Funds, plus the budget implementation for the year in commitment appropriations and payment appropriations (Annex 3) for the three Objectives, the Financial Instrument for Fisheries Guidance (FIFG) outside Objective 1, the Community Initiatives, and innovative measures and technical assistance.

⁽²¹⁾ See paragraphs 2.5, 4.1 and 4.7 of Special Report No 16/98 and paragraphs 3.25 to 3.27 of the Annual Report concerning the financial year 1999.

⁽²²⁾ Chapter 3, paragraph 2, of the Council Recommendation of 12 March 2001 on the discharge to be granted to the Commission in respect of the implementation of the general budget of the European Union for the financial year 1999.

⁽²³⁾ The Commission's 11th Annual Report on the Structural Funds (1999) (COM (2000) 698 final of 13.11.2000).

⁽²⁴⁾ 12th Annual Report on the Structural Funds (2000), (COM(2001) 539 final of 3.10.2001).

THE COURT'S OBSERVATIONS

3.37. As regards non-budgetary information, several initiatives to improve the situation have been taken by the Commission and the Member States in the 2000 to 2006⁽²⁵⁾ programmes. However, some significant improvements have still to be made. Consequently, at the end of 2001 there was still little knowledge of the actual progress of interventions on the ground, and the nature and results of jointly-financed projects. The dividing up of the management of structural measures amongst various Commission departments meant that it was still difficult to arrive at an understanding of the overall situation. Moreover, the common database for the Structural Funds, which is intended to make electronic exchanges of information possible, was not operational when the programmes were being negotiated. At the end of 2001 some information in particular concerning the IFOP, was still missing.

3.38. As regards the interventions themselves, the Annual Reports submitted by the Member States are the principal monitoring tool⁽²⁶⁾. Improvements have been planned for the new 2000 to 2006 period. These reports must now be forwarded each year on 30 June. As they are no longer linked to the closure of each annual tranche this will, in principle, ensure that information is provided on a regular basis. The situation during the 1999 programming year, for which the reports will not be available till the moment of closure, in 2002 or 2003, should no longer occur. However, it must be observed that the majority of reports for 2000 were submitted after the deadlines had expired.

3.39. The new legislation also requires that these reports should compare, *inter alia*, the progress of the main priorities and measures for each of the funds, with their specific objectives. However, for the first full year of implementation of the majority of the interventions, the Commission reached agreement with the Member States regarding the provision of a slimmed-down version of these reports, including an exemption from the requirement to quantify physical, result-based and impact indicators.

⁽²⁵⁾ In this connection, the Commission has published lists of specimen indicators, divided up by area of intervention. It has also defined the nature of the information to be made available to it and has created computerised systems for exchanging data. The Member States have started to develop new computer systems to improve intervention management and to meet the new legislative requirements.

⁽²⁶⁾ Article 37 of Regulation (EC) No 1260/1999.

THE COMMISSION'S REPLIES

3.37. *The Commission would refer to its reply to paragraph 3.35. As regards non-budgetary information, the 2000 report concentrated on a presentation of the implementation of programming for 2000 to 2006.*

Further information on the FIG will be added in 2002.

3.38. *The annual implementation reports for 2000 should have been forwarded to the Commission by 30 June 2001 at the latest. There were delays in sending these in some Member States, due to the fact that, for most of the new programmes, 2000 was the year in which they were adopted and the monitoring committees set up, leading to a low rate of implementation on the ground.*

3.39. *It was not possible to assess the quality of this information on the basis of the 2000 implementation reports available in 2001. This is because these initial reports do not always quantify the physical indicators, since they cover the period in which the assistance measures were launched and the management systems set up at national and regional level. Although eligibility of expenditure is retroactive to the date the plans are submitted, the late adoption of the assistance measures and the programming complements defining the indicators made it difficult for the managing authorities to collect physical data in 2000. The 2001 annual reports should rectify this.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Conclusions and recommendations

3.40. Contrary to its objective, the programming of the 2000 to 2006 period has not been characterised by swifter and simpler procedures than in the past. Considerable delays were noted at all levels.

3.41. This situation is explained in general by persistent uncertainty about the responsibilities of the Commission and the Member States and by legislation which is still complex in terms of the programming, management and booking of expenditure (see paragraphs 3.30 to 3.34). The Court therefore recommends that the necessary measures should be taken so as to prepare in due course an appropriate framework for future programmes, in particular in the context of the future enlargement.

3.42. Although the budgetary data do not make it possible to assess the actual situation on the ground, the question may nevertheless be asked as to whether the low budgetary implementation which has been the case for three years now is indicative of delays in implementation. However, reliable information on the progress of interventions is still unavailable (see paragraphs 3.35 to 3.39).

3.43. The Court reiterates the requirement for up-to-date information on interventions on the ground and for an overall vision of the management of the structural measures. To this end, the monitoring resources for which the regulations already provide should be employed. The Commission would thus also be able to improve on the information provided in the documents on budgetary implementation (see paragraphs 3.16 to 3.19).

3.44. The fact that problems identified by the checks are still unresolved at the time of closure several years later is one of the reasons for the delay in settling payments (see paragraph 3.28).

3.40. *The Commission would refer to its replies to the Court's observations in paragraphs 3.30 to 3.34.*

3.41. *In addition to its replies to paragraphs 3.30 to 3.34, the Commission refers to Regulation (EC) No 438/2001, which clarifies the requirements to be met by management and control systems.*

On the Commission's initiative, the simplification of future programming procedures is currently under review (see also the reply to paragraph 3.34). The Commission hopes that the timetable for adoption of the texts by the European Parliament and the Council will allow the programmes to be negotiated before the beginning of the period in which they are scheduled to be implemented. The pre-accession instruments are currently preparing the accession countries for programming and managing assistance under the Structural Funds and Cohesion Fund.

3.42. *The Commission would refer to its replies to paragraphs 3.30 to 3.34. The low rate of payments in 2000 and 2001 for assistance measures covered by the 2000 to 2006 period is due mainly to their late start. For the programmes for which commitments were made in 2000, the Commission will have exact information on the implementation rate at the beginning of 2003, after the rule of automatic decommitment in year $n + 2$ is applied for the first time.*

3.43. *The Commission would refer to the monitoring instruments mentioned in its replies to paragraphs 3.35 to 3.39.*

3.44 and 3.45. *Clearly measurable progress was made on the closure of files relating to periods prior to 1994. The Commission has assigned the major resources required for this task (see reply to paragraphs 3.27 and 3.28).*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

3.45. The Commission should take the necessary measures in due course in the light of its own findings and of those of the Court. This would obviate the need to resolve problems likely to entail protracted discussions with the Member States and would also make it possible, where appropriate, to provide all of the Member States with useful information.

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

3.46. In 2001 the Court continued its evaluation of the procedures for the closure of structural measures assistance and of the Member States' control systems for assistance from the period 1994 to 1999⁽²⁷⁾. A review of the management and control systems for the period 2000 to 2006⁽²⁸⁾ was initiated. The Court also examined the legality and regularity of individual commitment and payment transactions at the Commission⁽²⁹⁾. A selection⁽³⁰⁾ of interim payments⁽³¹⁾ and closures⁽³²⁾ was audited in the Member States.

⁽²⁷⁾ Commission Regulation (EC) No 2064/97 of 15 October 1997 establishing detailed arrangements for the implementation of Council Regulation (EEC) No 4253/88 as regards the financial control by Member States of operations co-financed by the Structural Funds (OJ L 290, 23.10.1997, p. 1).

⁽²⁸⁾ Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds (OJ L 63, 3.3.2001, p. 21).

⁽²⁹⁾ The samples for the Commission comprised 91 commitments and 146 payments of the year, as well as 213 earlier commitments still outstanding at the end of 2001.

⁽³⁰⁾ The transactions examined on the spot comprise:

- 13 interim payments for the period 1994 to 1999 in six Member States (France, Germany, Italy, Portugal, Spain and the United Kingdom),
- six closed measures in five Member States (Denmark, Germany, Ireland, Luxembourg and Spain),
- 12 interim payments for the period 2000 to 2006 in nine Member States (Austria, Belgium, Finland, France, Germany, Greece, Italy, Portugal and Spain).

⁽³¹⁾ Interim payments for the period 1994 to 1999, see paragraph 3.59.
Interim payments for the period 2000 to 2006 see paragraph 3.74.

⁽³²⁾ Closures: interventions for which the final balance has already been the subject of a payment or a recovery order.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

3.47. The observations concerning the reliability of the Community accounts and the reform of internal control at the Commission, as well as the general observations on the legality and regularity of the transactions, are set out in Chapter 9 of this Report. The specific observations on the systems examined and the legality and regularity of the structural measure operations that depend on these systems are set out below.

*Periods before 1994***Closure procedures still inappropriate**

3.48. The closure procedures again applied in 2001 did not always allow reasonable assurance of the legality and regularity of the expenditure presented for any given form of assistance. The procedures for examining final payment requests still took the form of inter-departmental consultations, and respective responsibilities had not been amended since the previous period. The primary aim of these procedures is to ascertain whether anomalies detected during any previous on-the-spot checks have been resolved. The follow-up of such audit observations continued to rely on various databases that had been set up without any coordination as the unified database announced by the Commission could not be operational before 2002⁽³³⁾. As in the past, the Commission did not subject the interventions to be closed to random sampling or risk analysis in order to carry out more thorough checks.

3.49. The Court's audits of 15 interventions closed in 2001 (three ERDF, eleven ESF and one EAGGF-Guidance) demonstrated the real risk associated with the insufficiency of specific checks and regular monitoring by the Commission and confirmed previous observations on this matter.

3.48. *The aim of the Commission is to have reasonable assurance at closure with regard to the expenditure declared for co-financing, and it has worked to establish procedures which will achieve this objective for the closure of the 1994 to 1999 programmes which will take place from 2002 onward. It is harder to attain the same level of assurance for the pre-1994 programmes because the legal requirements on the Member States were less rigorous and no independent declaration of validity was required. The Commission considers nevertheless that it would have been inappropriate to modify the allocation of responsibilities for closure. It is correct that there were few on-the-spot controls of pre-1994 programmes in 2001. In fixing priorities for its audit activities, the Commission has focused its efforts in particular on the preparation for closure of the 1994 to 1999 programming period (thus taking account of comments made by the Court concerning the need for assessment of the application of Regulation (EC) No 2064/97 in the annual report concerning the financial year 2000 paragraphs 3.47 and 3.56) and on the systems put in place for management and control for the 2000 to 2006 programming period. The new application (Sysaudit) for planning and follow-up of Commission audits for the Structural Funds is currently at the test stage and will be in use shortly.*

3.49. *Follow-up of many of the cases has been complicated by the particular circumstances of the dossiers.*

⁽³³⁾ See Annual Report 2000, Commission's reply to paragraph 3.70.

THE COURT'S OBSERVATIONS

3.50. This insufficiency in terms of monitoring is illustrated by the examination of 11 ESF files (Portugal) most of which had been suspended for a long time on grounds of a presumed irregularity (Article 7 of Decision 83/673/EEC of 22 December 1983). However, in nine cases all the information required for closure of the measures and, more specifically, cancellation of the unused amount, had already been available to the Member State or the Commission one or two years previously. In the case concerning the EAGGF-Guidance⁽³⁴⁾, closure took place three years after the information needed had been received by the Commission, in spite of a decision of May 1998 ordering the closure of the OP with immediate effect.

3.51. The checks carried out by the Commission while programmes are in progress are not systematically exploited. In the same EAGGF-Guidance case the Commission carried out an audit on the spot in 1996, but it neither prepared a mission report nor sent any conclusions to the Member State. For one ERDF SPD⁽³⁵⁾ on-the-spot audit by the Commission in 1995, only part of the findings was forwarded to the Member State in 1997. In both these cases the absence of any analysis of the findings or, where relevant, of the Member State's comments (ERDF SPD), made it impossible for them to be taken into account in the calculation of the final contribution from the Funds.

THE COMMISSION'S REPLIES

3.50. *In the ESF cases, the delays in processing highlighted by the Court result from the following circumstances:*

- *major timelags have been observed between completion of the procedures and notification of this fact to the Commission by the relevant national authorities,*
- *the consultations which must take place before modification of certain decisions on participation in Community funds, as a result of findings of investigations communicated to the Commission, were held up by the complexity of the cases involving a large number of bodies (entities) or by the fact that the same entity was involved in separate cases.*

The closure of the operational programme relating to EAGGF-Guidance took place after the Commission had examined the information necessary to calculate the exact amount of financial corrections regarding all programmes managed by the same administration.

3.51. *The Commission agrees that for the EAGGF-Guidance case no formal mission report had been drafted. This case should be considered an isolated one.*

For the ERDF SPD mentioned, all the observations considered relevant, following consultations with the various departments, were forwarded to the French authorities.

The Commission deducted from the amounts declared by the French authorities all expenditure found not to be eligible as a result of the audit concerned.

The audit file contained no traces of an analysis of the Member State's replies. The Commission will take steps to improve documentation on audit follow-up in future.

⁽³⁴⁾ Regional OP 92. DE.06.016 Saxony.

⁽³⁵⁾ SPD Objective 1 Guyana 1990 to 1993.

THE COURT'S OBSERVATIONS

3.52. Expenditure declarations and progress reports ⁽³⁶⁾ do not always contain sufficient information. For the EAGGF-Guidance OP, as a final report, the regional authorities only submitted a table summarising the payments made to recipients. In the case of the ERDF, the progress reports did not always show clearly the amounts actually paid to final beneficiaries. In the case of the ERDF SPD already mentioned the Commission cleared the balance without checking whether, in the case in point, the modulation of the aid rates led to over-funding in the Member State's favour. Although it is not formally required by the regulations, these reports should also contain more information, such as details of checks carried out, to provide assurance on the legality and regularity of the expenditure declared.

Automatic cancellation rarely applied

3.53. At the end of 2001 there were still 549 files open, representing more than 532,5 million euro of uncleared commitments (i.e. 119 ERDF commitments totalling 377,1 million euro, 380 ESF to a total of 117,3 million euro, 34 EAGGF-Guidance to a total of 31,4 million euro, 16 FIFG to a total of 6,7 million euro).

3.54. Regulation (EC) No 1260/99 provided for the automatic decommitment, by 30 September 2001 at the latest, of the sums corresponding to any intervention approved before 1994 in respect of which no application for final payment had been received by 31 March 2001 (excluding operations or programmes that have been suspended because of legal proceedings). The Commission had undertaken only four automatic decommitments.

THE COMMISSION'S REPLIES

3.52. Council Regulation (EEC) No 4253/88 does not specify the precise information which has to be contained in the reports on implementation, but for the final reports for the 1994 to 1999 period, the Commission has established a guidance document to ensure that the necessary information will be included. In addition, the guidelines on the closure of the 1994-99 programmes specifically require information on the amounts actually transferred to final beneficiaries. Finally, under Article 8 of Regulation (EC) No 2064/97, information on the checks carried out will have to be given as part of the closure statements. The final report for the operational programme relating to EAGGF-Guidance has been submitted by the Member State according to Article 2 and Annex II of Regulation (EC) No 1844/94 of 27 July 1994, specifying detailed rules for operational programmes under Regulation (EEC) No 866/90. The Commission considers that the report has been presented in accordance with the conditions of the applicable legislation.

As regards the comment on the balance paid to the Member State for the ERDF SPD, it was calculated on the basis of the internal rules applied to this period.

3.53 to 3.55. The Commission is endeavouring to close the files for periods before 1994 as quickly as possible, bearing in mind specific difficulties in a majority of cases, such as pending court proceedings or suspensions on account of a presumed irregularity.

⁽³⁶⁾ Required by Article 25(1) of Council Regulation (EEC) No 4253/88.

THE COURT'S OBSERVATIONS

3.55. The Court examined a sample of 140 commitments that were still open at the end of 2001 and found that 24 files should have been decommitted automatically; in addition, the Commission was unable to provide seven files (four ERDF and three ESF). On that basis, the Court estimates that 11 % of the 532,5 million euro of commitments still open at 31 December should have been decommitted automatically as at 30 September 2001 (see paragraph 9.34).

THE COMMISSION'S REPLIES

3.55. *The cases of automatic decommitment identified by the Court for the ERDF comprise four files that were not provided and five other files. Of the four files not provided, for which the commitments outstanding add up to EUR 4.2 million, two relate to technical assistance contracts, one to an integrated Mediterranean programme and one to a transitional support project. For three of the five files provided, the Member States had indeed failed to apply for final payment before 31 March 2001 and did not refer to cases of suspension for legal reasons. The Commission is in the process of analysing the documents provided subsequently by the Member States with a view to closure in accordance with the legislation. As regards the other two files, the Commission considers that the requests for final payment from the Member States were received before 31 March 2001, even though in one case the request was not accompanied by the final report and in the other it was subsequently amended by the Member State. Automatic decommitment can therefore not be applied.*

As regards the ESF, the six cases identified by the Court are being resolved.

For one of the two commitments of DG FISH identified by the Court, the payment request reached the Commission before 31 March 2001. In the other case, in view of the exchange of correspondence between the recipient and the Commission with a view to determining the amount to be paid, the Commission decided not to decommit the balance at 30 September 2001.

*Intervention for the period 1994 to 1999***Progress still to be made in control arrangements**

3.56. Special Report No 10/2001⁽³⁷⁾ and the 2000 DAS⁽³⁸⁾ discussed the implementation of Regulation (EC) No 2064/97⁽³⁹⁾. In spite of the Commission's and the Member States' efforts, the main points that emerged were:

3.56. *The Commission would point out that from the adoption of the Regulation onward, it has provided detailed guidance on its key requirements, most notably in the Structural Funds Audit Manual, and has responded systematically to questions of interpretation. Whilst the implementation*

⁽³⁷⁾ Special Report No 10/2001 on the financial control of the Structural Funds—Regulations (EC) No 2064/97 and (EC) No 1681/94 of the Commission.

⁽³⁸⁾ Annual Report 2000, paragraph 3.44 to 3.56.

⁽³⁹⁾ Regulation (EC) No 2064/97 provides that Member States are to verify the effectiveness of the management and control systems in place and verify selectively, on the basis of risk analysis, expenditure declarations made at the various levels concerned. The on-the-spot controls, which are carried out before the closure of each form of assistance, must cover at least 5 % of the total eligible expenditure and a representative sample of the projects or actions approved.

THE COURT'S OBSERVATIONS

- (a) the Commission's evaluation of Member States' implementation of the Regulation was limited;
- (b) problems of interpretation and the absence of clear guidelines from the Commission, both of which are necessary for effective control of interventions;
- (c) untimely and fragmented implementation by the Member States.

3.57. The audits carried out by the Court as part of the 2001 DAS in respect of 10 interventions spread over six Member States (Germany, Spain, France, Italy, Portugal and the United Kingdom) showed that the implementation of Regulation (EC) 2064/97 in the Member States had started to improve, though substantial progress was still necessary. The Commission carried out a series of on-the-spot visits, mostly for the ERDF. The results of these checks, which confirmed the Court's findings, were notified to the Member States concerned, along with recommendations. They were set out in a working document, submitted in September 2001. One of the aims of the document was to clarify which years should be audited, how the samples should be selected, definition of the expenditure audited, and the content of reports. In addition, DG REGIO coordinated the various Commission departments as regards the Regulation, even if some differences existed in the approach to the audits.

THE COMMISSION'S REPLIES

of the Regulation has been seriously delayed in a small number of Member States, and there are instances of incorrect application of certain provisions, many Member States have made serious and effective efforts to establish control systems which comply with the principal provisions laid down. Whilst the assessment of the application of the Regulation up to 2000 was carried out mainly on the basis of the reports provided by the Member States and in annual coordination meetings, the Commission has subsequently carried out detailed systems audits in all the Member States.

3.57. *All the Structural Funds services have focused their audit efforts on the national systems required under Regulation (EC) No 2064/97. The work has been coordinated by DG REGIO with the other Structural Funds services throughout the year, and the methodology established for the audit enquiry for the ERDF has been largely followed by the other services. For the ERDF, 25 audit missions were carried out; for the ESF, 11; for EAGGF Guidance, 14 during the second semester and 13 further missions on the same subject during the first semester 2002; and for FIFG, five audit missions were carried out. The results of these audits together with recommendations were set out in reports communicated to the Member States. In some cases, letters were also sent to Member States to notify them immediately of urgent findings. In many cases the weaknesses identified were similar to those previously found by the Court. On the basis of interim findings from the audit enquiry, an information note covering 11 different questions relating to the application of Regulation (EC) No 2064/97 was presented in September 2001 to the Committee for the Development and Conversion of the Regions, and to the other Structural Funds Committees. From the follow-up of its audit work the Commission has established that Member States have made significant efforts to follow recommendations and to correct errors in the application of the Regulation where they have occurred. This is for example the case, as regards ERDF, for certain regions of two Member States referred to by the Court (Italy and Germany).*

THE COURT'S OBSERVATIONS

3.58. The impact of these initiatives still has to be determined, especially as regards the resolution of the significant problems that remain (e.g. the definition of audited expenditure, composition of samples, risk analysis, and the low coverage of the expenditure for years 1994 to 1997). If these weaknesses are not corrected rapidly there is a risk of delays arising and of errors not being detected when interventions are finally closed, which should be from mid-2002 onwards.

Persistent errors in interim payments

3.59. The Court's audits of 13 payments in the same six Member States (see paragraph 3.57) indicated the persistence of errors (nine of the payments contained errors) in the declarations that give rise to interim payments for the 1994 to 1999 measures. For the main part the substantial errors of legality/regularity directly affecting the totals for the underlying transactions are at final beneficiary level. The most frequent errors affecting the eligibility of expenditure are of the same kind as those found previously, namely, actions unrelated to the programme concerned⁽⁴⁰⁾, revenue generated by projects not included in the accounts⁽⁴¹⁾, estimated amounts not actually incurred⁽⁴²⁾, failure to comply with a job-creation clause⁽⁴³⁾ and expenditure without supporting documents⁽⁴⁴⁾.

3.60. The errors of a formal nature are also similar to those of previous years, namely, at Commission level, non-observance of the two month deadline for making payment following receipt of an acceptable application, and at beneficiary level, the submission of lump-sum expenditure without adequate supporting documents⁽⁴⁵⁾, inadequate information on the purchase price of a plot of land⁽⁴⁶⁾ and incomplete documentation in respect of expenditure⁽⁴⁷⁾.

THE COMMISSION'S REPLIES

3.58. *The results of the Commission's audit activity are already apparent, and additional control work has been carried out in Member States as a result of recommendations made in order to ensure that there will be an adequate basis for closure and in particular for the closure statement by the independent body under Article 8 of the Regulation. Following reception of the request for closure, the Commission will verify that material shortcomings identified in its audit work have been satisfactorily dealt with prior to payment of the final balance.*

3.59. *Given the date when the Commission received the information from the Court on the individual cases, it has not been able to obtain a full set of replies from the Member States. It will analyse all the replies and undertakes to make any necessary corrections.*

For one of the cases cited, the Member State and the Commission do not agree with the Court that the job-creation clause was not complied with, since it did not apply to the project concerned, which had exceptionally moved from the previous programming period to the 1997 to 1999 period, with a specific allocation of funds. All the other projects under the measure audited by the Court complied with the job-creation clause.

3.60. *The Commission recognises that some delays in payments led to the two-month deadline being exceeded. The reason for this was, in general, the Commission departments' exceptional workload during the period of overlap between the closure of the 1994 to 1999 period and the start of the 2000 to 2006 period.*

The Commission carried out an audit of the project concerning which the Court identified a lack of information on the purchase of a plot of land. The Court's comments will be followed up in the context of this audit.

The Member States' replies in respect of the other formal errors listed by the Court will be analysed as soon as they are received.

⁽⁴⁰⁾ SPD Objective 2 Industrial South Wales 1997 to 1999, OP Objective 2 Cataluña 1997 to 1999.

⁽⁴¹⁾ SPD Objective 2 Greater Manchester 1997 to 1999, OP Objective 1 Infrastrutture Aeroportuali 1996 to 1999, OP Objective 2 Cataluña 1997 to 1999.

⁽⁴²⁾ SPD Objective 2 North Rhine-Westfalia 1997 to 1999, OP Objective 1 Infrastrutture Aeroportuali 1996 to 1999, SPD Objective 5b Poitou-Charentes 1994 to 1999.

⁽⁴³⁾ SPD Objective 2 Greater Manchester 1997 to 1999.

⁽⁴⁴⁾ OP Objective 2 Cataluña 1997 to 1999, SPD Objective 2 Industrial South Wales 1997 to 1999.

⁽⁴⁵⁾ SPD Objective 2 Northern Ireland 1997 to 1999.

⁽⁴⁶⁾ CF Portugal, Setúbal, water treatment.

⁽⁴⁷⁾ OP Objective 1 Infrastrutture Aeroportuali 1996 to 1999.

THE COURT'S OBSERVATIONS

3.61. The persistence of the anomalies found in declarations in support of interim payment requests demonstrates that there is still a significant risk of their affecting the Community budget, due either to premature payment of advances or, in view of the weakness of the checks made at the closure, payment of excessive final payments ⁽⁴⁸⁾.

Overpayments on closure (Objective 2 1994 to 1996 and Cohesion Fund)

3.62. In 2001 the Commission finally closed 53 1994 to 1996 Objective 2 interventions (16 ERDF and 37 ESF). At the end of 2001 there were still 53 interventions open, representing 575 million euro of commitments outstanding (including 44 ERDF for a total of 540 million euro and nine ESF for a total of 35 million euro). The closure procedures applied to 1994 to 1996 Objective 2 measures and Cohesion Fund projects are substantially identical to those for the preceding period. The observations in paragraph 3.48 thus apply equally to this category.

THE COMMISSION'S REPLIES

3.61. *With regard to interim payments, as the Commission has previously indicated, any impact on the Community budget would be limited and transitory because the effect would be on the timing of the advance payment and not on the amount, and because any anomaly can be rectified at final closure.*

For the 1994 to 1999 period, the Member States are required prior to closure to take steps to ensure that all non-eligible expenditure has been excluded, and to provide a declaration by an independent body to this effect.

For the closure of the programmes which will take place from 2002 onward, the Commission has put in place procedures intended to give reasonable assurance that non-eligible expenditure will not receive co-financing. In addition, closure audits will be carried out on a selection of programmes to check on the reliability of the information provided by the Member State at closure, and to identify and exclude all irregular expenditure.

3.62. *For the ERDF, the Commission carried out closure audits on a selection of Objective 2 programmes for the 1994 to 1996 period during the first half of 2002. The objective of the audits is to verify the accuracy of the expenditure declarations submitted by the national authorities and to make financial corrections where necessary. In the first instance, six programmes have been audited and the conclusions are being established. The Commission will then determine whether the scope of the audit work should be extended.*

⁽⁴⁸⁾ As the Court has pointed out in its previous reports in support of the Statement of Assurance, errors detected in expenditure declarations do not in themselves necessarily affect the payments made by the Commission. If the declared expenditure exceeds the required threshold, the level of eligible expenditure after the errors have been deducted may still justify payment of the advance or of the balance of the instalment concerned.

THE COURT'S OBSERVATIONS

3.63. Regulation (EC) No 2064/97 as amended by Regulation (EC) No 2406/98 ⁽⁴⁹⁾ in fact exempts the 1994 to 1996 interventions from the closure statement certifying that the prescribed checks have been carried out. It does not, however, exempt them from application of the minimum checking rate of 5 % of eligible expenditure (the rate may be reduced for intervention approved before the entry into force of the Regulation), which applies to the whole of the 1994 to 1999 period. The Commission nevertheless finally closed the 1994 to 1996 interventions without verifying whether the checks had been carried out.

3.64. The Court carried out in-depth audits in four Member States (Denmark, Spain, Ireland and Luxembourg) at subprogramme level for three ERDF measures and two of the Cohesion Fund projects. This work showed that the prescribed checks for the ERDF (see paragraph 3.63) had been very partially applied by the Member States and in most cases the final declarations of expenditure still contained significant errors which affected the payments from the Community budget, in line with previous years' findings ⁽⁵⁰⁾:

- (a) in the case of the ERDF interventions ineligible expenditure was identified amounting to 83 % ⁽⁵¹⁾, 9,3 % ⁽⁵²⁾ and 19 % ⁽⁵³⁾ of the declared expenditure, resulting in overpayments by the Fund for the three subprogrammes audited of 29,8, 0,4 and 1,5 million euro respectively;

THE COMMISSION'S REPLIES

3.63. For programmes for which the commitment deadline was 31 December 1996 or earlier, the Commission has not systematically required, as a precondition of closure, an assurance on the controls carried out by the national authorities either under Article 23 of Regulation (EEC) No 4253/88 or under Regulation (EC) No 2064/97, given that Article 8 of Regulation (EC) No 2064/97 requiring a closure statement by an independent body is not applicable. Nevertheless, information on controls is included in the final implementation reports for the 1994 to 1999 period. The audits currently being carried out on a sample of Objective 2 1994 to 1996 programmes will provide a basis for determining whether the controls effected by the Member States were adequate.

3.64.

- (a) For the first programme referred to by the Court, the Commission has also carried out a closure audit and identified certain additional irregularities, and is already in contact with the Member State concerned in relation to the correction of certain matters identified by the Court, and will now also follow up its own audit findings. However, there are other observations of the Court that still require information from the Member State before the Commission can confirm the percentage of the error found by the Court.

For the two other programmes referred to by the Court, the Member States concerned have partly contested the observations of the Court, and therefore the percentage of error may be reduced. The Commission will carry out a case-by-case examination of the answers of the Member States and will make the necessary recoveries.

⁽⁴⁹⁾ OJ L 298, 7.11.1998, p. 15.

⁽⁵⁰⁾ See Annual Reports concerning the financial years 1997 (paragraph 8.80), 1998 (paragraphs 3.29 and 3.30), 1999 (paragraphs 3.49 to 3.52) and 2000 (paragraph 3.39).

⁽⁵¹⁾ OP Objective 2 Madrid 1994 to 1996: university construction and equipment expenditure ineligible in the context of a subprogramme in support of research.

⁽⁵²⁾ SPD Objective 2 Luxembourg 1994 to 1996: projects carried out outside the eligibility period, expenditure of an ineligible nature, non-recovery of undue assistance.

⁽⁵³⁾ SPD Objective 2 Nordjylland DK 1994 to 1996: ineligible expenditure per se, expenditure on the construction of schools which was ineligible within the framework of Objective 2 and a project which was not eligible within the framework of the programme.

THE COURT'S OBSERVATIONS

- (b) for the Cohesion Fund projects, ineligible expenditure accounted for 1,7 %⁽⁵⁴⁾ and 2,6 %⁽⁵⁵⁾ of the declared amounts; in the first case this led to overpayment by the Fund of 7,7 million euro for the entire project; in the second case a declaration of 11,4 % more than the minimum had no effect on the amount paid.

THE COMMISSION'S REPLIES

- (b) *The first case cited by the Court relates to a situation of apparent infringement of the Community public procurement legislation, which is contested by the Member State. The Commission will carry out a detailed analysis of this case to determine whether the Member State's arguments are valid.*

In the second case, the Court's comments have been only partially accepted by the Member State. The Commission will follow up the case, but recovery will not be necessary owing to the over-declaration mentioned.

*Interventions for the period 2000 to 2006***Implementation of control arrangements still limited**

Introduction

3.65. Regulation (EC) No 438/2001 specifies the obligations of managing authorities⁽⁵⁶⁾, paying authorities⁽⁵⁷⁾ and intermediate bodies⁽⁵⁸⁾ as regards the definition and separation of functions within them, the effectiveness of the systems for verifying the reality of expenditure and the existence of an audit trail. It also provides for procedures for certifying expenditure and lays down the extent of the checks to be carried out by Member States. As with Regulation (EC) No 2064/97, on-the-spot checks must cover at least 5 % of the total eligible expenditure spread over the entire period and must make it possible to verify the effectiveness of the management and control systems, and to examine on the basis of a risk analysis expenditure declarations made at the various levels concerned. The Court

⁽⁵⁴⁾ CF Spain Autopista Rias Baixas: non-compliance with directives concerning public procurement.

⁽⁵⁵⁾ CF Ireland N4 Collooney/Sligo: expenditure outside the eligible period, failure to take account of the sale of a plot of land and inclusion of additional work.

⁽⁵⁶⁾ Managing authority: authority or body designated by the Member State to manage assistance; responsible for the efficiency and regularity of the management.

⁽⁵⁷⁾ Paying authority: authority or body designated by the Member States for the purposes of drawing up and submitting payment applications and receiving payments from the Commission.

⁽⁵⁸⁾ Intermediary body: any body which acts on behalf of a managing authority or a paying authority or which carries out tasks on their behalf.

THE COURT'S OBSERVATIONS

verified the implementation of Regulation (EC) No 438/2001 for 12 interventions in nine Member States ⁽⁵⁹⁾.

The Commission's role

3.66. In order to satisfy itself that the management and control systems meet the standards imposed by the regulations, the Commission is required to examine the functioning of the systems at regular intervals. For that, on-site visits are necessary. However, a small number of visits were made in 2001 by DG REGIO and PÊCHE, one was made by DG EMPLOI and DG AGRI made none at all. As a result the Commission did not have adequate assurance in 2001 regarding the reliability of these systems.

THE COMMISSION'S REPLIES

3.66. Regulation (EC) No 438/2001 entered into force in March 2001. Under Article 5, a description of the systems should have been communicated by the end of June 2001, but most Member States submitted descriptions only during the fourth quarter of 2001.

The main reason why not more of the new programmes have been audited on the spot is the allocation of resources to the other priority for audit work in 2001/2002, namely Member States' preparations for closure of the 1994 to 1999 programmes. On-the-spot audits of the systems put in place for the current programmes will be continued in future years. In the meantime all the systems are being desk-checked using the descriptions submitted under Article 5 of Regulation (EC) No 438/2001 and any concerns will be followed up. In general, the Commission is encouraged by results of the on-the-spot and the desk checks of new systems, indicating that the more stringent requirements laid down and the increased audit activity are leading to an improvement in standards.

DG REGIO carried out 29 preventive audits in 2001 in relation to the management and control systems established by Member States under Regulation (EC) No 438/2001. By mid-2002 DG REGIO had checked on-the-spot 31 % of the management and control systems for 2000 to 2006 Objective 1 and 2 programmes.

In 2001, four programmes were audited by DG FISH, with four further programmes audited in the first half of 2002. This is equivalent to 50 % of exclusively FIFG programmes and 16 % of all programmes with FIFG participation.

DG EMPL carried out one systems-audit for the new period (Denmark) in (December) 2001. By the end of 2002 it plans to have covered 34 % of 2000 to 2006 Objective 3 programmes and 17 % of all programmes with ESF participation for this period. The planned number of preventive audits

⁽⁵⁹⁾ Belgium ESF, Germany ERDF and ESF, Greece ERDF and EAGGF-Guidance, Spain FIFG, Finland ERDF, France ESF, Italy ESF, Austria ESF and Portugal ERDF and ESF.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Application of the Regulation by the Member States

The control systems of the managing authorities and intermediate bodies

3.67. In some Member States ⁽⁶⁰⁾ weaknesses, such as the absence of checks on paid invoices or equivalent documents, are present in the procedures for verifying the reality and eligibility of expenditure. As a consequence expenditure declarations are drawn up without any check on whether the expenditure was actually incurred (see paragraph 3.77).

3.68. In one Member State ⁽⁶¹⁾ the initial statements of expenditure were presented even though no on-the-spot check had been made. In two other Member States ⁽⁶²⁾ the managers' reports did not always mention on-site inspections. Lastly, in one Member State ⁽⁶³⁾, there was no audit trail, the declared expenditure corresponded to neither the payments made to the regional authorities nor the payments from the latter to those responsible for projects (see paragraph 3.77).

for 2001 by DG EMPL concerning a first evaluation of the descriptions of management and control systems (Article 5 of Regulation (EC) No 438/2001) had to be reduced mainly because of missing descriptions or late transmission of descriptions. As a result, only one preventive audit mission was carried out in 2001. This type of mission will form a major part of the controls in 2002.

In addition to the reasons mentioned above DG AGRI has not yet been able to start auditing EAGGF-Guidance in the new programmes due to the limited human resources available for the EAGGF-Guidance controls and the need to maintain an appropriate level of controls in other risk sectors. Its intention is to ask for assistance from a private audit firm to carry out this task.

3.67. *The importance of monitoring of projects, on the ground and thorough and timely checking of expenditure declarations at source against invoices and other supporting documents, has already been drawn to the attention of Member States by the Commission in its audits as the key to ensuring regular payments. Articles 4, 7 and 9 of Regulation (EC) No 438/2001 make clear the crucial importance of this work.*

3.68. *As a result of the activities of the Commission, all programme authorities should now be in no doubt about the requirements for on-the-spot checks (Article 10 of Regulation (EC) No 438/2001), the recording of monitoring visits (Article 4) and a sufficient audit trail (Article 7 and Annex I). The Commission will continue its verification of the systems of management and control and their functioning and will take appropriate measures when deficiencies are detected.*

Given the date when the Commission received the information from the Court on the individual cases, it has not been able to obtain a full set of replies from the Member States.

⁽⁶⁰⁾ Spain FIG, Portugal ESF, Germany ERDF and ESF and Finland ERDF.

⁽⁶¹⁾ Portugal ERDF.

⁽⁶²⁾ Spain FIG and Greece ERDF.

⁽⁶³⁾ France ESF.

THE COURT'S OBSERVATIONS

Paying authorities

3.69. Some paying authorities ⁽⁶⁴⁾ have not implemented adequate procedures for satisfying themselves that expenditure declarations contain only eligible expenditure. Certificates of expenditure collate the data recorded in the information systems by managing authorities or intermediate bodies and the paying authorities simply verify that it is consistent with the partial certificates or declarations already forwarded by the former (see paragraph 3.77).

3.70. In some cases, these paying authorities have made provision for carrying out checks, but have not yet established guidelines and check-lists for doing so ⁽⁶⁵⁾ or, the methodology has already been laid down, but was not being applied in 2001 ⁽⁶⁶⁾.

3.71. In two Member States ⁽⁶⁷⁾, the intermediate bodies act as paying authority for measures implemented in the territory or activity sector for which they are responsible, by making out partial certificates of expenditure. In this case, the designated paying authority often has only a limited knowledge of these bodies' systems and the possibilities of auditing their operations are limited. In another Member State ⁽⁶³⁾ the body that certifies expenditure at the regional level does not have the requisite independence in relation to the authoriser of the payments.

Sample checks

3.72. At the end of 2001 the resources and procedures needed for carrying out sample checks had not been fully put in place in any of the nine Member States visited and no checks had been carried out in relation to the minimum of 5 % over the full period.

THE COMMISSION'S REPLIES

3.69. Before certifying declared expenditure to the Commission for payment of the Structural Fund contribution, the paying authority must gain reasonable assurance of the accuracy, regularity and eligibility of the underlying claims. The Commission audits have also detected some inadequacies in the work of certain paying authorities. These have been followed up and in some cases improvements have already taken place. The Commission will maintain its efforts to ensure that the certification process provides a reliable basis for making interim payments in all Member States.

3.70. The Commission in its audits also identified delays in certain cases in establishing operational control systems, and has taken measures to remedy this.

3.71. In cases of allocation of certain functions of a paying authority to intermediate bodies, the Commission has insisted on formal agreements between intermediate bodies and the paying authority governing procedures, systems and reporting. Where the issue of the independence of the certifying body has arisen, the Commission has required an adequate separation of functions.

In the specific case in France referred to by the Court (footnote 63), the lack of independence of the body that certifies expenditure must be viewed in the light of the Community regulations and the terms of the circular from the Prime Minister of 15 July 2002 on improving the arrangements for managing, monitoring and auditing programmes part-financed by the Structural Funds.

3.72. The provisions of Regulation (EC) No 438/2001 on sample checks of expenditure are essentially the same as those in Regulation (EC) No 2064/97, and in many Member States the structures put in place for the earlier Regulation will continue to operate for the new period. Because Member States are having to ensure that all necessary controls have been carried out to allow closure of the 1994 to 1999 programmes, it is the case that sample checks of operations for the current programming period have been slow to start.

⁽⁶⁴⁾ Spain FIG, Finland ERDF, France ESF, Greece ERDF and EAGGF-Guidance and Portugal ERDF and ESF.

⁽⁶⁵⁾ Greece EAGGF-Guidance and ERDF.

⁽⁶⁶⁾ Portugal ERDF and ESF.

⁽⁶⁷⁾ Spain FIG and Finland ERDF.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Commitments: legal obligations not entered in the accounts

3.73. As in 1999 and 2000 ⁽⁶⁸⁾, but to a substantially lesser extent, there were some decisions that had not been the object of budgetary commitments (see paragraph 9.13). The Court notes that the budgetary commitment accompanies a legal commitment and is an obligation imposed by Article 36 of the Financial Regulation and may not be subordinate to technical considerations. The Court also wishes to point out that the carry-over of appropriations in order to cover these decisions does not comply with the conditions defined by Article 7(2) of the Financial Regulation which was intended to cover the case of items which have been virtually completed at 31 December, not for legal obligations that have already been entered into by that date.

Payments: ineligible expenditure

3.74. The payments effected in 2001 for the period 2000 to 2006 correspond, firstly, to the payment of the 7 % advance payment on the last interventions adopted in 2001 and on the interventions for which decisions were taken at the end of 2000 and which had not received an advance, and secondly, to the first reimbursements of incurred expenditure, based on the expenditure declarations certified by the Member States.

3.75. Regulation (EC) No 1260/1999 states that interim payments shall be calculated at the level of measures contained in the financing plan for the intervention. In the absence of any guidelines on the subject the departments responsible for the management of the various Funds applied different methods in 2001 when the actual rate of co-financing applied by the Member State did not coincide with the forecast rate. Some applied the actual rate, others applied the forecast rate.

3.73. *The Court points out that legal obligations were entered into without there being a corresponding budgetary commitment. This results from differing practices in the procedure for adopting programmes.*

In these circumstances, it is right for this kind of commitment, that has not yet been booked, to be included in off-balance-sheet commitments.

Where certain legal obligations were not covered by budgetary commitments at the end of the financial year, the only alternatives to carrying over the appropriations would have been to leave the legal obligations without any corresponding budgetary commitments, which would have been unacceptable, or to revise the financial perspective.

3.75. *The Commission laid down the rules for calculating interim payments in the spring of 2002, and more specifically, stipulated the need to comply with the rates per measure set out in the financing plan for the intervention at each payment. However, these rules are currently under review.*

⁽⁶⁸⁾ Annual Report 1999, paragraphs 3.41 and 8.17 and Annual Report 2000, paragraphs 3.28 and 9.16.

THE COURT'S OBSERVATIONS

3.76. The Court checked interim payments at the Commission and in the Member States (see paragraph 3.46). The checks showed that ineligible expenditure had been submitted in some declarations. In view of the fact that interim payments are reimbursed expenditure, ineligible expenditure has a direct effect on the Community budget, in proportion to the rate of co-financing applied.

3.77. In the framework of the 12 interventions audited (see paragraph 3.65) the Court identified seven in which there were errors of a type similar to that found in the context of the previous period, namely: projects that were wholly or partly ineligible⁽⁶⁹⁾, expenditure of an ineligible nature⁽⁷⁰⁾, expenditure without supporting documents or with insufficient supporting documents⁽⁷¹⁾, over-stated general expenses⁽⁷²⁾, revenue not included in the accounts⁽⁷³⁾, sums not yet incurred⁽⁷⁴⁾, non-compliance with public procurement obligations⁽⁷⁰⁾.

3.78. In the case of one Spanish ERDF OP, the Commission, having found a discrepancy between the total given in the expenditure declaration for a measure and that stated in the subsequent implementation report, obtained confirmation from the national authorities that the lower figure shown in the report was correct, as the main projects in the measure had been ruled ineligible. The Commission nevertheless calculated the amount for payment on the basis of the declaration and accordingly made an undue payment of 1,4 million euro.

THE COMMISSION'S REPLIES

3.76. *The paying authority designated by the Member State must satisfy itself that the expenditure it certifies to the Commission is eligible. In the specific instances identified by the Court, the Commission will take the necessary action to recover the amounts it considers to be ineligible. As part of its audit activities (see reply to paragraph 3.66), the Commission is currently verifying that paying authorities are functioning effectively, especially as regards certification of expenditure, and are complying with Regulation (EC) No 438/2001. If shortcomings are identified, the Commission will take appropriate action under Articles 38 and 39 of Regulation (EC) No 1260/1999. It would point out that Regulation (EC) No 438/2001 entered into force in March 2001, and that it did not necessarily have an obvious impact on all the expenditure presented by the Member States.*

3.77. *The Commission has not yet completed the examination of the replies received from the Member States, but notes that, in the cases mentioned by the Court, some of its comments have not been accepted by the Member States.*

The situations identified by the Court indicate that shortcomings persist in the Member States' management and control systems. The Commission is in the process of completing its first audits of the systems put in place by the Member States pursuant to Regulation (EC) No 438/2001, in order to ensure that the main components required are reliable.

3.78. *The amount paid in excess was deducted from the payment made to the Member State in April 2002. The Commission reminded the Member State of the need to ensure consistency between the financial data in the annual report and the declarations of expenditure.*

⁽⁶⁹⁾ SPD ERDF Objective 2 Lower Saxony and SPD FIFG non-Objective 1 Spain.

⁽⁷⁰⁾ OP ERDF Objective 1 Competitiveness Greece.

⁽⁷¹⁾ SPD ERDF Objective 2 Lower Saxony, OP ERDF Objective 1 Algarve and SPD ESF Objective 3 France.

⁽⁷²⁾ OP ESF Objective 1 Educação Portugal and SPD ESF Objective 3 France.

⁽⁷³⁾ SPD ESF Objective 3 France.

⁽⁷⁴⁾ SPD ERDF Objective 2 Lower Saxony and SPD ERDF Objective 2 Southern Finland.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Conclusions and recommendations

3.79. Interventions in the periods before 1994 were not governed by effective management and control systems, whether at the Commission or in the Member States. The closure procedures for these interventions were still unchanged in 2001. As a consequence the Commission does not have sufficiently reliable information. Furthermore it does not make up for this deficiency by means of its own controls in order to satisfy itself of the legality and regularity of the expenditure presented when these interventions are finally closed (see paragraphs 3.48 to 3.52).

3.80. The interim payments for the period 1994 to 1999 are still affected by the persistence of errors in the expenditure declarations presented by the Member States (see paragraphs 3.59 to 3.61). This situation is reflected in the closure of the 1994 to 1996 Objective 2 interventions, where the Court regularly finds high levels of ineligible expenditure. In the absence of adequate controls on the part of the Member States and the Commission, these anomalies result in undue payments from Community funds (see paragraphs 3.62 to 3.64).

3.81. The checks which the Member States are required to perform before the completion of each form of intervention from the period 1994 to 1999 are an essential component in the reliability of their systems and the regularity of requests for payments. Despite some improvements which are intended to bring about uniform application of the rules, the control systems still do not ensure that the checks, on which final declarations of expenditure rely, are rigorous and reliable enough. In view of the closures that will occur from 2002 onwards the Commission should therefore reinforce its initiatives, including improving the coordination of the work of the departments that are responsible for the different structural measures (see paragraphs 3.56 to 3.58).

3.79. *The legal framework for the management and control of the pre-1994 programmes was not as rigorous as that which is applicable for programmes which will be closed from 2002 onward. The Commission has endeavoured, given these limitations, to apply procedures at closure which ensure that irregularities identified have been satisfactorily dealt with. It has not carried out a full audit enquiry relating to the closure of the pre-1994 programmes, because it has given priority to the preparation for the closure of the much more significant 1994 to 1999 programmes and the review of the systems for the financial management and control of the 2000 to 2006 programming period.*

3.80. *For Objective 2 1994 to 1996 programmes, the Commission is auditing a sample of closed programmes and will draw the appropriate conclusions. For the closure of all other programmes of the 1994 to 1999 period, for which there is a requirement of a closure statement by an independent body, the Commission has established procedures at closure to give a reasonable assurance that only regular expenditure is taken into account for determination of co-financing. In addition a selection of closed programmes will be audited to verify the reliability of the information based on which the closure took place and to eliminate any irregular expenditure identified by way of recovery of undue amounts paid to Member States.*

3.81. *The Commission undertook a very substantial programme of audit activity in 2001 to obtain assurance with regard to the implementation of Regulation (EC) No 2064/97 by the Member States. As a result of the detailed recommendations communicated to the bodies concerned, significant efforts have been made by Member States to complete the necessary control work in line with the requirements of the Regulation prior to closure. The Commission will ensure that all material shortcomings are adequately dealt with prior to closure. It will also maintain and develop the effective coordination between the Structural Funds services which has been operating in relation to preparations for closure.*

THE COURT'S OBSERVATIONS

3.82. The regulatory management and control arrangements for the 2000 to 2006 period have been strengthened. However, their implementation is already marred by delay, the structures are not yet all operational and independent auditing of the operations effected has not begun (see paragraphs 3.67 to 3.72). Among the interim payments the Court detected the presence of ineligible expenditure of the same types as for previous periods, which suggests that some of those involved are not sufficiently conversant with the rules applicable (see paragraphs 3.74 to 3.78). The Commission should therefore try to complete its checks in the Member States as soon as possible and should ensure that the control standards and rules of eligibility, as well as the sanctions to be imposed for non-compliance, are circulated and understood at every level (see paragraph 3.66).

FOLLOW-UP OF PREVIOUS OBSERVATIONS

Special Report No 18/98 on Community measures to encourage the creation of joint enterprises in the fisheries sector

Introduction

3.83. The joint enterprises scheme was created in 1990 by the Council so as to help reduce the size of the Community fishing fleet by redeploying fishing vessels in the waters of non-member States.

3.84. The Court's main observations concerned the shortcomings of the monitoring and inspection procedures and the existence of anomalies in several projects which could give rise to recoveries. The Council, in its recommendation on the discharge for the financial year 1997, emphasised the need for stricter management and asked for all amounts paid in error to be recovered.

New monitoring and inspection procedures

3.85. In its replies to the Court's report, the Commission stated that it had taken or was going to take measures to improve the 'fleet' file, to develop an I. T. tool for monitoring aid for each vessel and to step up checks.

THE COMMISSION'S REPLIES

3.82. *Despite the delay in establishing the systems to meet the higher standards, Member States have now made significant efforts to put the necessary structures in place and are better informed of the requirements and better able to meet them than before. In its system audits and desk checks of system descriptions the Commission is focusing on the controls necessary to ensure accurate, regular and eligible expenditure from the bottom up. It will continue auditing these systems in future years, giving priority to programmes not yet covered and to the Cohesion Fund, for which similar requirements have now been laid down in Regulation (EC) No 1386/2002 of 29 July 2002.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

A restructured but still unreliable 'fleet' file

3.86. Major changes have been made to the system for managing the 'fleet' file in terms not only of the computer application but also of the procedure for recording the information forwarded by the Member States. Since February 2001, this system has thus provided the Member States in real time with the data concerning them and has enabled them to make the necessary changes in the event of divergences from their own information.

3.87. However, an analysis of the data in the 'fleet' file revealed problems in terms of the quality and the exhaustiveness of the data on individual vessels, in particular as regards the main capacity management parameters, namely tonnage and power. Inconsistencies, in particular, were singled out with the global data forwarded by the national authorities in the context of the multianual guidance programme. In addition, the present definition of engine power is not suitable, inasmuch, as it is the power guaranteed by the shipbuilders and not the power actually developed.

A new vessel-based monitoring system which is not yet operational

3.88. For the 1984 to 1994 period, the Commission made a considerable effort to create a database listing the main features of the allocated aid. The anomalies thus detected were individually monitored and more than half of the presumed infringements have already resulted in recoveries. For the more recent period, the Infosys system should make it possible to identify Community aid for each vessel. This system was still not fully operational in September 2001.

3.87. The Commission considers that the new software application for the Fleet Register enables Member States to submit exhaustive data and correct them at any time, therefore any inconsistencies should and could be readily corrected by the Member States.

The Commission is of the opinion that the GT tonnage, as defined by Regulation (EEC) No 2930/86, is the most reliable indicator of vessel tonnage that can be used. By the end of 2003, when its implementation is completed, the EU will have, for the first time, tonnage figures of Member States' fleets expressed in a homogeneous unit.

As for the measurement and certification of engine power, the Commission has undertaken actions to improve it, although technical difficulties raised by Member States have so far prevented a definitive solution which would justify a substantial revision of Community legislation.

3.88. For the 1994 to 1999 and 2000 to 2006 periods, under the terms of Regulations (EC) No 1796/95 and (EC) No 366/2001 Member States are obliged to provide a detailed annual report on the aid granted. This report contains financial and technical indicators for the projects funded. Since the Infosys computer system is not yet fully operational, the data provided by the Member States are currently processed manually, allowing reasonable monitoring of aid and its compliance with the rules, in particular by means of cross-checks with the data in the fleet register.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

More infrequent on-the-spot checks

3.89. After checking 18 projects (30 vessels) on the spot in 1998, i.e. before the Court's report was published, the Commission only carried out six more over the following 31 months (from 1 January 1999 to 31 July 2001), half of which gave rise to observations which, in some cases, recommended the recovery of the aid. The stepping-up of the on-the-spot checks announced by the Commission in its reply to the special report did not last, despite the frequency of the anomalies observed.

Adequate new legislation

3.90. Since the Court's report, the legislation has changed several times. Only the provisions currently in force ⁽⁷⁵⁾ were examined.

3.91. As regards the conditions for intervention, almost all of the shortcomings noted in the report gave rise to new legislation. The only exception was the abolition of alternatives to the payment of capital grants, which the Court wished to see encouraged. The nature of the information to be forwarded by the Member States should enable the Commission to carry out systematic file-based checks of compliance with the essence of the legislation. The new provisions substantially seek to rectify the weaknesses noted by the Court. However, they came into force too recently for an opinion to be given on their implementation.

3.89. *As soon as the Commission was informed of the anomalies identified by the Court, it decided to carry out an increased number of on-the-spot checks.*

As regards the six projects mentioned by the Court, it should be noted that for the three projects which gave rise to observations the financial assistance provided was cancelled in one case and reduced in the other two cases.

To improve the cost-effectiveness of inspections and given the nature of joint enterprise projects, the Commission subsequently gave priority to checking supporting documents by setting up a task force which so far has examined 44 projects.

⁽⁷⁵⁾ Council Regulation (EC) No 2792/1999 of 17 December 1999 laying down the detailed rules and arrangements regarding Community structural assistance in the fisheries sector (OJ L 337, 30.12.1999, p. 10) and Commission Regulation (EC) No 366/2001 of 22 February 2001 laying down detailed rules for implementing the measures provided for in Council Regulation (EC) No 2792/1999 (OJ L 55, 24.2.2001, p. 3).

Satisfactory monitoring of the anomalies

3.92. An analysis of these files shows that the Commission handled each of the 19 cases cited in the Court's report with sufficient care. As a result of its work, it confirmed the existence of irregularities in respect of nine projects ⁽⁷⁶⁾ and initiated the relevant procedures to recover, where appropriate, the sums paid in error ⁽⁷⁷⁾. In 10 other cases, it concluded, or confirmed, its opinion that there were no grounds for further action.

Conclusions and recommendations

3.93. Improvements have been made to the legislation and the monitoring mechanism for the 'joint enterprises' measure. Appropriate action has also been taken in respect of the individual anomalies observed. However, the restructuring of the system for managing the Community fishing-fleet register has so far not made it possible to resolve shortcomings in terms of the exhaustiveness, consistency and reliability of the capacity indicators. The Commission should therefore make qualitative improvements to this register in view of its key role in defining and managing Community fisheries policies (see paragraphs 3.86 and 3.87).

3.93. *Following substantial changes to procedures and the exchange of information between the Member States and the Commission in the management of fleet data, the register has been considerably improved. However, these improvements could not ensure that all Member States consistently met their obligations in full, which sometimes affected the reliability of the database. Infringement procedures were also opened against some Member States. Lastly, the Commission proposal for the reform of the common fisheries policy (CFP) provides for tougher sanctions (quota and fishing effort penalties).*

*Follow-up of observations on the Statement of Assurance***ERDF and Cohesion Fund: occasionally limited recoveries**

1998 Statement of Assurance

3.94. In its Annual Report concerning the financial year 2000, the Court pointed out that the Commission had not adequately monitored certain substantial errors detected in the context of the 1998 Statement of Assurance, in particular as regards five ERDF programmes closed in 1998, in respect of which the Court estimated that excess payments of 47,5 million euro ⁽⁷⁸⁾ had been made.

⁽⁷⁶⁾ For an overall minimum of 1,3 million euro.

⁽⁷⁷⁾ An amount 0,9 million euro has already been recovered.

⁽⁷⁸⁾ Paragraphs 3.113 and 3.115.

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3.95. In one case ⁽⁷⁹⁾ which had not been monitored, the Commission initiated the financial correction procedure in June 2001 by informing the Member State of the possible recovery of 19,4 million euro, the amount estimated by the Court. Since then, although the Member State did not reply within the two-month deadline, no recovery order has been issued.

3.96. In one case ⁽⁸⁰⁾ where the financial correction procedure had been initiated in September 2000, the Commission received the last comments from the Member State in June 2001. The Court believes that the excess paid, which was initially estimated at 13,9 million euro, may be reduced, in the light of the supporting documents since supplied, to 9,9 million euro. The Commission, however, has done nothing in this case and no sum to be recovered has been calculated.

3.97. In three cases ⁽⁸¹⁾ where the Commission envisaged financial corrections totalling 10,9 million euro, the procedures leading to the issuing of recovery orders lasted more than 16 months. In addition, the Commission restricted the amounts to be recovered to ineligible expenditure on projects audited by the Court. It neither carried out additional checks nor extended the observations to all expenditure which was potentially concerned. As a result, the amounts recovered total 4,10 million euro as opposed to the 12,50 million euro estimated by the Court.

3.98. Furthermore, in one of these three cases ⁽⁸²⁾, the subprogramme audited also entailed the Member State receiving excess financing of 1,6 million euro due to the fact that the Commission paid the ERDF contribution at the initially planned rate, even though the actual implementation reveals a financing rate of less than 9 %. The

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3.95. *The Member State concerned has provided new elements in order to reassess the case after the expiry of the deadline. Considering the importance of the case, the Commission has agreed to this extra time. The case can now be concluded, with a recovery to be made for which the amount has not yet been definitively fixed.*

3.96. *The Commission is now preparing a Decision in the light of the detailed replies received from the Member State. These replies have an impact upon the extrapolation calculation, but at present it is not possible to give a final figure. However, the final evaluation is likely to be of the order of EUR 9,9 million.*

3.97. *Until recently it was difficult for the Commission, with the audit staff and resources available, to extend inquiries in cases of error found by the Court as well as to carry out its own audit programme. With additional human resources, the situation has now significantly improved.*

As regards the difference between the amounts, the figure for the recovery effected by the Commission relates to the project costs found not eligible following completion of the examination procedure with the Member State; whilst the Court figure was an estimate.

3.98. *In the case cited by the Court, the Commission used at closure the internal rules applicable during this period. After examining the Court's comments and the information provided by the Member State, the Commission issued a recovery order for EUR 700 515.*

⁽⁷⁹⁾ 1992 to 1993 Nordrhein-Westfalen O2 SPD.

⁽⁸⁰⁾ 1989 to 1993 Tourism Ireland O1 Operational Programme (OP).

⁽⁸¹⁾ 1992 and 1993 Pays de la Loire O2 SPD; Provence-Alpes-Côte d'Azur Integrated Mediterranean Programmes (PACA IMP); 1989 to 1993 Martinique O1 OP.

⁽⁸²⁾ 1992 and 1993 Pays de la Loire O2 SPD.

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Commission is not recovering this excess payment. The Court considers that the payment of aid in excess of the amount actually due to final beneficiaries contravenes the principles of Regulation (EEC) No 2052/88 ⁽⁸³⁾.

1999 Statement of Assurance

3.99. The Court checked whether the Commission had adequately followed up the cases of substantial errors, requiring action by the Commission, pointed out in the context of the 1999 Statement of Assurance, in respect of 12 ERDF interventions and four Cohesion Fund projects.

3.100. As regards the interventions and projects which were not closed, the measures taken by the Commission proved satisfactory in eight cases ⁽⁸⁴⁾, as the adjustments to declared expenditure were made. In six cases ⁽⁸⁵⁾, the action taken by the Commission has not yet yielded results. In one of these cases ⁽⁸⁶⁾, the Commission nevertheless made several payments to the programme concerned.

3.100. *As regards the six cases for which the Court indicated that the measures taken had not yet yielded results at the time of its examination, the Commission would stress that these are complex cases, on account of the significant differences between the facts identified by the Court and the claims made by the Member States, and of situations involving interpretation of the ERDF implementing rules or non-compliance with Community policies, requiring contacts to be taken up with the national authorities and the recipients concerned in the Member States and inter-departmental consultations to be held within the Commission before any launch of financial correction procedures. To date, three of the six cases have been resolved by the Commission, and the other three will be dealt with as soon as possible.*

The Commission considers that there is not a sufficient basis to suspend interim payments for programmes in respect of which checks are still ongoing. However, it will ensure that all instances of error are resolved before accepting the Member State's request for the final payment for forms of intervention, and will at that point take appropriate action to recover any amounts unduly paid.

⁽⁸³⁾ Council Regulation (EEC) No 2052/88 of 24 June 1988 on the tasks of the Structural Funds and their effectiveness and on coordination of their activities between themselves and with the operations of the European Investment Bank and the other existing financial instruments (OJ L 185, 15.7.1988, p. 9).

⁽⁸⁴⁾ 1994 to 1999 Thüringen O1 OP; 1994 to 1999 Mecklenburg-Vorpommern O1 OP; 1994 to 1999 Sachsen O1 OP; Pilot project / IDAN/METT, Nordrhein-Westfalen; 1994 to 1999 Canarias O1 OP; 1994 to 1999 Bretagne O5b SPD; Lough Ree Catchment, CF Ireland; OP O1 Attica; 1994 to 1999.

⁽⁸⁵⁾ OP O1 Central Macedonia 1994-1999; 1994-1999 Infraestructura Científica OP; 1994-1999 Valencia O1 OP; 1997-1999 Madrid O2 OP; Digue de Botafoc, CF Spain; Residuos sólidos Galicia, CF Spain.

⁽⁸⁶⁾ 1997 to 1999 Madrid O2 OP.

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3.101. In the case of one closed ERDF programme ⁽⁸⁷⁾, where the Court estimates the impact of the errors on Community payments to be 1,3 million euro, the Commission took action vis-à-vis the Member State in July 2001. However, no results have yet been obtained and no recovery procedure has been initiated.

3.102. Concerning Cohesion Fund project closed in 1999, many questions regarding the rate of financing granted, the entry of revenue in the accounts, the breakdown of expenditure, the availability of accounting information and the eligibility of certain expenditure had been raised by the Court ⁽⁸⁸⁾. The Commission has admitted that there are high risks and has introduced into the applicable regulations, with effect from 2000, new obligations concerning the payment of balances and has strengthened its own control system.

ESF

3.103. During the 1999 DAS procedure for the Social Fund the Court observed eleven substantive errors concerning cases of ineligible expenditure or measures ⁽⁸⁹⁾. For these errors the Commission has since initiated correction procedures, except for one case ⁽⁹⁰⁾ concerning a project in the context of the 'equality of opportunity between men and women' measure of an operational programme. The Court maintains that the expenditure on this project, totalling 1,16 million euro, is not eligible because, contrary to the objectives of the measure, the promoter did not organise specific courses but financed participants attending various general courses without documenting relevant selection criteria.

Conclusions and recommendations

3.104. The Court notes that, in general, the Commission's follow-up to the observations made in the 1999 and following Statements of Assurance has been more diligent than for previous DASs (see paragraphs 3.99 to 3.103). Nevertheless, although the Court's observations often reveal management and inspection shortcomings which are common to many programmes, the Commission rarely extends its investigations beyond the

THE COMMISSION'S REPLIES

3.101. This case relates to a programme from the 1992/1993 period. Given the time that has passed and the complexity of the case, it took longer than usual to make enquiries of the Member State. The Commission has now reached a final position on the case, which has been communicated to the Member State. The financial consequences resulting from the Commission's analysis are similar to those indicated by the Court.

3.102. The Commission accepted that the particular type of project structure gave rise to difficulties in verifying eligibility of expenditure, even if there was no financial impact in this particular case. For the period 2000 to 2006 the control provisions of the Council Regulation have been reinforced, and a Commission Regulation setting out detailed rules on financial management and control has been adopted.

3.103. The Commission still considers that no error was committed as regards the eligibility of the whole project mentioned by the Court and that, as a consequence, no correction was to be applied. The promoter provided the Commission with explanations showing that 'the project, as initially submitted and operated, met the objective of delivering vocational training in areas where men or women are under-represented, and, as such, was clearly eligible for funding under Priority 3 (Pathways to Equal Opportunities between men and women), and was not an inappropriate use of the equal opportunities funding'.

3.104. It has been difficult during recent years for the Commission, with the staff and resources available, to extend inquiries in cases of error found by the Court as well as to carry out its own audit programme. With additional human resources, the situation has now significantly improved.

⁽⁸⁷⁾ 1989 to 1991 Fife O2 OP.

⁽⁸⁸⁾ Annual report concerning the financial year 1999, paragraph 3.50.

⁽⁸⁹⁾ Annual report concerning the financial year 1999, paragraph 3.44.

⁽⁹⁰⁾ Project 989592UK3 (United Kingdom).

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necessarily limited samples examined by the Court. Particularly with regard to closed interventions, the Commission should evaluate the impact of errors on the entire intervention concerned rather than confine itself to recovering undue financing in respect only of individual cases which have not been contested.

PRINCIPAL OBSERVATIONS IN SPECIAL REPORTS

Special Report No 3/2002 on the 'Employment-Integra' Community Initiative

3.105. Integra was launched in 1996 as a new, fourth strand of the 'Employment and development of human resources' ⁽⁹¹⁾ Community initiative (CI) for the programming period 1997 to 1999. From 1994 to 1997, Integra was an integral part of Horizon, but the importance attached by the European Parliament and the Council to the subject of people excluded from the labour market resulted in recognising this as a separate issue. With 418 million euro of appropriations made available, the Member States initially selected approximately one thousand projects for implementation during the 1997 to 1999 period.

3.106. The overall aim of the Court's audit was to ascertain whether:

- (a) the selection procedures for choosing promoters and projects ensured that projects were innovative and targeted people most at risk of exclusion from the labour market;

3.106. *As regards the objectives pursued by the Integra Initiative, the Commission feels that, inevitably, various methodological questions arise as to the means to achieve the end. Exclusion is a complex and multi-factored phenomenon. As a large number of assessments have shown, the effectiveness of assistance measures is not easy to gauge because the indicators frequently prove to be inadequate.*

⁽⁹¹⁾ This CI was launched on 15 June 1994, in the context of Article 11 of Council Regulation (EEC) No 4253/88 of 19 December 1988 laying down provisions for implementing Regulation (EEC) No 2052/88 as regards coordination of the activities of the different Structural Funds between themselves and with the operations of the European Investment Bank and the other existing financial instruments (OJ L 374, 31.12.1988, p. 1), as modified by Council Regulation (EEC) No 2082/93, of 20 July 1993 (OJ L 193, 31.7.1993, p. 20). Originally it had three strands: Now, Youthstart and Horizon.

THE COURT'S OBSERVATIONS

- (b) the experience acquired and lessons learnt were evaluated and followed up in a systematic, coherent and comparable way;
- (c) monitoring and dissemination were performed effectively and used in creating new models for combating exclusion from the labour market.

3.107. The Commission did not explicitly provide definitions of the keywords used in the guidelines or of the population of each target group and did not establish a priorities/problems list. At neither Commission nor Member State level were any benchmarks or baseline criteria developed and it is therefore difficult to assess when and how projects were innovative and likely to give added value or to improve or change existing approaches.

3.108. There is no evidence that the funds have been directed towards specific concentrations of the target groups, such as disadvantaged urban areas, and that the distribution of Integra funds was the most efficient way of gathering knowledge about the target groups and how to include them in the labour market.

3.109. The experience acquired and lessons learnt were not evaluated and followed up in a systematic, coherent and comparable way, either at Commission level or at that of the Member States.

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3.107. *No precise and inflexible definition of target groups beyond those listed in the communication to the Member States was attempted by the Commission in view of the often different circumstances prevailing in the various Member States. Concepts and definitions can differ from Member State to Member State, and a detailed top-down definition by the Commission risked limiting the scope of action of the Member States.*

Moreover, selection of projects to participate in Integra was the prerogative of the selection committees established in each Member State by the managing authority for the Initiative. The precise interpretation of innovation in each Member State was a responsibility of the selection committee.

For the successor Initiative, Equal⁽¹⁾, the Commission provided a clear and comprehensive set of definitions, based on the typology which emerged from the evaluation of Employment. Nevertheless, despite this definition, the appraisal of the innovative character of a project remains the exclusive responsibility of the project selection committees which arrive at a decision on the basis of their knowledge of conditions on the ground and the local context, among other things.

3.108. *The requirement for projects to be proposed by promoters working directly with the target groups led to an automatic concentration of effort on areas with a concentration of target groups. The specific problems of disadvantaged urban areas have also been specifically tackled by the Urban Community Initiative programmes.*

3.109. *As regards evaluation and follow-up of the lessons learnt, an EU-wide mid-term evaluation was carried out from August 1998 to January 2000, and an ex post evaluation of the Employment Initiative will be carried out in 2002 and 2003.*

⁽¹⁾ The Community Initiative Equal concerning transnational cooperation to promote new means of combating all forms of discrimination and inequalities in connection with the labour market, for the 2000 to 2006 programming period (OJ C 127, 5.5.2000, p. 2).

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3.110. The Commission and the Member States did not consider using indicators to describe the basic situations of the various target groups included in the initiative. Had they done so, they could then have formulated clear, unified and measurable criteria and created a baseline against which to evaluate the impact of the Integra initiative.

3.111. No evidence was found to prove that the dissemination was performed systematically and effectively and used in creating new models for combating exclusion from the labour market for each target group.

3.112. For none of the Member States visited was evidence found either at the national or transnational level of the organisation of systematic transfer of good practice. At promoter and local/regional level there was more evidence of such transfers. However, there was no systematic organisation of it and promoter contact and networking with local authorities and other promoters appear to have been the most important factors.

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As regards the achievements of the Initiative, considerable progress was achieved by the Commission and the Member States in drawing conclusions from the experience gained, among other things by means of:

- *a series of publications,*
- *publication of several hundred descriptions of best practice on the Web,*
- *regular meetings of working parties at Community level, and*
- *several conferences.*

3.110. *The Commission stresses the importance of the work currently being carried out on indicators as part of the 'Inclusion' process (following the Lisbon and Nice summits). This exercise clearly shows the difficulties involved in identifying harmonised indicators to shed light on the problem of exclusion.*

3.111. *The Commission produced guidance in 1997 entitled 'Impact Guide for Employment Project Promoters'. The Guide provides methods for planning a strategy to disseminate the successful outcomes of a project ⁽²⁾. This was followed in 1999 by a 'Guide to Public Relations Activities for Project Promoters', to enable projects under the Community Initiatives to realise their full potential through effective communication ⁽³⁾. As regards dissemination and mainstreaming applied to Integra, the new knowledge about combating exclusion from the labour market has been principally disseminated at EU, national and local levels via publications and web sites.'*

3.112. *The Commission's website at <http://europa.eu.int/comm/equal> contains the publications referred to above, and many more, giving examples of good practice and is freely accessible to all labour market decision-makers in the EU. The majority of the publications produced by the Commission have been printed and distributed widely throughout the EU.*

The events organised at national and Community level and the systematic feedback of the achievements into the programmes that took over from Integra (in particular the Equal

⁽²⁾ CE-V/7-97-003-XX-C, p. 32, 1997.

⁽³⁾ P. 28, 1999.

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3.113. The Integra initiative has raised public awareness of excluded groups. Nevertheless, it is not possible to draw any firm conclusion on the extent to which the Integra initiative has resulted in new knowledge about how to promote measures to combat exclusion from the labour market in the different target groups and whether that knowledge has been effectively disseminated to political decision-makers.

Special Report No 4/2002 on local actions for employment

3.114. Local employment promotes the creation of locally sourced jobs⁽⁹²⁾ and covers a wide range and typology of actions and activities: some pertaining to the European Employment Strategy (EES), which brings together Member States' national employment policies, some financed under the European Social Fund (ESF), which is administered by the Commission in partnership with the Member States, others directly managed by the Commission. While each of these strands derives from a different legal basis and has its own specific objectives, they each address the overall common objective of furthering a local employment strategy for job creation. The areas also differ in regard to the allocation of responsibilities for their achievement, as in the case of the ESF operational programmes, for which Member States have shared responsibility under the subsidiarity principle, and innovative and preparatory actions, for which the Commission has overall responsibility. In the 1994 to 1999 period, the Commission estimated that local employment accounted for approximately 10 % or 5 000 million euro of the total ESF funding, out of an overall total of approximately 20 455 million euro of Community funding spent on local development⁽⁹³⁾.

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Initiative) are indicative of the level of programme coordination activity. As far as transnational cooperation is concerned, the achievements are described in several publications available on the web.

3.113. *The final assessment of the effectiveness of Integra in achieving its objectives cannot be made in advance of the receipt and analysis by the Commission of the national final reports (due in June 2002) and the publication of the ex post evaluation in 2003.*

3.114. *The Commission endeavours to provide a more favourable framework for local employment with the various components of this policy area, on the assumption that the effectiveness of policy development and implementation can be improved by broadening the range of persons and institutions involved. The Commission must take into account the principles of proportionality and subsidiarity, as well as the open method of coordination established in Lisbon, which are particularly relevant in the field of local development, notably by fully respecting the national administrative and constitutional arrangements of the Member States.*

⁽⁹²⁾ Second pillar (entrepreneurship) of Council decision 2001/63/EC of 19 January 2001, on guidelines for Member States' employment policies for the year 2001 (OJL 22, 24.1.2001, p. 18).

⁽⁹³⁾ SEC(1994) 2199 of the Commission.

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3.115. While the Treaty makes provisions for a coordinated strategy, it provides no legally enforceable basis for a European employment policy as such. Thus the setting of employment priorities and actions, including the importance given to local employment actions in each Member State, remains the sole prerogative of national governments.

3.116. The Court's audit examined the Commission's (DG Employment) policy formulation and information gathering functions in the area of local employment and also the Commission's management of innovative projects which it directly funded in the period 1994 to 2001. Local employment projects were also visited on the spot in six Member States (Germany, Spain, France, Austria, Finland and United Kingdom).

3.117. The Community policy development on local employment measures lacked definition and a clear and detailed development plan for the scope and application of the policy in the Member States. Furthermore, the Commission did not have sufficient information at its disposal to fulfil its facilitative and coordinating function.

3.118. In the case of a sample of innovative and preparatory local employment projects which were directly funded by the Commission, the Commission's financial management procedures had not been sufficiently stringent in some cases. In addition, value for money on such projects was not assured due to a degree of overlap between the different innovative measures and the authorisation of some projects.

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3.117. *The Commission naturally recognises the need to improve Community policy formulation.*

However, due to the great variety of activities, and above all, of situations among Member States (size, powers and resources at infra-regional level), a single Community-wide definition of a local employment policy action would not be operational or desirable, and would not be within the remit of the ESF Regulation or the European Employment Strategy (EES). Such definition has not yet been attempted by any other international organisations such as the OECD's LEED programme. The Commission provides policy guidance, and promotes exchanges of experience through innovative and preparatory measures, including for local actors themselves, as shown in its November 2001 communication on local employment.

3.118. *The Commission agrees with the Court's general recommendation to rationalise budgetary support and improve financial management procedures for local employment actions under innovative and preparatory measures. It undertakes to implement these budget lines in the best possible way with the available human resources.*

As regards the 'late authorisation' of some projects, technical problems at promoter level have sometimes delayed the signing of agreements.

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3.119. The audit also identified a number of difficulties and obstacles arising in the effective implementation of local employment measures in Member States. For example, the introduction of a small provision in the ESF Regulation, whereby intermediary bodies are delegated responsibility for the allocation of assistance to final recipients, resulted in significant delays and administrative complexities in some Member States, with two Member States (Germany and Austria) postponing their participation in this innovative mechanism. Secondly, the prohibition in some Member States of advance payments to final recipients in the voluntary and community sectors, due to national administrative restrictions also presents obstacles to the advancement of local employment measures.

THE COMMISSION'S REPLIES

3.119. *As regards small grants, the complexities and restrictions rightly identified by the Court should be dealt with individually by the Member States and/or the managing authorities concerned. The Commission has pleaded for more simplification in this area but has no authority over national mechanisms or administrative arrangements.*

CHAPTER 4

Internal policies

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INTRODUCTION

4.1. The European Union's internal policies focus in particular on the implementation and development of the single market covering four complete subsections of the budget and several headings in another subsection:

- (a) training, youth, culture, audio-visual 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); and
- (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), and Article B1-3 8 2 (Enhancing public awareness of the common agricultural policy, formerly part of B2-5 1 2 2).

4.2. The responsibility for implementing the internal policies and managing the corresponding budget is spread across 13 Directorates-General (DG), the principal ones being the DGs Research (RTD), Energy and Transport (TREN) and Information Society (INFSO) in terms of appropriations managed.

ANALYSIS OF BUDGETARY MANAGEMENT

Budgetary execution and financial perspectives

4.3. **Table 4.1** gives an overview of the budgetary execution in 2001 in comparison with the ceiling of the financial perspectives. In **Tables 4.2** and **4.3**, the use of the available appropriations during the financial year 2001 is summarised.

Table 4.1. — Evolution and Implementation of the 2001 budget and comparison with the financial perspective ceiling

(Mio EUR)

Heading of the financial perspective: internal policies										
	Total internal policies		of which							
			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)	
	CA	PA	CA	PA	CA	PA	CA	PA	CA	PA
Financial perspective ceiling	6 272,0									
Evolution of the budget										
Initial appropriations ⁽¹⁾	6 232,2 ⁽⁴⁾	5 854,8 ⁽⁴⁾	3 920,0	3 610,0	1 068,5	1 036,8	810,3	762,7	283,6	390,8
Final appropriations available ⁽²⁾	7 178,2 ⁽⁴⁾	6 485,4 ⁽⁴⁾	4 497,6	3 865,6	1 171,6	1 100,6	1 017,0	1 051,8	472,0	444,3
Implementation of the budget										
Appropriations used ⁽³⁾	6 703,3	5 303,1	4 183,7	3 195,9	1 119,7	865,8	966,0	880,6	433,9	360,7
% of final appropriations available	93,4	81,8	93,0	82,7	95,6	78,7	95,0	83,7	91,9	81,2
Appropriations carried over to 2002	315,1	707,4	269,3	432,9	8,6	155,3	32,5	97,4	4,7	21,9
% of final appropriations available	4,4	10,9	6,0	11,2	0,7	14,1	3,2	9,3	1,0	4,9
Appropriations cancelled	159,9 ⁽⁴⁾	474,9 ⁽⁴⁾	44,7	236,8	43,3	79,5	18,6	73,8	33,4	61,7
% of final appropriations available	2,2	7,3	1,0	6,1	3,7	7,2	1,8	7,0	7,1	13,9

⁽¹⁾ Budget as finally adopted by the European Parliament on 14 December 2000 (OJ L 56, 26.2.2001) including the relevant provisional appropriations for Heading 3 written in Chapter B0-4 0.

⁽²⁾ Budget appropriations as amended after taking account of supplementary and amending budgets and transfers, including appropriations carried over from 2000, reuse of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.

⁽³⁾ Appropriations used, including appropriations carried over from 2000, reuse of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.

⁽⁴⁾ Including chapter B0-4 0 (reserve).

NB: CA = Commitment appropriations; PA = Payment appropriations.

Source: revenue and expenditure account of the European Communities — volume II, section 1 (SEC(2002) 404-FR).

Table 4.3. — Evolution and Implementation of the 2001 budget, broken down by titles

(Mio EUR)

Title/Subsection of the budget	Heading	Commitment appropriations					Payment appropriations				
		Initial budget ⁽¹⁾	Final budget after SAB and transfers and additional appropriations ⁽²⁾	Appropriations used ⁽³⁾	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)	Initial budget ⁽¹⁾	Final budget after SAB and transfers and additional appropriations ⁽²⁾	Appropriations used ⁽³⁾	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)
B2-5	Other agricultural operations	53,6	53,6	49,8	93,0	92,9	107,5	107,5	79,2	73,7	73,7
B2-6	Other regional operations	15,0	15,0	15,0	100,0	100,0	15,0	15,9	15,2	101,3	95,8
B2-7	Transport	25,2	25,2	23,1	91,8	91,8	21,3	21,3	14,5	68,2	68,2
B2-9	Other measures concerning fisheries and the sea	26,1	62,1	52,4	201,1	84,4	55,8	55,8	43,8	78,5	78,5
	Total in B2	119,8	155,9	140,3	117,1	90,0	199,6	200,4	152,7	76,5	76,2
B3-1	Education, vocational training and youth	491,3	605,4	582,2	118,5	96,2	427,8	657,5	567,6	132,7	86,3
B3-2	Culture and audiovisual media	120,1	141,8	130,9	109,0	92,3	109,8	138,9	97,1	88,5	69,9
B3-3	Information and communication	86,6	114,7	104,3	120,5	90,9	91,4	110,5	93,5	102,3	84,6
B3-4	Social dimension and employment	112,4	155,1	148,6	132,2	95,8	133,7	145,0	122,4	91,6	84,4
	Total B3	810,3	1 017,0	966,0	119,2	95,0	762,7	1 051,8	880,6	115,5	83,7
B4-1	Energy	33,8	65,5	62,6	185,1	95,6	33,0	44,3	34,6	104,8	78,1
B4-2	Euratom nuclear safeguards	17,7	18,0	17,7	99,9	98,4	17,3	19,2	17,6	101,6	91,5
B4-3	Environment	112,3	232,8	213,4	190,0	91,7	140,9	180,4	155,8	110,6	86,4
	Total B4	163,8	316,2	293,6	179,2	92,9	191,2	243,9	208,0	108,8	85,3
B5-1	Consumer policy and consumer health protection	22,5	22,9	21,2	94,3	92,6	20,0	20,3	19,1	95,3	93,9
B5-2	Aid for reconstruction	1,3	3,3	3,3	258,6	99,9	1,3	3,3	3,3	258,6	99,9
B5-3	Internal market	144,3	157,1	142,3	98,6	90,5	159,9	167,8	126,7	79,3	75,5
B5-4	Industry	p.m.	p.m.	n.a.	n.a.	n.a.	p.m.	p.m.	n.a.	n.a.	n.a.
B5-5	Labour market and technological innovation	119,6	144,8	133,1	111,2	91,9	122,8	143,6	111,0	90,4	77,3
B5-6	Statistical information	32,6	36,5	35,2	107,9	96,3	31,0	36,2	32,6	105,0	90,1
B5-7	Trans-European networks	650,6	665,8	655,2	100,7	98,4	595,2	605,4	482,1	81,0	79,6
B5-8	Area of freedom, security and justice	92,6	136,1	125,1	135,1	91,9	101,8	117,8	85,6	84,1	72,7
B5-9	Measures to combat fraud	5,0	5,0	4,4	87,3	87,3	4,8	6,2	5,5	115,5	89,4
	Total B5	1 068,5	1 171,6	1 119,7	104,8	95,6	1 036,8	1 100,6	865,8	83,5	78,7
B6-1	Joint Research Centre – Staff and Resources	209,3	255,6	252,5	120,7	98,8	211,2	250,6	243,2	115,1	97,1
B6-2	Joint Research Centre – Direct operating appropriations – Scientific and technical support for Community Policies – EC Framework programme 1998 to 2002	29,6	55,1	28,9	97,5	52,4	32,3	43,7	30,4	94,3	69,6
B6-3	Joint Research Centre – Direct operating appropriations EAEC framework programme 1998 to 2002	10,8	18,5	11,0	102,3	59,8	12,0	15,8	12,4	103,1	78,5
B6-4	Joint Research Centre – Direct action – Completion of previous joint and supplementary programmes and other Joint Research Centre activities	p.m.	114,5	19,3	n.a.	16,9	1,5	101,6	18,2	1 213,8	17,9
B6-5	Indirect Action (Shared-Cost Projects) ... Completion of Earlier Projects...	p.m.	296,6	163,7	n.a.	55,2	693,5	1 087,7	672,8	97,0	61,9
B6-6	Indirect Action (Shared-Cost Projects) ... fifth framework programme 1998 to 2002	3 670,3	3 757,4	3 708,2	101,0	98,7	2 659,5	2 366,2	2 218,9	83,4	93,8
	Total B6	3 920,0	4 497,6	4 183,7	106,7	93,0	3 610,0	3 865,6	3 195,9	88,5	82,7
BO-4 0	Provisional appropriations = reserve	149,7	19,9				54,6	23,0			
	TOTAL	6 232,2	7 178,2	6 703,3	107,6	93,4	5 854,8	6 485,4	5 303,1	90,6	81,8

⁽¹⁾ Budget as finally adopted by the European Parliament on 14 December 2000 (OJ L 56, 26.2.2001).⁽²⁾ Budget appropriations as amended after taking account of supplementary and amending budgets and transfers, but including appropriations carried over from 2000, reuse of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.⁽³⁾ Appropriations used, including appropriations carried over from 2000, reuse of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.

NB: p.m. = token entry; n.a. = not available.

Source: revenue and expenditure account of the European Communities — volume II, section I (SEC(2002) 404-FR).

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4.4. Internal policies account for a global amount of 7 178,2 million euro in final commitment appropriations and 6 485,4 million euro in final payment appropriations (see **Tables 4.2** and **4.3**). As can be seen from **Table 4.1**, the available commitment appropriations exceeded considerably (by more than 14 %) the ceiling of the financial perspective. The largest part of the commitment and payment appropriations (4 497,6 million euro and 3 865,6 million euro, respectively) relates to research and technological development, and the major part of this (3 757,4 million euro and 2 366,2 million euro, respectively) to indirect actions co-financed under the fifth framework programme. The amounts relating to the trans-european Networks (TEN) were 665,8 million euro and 605,4 million euro for commitment and payment appropriations, respectively.

Review of the revenue and expenditure account (1)

4.5. In comparison with the document provided for the 2000 closure of accounts, the revenue and expenditure account for 2001 (2) has again improved generally in terms of form and content. However, with regard to specific budget headings, important information on the management of these budget headings is still missing.

4.5. *The Commission appreciates the Court's statement that the Financial Management Report 2001 has generally again improved in form and content.*

The Commission pre-selected the most important budget lines and programmes (34 in heading 3 and 30 in heading 4, among others) for a detailed analysis. The selection criteria took into account both the size of the budget appropriations and the perceived political importance of the programme.

This analysis covers not only variations between the final budget appropriations and the initial budget adopted by the Parliament or the level of the utilisation of appropriations, but also the 'output' resulting from the expenditure.

(1) The Court has reviewed the information presented by the Commission in Volume 1 of the revenue and expenditure account. The purpose of this volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available, as well as between the appropriations finally available and those utilised. The review only sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading, and not to provide assurance as to the reliability of its contents.

(2) SEC (2002) 404-FR.

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4.6. As can be seen from **Table 4.3**, the budget implementation with regard to both final commitment and payment appropriations for titles B6-2, B6-3, B6-4 and B6-5 was low. However, no explanation for this was given in the Commission's document.

4.7. In addition, the Commission's document does not, for example, give any information on budget heading B5-2 (aid for reconstruction), where the final commitment and payment appropriations were more than twice the amount foreseen in the initial budget.

Analysis of non-automatic carry-overs

4.8. Non-automatic carry-overs of commitment appropriations according to Article 7.2 of the Financial Regulation for the past two years (from 2000 to 2001 and from 2001 to 2002) have been relatively high for budgetary items relating to education, youth policy and culture (items B3-1 0 0 0 and B3-2 0 0 8), and for item

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4.6. With regard to the JRC appropriations (B6-2, B6-3, B6-4), a distinction should be made between two components:

- in the case of the institutional appropriations for the framework programme (which account for 62 % of commitment appropriations and 71 % of payment appropriations), 98 % of commitments and 94 % of payments were implemented,
- however, in the case of earmarked revenue needed to implement shared-cost projects and other competitive activities (accounting for 38 % of commitment appropriations and 29 % of payment appropriations), the volume of commitment and payment appropriations is set when the revenue is received, whereas implementation normally takes a number of years.

Title B6-5 covers the completion of indirect shared-cost projects from previous framework programmes. It contains an item for revenue accruing from third parties as a result of association agreements under the fifth framework programme which accounts for 99,4 % of commitment appropriations and 34,7 % of payment appropriations.

High utilisation rates for commitment appropriations were possible only in part, owing to uncertainties and occasional delays in making funds available.

There are structural reasons for the failure to use payment appropriations in full. Payment appropriations corresponding to third-country contributions are not estimated on the basis of annual requirements, but, on the contrary, are set at the level of the commitment appropriations as and when contributions are made, although implementation normally extends over a number of years as is the case for other research projects.

4.8. For education and culture as a whole (B3), carry-overs from 2000 to 2001, the first year of implementation for four programmes, three of which were adopted only in the course of the year, accounted for only 2,6 % of appropriations available; carry-overs from 2001 to 2002 accounted for only 1,2 % of appropriations available.

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B5-3 0 0 2 A (Operation and development of the internal market, particularly in the field of notification, certification and sectoral approximation — expenditure on administrative management). The carry-overs for the B3 items were mainly due to the late decision on the new Socrates, Culture 2000 and Youth Policy. As summarised in **Table 4.4**, an increase in carry-overs was also noted with item B5-7 2 1 0 (Networks for the interchange of data between administrations (IDA)).

4.9. Frequent non-automatic carry-overs of payment appropriations were identified in article B5-7 1 0 (Financial support for energy infrastructure; TEN-E) for the years 1999 to 2000 and 2001 to 2002 as well as article B5-8 1 0 (European refugee fund) for the past two years. As regards energy infrastructure measures, the amount for the 55 commitments for which the final due date had expired at the end of 2001 amounted to a total value of 23,7 million euro. In contrast to that, the total payment appropriations for 2001 amounted to 18,0 million euro only. Due to difficulties in the contract management of grants, 3,6 million euro were carried over to 2002 (see *Table 4.4*). The Commission was unable to use these appropriations within the budgetary year due to late allocation of payment appropriations to budget headings, late signing of contracts and payment delays.

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- In Item B3-1 0 0 0, the main reason for the carry-overs from 2000 to 2001 (EUR 2,5 million) was the time required to finalise a call for proposals in the field of minority languages; carry-overs from 2001 to 2002 amounted to only EUR 0,5 million.
- In Item B3-2 0 0 8, the carry-overs from 2000 to 2001 (EUR 10.5 million) were largely due to the delay in adopting the new legal base; carry-overs from 2001 to 2002 amounted to only EUR 0,5 million.

As for Item B5-3 0 0 2 A, the amount carried over (EUR 112 900, i.e. 10,3 % of the allocation in this line) was intended to finance two projects which were ready, but could not be authorised, in December 2001. The carry-over here is not of a structural nature.

The carry-over of EUR 1 428 235 in Item B5-7 2 1 0, (6,1 % of the 2001 appropriation) concerned a file on which the ACPC gave a favourable opinion at the beginning of December, but for which the legal commitment could not be finalised before 31 December.

4.9. As regards Article B5-7 1 0, implementation of a new framework contract designed to afford better protection to the Commission's financial interests (bank guarantee for an amount equal to the advance payments), led to a delay in signing the contracts in question. As a result, the Commission was unable to make all the advance payments on TEN-E contracts.

The delay in adopting the legal base setting up the European refugee fund (Articles B5-8 1 0 and B5-8 1 1) meant that all the payment appropriations had to be carried over from 2000 to 2001 (the legal base was finally adopted on 28 September 2000). The Member States were unable to use up the first advance payment in the course of 2001, so that part of the appropriations had to be carried over once again from 2001 to 2002.

Table 4.4. — Budget articles with frequent non-automatic carry-overs

(1 000 EUR)

Commitment appropriations										
Article / Item	Heading	1999			2000			2001		
		Authorised	Carried over to 2000		Authorised	Carried over to 2001		Authorised	Carried over to 2002	
			Amount	%		Amount	%		Amount	%
B3-1 0 0 0	Preparatory action for cooperation in the fields of education and of youth policy	(¹)	(¹)	—	3 426,5	2 512,8	73,3	5 910,0	454,0	7,7
B3-1 0 0 1	Socrates	(¹)	(¹)	—	231 840,0	1 913,6	0,8	239 306,0	3 330,1	1,4
B3-1 0 2 1	Leonardo Da Vinci	140 393,0	1 851,9	1,3	138 230,0	619,9	0,4	142 397,0	579,1	0,4
B3-2 0 0 8	Framework programme in support of culture	—	—	—	35 843,0	10 521,7	29,4	31 580,0	527,6	1,7
B5-3 0 0 2 A	Operation and development of the internal market, particularly in the field of notification, certification and sectoral approximation — Expenditure on administrative management	—	—	—	1 215,0	99,0	8,1	1 093,5	112,9	10,3
B5-6 0 0	Policy on statistical information concerned with non-member countries	32 525,0	172,8	0,5	30 481,5	87,9	0,3	30 183,1	77,3	0,3
B5-7 2 1 0	Networks for the interchange of data between administrations (IDA)	(¹)	(¹)	—	22 371,0	275,2	1,2	23 516,0	1 428,2	6,1
B5-7 2 1 1	Networks for intra-Community statistics (Edicom)	10 950,0	1 459,0	13,3	(¹)	(¹)	—	9 370,0	149,2	1,6
B6-6 1 1 1	Quality of life and management of living resources — Operating expenditure	529 500,0	1 106,0	0,2	542 222,0	262,0	0,0	604 158,0	941,2	0,2
B6-6 1 4 1	Preserving the ecosystem (EC) — Energy, environment and sustainable development (EC) — Environment and sustainable development — Operating expenditure	(¹)	(¹)	—	235 077,0	1 467,3	0,6	276 386,0	5 137,8	1,9
Payment appropriations										
Article	Heading	1999			2000			2001		
		Authorised	Carried over to 2000		Authorised	Carried over to 2001		Authorised	Carried over to 2002	
			Amount	%		Amount	%		Amount	%
B5-7 1 0	Financial support for energy infrastructures	16 000,0	4 550,0	28,4	(¹)	(¹)	—	18 000,0	3 591,0	20,0
B5-8 1 0	European refugee fund	—	—	—	16 280,0	1 746,0	10,7	47 090,0	6 337,7	13,5

(¹) No carry-overs to next year.

Source: Commission (SEC(2000)481; SEC(2001)449; C(2002)1055.

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SPECIFIC APPRAISAL IN THE CONTEXT OF
THE STATEMENT OF ASSURANCE*Audit objectives and scope of the audit*

4.10. The objectives of the audit for the 2001 Statement of Assurance (DAS) in the internal policies (IP) budgetary area were:

- to contribute to the Court's Statement of Assurance on the general budget for 2001 (see Chapter 9 of this Annual Report) through the collection of sufficient, relevant and reliable audit evidence on the reliability of the accounts for the year ending 31 December 2001 and on the legality and regularity of the underlying transactions at Commission level, including an assessment of the reform of the Commission's internal control system, and
- to perform a system analysis of Trans-European transport networks (TEN-T) (see points 4.11 to 4.36) and a follow-up of the 2000 DAS system analysis ⁽³⁾ on the fifth European Community (EC) framework programme for research and technological development (see points 4.37 to 4.51).

*System analysis of the trans-European transport networks (TEN-T)***Nature of the expenditure and audit approach**

4.11. The TEN-T management system, which is wholly managed by DG TREN, is, in value terms, the largest non-research management system of the IP area. In the 2001 general budget, the budget heading TEN-T (B5-7 0 0) corresponds to commitment and payment appropriations of 575 million euro and 525 million euro respectively (99,5 % of which are for operational credits).

⁽³⁾ Annual Report concerning the financial year 2000.

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4.12. TEN-T actions are grants ⁽⁴⁾ which may take one or more of the following forms:

- co-financing of studies (including preparatory, feasibility and evaluation studies and other technical support measures);
- interest rebates whose duration may in general not exceed five years;
- contributions towards fees for guarantees;
- direct grants to investments in duly justified cases; and
- risk-capital participation.

4.13. According to Commission statistics, 803 TEN-T actions with an EU contribution of 2 987 million euro were funded between 1995 and 2001. Studies and direct grants to investments, amounting to 1 331 million euro and 1 417 million euro respectively, constitute the major part of the TEN-T actions funded, followed by interest rebates representing a total funding of 239 million euro.

4.14. TEN-T actions are implemented by Commission Decisions only or by Commission decisions accompanied by contracts, which both define a maximum EU contribution based on estimated eligible costs. Contracts are concluded with the final beneficiaries for less than 6,5 % of TEN-T actions amounting to 16 % of commitment appropriations. These Commission decisions must be addressed directly to the beneficiaries and to the Member States and must always state the responsible implementing authority, the recipient and the final beneficiary of aid. Although required by Article 10 of Council Regulation (EC) No 2236/95, 13 cases were found where Commission Decisions were notified to Member States only but not to final beneficiaries.

4.14. *The Commission states that from 2002 the decisions will also be notified to the beneficiary.*

⁽⁴⁾ Regardless of the intervention system chosen, the maximum EU contribution is fixed at 10 % of the total investment cost (including studies), except for TEN-T actions concerning 'Galileo' satellite positioning and navigation systems (other than studies) for which the EU contribution can reach a maximum of 20 % as from 2003. For studies related to projects including preparatory, feasibility and evaluation studies and other technical support measures, the EU contribution should not exceed 50 % of the total cost of the study.

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4.15. Payments for TEN-T actions are made as:

- advance payments which may not exceed 40 % for direct grants and 50 % for studies of the maximum EU contribution,
- intermediate payments upon provision of evidence that the actual costs for the TEN-T action have reached at least 70 % of the total estimated eligible costs, and
- final payments when the action has been duly completed.

4.16. For interest rebates, payments follow a schedule set out in the corresponding Commission decision and may be made in whole or in part. Advance and interim payments may not exceed 95 % of the maximum EU contribution granted.

4.17. The audit of TEN-T system was based on an evaluation of the system design and on a verification of its consistent, continuous and effective operation. For this purpose, a description of the administrative and control procedures as at December 2001 was established, walk-through tests were performed to check the accuracy of the description, and the operation of the key controls was tested on the basis of a sample of 32 TEN-T actions (covering 39 % of 2001 payment appropriations by value). Control and substantive tests were carried out at Commission level for all actions sampled, while cost claim-based payments were also audited at final beneficiary level.

Inadequate definition of work and eligibility of costs

4.18. The definition of eligible and ineligible costs provided for in the legal basis and the Commission decisions is insufficiently specific to establish the actual costs incurred by the beneficiary. The definition of eligible costs for TEN-T actions differs from the definition applied to similar infrastructure projects co-financed through Structural Measures, and the use of different funding rates carries the risk that beneficiaries may maximise funding by wrongly allocating costs to studies:

4.18. *More detailed indications on eligibility of costs can be found in the TEN Financial Assistance Committee Glossary. Concerning studies in particular, as from 2000, the application forms include information regarding external and internal costs. As from 2002, the standard text of the TEN-T Commission Decision for studies and projects has been substantially revised, it was inspired by the Cohesion Fund decision and provides more details of eligible cost and takes on board the Court's observations. The revised text will be applicable from the Commission's 2002 decision.*

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- Regulation (EC) No 2236/95, as amended by Regulation (EC) No 1655/99, and Annex II of all relevant Commission decisions simply specify that direct costs exclusive of VAT incurred by the action, as well as indirect costs subject to the application of generally accepted accounting principles (GAAP), are considered as eligible. In addition, a glossary adopted by the TEN Financial Assistance Committee exists which is, however, not legally binding,
- studies and direct grants to investments co-financed through TEN-T often relate to larger-scale infrastructure measures similar to those funded by structural measures. However, these programmes have a much more detailed definition of the eligibility of costs. In addition, cost categories not eligible for co-financing under structural measures (such as entertainment costs, interest charges or personnel costs for national civil servants are considered eligible under TEN-T,
- the use of different rates of EU contributions (up to 50 % of eligible project-related costs for studies as compared to up to 10 % of eligible costs for direct grants to infrastructure projects) carries the risk that costs associated with the construction of infrastructure may be charged to studies.

Moreover, no detailed technical annex defining what work has to be carried out under TEN-T actions is provided except for those actions implemented by means of contracts.

4.19. Given the lack of concise guidelines, final beneficiaries interpret the eligibility of project-related costs differently. The absence of standardised cost statement forms further complicates the review and evaluation of claims and makes it more difficult for Member States to exercise their control responsibilities. In addition, it was shown that Commission officials, when carrying out on-the-spot controls, assess the eligibility of costs on a case-by-case basis.

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The examples given by the Court are not eligible according to the Glossary and as a general rule are always excluded when detected in a declaration.

As far as studies are concerned, the risk mentioned by the Court may exist. However, in general cost claims, have to be substantiated and they are thoroughly examined, both technically and financially in order to minimise the risk of over-declaration or wrong allocation of costs.

The Commission is committed to improving the clarity of the definitions of eligible costs and the definition of works covered by a decision. However, the Commission also has the firm intention to keep the TEN-T funding mechanism as simple as possible.

4.19. *In the framework of the general review of the TEN-T procedures, DG TREN will examine the possibility of elaborating a more detailed standardised cost statement form, based on the existing payment claim form.*

Nevertheless, the absence of a standardised cost statement has no bearing on the Member States' capacities to exercise their responsibilities in accordance with Article 15 of Regulation (EC) No 2236/95.

It is clear, that during on the spot controls, judgement on the eligibility of specific costs relating to specific actions within a project has to be made case-by-case, whilst adhering to the general cost eligibility criteria and principles of the TEN Glossary.

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4.20. In addition, both the Regulation and the contracts or annexes of the Commission decisions include provisions (such as the duration of the co-financing period for each action) that allow for different interpretations ⁽⁵⁾. Some requirements (for instance with regard to the publicising of EU co-financing) differ depending on the legal relationship (i.e. Commission decisions or contracts) between the Commission and the final beneficiary. Such differences cannot otherwise be justified. This simply adds unnecessary complexity to the programme.

Official procedures manual not fully applied, no adequate segregation of duties and insufficient IT-support provided for TEN-T actions

4.21. The officially approved administrative and financial procedures of DG TREN are not always followed for the TEN-T programme. Instead, an unofficial and less detailed TEN-T process description is used for the management of this programme. This is not in line with the Commission's internal control standards. ⁽⁶⁾

4.22. Regarding evaluation and monitoring, the segregation of duties is inadequate as officials evaluating proposals are also responsible for monitoring the retained projects. Only road traffic management proposals are evaluated by two external experts who establish a 'project assessment form', which is later reviewed by the desk officer. Also, the Court found evidence that seconded national experts were in charge of evaluating and monitoring projects submitted by their own Member States, which presents the risk of a potential conflict of interests.

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4.20. *The revised Commission decision text, as from 2002, introduces fixed start and completion dates.*

In those cases where Member State, implementing authority, recipient and final beneficiary are notified of the Commission Decision, the legal relationship with the final beneficiary is the same irrespective of whether there is a contract in addition to a Commission Decision or not. The Commission agrees however, that provisions regarding certain issues, such as publicity, are more specific in the contracts than in the Commission decisions.

4.21. *In 2001 the TEN-T procedures had not been completely integrated in DG TREN's official Manual of administrative and financial procedures. The procedures in use since the adoption of the TEN-T legal basis in 1995 were still applied. The second revision of the Manual is expected to be completed by the end of 2002 and the new release will incorporate the procedures which are applicable to the TEN-T programme.*

4.22. *The Commission confirms that the desk officers play an important role in the evaluation of proposals and in the monitoring of projects. However, regarding the selection procedure, the desk officer's preliminary proposal for support for an individual study/project is subject to extensive consultations within Commission Services before it becomes a final proposal. The application of the practices followed in Road Traffic Management will be examined as to their suitability for expansion to other modes as well.*

The evaluation and monitoring of projects by seconded national experts for projects submitted by their own Member States cannot always be avoided. It is recognised that this situation is not entirely satisfactory, and supervision by the hierarchy is meant to minimise the risks.

⁽⁵⁾ Regulation (EC) No 2236/95 as amended by the Regulation (EC) No 1655/99: this is for instance the case when using expressions such as 'in general', 'as a general rule', 'indicative', 'in duly justified cases' or 'suitable' without identifying when exceptions to the general rule are to be accepted.

⁽⁶⁾ DG Budget — Central Financial Service, 'Standards for Internal Control within the Commission's services' (2 February 2001): point 15 'Documentation of procedures', p. 18.

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4.23. The central IT system of DG TREN, which has an interface to Sincom since early 2002, is not yet used for the TEN-T programme. Three different databases (providing information on proposals, evaluation and project monitoring) exist and they can also be used for the preparation of statistics on programme implementation. These three databases are incomplete, partly duplicate information and lack certain basic functions (such as progress and final reports, technical and financial appraisals related to studies or cost statements and due dates). Moreover, the information contained in the database which provides statistics on payments could not be reconciled with Sincom, calling into question its reliability.

Deficiencies in the operation of key controls

4.24. Tests of the operational key controls revealed that some have not been operating effectively. In particular, deficiencies were identified in respect of:

- the acceptance of proposals received after the final due date ⁽⁷⁾,
- the operation of the evaluation process, and
- the authorisation of cost-claim-based payments for studies where ineligible costs had been claimed by the final beneficiaries and accepted by the Commission following on-the-spot controls.

4.25. Furthermore interim and final payments were authorised and paid by the Commission, although specific pre-conditions required to consider the action as completed, or as one that had made sufficient progress, had not been fulfilled at the time of the authorisation. For example, technical reports and/or financial apprais

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4.23. *The three databases mentioned by the Court provide information on proposals, evaluation and project monitoring, thus are specific local applications for different purposes. The exercise for the integration of TEN-T into the central DG TREN IT project management system is under way. The first phase of the integration process will be operational by end 2002.*

4.24. *There are cases, where the official final due date for the acceptance of proposals has been extended either through official correspondence with the Member States or during the TEN-T Financial Assistance Committee meetings.*

The occasional flexibility exercised with regard to the acceptance of proposals after the due date is linked largely to the fact that there are different planning and budgetary timetables and considerations in the Member States. Each request for acceptance after the final due date is carefully examined and approval is only granted if the case is fully justified.

See paragraph 4.22 above regarding the evaluation process.

On the basis of evidence provided by the final beneficiaries and controlled by the Commission, the latter considers that no ineligible costs have been accepted that have an influence on the final amount paid. The Commission will review the cases identified by the Court.

4.25. *The obligation for Member States to submit appraisals to accompany final claim documentation was introduced in the TEN-T decision in 1995 only for studies. Only the recently proposed new revised decision text extends this obligation to works.*

⁽⁷⁾ In addition the reception date is not systematically registered, making it nearly impossible to assess whether the verification of this eligibility criterion is done correctly or not.

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als from Member States were missing in 12 out of 19 cases but were required by Article 2.1 of Annex II to Commission decisions. This resulted in payments not being charged to the correct budgetary year.

4.26. In addition, the documentation on the controls operated was not always adequate. Evaluation forms, technical approvals and authorisation forms for payments and commitments (i.e. CECOF fiche) were not always dated and signed and included in the file.

The audit concludes that, except for studies, assurance can be given as to the legality and regularity of transactions

4.27. Despite these weaknesses in internal controls, the audit concludes that overall reliance can be placed on the system and assurance can be given as to the legality and regularity of transactions, except for payments for the matters raised in paragraph 4.29 below.

4.28. Although all commitments audited were legal and regular, the Court has the following observations to make:

- the proposals were not always submitted within the deadlines set by the Commission, and
- the evaluation process was in some cases not sufficiently documented.

4.29. Payments were legal and regular except for studies, where in five out of the seven studies audited on-the-spot, evidence of overpayment due to the inclusion of non-eligible costs charged for work related to the construction of infrastructure were identified. For direct grants to investments, the audit found that, despite the risk that costs may be overstated by final beneficiaries,

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It is acknowledged that in a number of cases payments had been released before the formal receipt of the required reports because alternative evidence existed that the actions had progressed sufficiently. This evidence could be for instance the result of a site visit by the responsible desk officer. As the Commission agrees that formally the reports should have been received before the release of the payment, the Manual of administrative and financial procedures, which is under development for the TEN-T part, will emphasise the necessity to obtain the reports before making the payments.

4.26. *The Commission has taken note of the Court's finding. The reinforcement of the formal documentation of the operated controls and the archiving of all documents will accompany the release of the updated Manual of administrative and financial procedures.*

4.28. *In these cases an extension had been agreed as mentioned in paragraph 4.24.*

The individual appraisal forms per project, which were introduced in mid 2000 will facilitate an appropriate documentation of the evaluation process by the Commission services in the future.

4.29. *In the five cases mentioned by the Court the Commission's interpretation of the definition of eligible costs for 'studies' differs from the Court's interpretation.*

Article 4(1)(a) of TEN-T Regulation (EC) No 2236/95, states that Community aid for projects may take the form of co-financing of studies related to projects, including

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the declaration of ineligible costs for direct grants to investments is unlikely to result in an overpayment by the Commission. This is mainly due to:

- the limitation of the EU contribution to 10 % of the total investment costs, and
- the fact that actual project costs are usually higher than initially budgeted whereas a maximum EU contribution is defined in the contract or Commission decision.

In addition, for some final payments not all the requirements for their release were observed. As a result, these payments were charged to an incorrect budget year.

4.30. Moreover, the TEN-T programme is not being implemented consistently since different rules can apply to beneficiaries and ambiguity in some provisions may lead to different interpretations.

Strengthening of the legal and control framework for the TEN-T programme recommended

4.31. The Commission should aim for a homogeneous implementation of the TEN-T programme, applying the same provisions to all beneficiaries in all Member States. The legal framework of the TEN-T programme should be strengthened in order to improve the protection of the Community's financial interests. Where contracts are not concluded with final beneficiaries, offer letters could be implemented by Member States based on a framework set by the Commission. These offer letters, requiring a written acceptance by the beneficiary, should define the terms and conditions of the grant, thus enhancing the beneficiaries' awareness of the specific requirements to be met when implementing the action.

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preparatory, feasibility and evaluation studies, and other technical support measures for the studies. Under technical support measures, all preparatory phases concerning the technical, environmental and geological preparation of major projects, prior to construction, are being considered.

Development studies for traffic management applications or preparatory construction works linked to the exploring of the construction site, the construction of trial bore tunnels, drilling or geotechnical investigations, are considered eligible as technical support measures, qualifying for up to 50 % Community financial support. These pre-construction phases, entail the highest risk element of a project and are necessary for the award of building permits. It is obvious that the boundary between preparatory construction works and regular construction works is not always easy to define. Therefore, in most cases the Commission officials perform an on-the-spot visit to decide case-by-case whether the beneficiaries classification of the costs under preparatory works was acceptable.

As explained in paragraph 4.25, alternative evidence existed to satisfy the Commission that actions had progressed sufficiently and that payment could be released.

4.30. *The same legal basis and decision text is applicable to all beneficiaries receiving financial aid under TEN-T. To avoid interpretation problems the Commission will produce a Handbook for TEN-T users, based on the example of the Cohesion Fund Manual.*

4.31. *The new Commission decision text introduces stricter provisions and complements the existing legal framework.*

The Legal Service of the Commission has given an opinion, stating that it is not necessary to conclude contracts in addition to Commission Decisions. The Commission Decisions are to be notified directly to both the Member State and the final beneficiaries in accordance with Article 10 of Regulation (EC) No 2236/95. The Commission acknowledges, however, that until the end of 2001 only the Member State was notified, and the Member State informed the beneficiary.

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4.32. The Commission is also encouraged to develop and implement clearer rules with regard to the eligibility of costs. For that purpose, existing rules applied for similar types of infrastructure projects co-financed as structural measures could be used as a basis. In particular, the definition of eligible costs should also include a clear delimitation of which costs are eligible for studies (in particular for costs associated with exploring the construction site and preparatory construction works). The Commission should also provide for standardised cost statement forms. Ambiguous expressions should be avoided when drafting the legal basis and/or contractual provisions.

4.33. While regular on-the-spot checks are already performed by the Commission officials in charge of monitoring TEN-T actions, it is recommended that these controls should be complemented by *ex-post* financial and technical audits (where appropriate, carried out by DG TREN or external experts).

4.34. In order to comply with the Commission's Internal Control Standards, DG TREN is also invited to apply the procedures approved by its Director-General, modified where necessary to reflect the actual procedures in place for managing the TEN-T programme. Operational procedures should then be kept up-to-date.

4.35. DG TREN should rigorously apply eligibility criteria for proposals (in particular with regard to the reception dates) and strengthen the evaluation process by widening the use of external experts, as well as properly documenting all controls operated.

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4.32. *As mentioned in paragraph 4.18, as from 2002, the standard text of the TEN-T Commission Decision for studies and projects has been substantially revised and provides more details on eligible costs.*

As explained in paragraph 4.29, Article (4)(1)(a) of Regulation (EC) No 2236/95, states that Community aid for projects may take the form of co-financing of studies related to projects, including preparatory, feasibility and evaluation studies, and other technical support measures for the studies.

The Commission will examine the possibility of producing a more detailed standardised cost statement form as stated in paragraph 4.19.

4.33. *Financial control and technical verification visits on the spot at the closing stage of projects have been a long-standing practice for TEN-T. In general they are carried out by the Commission departments in charge. Only in a few exceptional cases have external experts been used. With the entry into force in early 2002 of a framework contract covering technical assistant activities, including particular provisions for audits on TEN-T projects, more use of external resources is likely to be made.*

In conformity with the Court's recommendation DG TREN's central financial audit cell will include a sample of TEN-T actions in its audit programme for the years 2002 to 2003.

4.34. *As mentioned in paragraph 4.21 the revision of the manual is in progress and the new release will incorporate the procedures which are applicable to the TEN-T programme.*

4.35. *As mentioned in paragraph 4.24 late receipts of proposal are justified by appropriate extensions.*

Regarding the evaluation process a wider use of external evaluators is a sensitive issue for reasons of confidentiality. Further in depth discussion and consultation (including the Member States) would be necessary.

The integration of the TEN-T procedures in the official manual of procedures will clarify the requirements concerning the appropriate documentation of controls.

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4.36. A migration from the current databases to the central DG TREN IT system should be done as quickly as possible, taking into account the specific requirements of TEN-T. In the meantime, solutions should be sought on how to cope with key functions with regard to proposal, contract and/or project management which are as yet missing or incomplete in the current IT systems.

Continuing the system analysis of the fifth framework programme

Nature of the expenditure and audit approach

4.37. Research activities financed under the EC section of the fifth framework programme consist mainly of indirect actions (about 93 % of the budget) carried out through contracts with third parties co-financed by the Community budget. The budget headings concerning the four thematic and three horizontal programmes (indirect actions) in the European Community (EC) section of the fifth framework programme correspond to payment appropriations of 2 366 million euro in the budget for 2001, which represents more than 60 % of the payment appropriations in subsection B6 Research and technological Development.

4.38. The Community section of the fifth framework programme is operated by five Research DGs (Research, Information Society, Energy and Transport, Enterprise and Fisheries). According to statistics provided by the Commission, 11 836 contracts for fifth framework programme indirect RTD actions with an EU contribution of 10 974 million euro had been signed by the Commission before the end of December 2001.

4.39. In the context of the 2001 DAS, the Court continued and extended its analysis of the administrative and control system of the fifth European Community framework programme for research, technological development and demonstration (RTD) activities. Whilst the DAS specific appraisal in last year's Annual Report ⁽³⁾ aimed at a qualitative assessment of the strengths and weaknesses of internal control at the Commission, the main objective of this year's audit was to provide a conclusion as to the legality and regularity of underlying transactions at the final beneficiary level.

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4.36. *As mentioned in paragraph 4.23 the integration of TEN-T into the central DG TREN IT project management system is under way.*

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4.40. In total, a sample of 19 contracts for indirect RTD actions with cost-claim-based payments authorised in 2001 were audited at the final beneficiary level. This sample provided a coverage of all programmes and most DGs and was intended to allow broad conclusions to be drawn. The contracts selected (all of which were included in the sample selected for the system analysis of the fifth framework programme reported last year) represent an EU contribution of up to 73,3 million euro.

Significant incidence of overpayments mainly due to beneficiaries not complying with the contractual provisions

4.41. For research framework programmes, financial contributions are granted based on claims for costs actually incurred, duly justified and necessary for carrying out the indirect RTD action. The audit concluded that, in all of the 19 contracts examined, costs had either been overstated by the beneficiary or the beneficiary was unable to justify the costs claimed. For the sample audited a significant incidence of overdeclaration in the cost statements audited was found, leading to a corresponding rate of overpayments by the Commission.

4.42. The main reason for these overclaims was due to the beneficiaries' non-compliance with contractually-defined obligations for the reimbursement of costs. In particular it was found that:

- the supporting documentation (such as time records for personnel costs) justifying the costs incurred was either non-existent or inadequate,
- the calculation methodology for personnel costs and overheads (for those beneficiaries participating under the full cost model) was incorrect,
- the beneficiary charged budgeted rates rather than actual costs, or average employment costs, which deviated significantly from actual costs, and
- the beneficiary claimed ineligible expenditure (such as VAT or subcontracting costs not approved by the Commission) or transferred parts of the budget between cost categories or contractors without the mandatory authorisation of the Commission.

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4.41. *The Commission acknowledges that there were errors in the cost statements of the beneficiaries audited by the Court. The Commission continues to reinforce its efforts to reduce such errors, both in the implementation of the fifth framework programme and with a view to the sixth framework programme (see replies 4.47 to 4.50).*

4.42. *The Court has identified key areas of difficulties for beneficiaries to apply correctly and fully the contracts of the fifth framework programme. The Commission acknowledges that some of these may have created errors.*

The Commission has taken and will continue to take initiatives to raise awareness among contractors in order to reduce the significant number of errors which are due to misunderstanding or misinterpretation of contractual conditions by beneficiaries.

Specifically:

- *the Commission agrees with the Court about the requirement of time recording (or records of presence). Alternative documentation fulfilling the terms of the contract has to be taken into account,*
- *the calculation methodology for personnel costs and overheads has been applied incorrectly in some cases,*
- *the charge of budgeted rates rather than actual costs is foreseen in the contract and if necessary needs to be corrected in the final cost statement. With regard to the choice of contractors between the use of actual or average employment costs, only a significant difference*

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Most of these irregularities can only be detected when carrying out an audit on the premises of the contractor.

4.43. In three cases, overpayments were also caused by administrative mistakes at the Commission (use of the wrong exchange rate, incorrect encoding of cost claims in IT systems, acceptance of expenditure outside the eligibility period or cost categories not provided for in the contract and the signing of contracts with ineligible types of activities) which should have been prevented or detected and subsequently corrected by the internal control system of the DGs concerned.

The audit concludes that there are serious concerns about the level of assurance that can be given as to the legality and regularity of transactions at beneficiary level

4.44. Cost claim-based payments for indirect RTD actions of the fifth framework programme recorded during the year revealed a significant incidence of errors mainly due to an overdeclaration of costs by final beneficiaries. Based on the sample audited, no overall improvement was noted as compared with the previous framework programme ⁽⁸⁾.

4.45. Based on the audit of the Commission's management system (covering mainly the parts of the system from the submission of proposals up to the payment of advances), the Court concluded in its Annual Report for the year 2000 that 'only a limited assurance can be derived from the internal control procedures in place' ⁽⁹⁾. The continuation and expansion of this work, in respect of cost-claim based payments, found a

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constitutes an error. The Commission insists that the significance of a deviation between average and actual rates can only be judged on a case-by-case basis. The assessment of the significance needs to take the structure of personnel cost categories of the recipient into account, and must maintain the objective of simplification. Neither the use of budgeted rates nor that of average rates has to be indicated by participants when submitting their cost statements.

4.43. *The cases of overpayment connected with an administrative error which have a financial impact identified by the Court have been corrected and appropriate measures have been taken to adjust the amounts in question.*

4.44. *The Commission agrees that overdeclaration continues to be an important issue. The first audit reports of the Commission on a much larger scale will be available by the end of 2002 and will enable further conclusions to be drawn.*

4.45. *Following the Court's system audit of the year 2000 and also in the context of the ongoing financial reform, the Commission has already improved several aspects of the internal control mechanisms.*

The current cost system is undoubtedly complex, and a further simplified approach has been proposed for the sixth framework programme (see 4.47 to 4.50). Sanctions exist, but will

⁽⁸⁾ Annual Report concerning the financial year 1999.

⁽⁹⁾ According to the Commission services, an auditable contractor is defined as a contractor participating in an active contract who has submitted at least one cost statement, which is recorded in the central database of the DGs concerned.

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sufficiently high incidence of errors to raise serious concerns about the reliance that can be placed on the control operated by the Commission to prevent or detect and correct overdeclarations by final beneficiaries. The current system of cost reimbursement with three main types of systems, i.e. additional cost (AC), Full Cost (FC) and Full Cost Flat Rate (FF), and ten different categories for direct, indirect and coordination costs, is too complex to be controlled effectively by the Commission services. Given the limited number of ex-post financial audits undertaken (with the objective of auditing up to 10 % of all contractors during the duration of the fifth framework programme) by, or on behalf of, the Commission (see paragraph 4.60), together with the absence of contractually-defined sanctions, there is little dissuasive effect to prevent beneficiaries from overstating their actual costs.

4.46. Moreover, as far as the AC system (which provides for a 100 % reimbursement of the costs claimed) is concerned, only costs additional to the recurring costs have to be substantiated and justified to the Commission. In the case of contractors covered by this cost system (mostly universities and public research institutes without an appropriate cost accounting system) a verification of the reality and the extent of their co-financing of indirect shared-cost RTD actions is, by definition, impossible.

Simplification of the cost reimbursement system and the introduction of more effective sanction mechanisms recommended

4.47. In order to reduce the risk of non-eligible expenditure being unintentionally or intentionally declared by final beneficiaries and to allow for more accurate and effective financial management of indirect RTD actions by the Commission services, a fundamental simplification of the cost reimbursement system in the forthcoming sixth framework programme (2002 to 2006) is recommended. The three main types of cost systems (AC, FC, and FF) should be replaced by a single system and the ten cost categories should be reduced to three (i.e. personnel, coordination costs and specific costs) with a much wider use of flat rates:

- personnel costs for staff directly employed by the beneficiary and carrying out scientific and

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also be reinforced (see 4.51). At the same time the efforts of explanation and communication, of significantly increasing the coverage of on-the-spot audits of contractors in fifth framework programme, of putting in place a more effective recuperation of amounts overcharged have been significant, and will be reinforced in the light of the findings of the Court

4.46. *The AC system is based on explicit provisions of the legal base and provides for a technical facility to basically those public bodies which do not have complex accounting systems comparable to private companies. The substantiation and verification of the co-financing of those contractors is therefore excluded by definition through the explicit provision of the legislator.*

4.47. *The proposal of the Court of Auditors has the merit of genuinely simplifying procedures and at the same time offering greater legal and financial certainty to the Community and to contractors alike. It was proposed by Commission departments when they were preparing the rules on participation and dissemination of results for the sixth framework programme 2002 to 2006. This proposal for a new single cost calculation system was rejected by the Council and Parliament.*

While the Council acknowledged that this new method was indeed simpler and more secure than those used in the fifth framework programme, it saw in it the major disadvantages of restricting the autonomy and flexibility of participants, and of being financially 'unfair' for individual participants (= same

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technical work should be claimed on the basis of actual costs (gross remuneration and related charges) incurred and necessary for the project and the average number of productive hours negotiated before the signature of the contract,

- coordination costs (which should cover the administrative and financial coordination of the indirect RTD action, travel and subsistence costs, consumables, computing and all indirect costs) should be defined as a flat rate amount,
- other substantial specific costs would cover itemised costs such as subcontracting, durable equipment purchased or used specifically for the indirect action or the protection of knowledge. However, given their exceptional character, they must be negotiated and clearly specified in the contract.

4.48. Such a drastically simplified cost reimbursement system would allow improved planning for all parties to the contract. In addition it would set the basis for a more efficient and cost-effective external certification of cost statements (as recommended in the Court's Special Report No 17/98 on the fourth framework programme 'Joule-Thermie' ⁽¹⁰⁾).

4.49. Alternatively, in particular where scientific and technological deliverables can be clearly defined, the Commission could negotiate value-based contributions for specific activities within an indirect RTD action. Following this approach a pre-set Community financial contribution per activity could be paid upon approval of completion or receipt of the deliverables defined in the contract.

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Community financial contribution where efforts are the same) compared with the methods used in the fifth framework programme.

The Council and Parliament made it clear that this new method could not be the only one in use for full-cost participants but that it might stand alongside a real full costs method with no flat-rate component and based on ex post audit.

Commission departments are therefore bound to use simplification options other than those recommended by the Court of Auditors.

4.48. *As regards the certification of cost statements, both the Commission's proposal and the relevant Council and Parliament texts clearly state that participants' costs in an indirect action must be certified by an external auditor or, for public-sector entities, by a competent and independent public officer (Article 14 of the rules on participation and dissemination of the results of the sixth framework programme). The experience of DG INFSO, DG ENTR and DG RTD's pilot projects in this area will be taken into account.*

4.49. *While the Commission's amended proposal of 10 January 2002 explicitly included the possibility of applying the concept of value per activity, its intention was to resort to this only in very specific and infrequent cases, and at the discretion of the authorising officer where he considered it relevant and appropriate.*

On this point, the text adopted by the Council and Parliament on the rules for participation and for the dissemination of results states explicitly that value per activity may be used only with the agreement of the participants (Article 14(2)) and by way of exception to the general principle of real costs.

⁽¹⁰⁾ OJ C 356, 20.11.1998.

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4.50. As recommended in the Court's Special Report No 9/99 on 'FAIR' ⁽¹¹⁾ (covering one of the specific programmes of the fourth framework programme), model contracts for indirect RTD actions should provide for participants to bear unlimited joint and several liability for the use made of the Community financial contribution (with the exception of participants such as public universities who cannot for legal reasons be held jointly and severally liable).

4.51. Finally, as stated in last year's Annual Report, the Commission is encouraged to protect the Community's financial interests by imposing the sanctions provided for in Council Regulation (EC, Euratom) No 2988/95 ⁽¹²⁾. In addition to the recovery of the wrongly obtained advantage, these sanctions should be visible and provide for proportionate administrative measures and penalties in order to be both effective and dissuasive. These sanctions could be defined in model contracts or introduced by means of a specific sectoral rule.

⁽¹¹⁾ OJ C 92, 30.3.2000.

⁽¹²⁾ OJ L 312, 18.12.1995, p. 1.

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4.50. *The principle of unlimited joint and several liability of participants was explicitly contained in Article 13 of the Commission's amended proposal of 10 January 2002 on the rules for participation and for dissemination of the results.*

The unlimited scope of liability was dropped at the request of the Council and Parliament.

However, in the text adopted by the Council and Parliament, the principle of joint and several liability is contained in Article 13, even though it is not referred to as such.

The text also defines the way in which this liability can be put into effect, instruments and situations being clearly distinguished.

4.51. *The reference to Regulation (EC, Euratom) No 2988/95, which the Commission made in its proposal, also appears in the text adopted by the Council in Article 19 of the rules on participation and dissemination of results. In addition the standard contracts will, where appropriate, provide for the penalties to which the Court of Auditors alludes, given that for the time being there are no sectoral rules.*

Furthermore, on a more general level, the Commission's action plan for 2001 to 2003 on the fight against fraud (COM (2001) 254 final) envisages the preparation of an initiative to integrate administrative measures and sanctions in the field of direct expenditure. This initiative should provide the possibility to impose administrative measures and sanctions in the field of direct expenditure. This initiative raises several legal questions, i.e. concerning the scope of new rules and procedural aspects ⁽¹⁾, which the Commission is examining.

Within the framework of Actions 73 (Advice on contracting), 74 (Contracts database) and 94 ('Fraud proofing' of legislation and contract management) of the White Paper on the reform of the Commission, a process of revision of contracts is under way in order to include clear clauses for the protection of the Communities financial interests (standard clauses, concerning checks and sanctions, making them more effective).

⁽¹⁾ See also the Commission's Annual Report 2001 on the fight against fraud (COM(2002) 348 final).

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ANALYSIS OF AUDITS CARRIED OUT BY THE COMMISSION IN INTERNAL POLICIES AND RESEARCH

Decrease in the number of completed audits

4.52. A comparison of the information received from the 13 DGs involved in internal policies reveals that in 2001 the number of 392 completed audits was lower than in 2000, when 537 audits were finalised (see **Table 4.5**). The number of contracts audited in the table shows an increase from 872 to 892 and the value of the contracts audited increased by more than 50 %.

4.53. However, excluding DG Justice and Home Affairs' (JAI) intensification of its internal control of training, exchange and cooperation programmes (articles B5-8 2 0) which are not *ex post* audits of contracts, the average number of contracts audited for the other DGs decreased by 28 %. Apart from DG JAI, both the audits completed and the number of audits effected by or on behalf of DG INFSO increased by 50 % from 2000 to 2001. The overall increase in the value of audited contracts was mainly due to the increase of DG TRENs audits which increased from 209 million euro to 1 026 million euro (see **Table 4.5**).

4.54. A considerable decrease in the number of audits completed and the number of contracts audited was noted in particular for DG Education and Culture (DG EAC). Considering DG EAC has more than 20 000 open contracts, and given the significant audit findings by the Court in the case of the Socrates and Youth for Europe programmes (see paragraphs 4.64 to 4.72), the audit of only 12 contracts in 2001 (compared with the audit of 172 contracts in 2000) is insufficient.

4.55. According to the Commission, the actual amount recoverable as a result of the 2000 audits was given as 25,5 million euro. Excluding the veterinary and phytosanitary actions managed by DG SANCO, the recoverable amounts increased considerably from 10,4 million euro to 16,2 million euro (see **Tables 4.5** and **4.6**). This is mainly due to the more intensive audit activities

4.52. *Taking into account all the indicators presented, the Commission feels that its audit activities are generally stable.*

4.53. *The Commission considers that the wide year-on-year variations for a particular DG are explained by cyclical factors.*

4.54. *In the case of DG EAC, the reason for the fall in the number of audits carried out in 2001 compared with 2000 is that the DG's audit resources were redirected towards the internal audit function, in line with the administrative reform of the Commission. At the end of 2001, DG EAC concluded framework contracts with three audit firms in order to increase significantly the number of audits of beneficiaries and any intermediaries involved. In the first half of 2002 alone, nearly one hundred audits were contracted out to these firms.*

4.55. *The size of the outstanding amount concerned is linked to the increase in audit efforts resulting in an increase in recoverable amounts in 2001.*

Table 4.5. — Audits completed by the Commission in 2000 and 2001 ⁽¹⁾

(Mio EUR)

Directorate-General	Number of audits completed		Number of contracts audited		Number of open contracts		Value of audited contracts		Value of open contracts		Amounts recoverable or reduced payments as a result of the audits	
	2000 ⁽²⁾	2001	2000 ⁽²⁾	2001	2000 ⁽²⁾	2001	2000 ⁽²⁾	2001	2000 ⁽²⁾	2001	2000 ⁽²⁾	2001
AGRI — Agriculture	4	4	⁽⁶⁾	⁽⁶⁾	550	387	12,29	12,94	73,66	69,40	⁽⁶⁾	⁽⁶⁾
EAC — Education and Culture	106	11	172	12	25 306	20 165	56,29	1,87	654,04	670,56	0,92 ⁽⁹⁾	0,44
EMPL — Employment and Social Affairs	13 ⁽²⁾	14	24 ⁽²⁾	36	1 742 ⁽²⁾	1 697	7,35 ⁽²⁾ ⁽³⁾	8,15 ⁽³⁾	114,77 ⁽²⁾ ⁽³⁾	125,64 ⁽³⁾	0,10 ⁽²⁾	0,65
TREN — Energy and Transport	35	21	93	55	4 774	2 996	209,17	1 025,86	1 656,20 ⁽³⁾	2 124,65 ⁽³⁾	1,28 ⁽⁹⁾	1,67 ⁽⁹⁾
ENTR — Enterprise	8	2	37	12	746	2 857	53,60	3,75	181,10	451,86	0,15	0,21
ENV — Environment	30	31	40	39	2 505	2 345	12,56	21,47	295,12	308,44	0,10	0,78
FISH — Fisheries	5	4	13	19	188	211	7,04	4,51	194,53	125,80	0,03	0,05
⁽⁸⁾	3	4	9	13	13	22	27,60	35,40	95,84	91,01	—	0,02
JAI — Justice and Home Affairs	64 ⁽⁵⁾	5	65 ⁽⁶⁾	269 ⁽⁷⁾	713	754	4,26 ⁽⁵⁾	1,78	31,95	30,87	0,45	0,06
SANCO — Health and Consumer Protection	8	12	18	25	978	712	3,03	5,65	85,48	93,26	0,05	0,21
⁽⁴⁾	10	14	12	14	n.a.	n.a.	96,65	109,21	⁽⁷⁾	⁽⁷⁾	15,03 ⁽⁹⁾	10,18
INFSO — Information Society	25	38	66	99	4 765 ⁽²⁾	4 502	40,09	66,60	1 481,60 ⁽²⁾ ⁽³⁾	1 657,80 ⁽³⁾	2,00 ⁽²⁾	5,17
MARKT — Internal Market	1	0	1	0	175	268	⁽⁶⁾	0,00	8,79	8,54	0,00	0,00
RTD — Research	220	232	317	299	11 358	14 441	820,20	699,80	3 387,00	4 302,00	5,30	6,90
TAXUD — Taxation and Customs Union	5	0	5	0	164	57	0,58	0,00	44,10	33,84	0,04 ⁽²⁾	0,00
TOTAL	537	392	872	892	52 518	50 660	1 350,71	1 996,99	8 123,08	10 093,67	25,45	26,34

⁽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 contract audited on the spot,

— amount recoverable: amounts calculated in the on-the-spot audits as recoverable and evidenced in the audit reports.

⁽²⁾ See 2000 Annual Report concerning the financial year 2000, Table 4.3a. In certain cases, data had subsequently been modified.⁽³⁾ Commission's share only.⁽⁴⁾ Veterinary and phytosanitary actions. Value of audited contracts means here claims of the Member States.⁽⁵⁾ In the table prepared for the year 2000, the number of 'audits completed' included those files where a final check of the supporting documents submitted at the final payment stage was made.⁽⁶⁾ Not specified, or not available.⁽⁷⁾ Includes Internal Audit Capability examination of internal control systems in place for budget line B5-8 2 0 audited on a sample basis (265 contracts).⁽⁸⁾ Fishery control measures. 'Contract' here means programme of a Member State; 'value of audited contracts' here means value of audited items within a programme; 'value of open contracts' here means the total value of the pluriannual measures for all Member States.⁽⁹⁾ The amounts recoverable are indicative only.

Source: Commission.

Table 4.6. — Recovery status

(1 000 EUR)

Directorate-General	Amounts recoverable or reduced payments as a result of the audits ⁽¹⁾	Actual recovery as at 31 December 2001					
	2000	Deducted from further payments	Actually recovered due to a recovery order	Not yet recovered; recovery order issued, but repayment outstanding	Not yet recovered; recovery order not yet issued or adjustment still outstanding	Not recoverable	TOTAL
AGRI — Agriculture	⁽²⁾	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
EAC — Education and Culture	920,00	20,00	250,00	480,00	170,00	—	920,00
EMPL — Employment and Social Affairs	100,64 ⁽³⁾	—	23,89	—	74,74	2,01	100,64
TREN — Energy and Transport	1 280,72 ⁽⁴⁾	77,02	14,44	—	1 074,42	—	1 165,88
ENTR — Enterprise	153,00	152,16	—	0,96	—	—	153,12
ENV — Environment	100,00	29,95	25,52	12,79	39,39	—	107,65
FISH — Fisheries	33,50	33,50	—	—	—	—	33,50
JAI — Justice and Home Affairs	452,00	400,00	—	—	—	53,00	453,00
SANCO — Health and Consumer Protection	49,00	49,00	—	—	—	—	49,00
	⁽³⁾ 15 025,00 ⁽⁴⁾	15 602,00	—	—	—	—	15 602,00
INFSO — Information Society	2 000,00 ⁽⁵⁾	—	500,84	1 270,37	197,18	—	1 968,39
RTD — Research	5 300,00	2 640,49	575,39	926,11	1 080,92	54,72	5 277,63
TAXUD — Taxation and Customs Union	38,71 ⁽⁵⁾	—	36,90	—	1,81	—	38,71
TOTAL	25 452,57	19 004,12	1 426,98	2 690,23	2 638,46	109,73	25 869,52

⁽¹⁾ As reported by the Commission; see 2000 Annual Report concerning the financial year 2000, Table 4.3a.

⁽²⁾ Not specified.

⁽³⁾ Veterinary and phytosanitary actions.

⁽⁴⁾ The amounts recoverable are indicative only.

⁽⁵⁾ Modified by the Commission.

NB: n.a. = not available.

Source: Commission.

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of the five Research DGs responsible for the management of the research framework programmes, accounting for recoverable amounts of 14 million euro (see paragraphs 4.57 to 4.60). Particularly in the case of DG INFSO, the recoverable amounts increased significantly from 2,0 million euro to 5,2 million euro. As far as the veterinary and phytosanitary actions managed by DG SANCO are concerned, the recoverable amounts decreased from 15,0 million euro in 2000 to 10,2 million euro in 2001.

4.56. However, more than 5,3 million euro (more than 20 %) of the amount established as recoverable at the end of 2000 had not yet been recovered as at 31 December 2001. Specifically DG RTD, DG INFSO and DG TREN had the recovery of considerable amounts outstanding (see **Table 4.6**).

Intensified audit activities in the area of research have not yet reached the 10 % target

4.57. Since 1999 the five Research DGs (DG RTD, DG INFSO, DG TREN, DG ENTR and DG FISH) operating the RTD Framework Programmes have significantly intensified their *ex-post* financial audits of final beneficiaries. This was suggested by the Court in its Annual Report concerning the financial year 1998⁽¹³⁾. The overall target defined by the Research DGs is to audit 10 % of the contractors⁽¹⁴⁾ during an RTD Framework Programme. For this purpose, and given the limited number of human resources, the Commission signed a framework contract with an external audit firm. An examination of these reports showed a distinct improvement in terms of the time needed to produce and exploit them, which was reduced, on average, from 23 to five months during the period 1999 to 2001. This facilitates the adoption of adjustment measures where necessary.

⁽¹³⁾ Annual Report concerning the financial year 1998, paragraph 4.19 and reply of the Commission to this paragraph.

⁽¹⁴⁾ Written Commission reply to the questionnaire of the Budgetary Control Committee of the European Parliament, paragraph 4.3, dated 21 December 2001. See also Court of Auditors, Annual Report concerning the financial year 1999. Reply of the Commission to paragraph 4.23.

THE COMMISSION'S REPLIES

4.56. Overall nearly 80 % of amounts recoverable have been recovered. The main reason in the research area for the outstanding balance is that cost statements against which adjustments will be made had not yet arrived at 31 December 2001. The Commission has refined its recovery procedures and there is an intensive and improved follow-up in progress to recover all outstanding balances. In the future with regard to indirect RTD actions of the fifth framework programme, recoveries can be made against other contracts for indirect RTD actions signed with the same beneficiary.

4.57. The Commission welcomes the statement of the Court that the average number of months needed to close an audit has dropped from 23 in 1999 to five months in 2001. This reduction is in itself a positive indicator of the Commission's efforts.

THE COURT'S OBSERVATIONS

4.58. In 2001 DG RTD (which manages approximately two-thirds of all contracts for indirect RTD actions) finalised 232 audits on 299 contracts for indirect RTD actions under the fourth framework programme (see **Table 4.7**). More than 94 % of these audits were by an external auditor.

4.59. According to DG RTD, unwarranted payments amounting to a cumulative total of 6,3 million euro had to be repaid to the Commission (see **Table 4.8**). The over-declaration rate established on the basis of the audits conducted by DG RTD rose from 4,8 % of the expenditure audited in 1999 to 8,7 % in 2001. The Court notes, contrary to the intention expressed by the Commission in its replies to the Annual Report on the

THE COMMISSION'S REPLIES

4.58. *The audit firms act as contractors for the Commission. The Commission has ultimate responsibility in all cases. See also paragraph 4.61.*

4.59. *The Commission points out that the rates of 2001 are the results of its new and more comprehensive audit strategy. The Commission now considers that it is not appropriate to measure progress in the area of audit on the basis of seeking reduction in the rates of overdeclaration.*

Table 4.7. — DG Research (RTD) — Statistics on audit reports examined and time-to-audit analysis

1999

Type	Number of audit reports examined	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)	
		Information available for number of audits	Average (months)	Information available for number of audits	Average (months)	Information available for number of audits	Average (months)
Internal ⁽¹⁾	21	9	8,7	10	8,4	21	25,4
External ⁽²⁾	25	17	13,6	20	11,7	24	21,2
Total	46 ⁽³⁾	26	11,9	30	10,6	45	23,1

2001

Type	Number of audit reports examined	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)	
		Information available for number of audits	Average (months)	Information available for number of audits	Average (months)	Information available for number of audits	Average (months)
Internal ⁽¹⁾	13	8	2,3	11	1,7	9	5,2
External ⁽²⁾	219	217	3,8	218	0,9	217	4,7
Total	232 ⁽⁴⁾	225	3,7	229	1,0	226	4,7

⁽¹⁾ Carried out by the DG Research services.

⁽²⁾ Carried out by external audit firms.

⁽³⁾ Extensive sample of total number of audit reports (74).

⁽⁴⁾ Total number of audit reports.

Source: Analyses made by the Court based on the Commission's information.

Table 4.8. — DG Research — Summary tables on audits and adjustments ⁽¹⁾

(1 000 EUR)

1999

	Total number of audits	Audits not included in the analysis ⁽²⁾	Number of audits analysed	Total audited amount	Adjustments in favour of the EU					Adjustments in favour of the contractor					No adjustments		
					Number of audits	% of audits ⁽³⁾	Audited amount	Adjustment	Level of adjustment on audited amount	Number of audits	% of audits ⁽³⁾	Audited amount	Adjustment	Level of adjustment on audited amount	Number of audits	% of audits ⁽³⁾	Audited amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)
Internal audits	21	5	16	12 053,7	12	75,0 %	3 995,8	544,6	13,6 %	2	12,5 %	432,6	7,2	1,7 %	2	12,5 %	7 625,3
External audits	25	10	15	9 419,7	10	66,7 %	7 300,3	491,5	6,7 %	2	13,3 %	1 117,6	31,5	2,8 %	3	20,0 %	1 001,8
Total	46	15	31	21 473,5	22	71,0 %	11 296,2	1 036,2	9,2 %	4	71,0 %	1 550,3	38,7	2,5 %	5	16,1 %	8 627,0
					Level of adjustment in favour of the EU on total audited amount				4,8 %	Level of adjustment in favour of the contractor on total audited amount				0,2 %			

⁽¹⁾ For the preparation of this table the adjustment considered is the global one for the audit, not the individual for each of the projects audited.

⁽²⁾ Concerns audits not requiring a review of cost claims.

⁽³⁾ Over number of audits stated in column 3.

2001

	Total number of audits	Audits not included in the analysis ⁽²⁾	Number of audits analysed	Total audited amount	Adjustments in favour of the EU ⁽¹⁾					Adjustments in favour of the contractor ⁽¹⁾					No adjustments ⁽¹⁾		
					Number of audits	% of audits ⁽³⁾	Audited amount	Adjustment	Level of adjustment on audited amount	Number of audits	% of audits ⁽³⁾	Audited amount	Adjustment	Level of adjustment on audited amount	Number of audits	% of audits ⁽³⁾	Audited amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)
Internal audits	13	2	11	4 223,2	5	45,5 %	2 212,2	448,1	20,3 %	1	9,1 %	372,9	59,3	15,9 %	6	54,5 %	1 638,1
External audits	219	3	216	68 346,7	150	69,4 %	46 275,1	5 861,4	12,7 %	59	27,3 %	16 431,4	1 306,8	8,0 %	29	13,4 %	5 640,2
Total	232	5	227	72 569,9	155	68,3 %	48 487,3	6 309,5	13,0 %	60	26,4 %	16 804,3	1 366,1	8,1 %	35	15,4 %	7 278,3
					Level of adjustment in favour of the EU on total audited amount				8,7 %	Level of adjustment in favour of the contractor on total audited amount				1,9 %			

⁽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. As the audits usually cover several projects, different kinds of adjustment are possible within the same audit (adjustment in favour of the EU, adjustment in favour of the contractor, no adjustment). To avoid double counting of the audited amounts, for those audits where different adjustments or no adjustments were noted, the way the amounts were split up was done with reference to the project. For the same reason, the sum of the number of audits of columns 5, 10 and 15 does not correspond to the total stated in column 3. To get the correct figure one has to deduct the number of audits where different adjustments were made.

⁽²⁾ Concerns audits of four fusion projects and one audit of the Marie Curie Fellowship Association.

⁽³⁾ Over number of audits stated in column 3.

Source: Analyses made by the Court based on the Commission's information.

THE COURT'S OBSERVATIONS

financial year 1999 ⁽¹⁵⁾, that the efforts undertaken by it to carry out checks have not resulted in a reduction of the overdeclaration rate but in better identification of the amounts overdeclared.

4.60. On the other hand, the Court found that the target defined by the five Research DGs of auditing 10 % of the contractors during the fifth research framework programme would be difficult to achieve despite the significant increase in the audits performed. According to figures provided by DG RTD, the number of audits completed in 2001 and 2000 was 9,2 % and 8,5 % of the auditable population of contractors ⁽¹⁶⁾, respectively. It should also be noted that the definition of 'auditable population' used by the Commission results in significantly less than 10 % of indirect RTD actions or cost statements being audited.

4.61. Furthermore, the framework contract signed with the external audit firm acting on behalf of the Commission provides that audit findings reported to the Commission should be agreed with the audited beneficiary. The Court found that in its assessment of reported audit findings the Commission relies exclusively on the audit firm's working documents and reports.

THE COMMISSION'S REPLIES

4.60. *The Commission believes it will be able to meet the target of auditing 10 % of contractors. Whereas the commitment period for the fifth framework programme period ends at the end of 2002, the auditing activities will continue beyond this date as many cost statements of the framework programme will only be submitted later.*

The projection for 2002 for DG RTD is to close about 280 audits. With this DG RTD is approaching its target.

4.61. *The framework contract signed with the external audit firms requires that it 'will discuss with the audited organisation the adjustments made... if the audited organisation disagrees, ... the contractor should obtain a written declaration... and annex it to the audit report.' This does not mean that audit reports are always agreed.*

According to the framework contract there is a coordination structure which supports the overall network of auditors conducting the individual audits. This coordination structure is in close contact with the Commission services, and ensures a harmonised audit process across the member states as well as compliance with the Commission audit standards laid down in the contract. The external audit firm's adherence to professional standards and to the Commission's audit guidelines and manuals are verified for each audit by Commission auditors when reviewing the draft audit reports.

⁽¹⁵⁾ Annual Report concerning the financial year 1999, reply of the Commission to paragraph 4.37.

⁽¹⁶⁾ The auditable population of contractors means contractors participating in an active contract who have submitted at least one cost statement recorded in the central databases of the respective DG.

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THE COMMISSION'S REPLIES

FOLLOW-UP OF PREVIOUS OBSERVATIONS

Direct management by DG Employment

4.62. The Court had observed the following management weaknesses in the past ⁽¹⁷⁾ within DG Employment: lack of harmonisation of procedures; lack of evaluation of the contractor's financial situation; lack of evidence of checks on the total aid applied for; lack of guidelines on the reports to be supplied; lack of financial guarantees when large advances were disbursed.

4.63. Following these observations the Commission established a vade-mecum on subsidies and DG Employment developed procedures and guidelines for direct management in which it included standards for the financial statements that are to be provided. All the same, there are still some weaknesses: the financial situations of contractors are not systematically examined; checks on aid applications are not documented; there are no guidelines for the intermediate and final implementation reports which contractors are required to supply.

SUMMARY OF SPECIAL REPORT NO 2/2002
CONCERNING SOCRATES AND YOUTH FOR
EUROPE ⁽¹⁸⁾

4.64. The Socrates and Youth for Europe programmes have been allocated budgets of 920 million euro and 126 million euro respectively. They have contributed to a strengthening of cooperation between universities in the European Union and in the other participant countries and have made multicultural exchange activities possible for the benefit of young people.

4.62 and 4.63. *The Commission is pursuing its efforts to remedy the shortcomings found by the Court in the field of direct management. It would stress the existence within its departments, and more specifically in DG Employment, of:*

- *an active financial training policy, widespread dissemination of information to financial managers via web technology and access to various databases enabling the evaluation committees set up for each invitation to tender/call for proposals to assess the financial soundness of a potential beneficiary or contractor at an earlier stage,*
- *networks of financial managers, led by DG Employment's financial unit, which are charged with examining certain specific issues and establishing harmonised procedures and guidelines for all authorising departments in the DG. The issues referred to by the Court at point 4.63 are being discussed within these networks that were set up as part of the Commission's financial reform.*

4.64 and 4.65. *Certain contextual factors cast light on the design and management of these programmes, which were considerably more generously funded than the preceding ones and whose annual funding grew by 39 % between 1995 and 1999. As they were the first programmes open to the associated countries, management was significantly complicated; they were also mass programmes subject to severe constraints,*

⁽¹⁷⁾ Annual Report concerning the financial year 1995, and in particular paragraphs 6.129 et seq (OJ C 340, 12.11.1996).

⁽¹⁸⁾ Special Report No 2/2002 (OJ C 136, 7.6.2002).

THE COURT'S OBSERVATIONS

4.65. Nevertheless, the Court's audit has revealed weaknesses in the design of the two programmes and shortcomings in the management of their implementation.

Design weaknesses

4.66. The two programmes Socrates and Youth for Europe (YfE) both suffer from shortcomings in their design. The design of the Socrates programme, in particular, is complex, with a heterogeneous array of 38 actions, subactions and measures. In consequence the programme was interpreted in different ways and cooperation between the Member States became more complicated. Likewise, the absence of definitions of criteria and parameters has made it difficult to evaluate the results obtained following implementation of the programmes. Furthermore, the design did not include an appropriate framework for producing synergy from the various Community programmes.

4.67. The Commission manages a number of measures from Brussels, which, for this reason, are referred to as centralised, through a technical assistance office (TAO), while those subject to decentralised management in the Member States and other beneficiary countries are run through national agencies. In both cases, the management system was marked by various types of shortcomings.

THE COMMISSION'S REPLIES

notably as regards the timetable; in addition, they were sometimes addressed to beneficiaries who were somewhat less organised than for other Community measures. Against this background, we should not underestimate the very real tension between ensuring rigorous management and the need to adopt user-friendly modes of management which 'respect' the principle of proportionality, having regard to the generally very small sums involved and the beneficiaries concerned, and the desire for simplification expressed by all parties involved in the programmes.

These programmes directly benefited over one million persons, in terms of mobility, and almost 10 000 cooperation projects. They helped to boost cooperation in their specific fields, along with other, more political, measures, which they rendered possible. All these parallel developments put great pressure on the Commission's inadequate human resources and explain the need to rely on alternative management methods (which have already been redefined for the future in the framework of the reform).

4.66. These two programmes already constitute a first attempt to rationalise Community measures in the field of education and youth policy. Socrates, in particular, which covered all the levels of education set out in the new Article 126 of the EC Treaty was the successor to no fewer than five disparate actions or programmes. The result may have been a complex architecture, but this did not act as a hindrance to participation in the programmes. These programmes have been simplified with the entry into force of the new generation (Socrates II and Youth), and improvements have been made as regards evaluation and cooperation with other Community programmes.

4.67. The two programmes are mass programmes involving thousands of transactions annually (generally for small sums of money). The Commission did not have sufficient internal resources for direct internal management, hence the reliance (degressively over the period) on a technical assistance office (TAO), which was constantly supervised and monitored. Because of their closeness to the beneficiaries and the volume of operations to be managed, the Commission also relied on national agencies; on the basis of experience in implementing the Socrates and Youth for Europe programmes, this decentralised instrument was significantly reinforced for the new generation of programmes.

THE COURT'S OBSERVATIONS

4.68. The delegation of responsibilities to the TAO gave rise to weaknesses which the Court was to come across repeatedly: irregularities in the delegation of responsibility, both with regard to the principle of delegation and the form its implementation took, various confusions of interest and risks for the Community's assets, and the costly nature of the management. The situations which arose from this were, however, nothing like as serious as those encountered in other Community programmes.

4.69. With regard to the decentralised actions, their implementation suffered both from the absence of a legal framework setting out the precise division of responsibilities between the Commission and the Member States and of an appropriate status for the NAs, which, in the majority of cases, did not have adequate means at their disposal to carry out the tasks entrusted to them.

Delays and shortcomings in implementation

4.70. Because of the time required by the legislator to adopt the relevant decisions, the start of the two programmes was delayed and there were delays in the implementation of new actions because of the lack of structures and of an appropriate information policy. The cumbersome nature of the management system caused additional delays in implementation of the programmes, the main consequence of which was to make achievement of the general objective of prefinancing the projects illusory. In fact, the beneficiaries sometimes did not receive Community aid until after the projects had been carried out. The accumulated delays made it impossible to close the actions by the deadlines set in the financial framework agreements. The management of these agreements was, in general, inadequate. Implementation was hampered by the use of unsuitable IT network systems.

THE COMMISSION'S REPLIES

4.68. *The general question of reliance on external assistance in the form of a TAO has been at the heart of the inter-institutional debate for several months, and new perspectives have been developed for the future; the Commission has already indicated that in the future it will rely on other instruments to manage the education and youth programmes. No such possibilities were available in 1995, and so the Commission had to rely on a TAO, as for other programmes. An in-depth audit by Financial Control recognised the quality of this organisation, even entrusting to it, under its control, instruments which the draft reform of the Financial Regulation says cannot be delegated.*

4.69. *Despite this insufficient legal supervision, the Commission took various measures to improve the effectiveness of reliance on networks of national agencies. For the future it has significantly strengthened the mechanism, with the entry into force of the new programmes: contractual relations with the national agencies are now part of a strict legal framework, which lays down the obligations of the Member States as regards ensuring that the agencies it nominates are properly funded.*

4.70. *To take account of the late adoption of the legal bases and the constraints of a timetable which is often based on the academic year, the Commission has to have recourse to transitional measures to avoid any interruption in the cooperation established via earlier programmes and actions. The Commission recognises how difficult it is to speed up its financing decisions, because of the huge mass of dossiers, the complexity of the management rules (notably in the wake of enlargement of the programmes to applicant countries) and the complexity of the internal and external consultation process. However, significant improvements have been made during the lifetime of the programmes, which have also made it possible to prepare more balanced proposals for the new programmes.*

THE COURT'S OBSERVATIONS

4.71. Management shortcomings were found in the majority of the 27 national agencies audited and the TAO, from the selection of projects to the monitoring of their implementation. These failings were aggravated by the lack of any genuine control and evaluation culture on the part of the managing bodies, both national and Community. For instance, the audit identified several projects where the Court notified the European Anti-Fraud Office (OLAF) of suspicions of fraud. On a more general level, these weaknesses had negative consequences for the results and the overall impact of the measures, although they cannot always be quantified due to the absence of relevant statistical data. This is the case for the Youth for Europe programme, which it is impossible to verify whether the wish expressed by the European legislator, that help should be given to disadvantaged young people, has been fulfilled.

4.72. Evaluation reports were delayed and their impact remains questionable. The contracting procedure and the management and monitoring of study and evaluation contracts revealed serious deficiencies and irregularities occurred at both Commission and contractors level.

RECOMMENDATIONS

4.73. With regard to budgetary management, the Commission should continue to improve its presentation of the revenue and expenditure account by giving explanations for those budget headings where either there is a considerable variation between the final budget appropriations and the initial budget adopted by the Parliament or the utilisation of appropriations falls below a certain level.

THE COMMISSION'S REPLIES

4.71. *The Commission concedes certain weaknesses in management which it is endeavouring to correct in the framework of the new programmes, while stressing the impact and results of this first generation of programmes. The various analysis and evaluation exercises, including those conducted by certain Member States, and the existence of intergovernmental initiatives such as the Sorbonne and Bologna Declarations (signed by all the participating countries and acknowledging the impact of the Socrates programme on their education systems), testify to the major impact of this programme. As regards the Youth for Europe programme the Commission considers, on the basis of the conclusions of the external ex-post evaluation of the programme, that the objective laid down by the legislator in favour of young disadvantaged people has been achieved. As regards the dossiers of which OLAF has been informed, the Commission will take the appropriate measures in due course.*

4.72. *The question of adapting the evaluation cycle to the life cycle of a programme is a general problem, having regard to the succession of programmes and the deadlines for negotiating the legal bases; in this connection, the few months' delay are without consequence. Rather, evaluation should be seen as a continuous progress whose conclusions are taken into account not only when preparing a new proposal for a legal basis, but also in the context of implementing the programmes. Numerous improvements which the Commission wishes to introduce into the management of the new programmes derive from the evaluation work done, at various times, on these two programmes.*

4.73. *The Commission appreciates the Court's statement that the Financial Management Report 2001 has generally again improved in form and content.*

The purpose of the Financial Management Report is to give an overview of the budget implementation in a readable form and with a manageable workload for the Commission Services. The above selection of budget lines and programmes implies that not all budget lines are commented upon in detail in the Report. However, such information is available in specific reports by the Services concerned or on the basis of ad hoc requests.

THE COURT'S OBSERVATIONS

4.74. For the TEN-T programme, the Commission should strengthen the legal and control framework in order to improve the protection of the Community's financial interests (for instance requiring offer letters between Member States and final beneficiaries and developing and implementing clearer rules with regard to the eligibility of costs). The evaluation of proposals should be improved by using external experts more intensively and should be properly documented. Administrative procedures and IT-systems should be modified by taking into account the specific requirements of the TEN-T programme. Completed TEN-T actions should be regularly audited.

4.75. With regard to the framework programmes for RTD activities, the Commission should fundamentally simplify the cost reimbursement system, introducing a single cost system with three main categories and using flat rates, thus allowing for a more efficient and cost-effective external certification of cost statements. Alternatively, the Commission could negotiate value-based contributions. Model contracts for indirect RTD actions should provide for participants to bear unlimited joint and several liability for the use made of the Community's financial contribution. The Commission should also improve the protection of the Community's financial interests by imposing visible and dissuasive sanctions.

4.76. The efforts to recover overpaid Community funds from beneficiaries need to be intensified, specifically with regard to DGs RTD, INFSO and TREN.

4.77. In its Special Report No 2/2002 (Socrates and Youth for Europe) the Court made a number of recommendations for improving the management of these programmes which should be taken into consideration. These include the replacement of the TAO with a Community agency, clearly defining the relationship between

THE COMMISSION'S REPLIES

4.74. As stated in paragraphs 4.18 to 4.36 the Commission is already well advanced in some of the directions indicated by the Court.

The revision of the standard texts of the Commission decisions as well as the introduction of additional annexes with more detailed specifications, definitions and requirements intends to provide an improvement to the current situation.

The recommendations made by the Court with regard to the evaluation of proposals, the administrative procedures and the IT systems are taken into consideration.

TEN-T ex-post audits will be included in the audit programmes for the years 2002 and 2003.

4.75. The measures proposed by the Court were contained in the rules on participation prepared by the Commission for the sixth framework programme. The Council and Parliament rejected the idea, regarding it as an obstacle to the autonomy and flexibility of the participants, chiefly because of the need for ex ante negotiation of costs. They considered it financially 'unfair' for individual participants because flat-rate amounts would have to be used. They consider reference to real costs to be the basic principle, flat rates being an exception to be used only with the agreement of the participants.

The Court's other proposals which were made by the Commission (external certification of costs, unlimited joint and several liability of partners and entry of penalties on the basis of Regulation (EC), Euratom 2988/95) were taken over with some adjustments by the Council and Parliament.

4.76. The Commission will continue its efforts with regard to recoveries. The increase of the audit efforts has already resulted in a greater level of recovery and in particular as far as the fifth framework programme is concerned, the Commission has simplified its recovery procedures.

4.77. A number of the Court's recommendations actually correspond to improvements already decided on or introduced by the Commission on the entry into force of the programmes that succeeded Socrates and Youth for Europe. In particular, the Commission announced its intention of relying on an executive agency for the future management of programmes in

THE COURT'S OBSERVATIONS

the Commission and national authorities, improving control and monitoring at all levels and providing effective and timely evaluations.

THE COMMISSION'S REPLIES

the field of education and youth. It has significantly strengthened its reliance on a network of national agencies. Under the new 'Provisions concerning the responsibilities of the Member States and the Commission as regards the national agencies', which are the cornerstone of this policy, national authorities are required to provide the national agencies with sufficient resources to accomplish their tasks. The Commission has already begun intensifying its scrutiny and monitoring of programmes, among other things by increasing the number of field visits. Evaluation frameworks have been defined for Socrates II and Youth, including indicators and timetables designed to ensure effective evaluation of these programmes.

CHAPTER 5

External action

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INTRODUCTION

5.1. This chapter deals with the traditional forms of aid financed from the general budget and the operations adopted by the Council under the Common Foreign and Security Policy. 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 analysis of budgetary management and the specific appraisal in the context of the Statement of Assurance (which concentrates on the specific expenditure on humanitarian and food aid), the chapter also contains sections on the follow-up of previous observations and on the principal observations in recently adopted Special Reports.

ANALYSIS OF BUDGETARY MANAGEMENT

Introduction

5.2. Heading 4, 'External actions', of the financial perspective applicable to the period 2000-2006 comprises measures covered by the budgetary headings given in **Table 5.1**, which shows the implementation of the budget for 2001.

5.3. In 2001, as in 2000, the apparent overrun of the financial perspective for this heading is the result of use of the flexibility instrument, which authorises the ceiling for a heading to be exceeded by 200 million euro, and of the utilisation, under Heading 4, of the emergency reserve covered by Heading 6. **Table 5.2** shows the changes in expenditure for subsections B7 and B8 over the last five financial years.

5.3. *The apparent overrun on the financial perspective is provided for in the financial perspective itself and in the inter-institutional agreement — flexibility instrument and emergency aid reserve. These instruments are mobilised on a proposal from the Commission and are specifically authorised by the budgetary authority.*

⁽¹⁾ See separate report on the EDFs.

Table 5.1 — External actions — Implementation of the 2001 budget

(Mio EUR)

Budgetary heading	Financial perspective ceilings	Budget changes ⁽¹⁾		Implementation of the budget					
		Initial appropriations ⁽²⁾	Final appropriations available ⁽³⁾	Appropriations utilised	% of final appropriations available	Appropriations carried over to 2002	% of final appropriations available	Appropriations cancelled	% of final appropriations available
		(a)	(b)	(c)	(d) = (c)/(b)	(e)	(f) = (e)/(b)	(g) = (b)-(c)-(e)	(h) = (g)/(b)
Commitment appropriations									
Pre-accession strategy for the Mediterranean countries (B7-0 4 and B7-0 5) ⁽⁴⁾		19,0	19,0	19,0	100,0	0,0	0,0	0,0	0,0
Humanitarian and food aid (B7-2)		928,0	978,0	974,7	99,7	2,3	0,2	1,0	0,1
Cooperation with developing countries in Asia, Latin America and southern Africa, including South Africa (B7-3)		904,3	866,5	829,0	95,7	24,0	2,8	13,5	1,6
Cooperation with Mediterranean third countries and the Middle East (B7-4)		896,3	912,7	909,1	99,6	0,0	0,0	3,5	0,4
Cooperation with partner countries in eastern Europe and central Asia and the western Balkan countries (B7-5)		1 308,3	1 344,8	1 269,6	94,4	67,4	5,0	7,7	0,6
Other cooperation measures (B7-6)		389,5	449,2	418,8	93,2	18,8	4,2	11,5	2,6
European initiative for democracy and human rights (B7-7)		102,0	105,4	104,7	99,4	0,0	0,0	0,7	0,6
External aspects of certain Community policies (B7-8)		345,3	267,3	263,8	98,7	0,0	0,0	3,5	1,3
Common Foreign and Security Policy (B8)		36,0	36,0	30,1	83,6	2,8	7,8	3,1	8,6
Total Heading 4	4 735	4 928,7 ⁽⁵⁾	4 978,7 ⁽⁵⁾	4 818,9	96,8	115,4	2,3	44,4	0,9
Emergency aid reserve (B7-9 1) ⁽⁶⁾		208,0	158,0	0,0	0,0	0,0	0,0	158,0	100,0
Total		5 136,7	5 136,7	4 818,9	93,8	115,4	2,2	202,4	3,9
Payment appropriations									
Pre-accession strategy for the Mediterranean countries (B7-0 4 and B7-0 5) ⁽⁴⁾		13,0	13,0	2,5	19,5	0,0	0,0	10,5	80,5
Humanitarian and food aid (B7-2)		873,0	1 100,1	1 038,0	94,4	50,0	4,5	12,1	1,1
Cooperation with developing countries in Asia, Latin America and southern Africa, including South Africa (B7-3)		757,0	734,5	633,7	86,3	0,0	0,0	100,8	13,7
Cooperation with Mediterranean third countries and the Middle East (B7-4)		459,4	605,7	578,2	95,5	4,2	0,7	23,3	3,8
Cooperation with partner countries in eastern Europe and central Asia and the western Balkan countries (B7-5)		961,0	1 455,5	1 283,7	88,2	100,0	6,9	71,9	4,9
Other cooperation measures (B7-6)		381,0	421,7	297,4	70,5	65,0	15,4	59,3	14,1
European initiative for democracy and human rights (B7-7)		81,8	75,8	51,1	67,4	0,0	0,0	24,7	32,6
External aspects of certain Community policies (B7-8)		359,8	275,8	233,9	84,8	0,2	0,1	41,8	15,1
Common Foreign and Security Policy (B8)		35,0	35,0	27,2	77,8	7,0	20,1	0,7	2,1
Total Heading 4		3 921,0	4 717,1	4 145,7	87,9	226,4	4,8	345,0	7,3
Emergency aid reserve (B7-9 1) ⁽⁶⁾		208,0	168,0	0,0	0,0	0,0	0,0	168,0	100,0
Total		4 129,0	4 885,1	4 145,7	84,9	226,4	4,6	513,0	10,5

⁽¹⁾ The appropriations placed in reserve (Chapter B0-4 0) were incorporated into the budget headings for which they were intended.

⁽²⁾ Budget finally adopted by the European Parliament on 14 December 2000 (OJ L 56, 26.2.2001).

⁽³⁾ Budget appropriations amended after taking into account supplementary and amending budgets and transfers, but not including appropriations carried over from 2000, appropriations resulting from the re-use of revenue, revenue resulting from contributions by third parties and other revenue corresponding to a defined purpose and appropriations made available again.

⁽⁴⁾ The other amounts of Chapter B7-0 come under Heading 7.

⁽⁵⁾ The overrun of the financial perspective was offset by use of the flexibility instrument at an amount of 200 million euro for Chapter B7-5 4 and use of the emergency aid reserve at an amount of 50 million euro.

⁽⁶⁾ The emergency aid reserve comes under Heading 6.

Source: 2001 revenue and expenditure account and for the B0-4 0 reserve, the budget and SINCOM2 datawarehouse.

Table 5.2 — External actions — Comparison of implementation of commitments and payments between 1997 and 2001 against the budget of the financial year*(Mio EUR)*

Heading	Title	Description	1997		1998		1999		2000		2001	
			Committed	Paid								
4	B7-0 4 + B7-0 5	Pre-accession strategy for the Mediterranean countries									19,0	3,0
	B7-2	Humanitarian and food aid	1 013,5	891,9	1 057,8	819,7	1 231,5	954,6	943,2	856,4	974,7	1 038,0
	B7-3	Cooperation with developing countries in Asia, Latin America and Southern Africa, including South Africa	797,2	472,2	771,0	463,4	685,8	569,7	802,4	621,9	829,0	633,7
	B7-4	Cooperation with Mediterranean third countries and the Middle East	1 075,9	403,9	1 068,7	421,5	1 027,4	333,5	1 005,7	472,9	909,1	578,2
	B7-5	Cooperation with partner countries in eastern Europe and central Asia and the western Balkan countries ⁽¹⁾	1 774,3	1 265,3	1 909,6	1 618,6	2 346,5	1 907,6	1 355,8	1 145,4	1 269,6	1 283,7
	B7-6	Other cooperation measures	370,5	297,4	337,0	281,6	343,8	302,0	337,4	272,9	418,8	297,4
	B7-7	European initiative for democracy and human rights	89,6	59,3	85,6	65,9	94,1	46,4	93,8	51,0	104,7	51,1
	B7-8	External aspects of certain Community policies	305,9	359,9	329,8	332,2	354,4	310,5	201,8	168,9	263,8	233,9
	B8-0	Common Foreign and Security Policy	16,1	16,1	29,9	22,4	28,8	27,1	30,8	19,6	30,1	27,2
		Total Heading 4	5 442,9	3 766,1	5 589,2	4 025,3	6 112,3	4 451,5	4 770,9	3 608,9	4 818,9	4 146,2
6	B7-9	Emergency aid reserve	5,3	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
		Total	5 448,2	3 766,1	5 589,2	4 025,3	6 112,3	4 451,5	4 770,9	3 608,9	4 818,9	4 146,2

⁽¹⁾ To enable comparison, Headings B7-5 and B7-0 3 have been combined since 2000 in the following table:

	B7-5 + B7-0 3	Cooperation with partner countries in eastern Europe and central Asia and the western Balkan countries + Phare	1 774,3	1 265,3	1 909,6	1 618,6	2 346,5	1 907,6	2 922,8	2 346,3	2 886,1	2 443,5
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THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

5.4. By its Decision of 16 May 2000 ⁽²⁾, the Commission drew up an ambitious reform programme which will have a major long-term impact on budgetary management, i.e.:

- (a) a full review of the programming of external aid,
- (b) the integration of the project cycle into a new management structure, the Europe Aid Cooperation Office (AIDCO), which has been operational since 1 January 2001, and
- (c) the deconcentration of management towards the Commission Delegations in third countries.

The deconcentration of management towards the Delegations began but had no effect in 2001

5.5. The Commission's deconcentration objectives for 2001 concerned 21 Delegations, but none of the 14 subdelegations of budget implementing powers granted right at the end of 2001 had any practical effect before 2002. As a result, and over and above previous initiatives for Heading 4 and mainly concerning Bosnia, the only payments made locally in 2001 consisted of 10 million euro under the regional reconstruction programme for central America. The deconcentration process envisaged for the 21 Delegations came up against logistical difficulties.

5.5. 2001 was both:

- a year of preparation of the deconcentration process as a whole, and
- the period over the course of which all obstacles had to be removed in order to give powers to 21 delegations before the end of the year. The object was not to execute the 2001 budget in a deconcentrated fashion.

The logistical aspects (office space, computing connections) and mobilisation of personnel are the critical elements which may delay the process.

The payment of EUR 10 million under the Regional Reconstruction Programme in Central America is based on a 1999 decision, i.e. a decision taken prior to that on deconcentration.

⁽²⁾ Document SEC(2000) 814/5 of 15 May 2000 on the Reform of the Management of External Assistance to third countries.

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THE COMMISSION'S REPLIES

Variable utilisation of payment appropriations

5.6. The efforts made to increase the volume disbursed during the financial year 2001 (14,9 % up on 2000) did not make it possible to cope with the significant increase in final appropriations (up by 21,3 %), whence the fall in the rate of utilisation of payment appropriations for the financial year is down compared with 2000 (87 % compared with 92,8 %) and the appropriations that remained unutilised were spread over the various budgetary headings. A more even distribution of the current payments over the financial year may be noted, even if the proportion of payments for the year made during the month of December remains comparable to that of 2000 (approximately 23,5 %).

5.7. In the case of the European Agency for Reconstruction, it was further noted that significant advances had been paid out right at the very end of the financial year (23,7 million euro for Serbia and 64,6 million euro for Kosovo) which far exceeded the Agency's immediate requirements at the very beginning of 2002. This practice seemed necessary due to the difficulty of using the 2002 appropriations straightaway, because of the time required to introduce a new budgetary framework.

5.8. The administrative expenditure headings contained in the operating part of the budget (BA) are still greatly under-utilised and the Commission has still not explained this situation.

Increase in the oldest outstanding commitments

5.9. Outstanding commitments (OCs) at the end of the financial year 2001 (12 674,1 million euro) remained stable compared with 2000. The trend which emerged over the last three years (from 1999 to 2001) was characterised by a reduction in the value of OCs that were less than three years old, from 8 810,3 million euro at the end of 1999 to 8 309 million euro at the end of 2001. This was due in particular to the considerable increase in the amounts paid out as from the first year of commitment compared with the amount committed during the financial year.

5.6. *The level of payments is a more important performance indicator than the rate of utilisation of payment appropriations because the latter are ultimately fixed and adopted by the budgetary authority. Thus the 2001 level of payments is an absolute record in terms of payments made.*

While it is true that there has been a deterioration in the utilisation rate compared with 2000, it should be stressed that SAB 4/2001 increased the initial appropriations by EUR 450 million and avoided a halt in payments over the course of the year. Hence, taking all increases into account, the available appropriations were EUR 796 million more than the initial appropriations and the payments made were also considerably higher than the initial appropriations. Finally, a number of additional increases were made at the end of the year, requiring a carryover to the following year so that the commitments could be honoured.

5.7. *Payments were made in favour of the European Agency for Reconstruction at the end of the year, because of the need to replenish the accounts of the Agency, whose disbursement operations are continuing to increase apace, and to provide the resources needed to make payments in the early part of the year.*

5.8. *The rate of payment implementation of the BA lines managed by the Office is around 47 % of the appropriations available at the end of the year. In fact, a considerable proportion of these appropriations was intended to finance the salaries of temporary staff recruited to the Delegations and auxiliaries recruited to headquarters to replace the BATs. As these recruitments were mainly made in the second half of the year, part of the payment appropriations earmarked for them remained unused.*

THE COURT'S OBSERVATIONS

5.10. On the other hand, despite the real efforts made by the Commission to clear OCs dating back five years or more, their cumulative value increased from 933,9 million euro at the end of 1998 to 1 589,6 million euro at the end of 2001. The increase was even more marked for commitments of three years or more, which rose from 2 758,0 million euro at the end of 1998 to 4 364,7 million euro at the end of 2001: the rate of disbursement has not improved for these OCs. These trends underline the need for constant monitoring of the OCs in order to contain them. It is important that the Commission equip itself with the means to obtain reliable and complete accounting and management information to facilitate the management of the measures financed. This information should make it possible to carry out in-depth analyses of the development of the OCs and the nature of the payments made (advances or others) in order to compare the rate of disbursement of the aid with the progress of implementation on the ground.

Room for improvement in the presentation of the analysis of financial management for the discharge authority ⁽³⁾

5.11. The information presented by the Commission in respect of the budgetary management ⁽⁴⁾ of Heading 4 for 2001 improved considerably compared with 2000 ⁽⁵⁾. The new structure makes it possible, from a

THE COMMISSION'S REPLIES

5.10. *The increase in the volume of OCs dating back 5 years or more is due to the fact that commitment appropriations increased continuously and substantially between 1994 and 1998 in spite of a payment performance that continued to grow between 1998 and 2001 (EUR 2 258,67 million paid in 1998, EUR 2 522,10 million in 1999, EUR 2 992,50 million in 2000, EUR 3 266,60 million in 2001) for the headings managed by EuropeAid.*

The Commission is aware of the need to monitor the share of old OCs in its external aid management portfolio, and it endorses the Court's comment on the need for constant monitoring of the OCs in order to contain them. Since 2000 the spending departments have been pursuing an active policy of systematic examination and closure of old or dormant external aid budgetary commitments wherever possible. This systematic examination and the closures carried out have also led to a significant volume of decommitments in 2001 (approximately EUR 629,7 million for the whole of heading 4).

As regards the accounting and management information needed to carry out a more detailed analysis of the evolution of the OCs, in the light of the state of implementation on the ground, in particular, and of the nature of the payments made, the CRIS Data Entry instruments (see reply to point 5.5) and the accounting system as adapted to the new requirements of the Financial Regulation with regard to different types of payments should make it possible to undertake such analysis from 2003.

5.11. *The Commission notes the Court's comments on improvements in the presentation of information on budgetary management, and will continue its efforts to this end,*

⁽³⁾ The Court analysed the information presented by the Commission in Volume I of the revenue and expenditure account which provides the comments on budgetary management for the financial year and, in particular, explanations on the differences between the appropriations entered in the initial budget as adopted and appropriations finally available and between the latter and the appropriations utilised. During this analysis, the Court has not sought to obtain an assurance as to the reliability of these explanations but rather to identify the significant differences which have not been explained and to detect any explanation which might mislead the reader.

⁽⁴⁾ Volume 1, Part II of the Revenue and Expenditure account 'Analysis of financial management'.

⁽⁵⁾ See Annual Report concerning the financial year 2000, paragraphs 5.19-5.23.

THE COURT'S OBSERVATIONS

general presentation, to find detailed explanations of the management of certain budget headings that are regarded as being particularly important, especially as regards the justification for the discrepancies between the budget and the actual implementation of it. Certain improvements have still to be made, however, in particular explanations of the justification of transfers of appropriations and the systematic production of the output implementation tables summarising achievements during the financial year, which are still missing for a good many major budget headings.

5.12. The search for greater transparency also finds expression in the decision to publish an annual report on the implementation of the European Commission's external aid. The report concerning the financial year 2001 was not available in time to be used by the Court in its Annual Report (6). The former aims to provide a picture which goes beyond mere budgetary and accounting information and is distinct from the report envisaged by Action 82 of the White Paper, which is designed to allow the Commission to satisfy various statutory obligations (7). The poor quality of the data in the management information systems adversely affects this exercise.

5.13. Whereas previously only Commission decisions justifying expenditure commitments were recorded in the accounts, during 2001 the resulting contracts started to be recorded as well, as was already the case for the EDF. This new system helps to reveal in part the actual stage of implementation of external measures, which has always been very inadequately perceptible in this field. For 2001 it may be observed that about a third, in value terms, of these decisions had already been followed, during the same year, by the signing of legal obligations. However, the Commission has not yet considered that it needed to include information of this kind in either the financial statements or the analysis of the financial management.

THE COMMISSION'S REPLIES

including on the explanations of transfers provided in the 'Analysis of financial management'.

As regards the possibility of systematically producing implementation tables in this report, this will depend on the preparation of the preliminary draft general budget for the year in question, and in particular on the availability of these tables under 'working documents, detailed analysis by budget heading'.

5.13. *The Commission will take account of the Court's comment and will, in future, include information on the utilisation of pre-commitments in Volume II of the annual reports.*

(6) A document of this type for the financial year 2000 was published at the end of 2001 and the 2001 annual report from the Commission to the Council and the European Parliament on EC development policy and the implementation of external aid was published in September 2002 (COM (2002) 490 final of 12 September 2002).

(7) By way of example, see Article 15 of Regulation (Euratom, EC) No 99/2000 of 29 December 1999 for the Tacis Programme, (OJ L 12, 18.1.2000, p. 1).

SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Introduction

5.14. The Statement of Assurance specific appraisal for this area has been based in recent years on a cycle of in-depth audits of different elements of the budgetary area (see **Table 5.1** for the budget headings concerned). In 1999 and 2000 the Court audited decentralised Phare expenditure (at the time part of Heading 4), co-financed activities managed by NGOs and expenditure for aid to Bosnia and the Tacis programme. In 2001 the Court decided to focus on humanitarian and food aid (Title B7-2 of the budget), representing almost 25 % of total external action (Heading 4 of the financial perspectives) payments in 2001 (see paragraphs 5.24-5.49).

5.15. In addition, the Court's review of the internal control systems in the context of the reform of the Commission, plus the work of the Commission's Internal Audit Service (IAS), has resulted in findings of particular relevance to the field of external action (see paragraphs 5.16-5.23).

The reform of the internal control systems still to be completed

5.16. The introduction of 24 standards of internal control to implement the general reform which the Commission is carrying out of its financial systems coincided ⁽⁸⁾, in the area of external actions, with the setting-up of a new administrative structure (AIDCO) and the preparation of a new method of management (deconcentration) ⁽⁹⁾. These two exercises were carried out, taking common-sense account of the spirit of the reform and the accompanying measures (increased formalisation of decisions, clearer definition of shared responsibilities providing better security, introduction of improved professional know-how for the staff who have to manage the aid). Many of these measures apply indirectly to the EDFs ⁽¹⁰⁾.

5.16. *The Commission shares the Court's view on the introduction of the 24 control standards in its departments.*

⁽⁸⁾ See paragraphs 9.51 to 9.94 of the DAS Chapter for the general presentation of the setting-up of a new internal control system.

⁽⁹⁾ Deconcentration will be applied to most of the management of Heading 4 of the financial perspectives.

⁽¹⁰⁾ See Chapter 2, paragraph 23 of the report on the EDFs.

THE COURT'S OBSERVATIONS

5.17. At this stage, these positive developments are still too recent to have resulted in all the expected improvements to the management systems. Nevertheless, the Court stresses that:

- (a) the internal audit capacity, responsible for providing the required assurance, was not operational until during the course of 2002;
- (b) no internal control standard, or even any White Paper specific measure, deals with the audits carried out by or for the Commission on transactions where management is entrusted by the Commission to intermediaries, or on the utilisation of Community funds by their final beneficiaries; and
- (c) considerable work still has to be carried out in order to develop practical tools (audit check lists, local management information systems) to complement the guidelines (financial and other) already prepared by AIDCO and to adopt the measures guaranteeing to AIDCO's senior management that the procedures and criteria which they have decided upon have been implemented. These two aspects are particularly important for the success of the deconcentration exercise.

5.18. In addition, the computerised management information systems have not yet been thoroughly transformed. The upgrading of the contents of the current tools (which mainly concern the system used in the areas of Asia, Latin America and the Mediterranean (MIS II)), and the development of new systems for the whole area of external action (the various modules of the Cris system) are not based on a detailed analysis of requirements and procedures, any more than they were in the past. Computerisation has not yet helped to make the method of management more secure, for example, by abolishing the practice of administrators taking their own individual approaches, due to the absence of an adequate procedural framework, and by helping them to manage better in practice.

THE COMMISSION'S REPLIES

5.17. *The control standards are being introduced gradually, in accordance with a precise timetable.*

The improvement and strengthening of the control environment is the result of the implementation of all the measures set out in the control standards.

A systems-based approach needs to be assessed on its functioning as a whole.

(b) *The Commission has put significant additional resources into auditing and methodologies and standards are being developed and improved. This will inevitably have an impact on the Commission's expectations and requirements for sub-contracted audits.*

(c) *The Commission acknowledges that there is still a considerable amount of work to be done, and it is currently finalising the necessary instructions and procedures.*

5.18. *The Court's analysis is based on the situation in 2001. The introduction of the CRIS (Common Relex Information System) in 2002 has considerably improved the situation.*

THE COURT'S OBSERVATIONS

5.19. Management cannot obtain a reliable picture of its area of responsibility from an aggregation of the information sent to it by the units placed under its responsibility, since their data are not homogeneous or complete and are, at least in part, unreliable.

5.20. In the case of Heading 4 (External actions) of the financial perspective, there are also the effects of a complex sharing of responsibilities, within and outside the Commission, in respect of the management of the budget headings concerned. In this respect, several Directorates-General, Community agencies and many third parties acting on the Commission's behalf are required to programme or authorise expenditure or manage funds. Moreover, Delegation staff, including those performing authorising duties delegated to them by AIDCO, are placed under the hierarchical responsibility of DG RELEX. Under these conditions, a system of internal control covering the Commission's overall needs in terms of external action is more difficult to introduce.

5.21. The reform does not deal sufficiently with audits of Community funds carried out by or for the Commission at the level of intermediaries and final beneficiaries (see paragraph 5.17(b)). Moreover, the human and financial resources allocated to this task — which were already insufficient in the past — were further reduced in 2001, so that the number of audits carried out by or for the Commission was limited. The importance of these audits is considerable, especially in the light of the high level of external management at the Commission (see paragraph 5.20). The Commission should deal with this matter quickly in order to ensure that systematic audit programmes are established, including by clearly stipulating the responsibilities required within the Commission, so that the conclusions of audit reports are acted upon.

THE COMMISSION'S REPLIES

5.19. *The Commission does not deny the urgent need to transform the various systems which existed prior to the creation of EuropeAid into a unified, effective system. Various measures were taken in 2001 and 2002 to improve data entry to make the data more homogeneous and more complete. The introduction of CRIS in 2002 is being accompanied by an 'upgrade' of the information in the existing system to make the data more reliable.*

5.20. *The Communication approved by the Commission on 2 July 2002 on the Unified External Service answers this question with a clear definition of the role and responsibilities and internal control systems of each of the RELEX family departments vis-à-vis the delegations.*

5.21. *It is in fact envisaged that, between now and the end of 2002, an integrated audit programme on external aid be established to cover the external audit activities of delegations and headquarters alike.*

In order to strengthen its audit activities under the direct supervision of its operational services AIDCO has launched a framework contract for audit assignments that became operational in September 2002. A second framework contract relating to audit of operations financed by the EDF will be launched when funds are available.

As far as determining responsibilities for follow-up of the audit reports within the Commission is concerned, it is the authorising departments which are responsible. The application of line management with the creation of the Office has enhanced this responsibility though the principle remains the same. As far as the formulation of instructions for following up the audits' conclusions and recommendations is concerned, it is therefore planned to adapt existing manuals and produce an audit manual for staff in the delegations and at headquarters.

For humanitarian aid, the Commission has engaged an external audit company to undertake audits on behalf of ECHO. By this means all of ECHO's partners will be audited every 2 years. Some 50 audits have already been commissioned. ECHO has devoted considerable resources in the past year to audits on its partners. Between 1995 and 2002 more than 130 audits have been carried out. Furthermore, the amount of human resources devoted to auditing has now been tripled for field and other audits.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Taking into account the work of the IAS

5.22. In February 2002 the IAS finalised a report entitled 'Governance Review of Aid Management in the External Relations Family'. It includes a comprehensive review of the Commission's management of external aid covering issues which constitute the overall control environment (organisation, allocation of responsibilities, human resources and accountability). It also covers internal control mechanisms, including those to be applied to, and by, partners of the Commission in the development aid process (intermediaries, other donors and beneficiary countries).

5.23. The report highlights the need openly to acknowledge the inherent risks associated with the Community's development aid programmes, particularly as they consist essentially of grants. It also touches on subjects of particular interest to the Court in the context of its audit work in the external aid field, such as management information systems, deconcentration to Delegations, and the multiplicity of financial instruments.

5.23. *The RELEX family of DGs has set up a working group to examine the implications of the IAS report.*

*Intensive audit in the field of humanitarian aid and food aid***Scope and nature of the audit**

5.24. The objective of the Court's audit was to provide conclusions as to the legality and regularity of the underlying transactions and to assess the functioning of the internal control systems of the two policy areas. The audit examined firstly the system of procedures and controls covering this area in order to evaluate their effectiveness in ensuring that transactions are legal and regular. Secondly, it looked at an examination of a representative random sample of 183 payments made in the year 2001 drawn from the Commission accounts. The audit was based on documentary evidence available at the Commission in Brussels, supplemented by visits to intermediary organisations (United Nations' World Food Programme (WFP) in Rome and EuronAid⁽¹⁾ in The Hague) and on-the-spot audits of underlying expenditure and physical inspections in six beneficiary countries (Bolivia, East Timor, Kosovo, North Korea, Mozambique and Tanzania). The transactions audited at the

⁽¹⁾ Euronaid is a Dutch European network of NGOs founded as an association under Dutch law, in charge of food purchases on behalf of the Commission.

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intermediary level and on-the-spot represent approximately 30 % of the total sample.

Objectives and nature of humanitarian aid and food aid

5.25. The primary objectives of the EU food aid programmes are to promote the availability and accessibility of foodstuffs for the populations in developing countries, as well as to support their efforts to improve their own living conditions, alleviating poverty at all levels. The humanitarian aid programme provides assistance, relief and protection operations to help people in third countries who are victims of natural disasters, man-made crises or exceptional circumstances.

5.26. The regulation concerning humanitarian aid was adopted on 20 June 1996 ⁽¹²⁾ to assist people affected by emergencies or longer-lasting crises. On 27 June 1996 the regulation on Food Aid policy and Food Aid management and special operations in support of Food Security ⁽¹³⁾ was adopted, with the general rules for the mobilisation of products being adopted on 16 June 1997 ⁽¹⁴⁾.

5.27. The majority of the projects in the humanitarian and food aid areas involve the financing of projects for the provision of food or non-food items to developing countries. This area is inherently high risk, exacerbated by the difficult conditions in the countries in which these activities take place. Humanitarian aid is normally planned and executed in a short period of time by virtue of its urgency. For both food aid and humanitarian aid it is obviously difficult to obtain proper evidence of the correct distribution of the food (see paragraph 5.30).

5.28. The humanitarian aid and food aid programmes are managed in Brussels by the EC Humanitarian Office (ECHO) and AIDCO respectively. They are responsible for all implementation aspects, control functions and evaluations.

5.29. The amounts committed and paid in 2001 are shown in **Table 5.3**.

5.28. *The Commission has taken note of the fact that the Court considered the ECHO and AIDCO (food aid) programmes at the same time. For practical reasons and for the sake of clarity, the Commission will reply separately where necessary depending on the source of financing.*

⁽¹²⁾ Council Regulation (EC) No 1257/96 (OJ L 163, 2.7.1996, p. 1).

⁽¹³⁾ Council Regulation (EC) No 1292/96 (OJ L 166, 5.7.1996, p. 1).

⁽¹⁴⁾ Commission Regulation (EC) No 2519/97 (OJ L 346, 17.12.1997, p. 23).

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Table 5.3 — Food and humanitarian aid commitments and payments for 2001 ⁽¹⁾

(Mio EUR)

	Budget area	Commitment appropriations	Commitments	Payment appropriations	Payments
Product mobilisation	B7-2 0 0	151,0	150,8	160,0	160,0
Food security	B7-2 0 1	157,9	157,5	150,0	149,6
Transport, etc	B7-2 0 2	155,8	153,1	179,7	174,2
Total food aid	B7-2 0	464,7	461,4	489,7	483,8
Humanitarian aid	B7-2 1	523,0	523,0	620,1	561,1
Total		987,7	984,4	1 109,8	1 044,9

⁽¹⁾ Including both appropriations for the financial year and additional appropriations.

Source: Commission's 2001 revenue and expenditure account.

Problems and constraints for the Court's audit

5.30. As on-the-spot audits of humanitarian aid and food aid were carried out by the Court after the event, the work often had to be limited to reviewing the supporting documentation and internal controls at local level, because carrying out a proper physical inspection of completed operations is impossible, the aid supplied having already been consumed.

5.31. The WFP manages a substantial proportion of the activities in this area and, thus, a considerable number of payments in the audit sample related to activities managed by it. The audit of the underlying transactions at the level of the WFP headquarters in Rome was affected by constraints on the Court's direct access to supporting documentation and by significant delays by WFP in replying to requests from the Court for accounting information. Also, an assessment of the relevant internal controls at the central level of the WFP could not be carried out within the time limit allowed. These limitations were the result of WFP's restrictive interpretation of the verification clause agreement between the Commission and the United Nations of 29 October 2001.

Audit findings

Internal controls at the level of the Commission are generally satisfactory

5.32. The support provided under food aid and humanitarian aid is in the form of grants. The organisations responsible for carrying out the activities are

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NGOs, international organisations and agencies or in the case of food security also the governments of the beneficiary countries.

5.33. Usually food aid is contracted directly by the Commission through international tenders. In the case of local or triangular (regional) food or non-food items, purchases can be made by a third party (e.g. NGOs) as part of overall projects awarded to them. Also transport and distribution of foodstuffs is done by third parties.

5.34. Where a third party is involved, the activities are covered by a contract with the Commission. This usually provides for the payment of a first advance, possibly intermediate payments based on the level of disbursement of the first advance disclosed in the intermediate report, and a final payment made upon approval of a financial and technical report.

5.35. The Commission ensures that food has been properly delivered to the final destination by means of inspection reports compiled by companies contracted by the Commission. These reports detail both the quantities and quality of the food. The Court's audit did not indicate any weaknesses in this procedure.

5.36. Projects for the mobilisation of food products and humanitarian aid are monitored on-the-spot by technical assistants contracted by the Commission staff in those countries where this is justified by the level of funding. The role of the technical assistance staff is to liaise with the contractors and to regularly monitor the projects. They do not have the responsibility to carry out any review of the tendering done by the contractor or of the supporting documentation of project expenditure.

5.37. For humanitarian aid ECHO carries out audits of the European headquarters of organisations with which it has signed contracts Partnership Agreement. Internal controls are reviewed and checks are carried out on the supporting documentation of a sample of ECHO-funded projects. On the food aid and food security operations only a limited number of audits of projects were carried out by AIDCO. However, most of the contracts with NGOs concluded from 2001 onwards contain provisions for independent audits to be carried out the projects' financial reports.

5.36. *Specialist Technical Assistants are contracted by the Commission to monitor and control the projects. The role of these Technical Assistants is to advise and assist in the implementation as well as monitor the projects and NGO partners in the field.*

5.37. *As far as food aid is concerned, audits and evaluations were carried out on NGOs in 2001. 10 audits and evaluations were planned and implemented (eight countries, EuronAid and Mitch). It is confirmed that financial audits are now conducted for all NGO projects by independent auditors.*

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Internal controls at the level of the implementing partners need strengthening

5.38. Internal controls vary considerably according to the size and resources of the organisation responsible for carrying out the activities. Account has been taken of this factor when assessing the appropriateness or absence of internal controls at intermediary or local level.

5.39. The internal controls for the maintenance of supporting documentation on-the-spot are often weak. This is particularly the case for the smaller organisations where decisions are taken without being properly documented, or supporting documentation is lost or destroyed. For instance, an NGO that was carrying out a food security project in Mozambique was unable to provide a proper list of expenditure at the time of the audit visit. In most cases of weak supporting information, however, compensating evidence could be obtained to show that there was no irregularity.

5.40. In some cases, internal controls on invitations to tender do not guarantee the transparency and open competition required by the Commission. In Tanzania, local food procurement by the WFP consisted of sending invitations to tender to suppliers selected from a database, but the existence of the database was not advertised locally nor were the reasons for the selection of particular suppliers documented. There is a risk that suppliers may be unfairly excluded from invitations to tender. For a humanitarian aid project in Mozambique, in the absence of a proper procedure, the invitations to tender were carried out by the NGO only by telephone and the evaluation of the offers received was not documented.

5.41. Some organisations have difficulties in following financial and tender procedures adequately because of a lack of experience in these areas (see also the example in paragraph 5.44). In Mozambique, after a food security project was awarded to private companies, it transpired that one of the contractors had financial problems and the first advance to that contractor was withheld. This situation could have been avoided by the inclusion of financial capacity as one of the criteria for the eligibility of the applicant.

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5.39. *On its visit to Mozambique, the Court noted problems due to the staff's lack of experience during the project start-up phase, in connection with the fact that the area where it was launched was remote and access to it was difficult. The Mozambique Delegation, the departments at headquarters and the NGO in question are doing what is necessary to remedy the situation.*

5.40. *ECHO partners are given a certain amount of instructions for procurement procedures and these are given in Article 16 and Document 14 of the Framework Partnership Agreement. In Article 16.1 it is stated that the procurement of goods and services is the responsibility of the partner. ECHO intends to revise and simplify the tender instructions so that the rules can be implemented by its partners more consistently.*

The Commission notes the Court's remarks concerning the project in Mozambique and will follow up the issues raised with the partner concerned.

5.41. *In future, this financial criterion will have to have greater weighting in the awarding of projects to the private sector.*

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5.42. The audit work undertaken on the basis of documentary evidence at the level of the Commission in Brussels did not reveal a significant level of material errors of legality and regularity on payments made at a central level. This is explained by the high proportion of first advance payments for projects, usually amounting to 50 to 80 % of the contract value. The risk of any such advance payment having an irregularity at the time it is made is negligible compared to that of an intermediate or final payment since only in the latter cases is the beneficiary required to comply with certain conditions, usually the presentation of a technical and financial report.

5.43. The Court's audit of the supporting documentation for 27 on-the-spot actions revealed significant irregularities, in particular in respect of project tendering procedures.

5.44. For example, the tendering committee of a humanitarian aid project in East Timor because of a lack of experience in this matter wrongly excluded one of the offers for building materials on the basis that it had been submitted too late. The offer, which had in fact been received on time, was significantly cheaper than the one selected and, in a similar tender carried out subsequently within the same project, the supplier was successful and the materials purchased were of acceptable quality. In respect of a food aid project, a tender launched by the Commission for the purchase of fertiliser for North Korea indicated an unreasonably and unnecessarily short deadline for the delivery of the commodity at the port of arrival, thus considerably restricting the number of potential suppliers.

5.45. The impact on payments of irregularities in tendering procedures is impossible to quantify. One example of such cases is a food security project in Bolivia for which the organisation in charge set a deadline shorter than the one set by the applicable national legislation for the presentation of the offers for the components submitted to tender. Given the complexity of the project, it was extremely difficult to prepare a technically valid offer in the short time given, so that when the tender committee came to review the financial envelopes for the three largest tenders, only one valid offer remained for each, all from the same contractor. The members of or observers on the committee, none of whom were independent of the locally-based government official ultimately responsible for the project implementation, did not object to this.

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5.44. *The Commission services will bring the full detailed instructions for procurement to the attention of the partner concerned in East Timor.*

Following long discussions with the North Korean authorities, the project was presented to the Member States in October 2000 and the agreement of the beneficiary authorities was received only on 22 January 2001. The invitation to tender was therefore not launched until very late, respecting, for delivery at the destination (April), the seasonal agricultural production process and the fact that the ports are closed in January/February/March.

5.45. *The tendering procedures work well generally.*

As regards the irregularity observed in the application of Bolivian legislation (call for tender procedures), this is contested neither by the delegation, nor by headquarters, nor by the national counterpart, which manages the PASA food security project. Since 2001, the national counterpart has improved monitoring and control of the application of procedures throughout the life-cycle of the project for more than 300 micro-projects, in close collaboration with the European technical assistants. However, the many constraints and burdens in the application of Bolivian legislation in the case of micro-projects should be noted. In this field also, on the basis of the experience acquired by the programme, dialogue with the government should be pursued in order to make the laws more functional and, hence, make controls more effective.

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5.46. A food security payment of 5 million euro to the Government of Mozambique was intended to finance 2000 expenditure in certain priority Ministries and institutions. However, the payment only took place in May 2001 and was transferred to the Treasury account from where it was not possible to trace its use or establish a link between this payment and the expenditure of the targeted bodies. The Court is therefore unable to express an opinion on the utilisation of this payment.

Conclusions

5.47. Taken as a whole, the payments made by the Commission were legal and regular on the basis of the documentary evidence available at the central level in Brussels. However, the audit at the level of the implementing organisations of the 27 operations examined on the spot revealed that in six cases irregularities had occurred, in particular concerning project tendering procedures, which is a matter of concern.

5.48. The limitation in the scope of the audit described in paragraph 5.31 on WFP as well as the non-opinion for the project in Mozambique (paragraph 5.46) concern those payments whose underlying transactions were audited at the level of the implementing organisations.

5.49. The Commission's lack of guidance to implementing partners, in particular NGOs, is in part the cause of inadequate internal control procedures at the level of such organisations (see paragraphs 5.40-5.41), the consequences of which remain undetected because of the Commission's lack of reviews and audits in certain areas (see paragraphs 5.36-5.37).

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5.46. *The payment was expected to be made in early 2001 (disbursements on 2000 budget possible up to 31 March 2001) but were delayed to May 2001 due to the late delivery of import statistics by the Central Bank.*

Despite this delay, the Government has apparently guaranteed the target public expenditure by pre-financing it as referred in the September 2001 audit report. This budget support has to be seen as the primary instrument for channelling financial resources to the public sector (the budget of Mozambique depends for 50 % on foreign support), to ensure that public services will be delivered by the State within and beyond the reform process the EC food security programme is supporting.

5.47. *The Commission takes note of the Court's conclusion and will review the cases cited. It considers that the measures undertaken in the context of the reform of the financial management will address the problems identified.*

5.49. *The Commission has already taken steps to increase the number of audits of its partners — in particular NGOs. In the new call for proposals, the audit procedure is now systematic for each of the NGO projects.*

In the area of humanitarian aid the Commission feels that the guidelines, rules, level of meetings and contacts, and controls and audits on the implementing partners are relatively extensive. However, the Commission services intend and always seek to improve their guidance for the best result.

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Recommendations

5.50. The Court recommends that:

- (a) the Commission takes further steps to ensure that organisations responsible for handling EU funds strengthen their internal control systems, in particular to ensure the adequacy of supporting documentation and their tendering procedures. The Commission should lay down more specifically the minimum standards which are required;
- (b) the Commission takes the steps necessary to ensure that sufficient reviews and audits are carried out by it, or on its behalf, to enable it to judge whether the internal control procedures applied by its implementing partners are adequate, and takes corrective action if necessary;
- (c) the verification clause agreement between the Commission and the United Nations should be clarified in order to ensure proper and timely cooperation between the EU institutions and the UN bodies concerned.

5.50.

- (a) 1. *For humanitarian aid, the Commission believes that the problem relates to a small number of cases only. The ECHO partner vetting, instructions, communication, dialogues, evaluation, monitoring, controls and audits are extensive and relatively exhaustive. The partners are informed of the minimum standards but these need to be modified and streamlined to enable the partners to implement the rules more consistently.*

In the light of the reform, new financial regulations and implementing rules, a new Framework Partnership Agreement is being drafted.

2. *Regarding food aid, a number of measures have been taken by the Commission to check the correct application of procedures as specified below:*

- *EuronAid allocations: verification that tendering procedures are respected, with formal agreement on the award of contracts and external audit of this organisation,*
- *NGO financial allocations: obligation for the NGOs to carry out an annual audit as well as a final audit upon closure of the project and to send the report to the Commission (Article 16(4) of the General Conditions). These audits also include checks on whether the expenditure is incurred in conformity with the rules for awarding contracts,*
- *direct allocations to governments (see point b).*

- (b) 1. *For humanitarian aid, the Commission engaged in June 2002 an external audit company to undertake audits on behalf of ECHO which will substantially increase the audits already carried out. In particular, by this means all of ECHO's partners are expected to be audited every two years. Furthermore, the human resources devoted to auditing have tripled.*
- 2. *As far as food aid is concerned, mid-term reviews, final reviews and audits are organised regularly, for both direct and indirect aid.*

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Synthesis of specific appraisal

5.51. The Commission has made a good start on its reform of the internal control system in the field of external actions and the IAS has made a valuable contribution to identifying the risks inherent in the field and the problems which need to be addressed. Certain issues, however, still need considerable attention before they can be resolved, notably the putting in place of a satisfactory systematic audit of Community operations at the level of intermediaries and final beneficiaries, and the maintaining of complete and reliable management information. Furthermore, the measures taken to improve financial management will only become fully effective when appropriate tools are developed to ensure the consistent application of AIDCO's guidelines in all the areas for which it is responsible.

5.52. Under these circumstances, the Court cannot yet rely on the Commission's control and supervisory systems to contribute part of the assurance it seeks to provide for the area of external actions. For 2001, the Court examined the internal control systems and the legality and regularity of underlying transactions in the fields of humanitarian and food aid. It concluded that, whereas payments made were legal and regular at the level of the Commission, shortcomings in implementing partners' internal control procedures meant that there were irregularities at local level. The Commission should therefore improve its monitoring and provide better guidance to its implementing partners on their internal control procedures (see paragraphs 5.47 to 5.50).

FOLLOW-UP OF PREVIOUS OBSERVATIONS

*Tendering procedures for service contracts under the TACIS programme***Introduction**

The Court's earlier audit

5.53. Special Report No 16/2000⁽¹⁵⁾ covered tendering procedures for service contracts under the Phare

5.51. *The Commission accepts that certain issues still need attention and is already taking the necessary measures.*

5.52. *The Commission has taken note of the Court's general conclusion. As explained in the preceding points, it has already taken the necessary measures to step up the control of the procedures and accounts of the different projects, notably with NGOs. This policy has already been made systematic for all new awards of contract or calls for proposals.*

In the area of humanitarian aid the Commission feels that the guidelines, rules, level of meetings and contacts, and controls and audits on the implementing partners are relatively extensive. However the Commission services intend and always seek to improve their guidance for the best results.

⁽¹⁵⁾ OJ C 350, 6.12.2000.

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and Tacis programmes. This audit of contracts concluded between 1996 and 1998 highlighted risks in the awarding of service contracts and weaknesses in the Commission's systems at that time, which impaired the competition between tenderers and the transparency and effectiveness of procedures.

5.54. The main recommendations of the Special Report were:

- (a) the procedures for awarding service contracts should be harmonised within the Commission;
- (b) the discipline with which the pre-selection and evaluation procedures are carried out should receive particular attention. The Commission should ensure rigour and independence on the part of evaluators (avoiding conflicts of interest) and see to it that Evaluation Committees do not deviate from the evaluation criteria and rules issued to tenderers;
- (c) turnover among the staff allocated to tasks which are essentially civil service duties should be reduced and adequate knowledge of procedures provided for;
- (d) a database containing details of experts and their performance should be created and maintained;
- (e) the follow-up given to complaints and irregularities should be recorded accurately and comprehensively.

5.55. The Commission replied that, since the audit, many measures had been introduced, such as the new Manual of Instructions (Contracts for Works, Supplies and Services concluded for the purposes of Community cooperation with Third Countries, approved by the Commission in November 1999), the standardisation of documents and the creation of a website.

Situation in 2002

5.56. During the discussion on Special Report No 16/2000, the Budgetary Control Committee of the European Parliament invited the Court to undertake a follow-up of the new tendering procedures.

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5.57. The objective of this follow-up review was to examine whether, for the Tacis programme, the Commission had introduced and effectively implemented the measures recommended by the Court and whether the measures themselves were proving effective. Evidence was obtained through file reviews and interviews and by examining a sample of 30 contracts (around 15 % of the total) which passed through the Tacis procurement system in 2001.

Implementation of the Court's recommendations

Harmonised procedures and rules were introduced in 2001 but their implementation can be improved

5.58. The new Manual of Instructions was complemented by a 'Practical Guide to EC external aid contract procedures' in January 2001. The introduction of measures such as the use of checklists, standard forms and contracts (including a simplified breakdown of costs), *in camera* evaluation (to ensure security and confidentiality) and limited use of interviews during technical evaluations (now practically eliminated) greatly improved the procurement system.

5.59. Although the Commission's record-keeping and filing have seen further improvements, procurement personnel do not yet benefit from a system of recording and analysis of problems and complaints which would provide feedback aimed at avoiding future unsatisfactory situations.

5.60. In one third of the contracts examined just one or two firms passed the technical evaluation. The deliberate decision, taken with the introduction of the Manual of Instructions, to increase the basis of weighing the technical quality against price (from 70-30 to 80-20) further reduced the price competition in the awarding of service contracts.

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5.57. The contracts examined by the Court were the first contracts to be prepared in conformity with the Practical Guide to EC external aid contract procedures. The Service Commun Relex has just been disbanded. The staff of the former Technical Assistance Offices had to be integrated into the newly restructured EuropeAid Cooperation Office. Inevitably, there was an initial learning period when staff were familiarising themselves with a new organisation and with new procedures. This was not therefore a period of normal operation for the services concerned.

5.59. The network of Financial and Contract Management Units established within the EuropeAid Cooperation Office provides a regular forum in which problems are discussed so that joint solutions are found. Appropriate action to prevent the recurrence of particular situations takes the form of an instruction note and/or revision of the standard documents annexed to the Practical Guide. There are also plans to establish a Frequently Asked Questions page on the EuropeAid website.

5.60. This rule was established to demonstrate our emphasis on quality rather than price. It is strongly supported by practitioners, including the Member States. It works well in practice, and ensures that we do not award contracts to poor quality tenderers simply because they are cheaper. The maximum budget is published in the procurement notice so tenderers usually attempt to make financial offers as close as possible to this amount. Hence there is rarely a major difference between

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5.61. The evaluation committees closely followed the evaluation criteria issued to tenderers, which is an improvement on the situation found previously. However, selection and award criteria were sometimes vague and difficult to assess.

5.62. Conflicts of interest continue to be a risk factor. This is particularly relevant for the appointment of external evaluators and for cases where a tenderer has gained unfair competitive advantage through the involvement in writing the Terms of Reference. There was one such case among the contracts examined (the same expert wrote the terms of reference and acted as an evaluator, and was also associated with a national business institute which was part of the successful tenderer). According to the Practical Guide, the tenderer should have been excluded from participating in this tender. In another case examined, the Task Manager, all the evaluators and the successful tenderer (company and key experts) were all of the same nationality, thus increasing the risk of bias. Although it cannot be proved that another tenderer should have won in this case, such occurrences reduce confidence in the fairness of the procurement system.

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them. It is therefore inappropriate to place any significant weight on the comparison between financial offers in deciding between the technically compliant offers. Internationally, there have been many instances of commercial operators taking advantage of public tender procedures in which tenderers won on price but subsequently failed to deliver quality services. We want to ensure that tenderers are aware that the main factor for us is the technical quality of their tenders. This weighting is in line with the practice at the World Bank and other international donors.

5.61. *During the transitional phase of the introduction of the new procedures, it took some time for personnel to get used to setting appropriate selection and award criteria. The situation has subsequently improved.*

5.62. *In the first case, all evaluators had signed a declaration of impartiality and confidentiality in which they attested to their independence, taking into consideration whether there exists any past or present relationship, direct or indirect, whether financial, professional or of another kind. One of the evaluators, from the Ministry of Foreign Affairs of an EU Member State, had also been involved in writing the terms of reference. He was subsequently found to have been associated with a national business institute which was part of the successful tenderer, contrary to the statement made in his declaration of impartiality and confidentiality. The Commission investigated this isolated case and concluded that, since this evaluator had given the lowest score to the successful tenderer, there was no evidence that the impartiality of the evaluation had been compromised.*

Evaluators are selected for their technical expertise, irrespective of their nationality. For practical reasons, the Commission seeks to have at least one voting member of the Evaluation Committee from the beneficiary country, which would necessarily imply at least two nationalities among the minimum of three voting members. In the second case cited by the Court, which is exceptional, the beneficiary country's representative was unable to attend and an alternative evaluator was appointed at short notice. The Commission has investigated this case and concluded that the nationality of the evaluators had no influence on the outcome of the evaluation. In general, cancelling the tender procedure simply because the only suitably qualified evaluators available were of the same nationality would have been criticised by both the tenderers concerned and by the beneficiary country.

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The Commission's reorganisation and associated human resources problems hindered Tacis procurement planning

5.63. The new EuropeAid Cooperation Office was set up in January 2001. At the same time many Technical Assistance Offices (TAOs) were dismantled, including the Tacis Procurement Unit which was discontinued at the end of March 2001. Although intended to reduce the turnover among staff allocated to essentially civil service duties, these changes adversely affected the Tacis programme implementation and tendering process. During 2001 continuing high staff turnover and the late recruitment of permanent procurement managers delayed the launch of tenders and thus reduced the effectiveness of the procurement system.

5.64. By the middle of 2001 it had become clear that a number of tenders already launched or about to be launched could not meet the deadlines for contracting and/or disbursement because the Terms of Reference were not yet ready at all or endorsed by the beneficiary. For one fifth of the projects examined the duration was significantly reduced while the same budget was kept and the Terms of Reference amended, either just before the invitation to tender was issued, or afterwards while negotiating the contract or even after the contract had been signed.

Conclusion

5.65. The procurement system of the Tacis programme has been strengthened, particularly with the introduction of harmonised procedures and standard contracts. There are however some areas where further improvement is necessary in implementing these procedures in order to achieve the highest level of transparency and fair competition in tendering.

Recommendations

5.66. The Court emphasises its earlier recommendation that a stable staff situation is crucial and should be further pursued.

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5.63. The Commission accepts the Court's comments on staffing in relation to the first part of 2001. The staff of the former Technical Assistance Offices had to be integrated into the new structure, which inevitably affected programme management. Since the second half of 2001 efforts have been made to improve the situation within the limited resources available.

5.64. The Commission had to reduce the duration of some projects financed under older action programmes to allow it to continue to implement the projects. However in these cases, even with the reduced time frame, the scope of the work (and hence the maximum budget available) remains the same. The Commission nevertheless took care to ensure that the projects remained feasible and that competition was not at risk.

5.65. The Commission is pleased to note that the Court welcomes the introduction of the Practical Guide and recognises the improvements made already. The implementation of the new procedures improved after the initial transition phase included in the Court's period of review.

5.66. The Commission has taken measures to improve the staffing situation within the resources available.

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5.67. An information and management system containing data on experts and contractors should be developed.

5.68. The follow-up given to complaints and irregularities, together with descriptions of any problems occurring during the tendering process, should be recorded and reviewed regularly by all procurement officers.

Co-financing of activities implemented by non-governmental organisations (NGOs)

Introduction

5.69. The audit of the co-financing of NGOs carried out for 1999 covered the management of the Commission as well as the management and the internal control systems of a sample of NGOs.

5.70. The main observations made by the Court in its 1999 Annual Report ⁽¹⁶⁾ were:

- (a) the proposals for projects made by the NGOs usually did not contain indications on how the sustainability of the projects could be ensured;
- (b) the procedures for contracting with NGOs varied according to the different budget headings;
- (c) the delay between the NGOs' requests for aid and the Commission's decisions was too long;
- (d) ex-post controls on the implementation of NGO-actions should be improved and evaluations should be carried out on a regular basis.

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5.67. *The Practical Guide to EC external aid contract procedures already includes contractor assessment forms which must be completed at the end of each project by the project manager of the Contracting Authority. This provides the Financial and Contract Management Units of the EuropeAid Cooperation Office with information on the performance of experts and contractors.*

While this information is not currently recorded in a computerised database, this is clearly the intention. A Commission-wide database of contract information is already being developed.

5.68. *See reply to point 5.59. Recurrent problems encountered during tender procedures are discussed at monthly meetings of a network of procurement officers throughout the External Relations DGs. Minutes of these meetings are made available internally in electronic form. Follow-up action has included internal instructions and revision of the standard documents of the Practical Guide.*

⁽¹⁶⁾ Paragraphs 5.21-5.27 and 5.79-5.93.

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5.71. In the context of the discharge procedure for the financial year 1999 the Commission announced, in its Action Plan ⁽¹⁷⁾, improvements in monitoring, ex-post controls and standardising of procedures for contracting with NGOs.

The Commission's initiatives

NGOs' proposals and the contracting procedures

5.72. The Commission solved the problem of the unclear content of the proposals made by NGOs and the differences in procedures by introducing in 2000 a new 'call for proposals' procedure. According to this procedure, NGOs can submit proposals for actions to be (co)financed by the Commission. The proposals should contain precise information about the NGO (including its financial situation and previous contracts with the Commission), on the proposed action, covering aspects such as the nature of the intervention, the beneficiaries and monitoring, as well as on the interrelationship between objectives, activities, results, inputs and performance indicators (logical framework), and the factors determining the sustainability.

5.73. The proposals for the year 2000 were assessed on the basis of criteria on the relevance of the actions (e.g. target groups, needs, objectives), the methodology proposed (e.g. project design, involvement of partners), the sustainability and the budget and management capacity of the NGO. Although the procedure foresaw that the Delegations should play an important role in the assessment process, in practice their contribution was restricted because they were not given sufficient time by the central services to respond. Consequently, most of the assessment work was carried out in Brussels. Of approximately 1 100 proposals about 400 projects were selected based on the outcome of the assessment and the availability of funds.

Delays

5.74. The above action has harmonised the procedures applying to contracting with NGOs and has made the selection process much more transparent. However, this

⁽¹⁷⁾ Communication from the Commission SEC (2001) 246 final of 5 March 2001.

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intensive and thorough procedure needed substantial resources and time on the part of the Commission's central services. Consequently the delay between the NGOs' proposals and the conclusion of contracts with NGOs was still more than one year for 66 % of the cases examined.

5.75. The number of proposals to be processed in future is unlikely to decrease and the number of staff at central level involved in the management of NGO contracts will presumably remain the same. As a result delays are unlikely to be shortened as long as the existing procedures apply. The Commission should consider having a greater part of the assessment work carried out by the Delegations on the basis of clear instructions and guidance from the central services, subject to subsequent monitoring.

Ex-post controls and monitoring

5.76. The Commission is in the process of strengthening its monitoring and evaluation of projects. In particular the obligation for NGOs to carry out monitoring and evaluations as specified in the call for proposals procedure, should provide a sound basis for further improvements. Moreover, the Commission is setting up a global monitoring system for development projects, which should lead to systematic monitoring of projects on the basis of criteria such as relevance, effectiveness, efficiency, impact and sustainability. The results of this monitoring are to be included in a database which Commission staff will be able to access easily.

5.77. In setting up this monitoring system some 500 projects were monitored. The consultancy firm which assisted the Commission in implementing the system made an assessment of the present situation of this project. The report concluded that the monitoring tools such as reports and criteria for monitoring are now well established. Whereas the monitoring system can now identify projects' weaknesses, additional work needs to be carried out to be able to analyse their underlying causes. Furthermore the quality, performance and methodology of the monitoring system should be regularly evaluated by the Commission.

THE COMMISSION'S REPLIES

5.75. The existing procedures foresee an active involvement of delegations in the assessment of proposals, and the Commission will ensure that proposals are received in due time for them to be assessed.

The Commission has tightened the eligibility criteria and the areas of priority financing in order to limit the number of proposals for any given call for proposals. This should have the effect of reducing the time needed to carry out the evaluation as well as shortening the time between the submission of proposals and the signing of the contracts.

5.76. Improvements in monitoring have taken place, as described by the Court. The two systems (i.e. the monitoring system specified in the call for proposals, and the global system for results-oriented monitoring) are being kept under review, but it is too early to make a full evaluation. The internal database on the results of the results-oriented monitoring system is already functioning.

5.77. The Commission expects to continue improving and developing the methodology. There are also firm plans to assess, after the system has been in use for two or three years, the usefulness of the monitoring reports and their application in practice.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Conclusion

5.78. The Commission has undertaken a number of significant actions to improve its management of its co-financing of actions managed by NGOs. However Delegations should be allowed sufficient time for giving their opinion on proposals made by NGOs. The Commission should also examine alternative procedures to shorten the time between the NGO's submission of proposals and the signing of the contracts.

5.78. *The Commission welcomes the Court's comments on the actions taken. The consultation process will involve delegations, and sufficient time will be allowed for them to comment.*

PRINCIPAL OBSERVATIONS IN SPECIAL REPORTS*Macro-financial assistance to third countries and structural adjustment facilities in the Mediterranean countries*

5.79. The Court examined European Union macro-economic level support for general economic transition and structural reform processes in selected third countries⁽¹⁸⁾. In the EU Accession countries, the Western Balkans and the Newly Independent States this assistance usually takes the form of 'Macro-Financial Assistance' (MFA), whereas in the Mediterranean non-member countries (MEDA) it is in the form of 'Structural Adjustment Facilities' (SAF)⁽¹⁹⁾. During the period 1998 to 2000, 822 million euro were disbursed as MFA in nine countries (of which 704 million euro were given in the form of loans). Between 1996 and 2000, 470 million euro were paid as grants to five countries under the SAF programmes.

⁽¹⁸⁾ Special Report No 1/2002 concerning macro-financial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries (OJ C 121, 23.5.2002).

⁽¹⁹⁾ The EU also provides structural adjustment assistance to the African, Caribbean and Pacific countries. See Special Report No 5/2001 on counterpart funds from structural adjustment support earmarked for budget aid (seventh and eighth EDFs) (OJ C 257, 14.9.2001).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

5.80. The main audit objectives were to assess:

- (a) the rationale of the design of the instruments;
- (b) the quality of the Commission's payment approval and monitoring process;
- (c) whether the Commission fulfilled satisfactorily its reporting duty and made comprehensive evaluations.

5.81. When giving MFA assistance the Commission did not always respect the five policy principles (exceptional character, political pre-conditions, complementarity, conditionality and financial discipline) agreed by the ECOFIN Council in 1995. For SAF programmes the Commission did not document how, and on what basis, it made key decisions such as determining the size of the grants, or the size and timing of payment instalments. The programme conditions were often limited to the presentation of legislation and action plans rather than their actual implementation.

5.82. The Commission has not made comprehensive specific assessments of the reliability of the budgetary and accounting processes of MFA and SAF recipient countries. This is a significant weakness for budgetary support operations as the money goes directly into the recipient country's budgetary system and its use cannot be separately identified.

5.83. Whereas the need to have a margin of judgement is inherent in an instrument like SAF or MFA, the Commission has not always clearly established whether certain conditions had been fulfilled. In particular, the justification for waiving conditions was not sufficiently documented.

5.81. The ECOFIN conclusions referred to by the Court are informal and not legally binding and they provide general guidance for the design and implementation of MFA. The vast majority of MFA follows these principles. Some exceptions may occur, which is not unexpected given the nature of the programme, though these are known about and subject to appropriate review.

As SAFs accompany the reform programmes of the Mediterranean partners, a fixed timetable of disbursements is not required (instalments are released only upon compliance with conditionality). This is because (a) the pace of reforms of the partner country should be respected and (b) SAFs are not exceptional instruments to be used in the urgent financing of internal and external deficits.

5.82. All the countries in receipt of such aid are regularly subjected to IMF Article IV review, when budget implementation and the quality of the data concerning public finances are examined and evaluated. These provide a major input to assessing the quality of budgetary and accounting processes.

5.83. Disbursement can be based on an overall evaluation of the achievement of set objectives though all relevant available information should be weighed up to arrive at an appropriate conclusion. Some actions which may not have been foreseen in an original agreement may be important in achieving the overall objective.

The Commission endeavours in all cases to document fully the reasons for waiving conditions.

THE COURT'S OBSERVATIONS

5.84. The evaluation of the measures by the Commission was found to be either non-existent (MFA) or of limited scope only (SAF).

5.85. The Court recommended that:

- (a) the added value of the European Union's interventions in comparison to the World Bank and the International Monetary Fund should be more clearly established;
- (b) consideration should be given to creating a more harmonised approach between MFA and SAF, so that countries in similar situations are dealt with in a similar manner;
- (c) the Commission's decision-making for the various phases of the management of macro-economic assistance should be more transparent, and in particular the Commission should document its justification for waiving conditions;
- (d) the Commission's monitoring of the quality of financial management in beneficiary countries should be considerably improved and involve all relevant Directorates General;

THE COMMISSION'S REPLIES

5.84. *The Commission is planning to initiate independent evaluations of selected MFA programmes from 2003 onwards. This will complement the evaluation of economic adjustment and reform in the beneficiary countries already laid down in the annual reports concerning implementation of MFA.*

An evaluation of macro-economic policy support is planned for 2004/2005. It is not planned to cover MFA. Once the evaluation report is finalised, it will be made available on the Commission's website.

5.85.

- (a) *A systematic effort is made to ensure adequate complementarity with IMF/WB programmes. Generally the mobilisation of MFA and SAFs is associated with additional reform efforts being required from the recipient partner countries. Furthermore, the economic policy conditions (notably on structural reform) attached to the implementation of EC assistance are inspired by the economic co-operation agenda between the EU and the recipient country as set out in association or cooperation agreements.*
- (b) *Although the MFA and SAF are designed differently and pursue somewhat different objectives, an effort is under way to ensure consistency in their implementation procedures. The observation of the Court will be taken into account in this context.*
- (c) *The Commission will ensure, in all cases, that reasons for granting waivers are adequately documented.*
- (d) *Commission departments, including the delegations, regularly monitor the economic and political developments of the beneficiary countries. The Commission is enhancing the delegations' capacity to monitor the political and economic conditions in beneficiary countries.*

THE COURT'S OBSERVATIONS

- (e) more priority should be given to carrying out evaluations.

THE COMMISSION'S REPLIES

- (e) *A greater focus on evaluation is already a part of the general reform. Evaluations of selected MFA programmes are planned to take place from 2003 onwards, and all SAFs approved since 2000 include financial provision for a final independent evaluation.*

CHAPTER 6

Pre-accession aid

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INTRODUCTION

6.1. This chapter deals with the instruments for countries preparing for accession to the European Union. It includes observations on budgetary management for heading 7 of the financial perspectives and on the second year of implementation of the Sapard programme in the area of agricultural and rural development. Heading 7 of the financial perspectives only contains the appropriations for the pre-accession instruments (PHARE, ISPA and Sapard) and not those in favour of the Mediterranean countries, which remain under heading 4.

ANALYSIS OF BUDGETARY MANAGEMENT

6.2. **Table 6.1** gives an overview of budgetary management under Title B7-0, concerning the pre-accession instruments and the pre-accession strategy in favour of Mediterranean countries for the financial year 2001.

The Commitment appropriations were fully utilised

6.3. All the commitment appropriations under heading 7 were utilised in 2001. For the two new instruments (Sapard and ISPA), commitments entered into during this financial year amounted to 540,0 million euro and 1121,2 million euro respectively ⁽¹⁾. For the Sapard programme this concerned the Commission's expenditure decisions (and not actual projects), whereas for ISPA it concerned legal contractual commitments actually entered into for each project.

6.2-6.3. *The budgets for pre-accession aid are based on an assessment of the needs of the candidate countries. They are drawn up in response to calls by the European Council, notably the Berlin summit, and the wishes expressed by the Council and the European Parliament for there to be significant sums available to the candidate countries from an early date so that this would not act as a brake on them carrying out all the necessary activities in order to achieve accession. Sapard is mainly an institution-building device to ensure the easy take-up by these countries of Community practices after accession. ISPA is financing very specific measures in the environmental and transport sectors, although it also certainly includes some element relating to the preparation of candidate countries for the Cohesion Fund.*

⁽¹⁾ Including 41,2 million euro committed in 2001 on appropriations from the financial year 2000 that were carried over to 2001 by a Commission Decision.

Table 6.1 — Pre-accession aid — Implementation of the 2001 budget

(Mio EUR)

Budget heading	Ceiling of financial perspectives	Changes in the budget		Implementation of the budget ⁽⁴⁾			
		Initial appropriations ⁽¹⁾	Definitive appropriations available ⁽²⁾	Utilised appropriations	% of definitive appropriations available	Cancelled approps	% of definitive approps available
		(a)	(b)	(c)	(d) = (c)/(b)	(e)	(f) = (e)/(b)
Commitment appropriations							
Aid instrument for Agriculture and Rural Development (Sapard) — pre-accession (Chapter B7-0 1)	540	540,0	540,0	540,0	100,0	0,0	0,0
Instrument for Structural Policies for Pre-accession (ISPA) (Chapter B7-0 2)	1 080	1 080,0	1 080,0	1 079,9	100,0	0,0	0,0
PHARE Instrument — pre-accession (Chapter B7-0 3)	1 620	1 620,0	1 620,0	1 616,5	99,8	3,5	0,2
Total Heading 7	3 240	3 240,0	3 240,0	3 236,4	99,9	3,5	0,1
Pre-accession strategy in favour of the Mediterranean countries (Cyprus and Malta) (Chapter B7-0 4) ⁽³⁾		19,0	19,0	19,0	100,0	0,0	0,0
Pre-accession strategy in favour of the Mediterranean countries (Turkey) (Chapter B7-0 5) ⁽³⁾		p.m.	p.m.				
Pre-accession strategy (Title B7-0)		3 259,0	3 259,0	3 255,4	99,9	3,5	0,1
Payment appropriations							
Aid instrument for Agriculture and Rural Development (Sapard) — pre-accession (Chapter B7-0 1)		330,8	330,8	30,5	9,2	300,3	90,8
Instrument for Structural Policies for pre-accession (ISPA) (Chapter B7-0 2)		350,0	350,0	203,3	58,1	146,7	41,9
Phare instrument — pre-accession (Chapter B7-0 3)		1 420,4	1 420,4	1 159,8	81,6	260,6	18,4
Total Heading 7		2 101,2	2 101,2	1 393,6	66,3	707,7	33,7
Pre-accession strategy in favour of the Mediterranean countries (Cyprus and Malta) (Chapter B7-0 4) ⁽³⁾		13,0	13,0	2,5	19,5	10,5	80,5
Pre-accession strategy in favour of the Mediterranean countries (Turkey) (Chapter B7-0 5) ⁽³⁾		p.m.	p.m.				
Pre-accession strategy (Title B7-0)		2 114,2	2 114,2	1 396,1	66,0	718,1	34,0

⁽¹⁾ Budget adopted definitively by the European Parliament on 14 December 2000 (OJ L 56 of 26.02.2001).

⁽²⁾ Budget appropriations modified after taking into account the supplementary and amending budgets and transfers, but not including the appropriations carried over from 2000, appropriations resulting from the re-utilisation of revenue and revenue resulting from the participation of third parties and other revenue corresponding to a specific purpose and reconstituted appropriations.

⁽³⁾ The pre-accession strategy in favour of the Mediterranean countries comes under heading 4.

⁽⁴⁾ Appropriations carried over to 2002: 0,0 Mio EUR except for Chapter B7-0 2: 0,1 Mio EUR.

Source: Revenue and expenditure account 2001.

THE COURT'S OBSERVATIONS

Under-utilisation of payment appropriations for the new pre-accession instruments

6.4. With regard to Chapter B7-03, the payment appropriations for the financial year were utilised at a high rate for the Phare programme as such (81,6 %).

6.5. For the new instruments, the amounts paid out were very low. For Sapard programme commitments contracted at the end of 2000, 30,5 million euro, or 9,2 % of the appropriations entered in 2001, and 6,5 % of available appropriations were paid out in the form of advances to the administrations of the candidate states, which transferred 1 million euro to final beneficiaries (see paragraph 6.11). Since these commitments had thus hardly been used by the end of 2001, there is a risk that the extended deadline for payments will not be met (see paragraph 6.10). For the ISPA programme, the Commission made payments amounting to 25,3 million euro relating to the commitments for the financial year and 177,9 million euro for those still outstanding at the end of 2000, representing 58,1 % of the appropriations provided.

6.6. In these two cases, the Commission greatly over-estimated the beneficiaries' absorption capacity and did not base its budget estimates on a realistic assessment of the time needed to set up management systems. For the ISPA programme, the Commission has stated that, here too, advances were paid out on the basis of the approval of the projects to be supported.

THE COMMISSION'S REPLIES

6.4. *The utilisation of appropriations was high since a good number of the budgeted activities took place as planned. This was helped by fact that the Phare programme is well established, which was not the case with the other pre-accession instruments.*

6.5. *Sapard is being implemented on a fully decentralised basis and so payments by the Commission require candidate countries to set up administrative structures capable of ensuring the sound financial management of Community funds. The five countries that had put these structures in place by the end of 2001 represented less than one quarter of the overall SAPARD allocation. An additional factor for low budget execution was the Commission practice of limiting payments on account to only half of the legal maximum. Moreover payments to final beneficiaries are only possible when the latter have incurred eligible expenditure. This inevitably occurs often months after the project has been approved, as is the case in Member States.*

6.6. *The estimates of expenditure for 2001 were made well before the end of 2000. Since there was no previous experience of decentralised management in non-member countries at the time, the estimates were based on the assumption that all the countries eligible would be able to start applying the instrument at the end of 2000 and would do so fully in 2001. This assumption appeared realistic at the time, a view shared by the countries concerned.*

Concerning ISPA, the Commission would like to point out that most of the projects for that year were decided by the Commission very late in 2000, as the Court already observed in its Annual Report for 2000. Moreover, unlike the practice in Member States, the Financing Memoranda need to be countersigned by the beneficiary country, and the timing of this is largely outside the Commission's control. No payments were made in 2000, but they started to flow in 2001. Certain weaknesses in the administrative environment in candidate countries and difficulties in the management of large infrastructure investment led to some delays in the running-in phase of ISPA implementation.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Outstanding amounts

6.7. 7,4 % of the 3 206,5 million euro committed since the introduction of the new instruments could be settled at the end of 2001 (2,9 % of the 1 069 million euro committed for Sapard and 9,6 % of the 2 137,5 million euro committed for ISPA). The volume of the outstanding commitments for the Phare programme also increases regularly.

6.7. *The implementation of large infrastructure projects requires substantial preparatory work before contracts can be signed and payments flow. Experience shows that the tendering process for large infrastructure contracts takes, in the best case, at least nine months from publication of the procurement notice to the signing of the contract. Reflecting progress in implementation, EUR 203 million was paid out in 2001 and the results for the first six months of 2002 show that payments have accelerated substantially.*

With regard to Phare, the increase in unspent commitments is due to the high level of new commitments made in the period 2000/2001 which had not been paid at the end of 2001. This is in line with the three-year cycle of implementation, which means that candidate countries have two years to implement contracting and a further year to carry out the projects.

SAPARD

Introduction

6.8. The Sapard Regulation ⁽²⁾ fixed the starting date of the Sapard programme at 1 January 2000. Implementation of Sapard in 2001 mainly involved the setting up of management and control systems in the candidate countries ⁽³⁾ and their review and approval by the Commission. The rules for the approval of the systems were adopted by the Commission on 29 November 2000 ⁽⁴⁾ on the basis of its Regulation (EC) No 2222/2000 ⁽⁵⁾ of 7 June 2000. Since payments to final beneficiaries were very low, the Court's audit of Sapard concentrated on how the Commission had analysed and monitored the setting up and functioning of the management and control systems in the candidate countries.

⁽²⁾ Council Regulation (EC) No 1268/1999 of 21 June 1999 on Community support for pre-accession measures for agriculture and rural development in the applicant countries of central and eastern Europe in the pre-accession period (OJ L 161, 26.6.1999, p. 87).

⁽³⁾ Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia (Sapard does not apply to Cyprus, Malta and Turkey).

⁽⁴⁾ See the Annual Report concerning the financial year 2000, paragraphs 6.43 and 6.52.

⁽⁵⁾ OJ L 253, 7.10.2000, p. 5.

THE COURT'S OBSERVATIONS

6.9. Sapard is the first EU external aid programme which has been implemented in a decentralised manner. This means that project selection, tendering and contracting decisions ⁽⁶⁾ are not taken by the Commission but by the candidate countries and that the Commission's audit of expenditure is limited to ex-post control. The legal basis for Sapard sets, as a condition for decentralised management in a candidate country, a decision by the Commission, which should be based on an analysis of the management and control systems of the country concerned. This analysis is made following so-called 'national accreditation', which means that the competent national authorities approve the management and control systems. **Table 6.2** shows, for each of the ten candidate countries, when national accreditation of the systems was granted and when the Commission approved the management and control systems (known as conferral of management).

6.10. Sapard funds follow the same procedure for decommitments as those applied for the Structural Funds in the Member States. Thus, funds provided under the 2000 budget which have not been spent in the two following years (i.e. by the end of 2002) should be cancelled. The Financial Regulation states that the Commission may, in special circumstances, adjust the time limit for the implementation of multi-annual commitments. As a result of the delays referred to in paragraph 6.8, no decisions on the conferral of management to the candidate countries were taken in 2000. The Commission decided that these were special circumstances and extended the expiry date for the 2000 funds from the end of 2002 to the end of 2003.

Delayed implementation in the candidate countries

6.11. **Table 6.2** also shows the implementation status of Sapard in the 10 beneficiary countries as at 31 December 2001. In 2001, the Commission approved the management and control systems in five countries in respect of just over half of the measures planned by those

THE COMMISSION'S REPLIES

6.9. *Implementing Sapard in this decentralised way was considered the most effective means to prepare candidate countries for applying the *acquis communautaire* as set out in the basic Council Regulation. At the time of accession the system created for Sapard will require at most minor adjustments in order to fulfil responsibilities relating to both the existing Structural Funds and EAGGF Guarantee requirements.*

6.11. *The reason for not all measures being involved in the approved systems at the initial stage, was to minimise delay in completing preparatory work in each beneficiary country.*

⁽⁶⁾ Under the external aid provisions of the Financial Regulation these key points are managed by the Commission. Whilst this is done for Phare and ISPA, Sapard is managed on a decentralised basis.

Table 6.2 — Implementation of Sapard in 2001 in candidate countries

(Mio EUR)

	National accreditation date ⁽¹⁾	Date of Commission Decision ⁽¹⁾	Available EU funds 2000	Available EU funds 2001	Available EU funds total	Number of projects approved	Amount of projects approved ⁽²⁾	Execution rate commitments (%)	Actual expenditure 31/12/2001 ⁽⁴⁾	Execution rate payments (%)
					(a)	(b)	(c)	(c)/(a)	(d)	(d)/(a)
Bulgaria	18/12/00	14/5/01	53,0	54,1	107,1	41	6,1 ⁽²⁾	5,7	0,7	0,7
Estonia	15/6/01	15/6/01	12,3	12,6	24,9	130	5,9	23,7	0,3	1,2
Slovenia	11/9/01	19/11/01	6,5	6,6	13,0	0	0,0	0,0	0,0	0,0
Lithuania	26/11/01	26/11/01	30,3	31,0	61,3	0	0,0	0,0	0,0	0,0
Latvia	7/7/01	6/12/01	22,2	22,7	44,9	0	0,0	0,0	0,0	0,0
Czech Republic	13/11/01	15/4/02	22,4	22,9	45,3	0	0,0	0,0	0,0	0,0
Slovak Republic	7/1/02	15/4/02	18,6	19,0	37,6	0	0,0	0,0	0,0	0,0
Poland	21/9/01	2/7/02	171,6	175,1	346,6	0	0,0	0,0	0,0	0,0
Romania	12/6/02	31/7/02	153,2	156,3	309,5	0	0,0	0,0	0,0	0,0
Hungary	—	—	38,7	39,5	78,2	0	0,0	0,0	0,0	0,0
TOTAL			528,9	539,7	1 068,6	171	12,0	1,1	1,0	0,1

NB: Situation as at 31 December 2001 except ⁽¹⁾ as at 5 September 2002 and ⁽²⁾ as at 10 December 2001.⁽³⁾ EU share⁽⁴⁾ Paid to final beneficiaries

Source: Court of Auditors.

THE COURT'S OBSERVATIONS

candidate countries (7), which represented 82 % of the funding foreseen for these countries. Projects were approved and implemented in only Bulgaria and Estonia. Payments to final beneficiaries in those countries amounted to 1 million euro. This means that two years after the programme had been launched, only 0,1 % of the total available funds had been used.

6.12. In 2001, the Commission made advance payments amounting to 30,5 million euro to the five countries where the conferral of management was granted in 2001. Since payments to final beneficiaries in those countries amounted to only 1 million euro in 2001, the bulk of these funds have remained unused in bank accounts. The agreements concluded between the Commission and the candidate countries (known as Multi-Annual Financing Agreements (MAFAs)), state that all interest earned shall be used exclusively for the programme, and shall be counted as a further contribution from the Community. The agreements do not explicitly require the candidate countries to report on the interest earned although the candidate countries do so.

6.13. The MAFAs, which are legally binding international agreements, specify that 'all interest ... shall be counted as a further contribution by the Community'. Therefore, such information should be entered in the Commission's accounts. At present, this is not the case. The Commission has recorded 289 562,55 euro for 2001, and the Court estimates that the amounts involved may be 2 million euro for 2002 (see also paragraph 9.28).

6.14. For the five countries where the systems were approved, the conferral of management is provisional (see also paragraph 6.25) and only covers around half of the measures provided for in the Rural Development Plans. Moreover, when the Commission approved the management and control systems, this was based on systems which were mainly or exclusively manual for all countries except Estonia. Thus, the five candidate countries are still developing their systems and the Commission will need to examine them further when they have been automated or when procedures for further measures have been completed.

THE COMMISSION'S REPLIES

The Commission's first priority was to ensure that candidate countries had the structures in place to manage the funds properly. Payments to final beneficiaries are made only when they have incurred eligible expenditure, often several months after the beneficiary has been selected. A similar situation exists with Member States under the Structural Funds.

6.12. *The amount of interest earned on the Sapard euro bank accounts in 2001 amounted to EUR 289 562,55 for the countries concerned. The interest earned may only be used after inclusion in a programme measure. To date no such decisions have been taken.*

6.13. *The Commission agrees that both the receipt and use of interest should be reported (see reply on point 6.12. above). This will be done after a decision concerning its use has been taken. Under the new draft implementation rules for the new Financial Regulation, which will apply from 1 January 2003, the Commission has made it clear that interest arising from prefinancing of actions under the pre-accession instruments will not be considered as belonging to the Commission.*

(7) Number of measures identified by candidate countries in their Rural Development Plans: Bulgaria 11, Estonia 8, Latvia 8, Lithuania 8, Slovenia 5. Number of measures for which the Commission decided on the conferral of management: Bulgaria 3, Estonia 4, Latvia 6, Lithuania 5, Slovenia 4.

THE COURT'S OBSERVATIONS

6.15. **Table 6.2** shows the low number of projects approved in Bulgaria. In addition, both the number and the value of the projects approved decreased significantly during the year 2001. Whereas 38 projects were approved in the first four months after the programme had started (June 1), only three were approved in the last quarter of 2001. According to a progress report from the Bulgarian Sapard Agency, it was only after the start of the programme that it was discovered that applicants had major problems in obtaining the required documents and in securing the advance financing of project amounts. As Bulgaria was the first country to start with decentralised management, and in view of the limited time to implement Sapard before the accession of the beneficiary countries, the Commission should have analysed the implementation problems and provided guidance to all beneficiary countries.

6.16. The Court was not able to make a similar analysis for Estonia, showing how the number and value of the applications have developed, because the Commission did not have the data. At present, the Commission receives information on the number of projects and their value at the six-monthly monitoring committee meetings. The frequency with which this information is received is not sufficient to identify trends in Sapard implementation at an early stage. Decentralising the management of aid does not release the Commission from its ultimate responsibility for the implementation of the programme or from the need to be informed.

Shortcomings in the Commission's methodology for approving national management of Sapard

6.17. The first step in the decentralisation of management is national accreditation, which should be based on an examination of management and control systems by the candidate countries themselves. Subsequently, the Commission analyses these systems before it decides on the decentralised management of aid. However, the documents issued by Estonia and Lithuania, granting national accreditation, showed that it was conditional on a satisfactory review of the systems by the Commission. The Court considers that the Commission should have required Estonia and Lithuania to resubmit their accreditation document without such a condition.

THE COMMISSION'S REPLIES

6.15. As regards the specific case of Bulgaria, the issue of project approval difficulties was addressed in the Monitoring Committee meeting of December 2001. The following Monitoring Committee meeting in June 2002 received data showing that 95 projects have been approved involving an EU contribution of EUR 14,6 million. Thus, the figure for the last quarter of 2001 is not indicative of a trend.

Already at the programming stage the Commission advised the beneficiary countries to endeavour, where possible, to draw up rules that would be simple to apply. Subsequently the Commission financed two seminars in mid-2001 and mid-2002 giving all the candidate countries the opportunity to discuss any matter relating to implementation. Moreover the Commission seeks, in its advisory role in monitoring committees, to contribute ideas that could facilitate implementation. Where implementation may be frustrated by provisions in the Multi-annual Financing Agreements, the Commission has also asked all the beneficiary countries to consider suggestions for simplifying the text.

6.16. The Commission considers that the information it receives from the six-monthly monitoring committee is, as a rule, sufficient for its management needs.

6.17. It is true that these two countries made their national accreditation 'conditional' on the Commission's review, although this has had no implications in practice and the Commission did not consider it necessary to require the resubmission of the Act of Accreditation; both countries have been monitored and visited since the conferral decision and no significant control issues have arisen.

THE COURT'S OBSERVATIONS

6.18. The Commission's analysis of the management and control systems is of crucial importance, because it aims to ensure that EU funds will be used properly. The Court's audit focused on a review of the Commission's analyses, which were in the form of audit files supporting the Commission Decisions on the conferral of management. The main shortcomings noted were a lack of documentation on the nature, timing and extent of the audit procedures performed, some conclusions on the systems that were not supported by sufficient and reliable evidence and no systematic file review by the responsible hierarchy. The Court's audit concluded that, in these areas, generally accepted auditing standards were not applied satisfactorily, because, although certain file sections met these standards, there were others that did not.

6.19. The applicable Council Regulation ⁽⁸⁾ lists the availability of adequate staff with suitable experience as one of the minimum criteria and conditions for decentralising management. The importance of this is underlined in the Commission's annual analysis of the enlargement process. The conclusions to this analysis identify the need to strengthen administrative capacity for public control and for the fight against fraud. For most candidate countries, the Commission concluded that further efforts were required to ensure the sound, efficient and auditable management of EU funds ⁽⁹⁾. Despite the importance of the issue, the audit files supporting the Commission Decisions contain insufficient evidence about the existence, experience and qualifications of staff.

THE COMMISSION'S REPLIES

6.18. *The comprehensive audit programme includes a note specifying how reasonable assurance can be obtained for each stage of the process. The necessary assurance can often be obtained and demonstrated by a cross-reference to a procedure alone, with no need for further elaboration. The Commission does not generate additional workpapers when the test is self-explanatory.*

The head of each section in the audit programme ('review of procedures and documentation', 'observation' and 'discussions with the appropriate staff') mirrors the requirements of the relevant standard. Computation and analysis are also performed when required. The final conclusions reached (which served as the basis for the management conferral decision) were soundly based upon the evidence presented, despite the fact that this was not always documented in the Commission's files.

The objective that the responsible hierarchy should be aware of the work done and matters arising has been achieved via (a) meetings with the Director, held each week, and, (b) meetings chaired by the Head of Unit before finalisation of each audit report. In addition, a 'peer review' system was used on several occasions within the team, as per the relevant standard.

6.19. *The qualifications and knowledge of senior and other key staff, both at the Sapard Agency and the Regional Offices, were verified in detail in numerous interviews. The Commission gained reasonable assurance concerning the capabilities of the staff, notably in assessing their familiarity with the tasks assigned to them and the relevant procedures (via observation of reperformance of duties). It is true, however, that this was not systematically documented, and this finding will be addressed in the future.*

⁽⁸⁾ Council Regulation (EC) No 1266/1999 of 21 June 1999 on coordinating aid to the applicant countries in the framework of the pre-accession strategy and amending Regulation (EEC) No 3906/89 (OJ L 161, 26.6.1999, p. 68).

⁽⁹⁾ The Commission's political documents related to the enlargement process: Strategy paper 2001, Regular reports 2001, November 2001.

THE COURT'S OBSERVATIONS

6.20. In addition to staff, the following other key risk areas were not sufficiently covered by the Commission's examination:

- (a) the Commission did not perform sufficient checks to ensure that the systems that were set up examined the economy and cost-effectiveness of projects. There is a risk that Article 2 of the Financial Regulation ⁽¹⁰⁾ requiring sound financial management may not be respected;
- (b) the Commission performed insufficient checks to determine whether the systems set up prevented the double funding of projects. Whilst the Commission verified that application forms contained a question requiring a beneficiary to declare other sources of funding for the project, and that this was checked by the Sapard agency, it did not ensure that the persons checking application forms had the relevant information on other sources of funding, that there was an exchange of information between the various national and EU programmes, and that audits by the candidate countries addressed these issues.

6.21. The above shortcomings in the Commission's methodology had already been identified in the Court's Annual Report concerning the financial year 2000 ⁽¹¹⁾. The Commission, however, has not sufficiently addressed this in its methodology, and, as a result, has missed the opportunity to ensure that these risk areas are covered by the design of the system.

6.22. To a certain extent, the issues identified above can be explained by the difficult situation in which the staff of the Commission examining the systems were working. These were caused in particular by considerable pressure to approve the systems after the delays encountered, and numerous changes in Commission staff.

⁽¹⁰⁾ 'The budget appropriations must be used in accordance with the principles of sound financial management, and in particular those of economy and cost-effectiveness'. Financial Regulation applicable to the general budget of the European Communities (OJ L 356, 31.12.1977, p. 1).

⁽¹¹⁾ Paragraph 6.50.

THE COMMISSION'S REPLIES

6.20.

- (a) *Project economy and cost-effectiveness are examined by means of a review of business/development plans, which must be satisfactory for the application to succeed.*

These matters will receive close attention in subsequent audits.

- (b) *The procedures feature a detailed documentary check where only originals are accepted, as well as a detailed on-the-spot control visit for each payment claim.*

With regard to the absence of exchange of information and therefore increased risk of double funding: for most of the accredited measures, the risk of overlap between SAPARD projects (whose essential characteristic is a large volume of small projects) and ISPA and Phare projects (small volume of larger projects) centres on a small number of projects. Moreover, where national support schemes are also handled by the Sapard Agency, the risk of a double submission going undetected is reduced. These matters will receive close attention in subsequent audits.

6.21. *Concerning point 6.20 (b) above, checks addressing the risk of double funding have been included in the revised audit programme, dated 14 September 2001, for both applications and claims (although the original version does feature this check at the application stage). As regards point 6.20 (a) above, which relates to economy and cost-effectiveness, reference should be made to the Commission's comments under that point. Nevertheless as indicated above, these matters will receive close attention in subsequent audits.*

THE COURT'S OBSERVATIONS

6.23. The Commission Decisions on the conferral of management are based on its audit reports, which provide conclusions on its examination of the systems. The Commission's audit reports relating to three countries (Latvia, Slovenia and Lithuania) list a number of items that need to be rectified before the reception of any project submissions. However, these items and restrictions are not mentioned in the Commission Decisions, nor did the Commission systematically check that these items were indeed rectified by the countries concerned.

6.24. The Commission has undertaken detailed work for its analysis of the management and control systems of candidate countries. It has prepared the concepts of a well-defined system to be put in place in the candidate countries. However, the decisions for the conferral of management were not based on the sufficient and reliable evidence required to ensure that the systems work as planned. In three of the five Commission Decisions for the conferral of management made in 2001⁽¹²⁾, there was insufficient evidence on file on the existence, experience and qualifications of staff and therefore that the key processes, such as project selection, which will be managed by the staff in question, would function properly.

Insufficient verification that the systems work in practice

Insufficient monitoring of the systems

6.25. Since Sapard has decentralised management of external aid, and the systems in the candidate countries are new, the Commission should verify, on a continuous basis, that the systems are working in practice. The Commission recognised this and laid down⁽¹³⁾ that it should monitor continued compliance with the conditions and provisions for decentralised management. The Commission was therefore right in conferring management on a provisional basis. It stated in its decisions

THE COMMISSION'S REPLIES

6.23. *The Letters of Observations contain recommended operational and control improvements, with matters for future consideration. The detailed requirements flowing from the audit are not mentioned in the Commission Decision as they are not of a nature to prevent the system operating properly.*

The Commission has already received assurances from certain candidate countries concerning the rectification process. However, full verification of corrective action taken can only be achieved during the on-the-spot compliance audits. These are already under way. Moreover no reimbursement payments are made until all relevant weaknesses have been rectified.

6.24. *The Commission assessed the familiarity of staff in situ with the procedures through interviews and on-the-spot observation of how they performed their duties, thereby gaining reasonable assurance that the key processes would function properly. For more details, reference should be made to the Commission's comments under point 6.19 above.*

6.25. *The Commission (for example in Article 13(3) of Section A of the MAFA) can require candidate countries to provide any information or to take suitable control action to ensure proper implementation of the programmes. The Commission takes such information into account before authorising payments.*

⁽¹²⁾ Estonia, Lithuania, Latvia.

⁽¹³⁾ Article 3(3) of Commission Regulation (EC) No 2222/2000 of 7 June 2000 laying down financial rules for the application of Council Regulation (EC) No 1268/1999 (OJ L 253, 7.10.2000, p. 5).

THE COURT'S OBSERVATIONS

that full conferral of management was only to be envisaged after further verifications had been carried out to ensure that the systems operated satisfactorily. This is necessary because the timing and scope of the checks laid down in the MAFAs (the so-called clearance of accounts procedure) do not guarantee that weaknesses and errors are identified at an early stage.

6.26. When the Court carried out its examination (in April 2002), there had been no systematic further verification by the Commission, and no methodology existed for this. This is mainly because the Commission's priority is still the conferral of management to the candidate countries where the systems have not yet been approved. No resources were allocated to monitoring compliance after provisional conferral. As the Commission has neither a timetable nor a methodology as to when and how full conferral of management will be granted, the candidate countries are unaware of the requirements they will have to fulfil.

Deficiencies in reporting after conferral of management

6.27. The candidate countries are required by the MAFAs to submit annual implementation reports and Certifying Body reports to the Commission ⁽¹⁴⁾, providing information on progress in the implementation of priorities and measures, steps taken to ensure quality and effectiveness in the implementation and co-ordination of all Community pre-accession assistance. The provisions in the MAFAs neither provide for timely reports nor for timely review and recommendations for adjustments from the Commission. If the

THE COMMISSION'S REPLIES

6.26. *The Commission is currently preparing the tendering procedure for contracting external audit services to check the financial implementation of SAPARD; this will help achieve the objective of 'systematic further verifications'. It will be financed under the SAPARD technical assistance line.*

In addition to the inspections carried out as part of the clearance-of-accounts process, the Commission has systematically reviewed internal audit reports (reappraisals of how the system works following the submission of the first batch of projects and payment claims), and when necessary carried out checks on the spot (missions in Bulgaria and Lithuania). The Commission also asked all candidate countries (at a seminar in June 2002) to provide a timetable for national accreditation of the remaining measures.

Full conferral of management is not a current priority for the Commission or the candidate countries.

6.27. *In addition to annual implementation reports and certificates, the Commission is informed through the monitoring committee (which usually meets at least twice a year) and through working groups as needed. This committee provides a vehicle for conducting reviews and making recommendations in a more timely manner than through annual reports to be submitted at any predetermined time. In addition there are frequent contacts between candidate countries and the Commission to address matters as — or, where possible, before — they arise.*

⁽¹⁴⁾ MAFA, Section B, Article 8(1).

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programme starts early in a given year, the Commission will not be informed of the first year of implementation until June two years later. For example, in the case of Bulgaria, conferral of management was decided in May 2001. The Commission will receive the first annual report 6 months after the first full calendar year, which is June 2003, more than two years after the start of the programme, resulting in the Commission's review, comments and recommendations being unnecessarily delayed. This is particularly worrying since the first year of implementation is the most risky due to the operation of new untested systems.

6.28. The Commission has recognised the need for additional and more timely information and has requested the candidate countries to provide, at the earliest moment, audit reports about their verification of the extent to which the Sapard agency operates as designed. However, the Commission did not systematically follow up on the information requests and, as a consequence, not all the information was received within the time limits set.

CONCLUSIONS AND RECOMMENDATIONS

Delayed implementation in the candidate countries

6.29. Unrealistic disbursement schedules were included in the general budget of the European Union for the new pre-accession instruments. This has led to persistently low use and significant cancellations of payment appropriations in two successive years.

6.30. This is particularly true for Sapard, the implementation of which, in 2001, principally involved the setting up of the management and control systems in the candidate countries and their review by the Commission. Two years after the start of the programme, payments to final beneficiaries were made in only two countries and amounted to 0,1 % of the total available

THE COMMISSION'S REPLIES

6.28. *The Commission has received re-performance reports and conducted financial clearance audit missions for Bulgaria and Estonia (the only countries to make payments in 2001). Conformity audits have also been carried out. In the Commission's view this constitutes adequate follow-up.*

6.29. *As indicated in the reply to point 6.6, the disbursement schedules for 2001 drawn up in 2000 were based on the most realistic information available at the time for the SAPARD instrument.*

6.30. *After 2000 the rate of progress is largely a function of candidate countries' efforts in constructing agencies fit to run SAPARD.*

Decentralised management of SAPARD requires candidate countries to set up the necessary administrative structures capable of ensuring a sound financial management of

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funds. In one of these countries (Bulgaria), the Commission did not take action following the lower than expected and decreasing rates of implementation. Information for other countries is not available.

Recommendation

- Considering that Sapard is a key instrument for solving priority agricultural and rural development problems in the candidate countries before enlargement and given the fact that funds from the 2000 budget will be cancelled at the end of 2003 if they have not been spent, the Court considers that the Commission should analyse the reasons for the slow rate of implementation. It should also provide guidance in order to diminish the risk of further delays and similar situations arising in other candidate countries.

Shortcomings in the Commission's methodology for approving national management of Sapard

6.31. Shortcomings were noted in the Commission's analysis of the systems set up in the candidate countries. There were insufficient checks in key risk areas and there was insufficient evidence concerning the existence and experience of staff. For three of the five countries where conferral of management was granted, there was insufficient evidence to provide reasonable assurance that all requirements ensuring that EU funds will be used properly were fulfilled. The Commission itself also noted items which should be rectified before decentralised implementation but they were not systematically followed up.

THE COMMISSION'S REPLIES

Community resources. Some candidate countries managed to complete most of the work in 2000 (or by January 2001). Others have only done so in 2001 and are now at the starting stage in terms of implementation. Some other countries have not yet reached this stage. In the Bulgarian case mentioned, it was the Monitoring Committee, acting in accordance with its remit, and not the Commission, that took steps to initiate changes to expedite implementation.

The Commission regularly monitors the level of SAPARD implementation in each country. With few exceptions commitments to beneficiaries are rising over time in line with the expectations of the implementing authorities. In the case of some countries they now forecast that the instrument will be running at a rate consistent with normal annual execution by the end of 2002. Information concerning execution for all countries where conferral decisions have been taken is made available at each monitoring committee. At seminars in June 2002 and July 2001, the Commission indicated various options each country could consider to expedite implementation.

6.31. *The key risk areas referred to by the Court (for more details see the reply to point 6.20) are the issues of sound financial management and double funding. Sound financial management is considered at the programme development and system accreditation stages, although, with a system that is not yet operational, verification is difficult. As for the 'double funding' issue, this is addressed in the Commission's audit programmes and examined via the review of procedures.*

The existence and experience of staff (for more detailed replies see the comments under points 6.19 and 6.24) and assurance that the procedures would operate as designed in practice (thereby ensuring proper use of EU funds) was obtained through discussions with staff (assessing their familiarity with the procedures) and an in situ observation of (re)performance of duties (as per point 6.24).

Adequate follow up is assured through receipt of assurances from the candidate countries as to progress made, and confirmation by means of (ongoing) on-the-spot visits (for details see comments to point 6.23).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendation

- When the Commission monitors compliance with the conditions for decentralised management, it should ensure that the shortcomings identified by the Court are sufficiently covered. The Commission should also review that the items mentioned in its own audit reports are rectified.

Insufficient verification that the systems work in practice for Sapard

6.32. In 2001, the Commission did not start testing the Sapard management and control systems to ensure that they function in practice. The conferral of management was granted on a provisional basis. However, the Commission does not have a timetable or a methodology as to how and when full conferral of management will be granted. Therefore, the candidate countries are unaware of the requirements they will have to fulfil. In addition, the MAFAs do not provide for sufficient timely information.

Recommendations

- The Commission should systematically monitor the implementation of Sapard, which is necessary to verify that systems work in practice. The Commission should carry out audits shortly after the provisional conferral of management and should cover all levels of control between the Commission and the final beneficiaries.
- The Commission should develop a timetable and a methodology as to when and how full conferral will be granted and inform the candidate countries about them.
- The Commission should make the necessary changes to the MAFAs to ensure that it receives more timely annual reports, audit reports, and information concerning the amount of interest and its utilisation.

In the Commission's view, the significant shortcomings concern the lack of filed evidence as to the experience of staff. These matters will be addressed. As regards follow-up, the Commission already has a suitable mechanism in operation, as explained in point 6.24.

6.32. *The Commission has carried out missions in Bulgaria (in February 2002) and in Lithuania (in July 2002) to evaluate the management and control system. The Commission also carried out financial clearance audits in Bulgaria and Estonia in 2002 (see point 6.30 above). The Commission has also received SAPARD Agency internal audit reports, which show the results of reperforming the key processes. No major findings were highlighted in these reports.*

The Commission has monitored systems operation through receipt of process re-performance reports from the Internal Audit departments of the SAPARD Agencies and, when necessary, through subsequent on-the-spot controls (both financial and conformity clearance missions, as explained above and in the MAFAs). These are both ongoing processes; the Commission considers that this recommendation is being adequately addressed.

Candidate countries were asked at a seminar in June 2002 to provide a timetable for national accreditation of the remaining measures. Full conferral of management is not a current priority either for the Commission or for the candidate countries.

For the reasons indicated in the reply to point 6.29 the Commission sees no advantage in modifying the MAFAs as regards the timing of annual reports but will seek to include in MAFAs the obligation to present quarterly reports on interest earned by the SAPARD accounts.

CHAPTER 7

Administrative expenditure

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ADMINISTRATIVE EXPENDITURE OF THE INSTITUTIONS AND COMMUNITY BODIES

Introduction

7.1. Heading 5 of the financial perspective, 'Administrative expenditure', contains the Institutions' and other bodies' administrative appropriations (Part A of the budget in the case of the Commission). These appropriations are managed directly by these authorities and are used primarily to pay the salaries, allowances and pensions of persons working for the Community Institutions, as well as rent, property, purchases and miscellaneous administrative expenditure. In the Commission's case, these appropriations also enable subsidies to be given to associations and organisations that assist in the implementation of various aspects of the European Union's activities.

Analysis of budgetary management

7.2. The Court has reviewed the information presented in Volumes I to IV of the revenue and expenditure account. Volumes I and III provide a commentary on budgetary management for the year and, in particular, explanations of variations between the approved budget and the appropriations finally available, as well as between the appropriations finally available and those utilised. 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 explanation that might be considered misleading. The review did not reveal any such case.

7.3. In response to the Court's observations in paragraph 7.3 of the Annual Report concerning the financial year 2000 ⁽¹⁾, the Commission and the Parliament have improved the presentation and user-friendliness of their analysis of budgetary management. In particular, the Commission has provided some global analysis and has introduced a more logical and consistent presentation between chapters and the Parliament has given factual information about the results achieved with the budgetary appropriation used. However, Institutions other than the Commission continue to focus on describing changes in levels of appropriations during the year and on commitments made and not on the differences

7.3. THE EUROPEAN PARLIAMENT'S REPLY

Parliament notes the improvement detected by the Court and will pursue its efforts in accordance with the Court's wishes.

7.3. REPLY OF THE COURT OF JUSTICE

The analysis of budgetary management in respect of the financial year 2001 of the Court of Justice focuses on the explanations given with regard to the main differences between

⁽¹⁾ OJ C 359, 15.12.2001.

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between sums committed and sums paid. It is still the Court's opinion that it would be desirable for all the Institutions to provide a more global analysis of their budgetary management which highlights and explains trends over time in expenditure and the funding of major capital items, and which offers key measures of economy and efficiency. Sufficient explanations are now given on the specific issue, highlighted in paragraph 7.3 of the Annual Report concerning the financial year 2000, of the way the Parliament transfers to the budget heading 'Rent and annual lease payments' unused appropriations from other budget headings to make capital repayments on buildings. Moreover, the Parliament explains that additional appropriations were made available for such repayments through Supplementary and Amending Budget No 5 for the financial year 2001.

7.4. The Council used 1,4 million euro of budget item 2501 (Meetings in general) to pay expenditure actually incurred in 2000 but not paid in that year because the budgetary appropriations for 2000 had already been used up. For a similar reason, expenditure of the same kind incurred in 2001 for an amount of 1,84 million euro has been paid in 2002 using appropriations of the 2002 budget. This does not conform to the principle of annuality as described in Article 6, fourth subparagraph, of the Financial Regulation. Where initial budgetary appropriations prove to be insufficient, they should be increased through transfers or supplementary budgets.

the initial amount of the appropriations and their ultimate utilisation. As regards the view expressed 'that it would be desirable for all the Institutions to provide a more global analysis of their budgetary management which highlights and explains trends over time in expenditure, the funding of major capital items, and which offers key measures of economy and efficiency' ⁽¹⁾, the Court of Justice considers that that desire is satisfied by its revenue and expenditure account, taken as a whole, including the relevant tables and its balance sheet as at 31 December 2001.

However, the Court of Justice will be happy to participate in any inter-institutional action aimed at harmonising the analysis of budgetary management.

7.3. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

In future, the EESC will take account of the Court's comments on the presentation and readability of its analysis of budgetary management.

7.3. REPLY OF THE COMMITTEE OF THE REGIONS

In future, the Committee of the Regions will take account of the Court's comments on the presentation and readability of its analysis of budgetary management.

7.4. REPLY BY THE COUNCIL

With regard to the management of budget item 2501 (Meetings in general), the Council shares the Court's analysis and recommendations. It is intended that the measures needed to prevent the problem noted by the Court from occurring in future will be taken before the end of the financial year 2002.

⁽¹⁾ Court of Auditors' Annual Report, financial year 2000, point 7.3.

THE COURT'S OBSERVATIONS

*Specific appraisal in the context of the Statement of Assurance***Scope of the audit**

7.5. The audit of the reliability of the accounts consisted of analytical and substantive testing on all balances material to the consolidated accounts. With regard to the legality and regularity of the underlying transactions, the audit was based on an overview of the audit field (budget, final accounts, administrative practices, etc.) and on substantive testing of transactions relating to administrative expenditure included in a sample drawn from the entire budgetary accounts. In addition, a specific examination was carried out of expenditure relating to salaries of officials and temporary staff of the Commission and the Parliament. In this area, an evaluation of the internal control systems and substantive testing on a sample of transactions were performed.

Reliability of the accounts

7.6. This section summarises the most significant findings and observations relating to the Court's audit of the reliability of the accounts of each of the Institutions.

Parliament

7.7. The Court maintains the observations concerning the Louise Weiss building in Strasbourg made in paragraph 7.8 of the Annual Report concerning the financial year 2000. The notes to the balance sheet still do not indicate that the net accounting value of 329,9 million euro is an estimated value or that various construction-related costs are contested by the Parliament. Furthermore, the Parliament has continued to depreciate 'special equipment' (historic cost: 80 million euro) at the maximum rate of 25 %, with the result that full depreciation is achieved at the end of the financial year 2001. The nature of the different components of the equipment should have been disclosed and the corresponding depreciation rates applied in accordance with Commission Regulation (EC) No 2909/2000 ⁽²⁾.

7.7. THE EUROPEAN PARLIAMENT'S REPLY

Owing to an oversight at the time of preparation of the financial statements, the footnote to the balance sheet omitted to mention that an estimated amount had been used. If the definitive value of the building is not known by the end of 2002, the text of the relevant footnote will include a comment that the cost is estimated. As negotiations relating to the definitive cost of the buildings are ongoing, it is not considered appropriate to disclose in the footnotes to the balance sheet an amount of contested costs as this may prejudice the European Parliament's position in current negotiations. The exact nature of the special equipment referred to in the Court of Auditors sector letter is currently the subject of investigation. Detailed information on the breakdown of the assets under this item is being sought from SERS, the current owner of the building. The outcome of these efforts should enable the Institution to ascertain whether it is appropriate to continue to apply the depreciation rate of 25 % to the special equipment item, in line with the recommendations of the Court of Auditors and in accordance with Commission Regulation (EC) No 2909/2000.

⁽²⁾ Commission Regulation (EC) No 2909/2000 of 29 December 2000 on the accounting management of the European Communities' non-financial fixed assets (OJ L 336, 30.12.2000, p. 75).

THE COURT'S OBSERVATIONS

Council

7.8. The Council has completed the physical inventory mentioned in its reply to the Court's observations in the Annual Report for the financial year 2000 ⁽³⁾. However, the problem of the reliability of the accounting inventory that it was meant to resolve has, in fact, not been resolved. Unexplained differences between the physical inventory and the accounting inventory continue to exist, with the result that the value of the balance sheet subheadings B, C and D of the heading 'tangible fixed assets' may be overestimated by about 0,9 million euro.

Commission

7.9. The Commission is purchasing over a four-year period, partly on behalf of other Institutions, site licences ⁽⁴⁾ for a total price of 3,3 million euro. The consolidated balance sheet only shows the value recorded in the Commission's balance sheet of the licences used by the Commission itself. The value of the licences used by other Institutions appears neither in the Institutions' individual balance sheet nor in the consolidated balance sheet.

7.10. As advances and payments on account in respect of tangible assets are not recorded in balance-sheet accounts as soon as payments are made, the total balance-sheet value cannot be derived from an accounting balance. This value is established on the basis of amounts determined at the year-end by the different administrative units concerned and is not reliable. The Court found that an amount of 1,4 million euro relating to the purchase of security equipment for 'Eurodac', as well as a total amount of around 150 000 euro concerning improvements to buildings were not included in the abovementioned balance-sheet value.

7.8. REPLY BY THE COUNCIL

In order to ensure reliability of the accounting inventory, the Council has decided to give greater priority to conducting a physical inventory.

In view of the scale and complexity of the physical inventory operation and the reconciliation work under way, the latter is due to continue until the end of 2002, in parallel with studies concerning the upgrading of the inventory management systems and procedures.

7.9. COMMISSION'S REPLY

The Commission checks and pays the annual invoice for site licences on behalf of all the participating institutions. It records its share of the site licences in its balance sheet under the heading 'Intangible fixed assets' but does not declare the other institutions' shares. The Commission recently reminded the institutions which are parties to the framework contract for the purchase of site licences of their obligation to declare their share under the heading 'Intangible fixed assets' in their balance sheet.

The Commission will be able to show this information in the consolidated balance sheet only once it has received it from the other institutions.

7.10. COMMISSION'S REPLY

The Commission's accounting system does not enable advances and payments on account to be recorded in the balance sheet at the time when they are made. This problem will be solved as part of the project for modernising the accounting system which is currently under way.

Article 81 of the recently adopted Financial Regulation requires a distinction to be made in the accounts between the different types of payment.

⁽³⁾ Page 316, point 7.12.

⁽⁴⁾ A site licence for computer software requires the Institution to pay a flat charge irrespective of the number of users (see Article 22(1) of Commission Regulation (EC) No 2909/2000).

THE COURT'S OBSERVATIONS

7.11. The explanatory notes to the balance sheet do not disclose that rental payments on a building since October 1999 are provisional as the final rental value has not been agreed with the owner.

Court of Justice

7.12. No observations arose from the audit of the Court of Justice's balance sheet.

Court of Auditors

7.13. No observations arose from the audit of the Court of Auditors' balance sheet.

Economic and Social Committee and Committee of the Regions

7.14. According to generally accepted accounting practices, land should not be depreciated. Contrary to this principle, accumulated depreciation on the land of the Montoyer building has been included in the accounts.

7.15. The reliability of the value of the heading 'other tangible fixed assets' cannot be guaranteed as no physical inventory has been conducted since 1998. The heading also includes items that have been disposed of without the required writing-off procedure having been properly completed.

7.11. COMMISSION'S REPLY

The objective pursued by the Commission in negotiations with the owner is for the rental value for the period until the building is brought up to standard to be set at a level that does not exceed the advance payable under the existing agreement.

7.14. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

Depreciation of the Montoyer building began in 2001. The accounts were finalised on the basis of depreciation of the total value of the building, including the site. In April 2002, the Montoyer and Belliard buildings were valued by an external expert. The depreciation will be recalculated accordingly and will be accounted for correctly at the close of the 2002 financial year.

7.14. REPLY OF THE COMMITTEE OF THE REGIONS

Depreciation of the Montoyer building began in 2001. The accounts were finalised on the basis of depreciation of the total value of the building, including the site. In April 2002, the Montoyer and Belliard buildings were valued by an external expert. The depreciation will be recalculated accordingly and will be accounted for correctly at the close of the 2002 financial year.

7.15. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

The Committees regret that in this case the rules were not fully applied. They accept the need for the inventory rules to be strictly applied in future. A physical inventory is now well underway and will be completed by the end of 2002.

THE COURT'S OBSERVATIONS

A number of obsolete items of computer equipment were not removed from the inventory, despite instructions for this to be done. In future, the IT department will ask for confirmation.

7.15. REPLY OF THE COMMITTEE OF THE REGIONS

The Committees regret that in this case the rules were not fully applied. They accept the need for the inventory rules to be strictly applied in future. A physical inventory is now well underway and will be completed by the end of 2002.

A number of obsolete items of computer equipment were not removed from the inventory, despite instructions for this to be done. In future, the IT department will ask for confirmation.

Overall opinion

7.16. Except for the minor findings mentioned above, the audit of the reliability of the accounts did not reveal any evidence of misstatements considered material to the consolidated accounts of the European Communities.

Legality and regularity of the underlying transactions

Legal questions concerning certain provisions of the 2001 general budget and of the related expenditure.

7.17. According to footnotes to the establishment plans of the Parliament and the Court of Auditors, some of the permanent posts shown in a given category have to be considered as posts of a higher category. Based on these footnotes, the two Institutions pay staff of a given category the remuneration corresponding to a higher category. This is not in accordance with the Staff Regulations, Article 45(2) of which states that 'an official may be promoted from one category to another only on the basis of a competition'.

7.17. THE EUROPEAN PARLIAMENT'S REPLY

The only officials whose posts are the subject of the footnotes referred to are those who have been awarded an ad personam promotion. Such promotions are awarded, to a very limited number of officials (principally in the lower categories) who combine long service with exceptional merit, by Parliament's Bureau in accordance with the institution's internal implementing rules and are included in Parliament's annual estimates of revenue and expenditure.

7.17. THE COURT OF AUDITORS' REPLY

In accordance with the authorisation given by the budgetary authority in the table of posts for the financial year 2001, the Court appointed six staff to a higher grade ad personam.

The Court has nevertheless decided not to make any further appointments of this type.

THE COURT'S OBSERVATIONS

7.18. The remarks relating to heading 1 0 9 0 (Weightings) in the budget sections of the Commission and the Court of Justice state that appropriations are available to cover weightings applied to the transfer of part of the emoluments of Members of the Institutions to a country other than the country of employment. The remarks relating to the same heading of the budget section of the Court of Auditors are not so explicit, but can be interpreted, as the Court of Auditors actually did, as making appropriations available to cover the same kind of weightings. The application of such weightings increases the total amount of emoluments paid. The rules applying to the remuneration of the Members of the Institutions do not provide a specific legal basis for such transfers. However, for several years there has been an application by analogy of certain provisions of the Staff Regulations. While awaiting clarification the Institutions decided to suspend the use of weightings for the Members concerned as from July 2002.

7.18. COMMISSION'S REPLY

The Commission takes the view that transfers of part of the remuneration of Members of the Commission have always been carried out on a proper basis. Nevertheless, in line with the position taken by the Court of Auditors, it has decided to suspend such transfers.

7.18. REPLY OF THE COURT OF JUSTICE

The Court of Justice confirms that its Administrative Committee, meeting on 12 June 2002, decided, 'having regard to the decisions adopted by the Court of Auditors and the Commission, and without calling in question the merits of the practice followed hitherto', to suspend, with effect from July 2002, transfers of remuneration by Members to which weightings are applied.

That suspension, which was decided on a provisional basis and pending receipt of clarification, was intended to enable the Administrative Committee to examine in depth the arguments which had prompted the Court of Auditors to contest the regularity of such transfers, in particular the contention that there was no specific legal basis for that practice in the absence of an express provision in the rules laid down by the Council governing the emoluments of Members and that the mere entry of the appropriations relating thereto could not constitute a sufficient basis for that item of expenditure, which would, moreover, necessitate the adoption of a basic act by the legislative authority.

Having completed that examination, which it carried out on 25 September 2002, the Administrative Committee concluded that the arguments thus raised were not such as to justify discontinuance of the arrangement enabling Members to transfer part of their remuneration after the application of weightings thereto, for the following reasons:

- *that long-standing practice is founded on the consideration that the provisions of Article 17 of Annex VII of the Staff Regulations of Officials apply by analogy to Members, as is moreover indicated in the commentary relating to the budget heading under which the corresponding appropriations are entered;*
- *such application by analogy satisfies the objective pursued by the possibility of transferring part of the recipient's remuneration, which clearly applies as much to Members as to officials;*
- *it is confirmed by the provisions of Article 4a of the rules governing the emoluments of Members, according to which Members' basic salaries and allowances are to be subject to the weighting fixed by the Council in respect of officials employed in Belgium, and which were*

THE COURT'S OBSERVATIONS

introduced into the rules governing emoluments by Regulation No 1546/73 of 4 June 1973, the sole recital in the preamble to which refers to 'the maintenance of a differential between the salaries of... Members of the Court of Justice, on the one hand, and those of officials of the European Communities, on the other'. The very wording of those provisions, and the intention expressed by the legislature in the abovementioned recital, necessarily mean that the weighting system is as much applicable to Members as it is to officials.

The Administrative Committee consequently took the view that the legal basis of the practice in question was to be found in the provisions of Article 17 of Annex VII of the Staff Regulations of Officials, which are applicable by analogy to Members, and that the institution was obliged to discontinue the suspension decided upon on 12 June 2002 and to resume the transfers in respect of Members on the same conditions, and in accordance with the same arrangements, as those applicable to officials.

7.18. THE COURT OF AUDITORS' REPLY

As indicated, the Court actually ceased to apply these weightings on 1 July 2002.

Parliament

7.19. The evaluation of the internal control systems and the outcome of the substantive testing of a sample of transactions relating to salaries paid to officials and temporary staff did not give rise to any significant observation. The issues mentioned in paragraph 7.17 also concern the Parliament.

7.20. As the Court has already observed in the Annual Report concerning the financial year 1998 ⁽⁵⁾, the scales used to pay mission expenses to staff of categories C and D are higher than those provided for in the Staff Regulations ⁽⁶⁾. In its reply the Parliament stated that C and D staff were treated in the same way as A and B staff because of the difficulties arising from the dispersal of its departments over the three main places of work and because many meetings are held outside those three working places. These arguments do not change the fact that the Parliament's practice does not comply with the Staff Regulations.

7.20. THE EUROPEAN PARLIAMENT'S REPLY

Payment of mission expenses is in accordance with the Bureau decision of 14 May 1992. The latter takes account of the particular nature of Parliament, with its work spread over three sites and a large number of meetings held either in one or other of these sites or indeed outside them. In its proposal for a Council regulation amending the Staff Regulations the Commission has abolished the difference which exists between the categories as regards both reimbursement of travel expenses and the value of mission allowances. The proposal is in accordance with the provisions currently in force at Parliament.

⁽⁵⁾ Point 6.18.

⁽⁶⁾ Articles 12 and 13 of Annex VII to the Staff Regulations. Generally, for journeys by train under 800 km, C and D officials should be reimbursed a second-class ticket. As to the daily allowances, the difference between the scales for A-B and C-D officials ranges, for most Member States, from 10 to 15 euro.

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Commission

7.21. The evaluation of the internal control systems and the outcome of the substantive testing of a sample of transactions relating to salaries paid to officials and temporary staff did not give rise to any significant observation.

7.22. The audit of a payment relating to a legal service contract revealed that the service had not been provided on the basis of a written contract, as required by Article 58(1) of the Financial Regulation. Furthermore, the contract was made by private treaty although its amount exceeded the limit within which private treaty is allowed. There was no evidence of any of the specific circumstances set out in Article 59 of the Financial Regulation applying and hence justifying tendering procedures not having been carried out. According to the information obtained, this situation applies, in general, to the external legal services contracted by the Commission's Legal Service.

7.22. COMMISSION'S REPLY

While the contractual agreement between the Commission and the law firm was not fixed in a single document signed by both parties, the Commission considers that a contract was established in agreement with the Financial Regulation. However, the Commission will forthwith endeavour to propose to external lawyers the signing of a single contractual document, although formalised documents of that nature are somewhat uncommon in the legal profession. The Commission considers that the present selection procedures for external lawyers are in compliance with the spirit and letter of Article 59 of the Financial Regulation, and in particular paragraphs (b), (c) and (d) thereof.

AUDIT OF THE COMMUNITY SATELLITE BODIES

Introduction

7.23. The annual audits of the Community satellite bodies have been reported on in specific annual reports (7). The main features of the satellite bodies are shown in **Table 7.1**.

Implementation of the budget

7.24. The satellite bodies' budgets totalled 1 060,1 million euro in 2001, compared with 982 million in 2000. The overall staff of these bodies has risen in number from 1 634 in 2000 to 1 919 in 2001. Much of this increase in staff is due to the development of the European Agency for Reconstruction.

(7) Being published in the Official Journal.

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7.25. The implementation of the budgets of most of the satellite bodies is affected by carry-overs of appropriations, which remain at a high level, despite the efforts that have been made. This situation is very often due to the fact that the processes of deciding on and implementing their work programmes and their budgets are out of step with each other. Thought needs to be given to determining the most suitable approach to adopt so that the planning of the work is more tailored to the principle of the annuality of the budget.

Table 7.1 — Budgets and staff for 2000 and 2001 — the Community satellite bodies (SBs)

	Headquarters	Year of creation	Budget (Mio EUR)		Permanent posts	
			2000	2001	2000	2001
I. First-generation SBs						
European Centre for the Development of Vocational Training (Cedefop)	Thessaloniki	1975	13,3	13,5	81	81
European Foundation for the Improvement of Living and Working Conditions	Dublin	1975	15,0	15,3	85	78
II. Second-generation SBs which are not self-financing						
European Environment Agency (EEA)	Copenhagen	1990	18,9	21,7	76	87
European Training Foundation (ETF)	Turin	1990	16,2	16,8	130	130
European Monitoring Centre for Drugs and Drug Addiction (EDMC)	Lisbon	1993	8,2	9,2	48	71
European Agency for Safety and Health at Work (EAHS)	Bilbao	1995	7,0	12	26	26
European Monitoring Centre for Racism and Xenophobia	Vienna	1997	4,9	5,3	26	25
III. Second-generation SBs which are wholly or partially self-financing						
European Agency for the Evaluation of Medicinal Products (EMA)	London	1993	55,3	65,9	210	211
Office for Harmonisation in the Internal Market (OHIM)	Alicante	1994	133,0	163,6	713	798
Community Plant Variety Office (CPVO)	Angers	1994	7,2	8,6	44	31
Translation Centre for Bodies of the European Union (TCBEU)	Luxembourg	1994	20,7	27,2	144	140
IV. SBs for implementing Community programmes						
European Agency for Reconstruction	Thessaloniki	2000	682,3	701	51	241
Total			982,0	1 060,10	1 634	1 919

THE COURT'S OBSERVATIONS

Financial statements and the keeping of the accounts

7.26. The way in which the satellite bodies' financial statements are presented should be harmonised. The presentation should also take account of the special nature of the satellite bodies in order to highlight their economic outturn more.

7.27. Special attention was paid to the satellite bodies' cash-flow management. Some satellite bodies, in view of the size of the funds they manage, should ensure that they are obtaining the best possible return on these funds, either by grouping certain bank accounts together or by ensuring that better terms are negotiated with the banks.

7.28. By the end of 2001, all the satellite bodies concerned had implemented the SI2 budgetary accounting system. They must keep up their efforts to interface it with their general accounting systems.

7.29. In the Annual Report concerning the financial year 2000 ⁽⁸⁾, the Court recommended that the satellite bodies take the necessary steps to improve their inventory systems and make the requisite adjustments to their own Financial Regulation to incorporate the provisions on the accounting management of non-financial fixed assets adopted by the Commission in December 2000 ⁽⁹⁾. Most of the satellite bodies have followed this recommendation and they should continue to improve their inventory-keeping.

7.26. COMMISSION'S REPLY

The new Financial Regulation extends the scope of consolidation to include satellite bodies and stipulates that they must apply the same accounting rules as the institutions so that their accounts can be consolidated with those of the Commission for the 2005 financial year at the latest.

To that end, the Commission's accounting officer will adopt the accounting rules and methods and the harmonised accounting plan to be followed by all the institutions, agencies and satellite bodies.

Harmonisation of the way in which financial statements are presented will thus be achieved.

⁽⁸⁾ See point 7.98.

⁽⁹⁾ Commission Regulation (EC) No 2909/2000 of 29 December 2000.

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Procurement of goods and services

7.30. The procurement of goods and services was examined at five satellite bodies (the European Environment Agency, the European Agency for the Evaluation of Medicinal Products, the Translation Centre for Bodies of the European Union, the European Monitoring Centre for Drugs and Drug Addiction, the Office for Harmonisation in the Internal Market). During their start-up period, pressure of time meant that the satellite bodies were not able to set up rational planning for their purchases and to strictly apply the principle of invitations to tender. Over the last few years, the satellite bodies have started setting up more rational systems, going beyond the context of preparing the annual budget, particularly as regards the purchasing of IT goods and services. If these efforts are to go on producing results, they need to be continued and stepped up.

7.31. The tendering procedures should be made more user-friendly for the tenderers. It should be noted, in this respect, that some satellite bodies have taken the initiative of publishing the invitations to tender on their website and of supplying links to useful information for potential tenderers on the procedures to be followed.

7.32. The evaluation procedures must also be improved in order to better ensure the comparability of the bids, and the administrative procedures should be clarified in order to guarantee their objectivity.

AUDIT OF THE EUROPEAN SCHOOLS

7.33. 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, but not published in the Official Journal. In line with the cyclical audits planned for the European Schools, the audits conducted in 2001 focused on the Culham and Varese Schools. At the start of the school year in 2001, 16 985 pupils were enrolled at the Schools, of which 10 072 were automatically entitled to a place. The staff of the Schools comprised the equivalent of 1 492,5 persons including 1 152 seconded teachers. The Schools' budget totalled 194 million euro, which was mainly financed by a subsidy from the Commission (120,3 million) and contributions from Member States (39,0 million).

THE COURT'S OBSERVATIONS

7.34. The efforts already made to achieve greater uniformity in the presentation of the Schools' accounts should be continued with a view to making their consolidation less difficult. The Schools' accounting plan fails to provide for any fixed-assets accounts and the property which is supposed to be entered on the inventory is not recorded in the general accounts: the fixed assets are not entered in the individual balance sheets of the Schools or of the Office of the Representative of the Board of Governors. In the Court's report concerning the financial year 2000, shortcomings in the inventory-keeping were highlighted. In this respect, there has been hardly any change in the situation.

7.34. COMMISSION'S REPLY

The European Schools will continue to work towards more uniform presentation of their accounts.

The Schools are currently taking the necessary steps to complete the inventories as soon as possible. The inclusion of fixed assets in the general accounts is currently being discussed between the Office of the Representative of the Board of Governors and the Schools.

CHAPTER 8

Financial Instruments and banking activities

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GUARANTEE FUND FOR EXTERNAL ACTIONS

Introduction

8.1. The Guarantee Fund for external actions was established on 31 October 1994 by Council Regulation (EC, Euratom) No 2728/94 ⁽¹⁾ and was built up by contributions from the EU budget over the following years. The Fund is drawn on if the beneficiary of a loan granted or guaranteed by the Community to or in a third country defaults. The Commission carries out the administrative management of the Fund and the European Investment Bank (EIB) its financial management (treasury management). The Court audited the Fund for the financial year ended 31 December 2001.

Guarantee operations and budgetary management

8.2. The outstanding capital liabilities for loans and loan guarantees for third countries including unpaid interest due amounted to 15 577 million euro as at 31 December 2001, the Fund's assets were 1 774 million euro ⁽²⁾ or 11,4 % of that total. The Council Regulation ⁽³⁾ states that the Fund has to reach an appropriate level (target amount), set at 9 % of the amount guaranteed, for potential payments. On the basis of this the target amount was set at 1 402 million euro at the end of 2001 and the amount to be refunded to the EU budget at 372,5 million euro.

Handling fee for late payments

8.3. Following an implementation agreement, which was signed in 1999 by the Commission and the EIB, the latter receives an additional 'handling fee' for repayments of loans on which the guarantees have been

8.3. *Following negotiations, stretching well into 2002, the European Investment Bank (EIB) reduced its handling fee to EUR 3 million as in this incomparable case the Commission's services have been pivotal in the resettlement of the debt.*

⁽¹⁾ Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 (OJ L 293, 12.11.1994, p. 1), as amended by Council Regulation (EC, Euratom) No 1149/1999 of 25 May 1999 (OJ L 139, 2.6.1999, p. 1).

⁽²⁾ Annual Report from the Commission on the Guarantee Fund and its management in 2001, (COM(2002) 305 final, 13.6.2002).

⁽³⁾ Article 1 of Council Regulation (EC, Euratom) No 1149/1999.

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activated earlier. This fee is calculated as 1 % *per annum* on the time between the date on which the loan in default is paid by the Commission to the EIB until the date on which the EIB recovers this loan amount. In 2001, the EIB deducted a handling fee of 10,8 million euro from the reimbursement of a significant loan which was partially related to the Guarantee Fund. This reimbursement was a result of a restructuring of loans mainly handled by the Commission. Following negotiations in 2002, the EIB agreed to reduce the handling fee for this case to 3 million euro. The Court recommends that the Commission takes steps to amend the implementation agreement to ensure that the fees in all future situations are known in advance.

Follow-up to previous observations

8.4. In its annual report on the financial year 1999, the Court recommended that the annual fee of 0,05 % for the treasury management should be reviewed. In its reply, the Commission said it would ask the EIB 'to present an overview of the costs incurred' (4). No such overview has, as yet, been presented to the Commission.

8.5. In May 2002 the fee structure was modified by a new agreement amending the last agreement in force dated September 1996. This agreement was retroactively applied in 2001.

8.4. *The Commission has received from the Bank some information on the subject.*

**THE EUROPEAN INVESTMENT FUND (EIF) —
MANAGEMENT OF MEASURES UNDER
MANDATE***Support for innovative and job-creating small and
medium-sized enterprises*

8.6. In its communication of 31 March 1998 'Risk capital — A key to job creation in the European Union' (5), the Commission stated that 'many good European ideas — themselves the result of expensive public investments in education and research — end up being

(4) Annual Report concerning the financial year 1999, Commission's reply, paragraph 7.8.

(5) Commission communication of 31 March 1998: Risk capital — A key to job creation in the European Union, SEC(1998) 552 final.

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developed in the United States where capital, know-how and the business environment are more conducive to their development and success'. The Commission considered that 'developing risk capital in the European Union is essential for major job creation in the EU' and that 'the real political challenge is to provide the tools, enabling technologies and financial instruments for a new generation of European entrepreneurs to start up and succeed.'

8.7. On 19 May 1998, the Council issued a decision on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs) — the growth and employment initiative ⁽⁶⁾. It is a programme aimed 'at stimulating job-creation by facilitating and strengthening the establishment and growth of innovative SMEs' ⁽⁷⁾. The programme (for its historical development, see **Annex 8.1**) consists of three complementary facilities ⁽⁸⁾:

- (a) a risk-capital scheme (ETF ⁽⁹⁾ Start-up) managed by the European Investment Fund (EIF);
- (b) a scheme for financial contributions supporting the creation of transnational joint ventures by SMEs within the Community (Joint European Venture — JEV) managed by the Commission; and
- (c) a guarantee scheme (SME Guarantee facility) managed by the EIF.

The detailed terms and conditions for implementing the ETF Start-up facility and the SME Guarantee facility by the EIF — including monitoring and control — are laid down in agreements between the Commission and the EIF ⁽¹⁰⁾.

⁽⁶⁾ Council Decision 98/347/EC of 19 May 1998 (OJ L 155, 29.5.1998, p. 43).

⁽⁷⁾ Article 1 of Council Decision 98/347/EC.

⁽⁸⁾ Article 2 of Council Decision 98/347/EC.

⁽⁹⁾ European Technology Facility.

⁽¹⁰⁾ Articles 3(2) and 5(4) of Council Decision 98/347/EC; see also Annex I and Annex III to the Council Decision.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

8.8. Budgetary appropriations committed from 1998 to 2001 for the two measures implemented by the EIF amount to 433,2 million euro: 184,3 million for the ETF Start-up facility and 248,9 million for the SME Guarantee facility ⁽¹¹⁾. The EIF makes disbursements following the requirements of the financial institutions participating in these facilities.

The Court's audit

8.9. During 2001 the Court audited the management of the two facilities by the EIF. The Court's audit was mainly focused on the following topics: achievement of the objectives of the facilities, completeness and correctness of information provided on the implementation of the measures and accordance of the EIF remuneration with the accepted market practices. Visits were made to the premises of the EIF ⁽¹²⁾ and the Commission's departments involved. In addition, on-the-spot visits were carried out to venture-capital Funds (glossary of terms used, see **Annex 8.2**) in Germany, France and Luxembourg and to Guarantee institutions (intermediaries) in six Member States (Germany, France, Italy, Austria, Portugal and United Kingdom). 30 SMEs, as final beneficiaries, were also visited.

Increasing the availability of risk capital: the ETF Start-up facility

8.10. The objective of the ETF Start-up facility is to increase the availability of risk capital to innovative and job-creating SMEs during their establishment and their early stage development. The EIF invests the Community funds in specialised venture-capital Funds through equity participations. These Funds invest in SMEs. Funds are selected by the EIF and submitted to the Commission for approval.

⁽¹¹⁾ Heading B5-5 1 1 — Programme for enterprises: improvement of the financial environment for SMEs and heading B5-5 1 2 — Completion of the Employment initiative (1998 to 2000) in the 2001 budget.

In 2001, an additional amount of 13,6 million euro was budgeted as income from investments and interest earned up to the end of 2000.

⁽¹²⁾ The audit was carried out in accordance with Article 248 of the EC Treaty.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Delays in the implementation

8.11. As stated in the indicative outline annexed to the Council Decision, the EIF will use its best efforts fully to commit the funds allocated to the facility not later than during the calendar year following the year in which the relevant budgetary payments are made' (¹³).

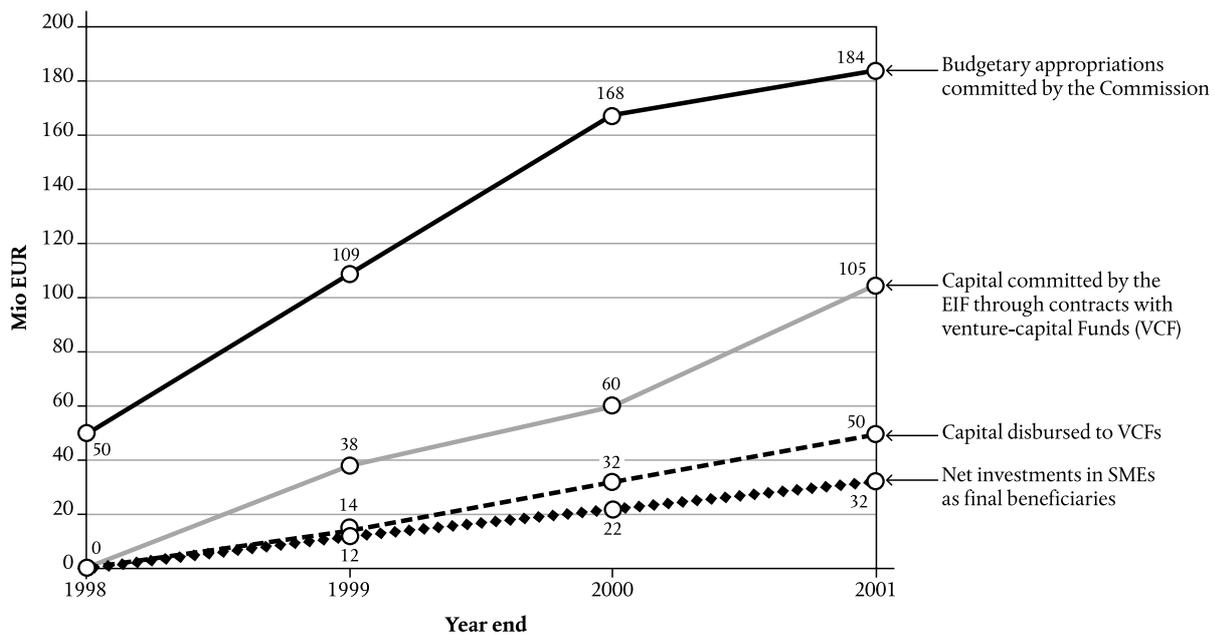
8.12. Out of the total amount of 184,3 million euro committed from 1998 to 2001, at the end of 2001 the EIF had contracted 105,3 million euro with venture-capital Funds, an amount of 49,8 million euro had been disbursed to them and the net amount invested by these Funds in final beneficiaries stood at 32,2 million euro (¹⁴) (for comparative evolution, see **Figure 8.1**). The Commission considers that there is bound to be a time lag between the transfers made to the trust account

8.11 to 8.12. Concerning the take-up of the Facility, by the end of May 2002, the European Investment Fund (EIF) Board and the Commission had committed to European Technology Facility (ETF) Start-up investments (including related EIF fees and expenses) an amount of EUR 181 million. Of this EUR 181 million, the EIF has signed contracts with venture-capital funds for an amount of EUR 105 million.

The Commission is therefore of the opinion that the scheme is successful and that take-up has been good, even more so considering the difficult macroeconomic market circumstances and the general trends in the venture-capital industry as reported by US and European venture-capital associations.

Furthermore, the ETF Start-up has quite specific eligibility criteria (new venture-capital teams, early stage investments,

Figure 8.1 — 'ETF Start-up' — Accumulated commitments and investments



Source: EIF's annual reports to the Commission 2001.

(¹³) Annex I(5) to Council Decision 98/347/EC.

(¹⁴) Net invested amount in final beneficiaries of 32,2 million euro: disbursed capital of 49,8 million euro minus cost of realised investments, minus cash held by venture-capital Funds and minus management fees of the Funds.

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by the Commission and the draw-downs made by the EIF to the venture-capital Funds and that this has no adverse budgetary impact since the treasury generates returns. The Court notes that the rate at which the scheme is being implemented is slower than that expected by the Council. The Commission should adapt the transfers made to the trust account to the real needs of the EIF, also taking into account that a net gain of 13,6 million euro from realised investments became available for reuse.

No indicators established at the launch of the programme to measure its effectiveness

8.13. Under the Council Decision 'the Commission shall report annually to the European Parliament and to the Council on the implementation of this Decision and the different schemes under it, notably this Decision's impact on the access to financing by SMEs, its immediate effects on the creation of employment, the prospects for the creation of employment in the long term and the coherence between the financial allocation to the different schemes and the objectives of the programme' ⁽¹⁵⁾. The Commission admits that the investment of Community funds in this scheme was not tied to particular requirements concerning its impact. This was not in conformity with the principle of sound financial management according to which Community spending for the financing of public interest schemes must be accompanied by indicators to measure the effectiveness of the spending. The Court notes that the Council Decision of 20 December 2000 on a multiannual programme for enterprise and entrepreneurship (MAP) ⁽¹⁶⁾ stipulates the adoption of performance

THE COMMISSION'S REPLIES

less-favoured geographical regions, 50 % of funds from private sources, pari passu, etc.) that do not follow the typical investment criteria of 'mainstream' funds. This choice was made deliberately by Council to address identified market failures and taking into account existing mainstream venture-capital market activity.

With regard to the transfers, in line with standard venture-capital market practice, money is 'called' (drawn-down) by the venture-capital funds (VCFs) in accordance with their projected investments into SME portfolio companies. The drivers in the disbursement process are thus the VCFs supported through the facility, who determine the actual rhythm and timing of these draw-downs, and not the Commission or the EIF.

The Commission is convinced that sufficient liquidity on the trust account is necessary to cover the Commission's and the EIF's legal commitments to VCFs and to be able to honour their draw-down requests.

8.13. *The Financing Proposal prepared prior to the launch of the G & E programme, in 1998, did indeed not provide for detailed performance indicators.*

The Commission's July 2000 communication on evaluation ⁽¹⁾ stipulates that when proposing a new legal base for any action incurring expenditure from the general budget, the operational service(s) responsible will set out the intervention logic of the proposed programme. Where possible, the expected results and outputs should be expressed by way of verifiable indicators.

Now existing procedures require operational services to define verifiable objectives before a programme is initiated and to describe evaluation procedures in financial statements accompanying legislative proposals.

In line with these procedures, indicators have been defined for ETF Start-up under the multiannual programme for enterprise and entrepreneurship (MAP).

⁽¹⁵⁾ Article 7 of Council Decision 98/347/EC.

⁽¹⁶⁾ Article 4(1) of Council Decision 2000/819/EC of 20 December 2000 (OJ L 333, 29.12.2000, p. 84).

⁽¹⁾ SEC(2000) 1051.

THE COURT'S OBSERVATIONS

indicators for evaluating the actions needed to achieve the objectives of the programme. The MAP programme provides a new legal basis and additional resources for the ETF Start-up facility.

Reporting problems

8.14. Since there are no precise targets to be achieved, it is particularly important that reports on the implementation of the facility and on employment and job creation are reliable, that the relevant figures are accurate and that the facility is coherent with others managed by the EIF and running parallel to it.

8.15. The information on commitments and draw-downs made by the EIF for investments in venture-capital Funds is available for the full year 'n' during the first quarter of the following year ('n + 1'). On the other hand, information on employment from SMEs concerning year 'n' is transmitted to the Commission through the venture-capital Funds and the EIF in the third quarter. The Commission considers that it is reasonable to keep the existing deadlines, rather than to oblige SMEs to either change their financial reporting cycle or send a report in two parts. The Court notes that the budgetary authority is not informed about the development of the scheme before budgetary decisions are made in the year 'n + 1'.

THE COMMISSION'S REPLIES

The Commission wishes to stress that the actual reporting done to the budgetary authorities for ETF Start-up under the Growth and employment initiative covers de facto all the relevant indicators that have been identified and formalised in the context of MAP, thus providing the necessary information to measure the effectiveness of the spending in line with the principles of sound financial management.

In addition, these questions have been addressed in more detail in the context of the evaluation report on the Growth and employment initiative, that is attached to the 2002 Annual Report from the Commission to European Parliament and to Council.

It must be stressed that under ETF Start-up equity investments are being undertaken on commercial terms and therefore no subsidy exists. Therefore it is not possible to directly link as a condition of investment the number of jobs created to the equity participation. However, the development of the portfolio companies including the number of jobs created is regularly followed up. Obviously, the financial performance of the companies is a key monitoring item.

8.14. *Like the Court, the Commission and EIF attach great importance to the reliability of figures provided regarding the implementation of the facility. Figures regarding commitments, contract signature, draw-downs and repayments are verified by the EIF and monitored by the Commission.*

The Commission considers that the collection and analysis of statistical data including employment is best addressed in the context of evaluation. In accordance with the Council Decision, an ex post evaluation was recently carried out.

8.15. *Until the new fiduciary and management agreement entered into force the EIF provided information on commitments and draw-downs twice a year. Under the new framework agreement the information will be provided four times a year.*

The Commission considers that the budgetary authority is adequately informed about relevant parameters concerning the development of the scheme.

THE COURT'S OBSERVATIONS

8.16. As regards financial information supplied by the EIF to the Commission, the EIF assumes full responsibility both for the reports and for the accounts. The EIF does not, however, assume any responsibility for statistical data provided by venture-capital funds and final beneficiaries in response to surveys, neither is the reliability of these statistical data verified by the Commission ⁽¹⁷⁾.

8.17. The EIF managed (on behalf of the EIB or on the basis of its own resources) other instruments targeting venture-capital Funds; such instruments operated in parallel to the Funds selected for the ETF Start-up facility. The way in which these instruments fit together or complement each other is not addressed in the Commission's annual report on the implementation of the ETF Start-up facility.

THE COMMISSION'S REPLIES

8.16. *The Commission considers that the verification of information of a microeconomic and financial nature received in response to questionnaires is not an area presenting specific risks to Community funds and hence requiring particular verifications to ensure the correct use of funds.*

Furthermore, the Commission wishes to point out that the investment of Community funds under ETF Start-up is not tied to particular requirements of job creation. The beneficiaries providing the information referred to by the Court do not have any valid reason for providing inaccurate information.

8.17. *The particular investment policy of ETF Start-up has a clear focus on higher risk profile VC funds (new VC teams, early stage investments, less-favoured geographical regions).*

ETF Start-up is indeed targeting specific funds with a higher risk profile than those targeted by the other EIF mandates, which have a much wider scope and a correspondingly wider market throughout the different member states. The market circumstances were such that during the initial period of the ETF Start-up Facility, it was easier for new VC teams to raise new early stage funds in countries where the venture-capital culture was more developed.

The Commission and the EIF are convinced that ETF Start-up is addressing a clear market failure and that the market requires such an instrument.

This conviction is strengthened following the MAP Council Decision, as ETF Start-up will 'reinforce further upstream' the other facilities managed by EIF by financing only start-up companies.

⁽¹⁷⁾ Therefore the information given in the latest available Commission report (COM(2001) 0399 final of 16.7.2001), that a total number of 4 796 employees was counted in the 133 investee companies supported by the facility at year-end 2000 has to be taken on the proviso that the underlying data were in some cases unreliable, as the Court found during its audit.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Target distribution of investments not yet achieved

8.18. The Council indicated that the EIF should 'use its best efforts to target investments throughout the Community' ⁽¹⁸⁾. Nevertheless, under its management agreement, the EIF is entitled to assess each proposed investment on its own merits. At the end of 2001, after three and a half years, investments had been made in venture-capital Funds in eight Member States ⁽¹⁹⁾ (see **Table 8.1**). 52 % of the 181 investees were located in one Member State ⁽²⁰⁾. No indication is given as to whether and by when investments throughout the Community can be achieved.

8.18. *The Commission has set indicative geographic targets to be followed. Such target distribution was defined as 'indicative' as the Commission was fully aware of the market differences and the possible absorption difficulties in certain Member States. The EIF made considerable efforts to achieve a broad geographic distribution and has succeeded to date in finding venture-capital funds in 12 countries.*

Based on the experience gained under the Growth and employment initiative and given the different needs of each Member State, it was considered that it would be more appropriate to

Table 8.1 — Cumulative ETF Start-up investments compared to cumulative EIF portfolio as at 31 December 2001

(Mio EUR)

Member State	Cumulative ETF Start-up investments ⁽¹⁾		Cumulative EIF portfolio ⁽²⁾
	Number of VCFs	Amounts invested	Amounts invested
Belgium	1	2	33
Denmark	1	3	31
Germany	2	11	235
Greece			20
Spain			160
France	5	19	264
Ireland			79
Italy			239
Luxembourg	1	5	19
Netherlands			41
Austria			42
Portugal			22
Finland	1	1	99
Sweden	1	4	60
United Kingdom	1	5	296
TOTAL	13	50	1 640

⁽¹⁾ Source: EIF: Paid in capital.

⁽²⁾ Source: EIF: EIF Equity operations — Cumulative portfolio including ETF Start-up investments.

⁽¹⁸⁾ Annex I(2) to Council Decision 98/347/EC.

⁽¹⁹⁾ Belgium, Denmark, Germany, France, Luxembourg, Finland, Sweden and the United Kingdom.

⁽²⁰⁾ France.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The calculation of the EIF's remuneration lacked objective basis

8.19. Under the Council Decision 'management fees paid to the EIF shall be determined in accordance with the accepted market practice' ⁽²¹⁾. In line with the accepted market practice fees must be clearly linked on the one hand to the take-up of the scheme (based on amounts committed and the number of agreements signed by the EIF), and, on the other, to the monitoring of and reporting on the investments made (based on outstanding commitments). Up to the end of 2001, the EIF's remuneration was in two different parts: a fixed annual management fee of 1 million euro and a quarterly performance fee, which was variable. Management and performance fees amounted to a total of 1,4 million euro in 2001.

8.20. As to the annual management fee, neither the fiduciary and management agreement nor the fee letter indicated how the amount of 1 million euro had been calculated, which costs it should cover and which services it should remunerate. The Commission stresses that the fee corresponded to slightly less than 0,6 % of the total budgetary allocation of the Start-up facility. This notwithstanding, it is the view of the Court that the fee amount was arbitrary since it was not based on any analysis. Furthermore, the full amount of the fee was paid for 1998, although the management of the facility was only delegated to the EIF at the end of July.

seek a balanced global geographical distribution for all the financial instruments together managed by the EIF in the context of MAP.

Concerning geographical distribution of beneficiary SMEs, it should be stressed that the facility started its activities on a 'first come, first served' basis. This resulted at the beginning in an unevenly balanced absorption.

8.19. *EIF's total fees for ETF Start-up of 1,33 % of commitments, compare in fact rather favourably with rates in the market of between 0,75 % and 2 % of total available amounts, to which is added a substantial participation (7,5 % to 15 %) in the proceeds from investment returns once the original capital has been repaid (carried interest).*

The EIF's remuneration under ETF Start-up is not comparable on annual basis with the remuneration perceived under the EIB risk-capital mandate. In fact, the latter includes a part linked to the performance of the VC funds (carried interest), which is not the case under ETF Start-up. The carried interest normally materialises towards the end of the life of the VC funds in which the EIF has invested. Therefore a comparison could only be made taking into account the whole life of the respective facilities.

8.20. *The Commission considers that the level of remuneration of the EIF is in line with accepted market practice, as required by the legal basis of the ETF Start-up facility.*

Due to the initial costs linked to the launch of the facility (e.g. contractual arrangements, product development, promotion, extensive travel, hiring of staff, etc.), a minimum annual fee of EUR 1 000 000 was agreed for the initial period of five years. This annual fee corresponds to slightly less than 0,6 % of the total budgetary allocation for ETF Start-up.

An overall cap on the management fees during the 16 year life of the facility, expressed as a percentage of the final overall budget allocation, was agreed in order to counterbalance the front-loading of fees and keep an appropriate balance between the resources devoted to the management of the facility and the resources invested in VCFs. The management fee for 1998 covers the costs of the EIF as regards the preliminary work during the negotiation phase with the Commission prior to the Council decision in May 1998 as well as the set-up costs of the facility. It also covers the implementation costs for that year, including the costs incurred by the EIF before July 1998.

⁽²¹⁾ Article 6 of Council Decision 98/347/EC.

THE COURT'S OBSERVATIONS

8.21. A new fee structure was agreed with effect from January 2002 onwards. This new structure is very complicated and not clear.

Covering the cost of guarantees within limits: the SME Guarantee facility

8.22. The aim of the SME Guarantee facility is to cover the cost of guarantees and counter-guarantees issued by the EIF in order to promote an increase in the loans granted to innovative and job-creating SMEs ⁽²²⁾. The facility increases the capacity of guarantee schemes operating in the public or private sectors in the Member States. There are different systems applied for the guarantees: in the simplest case, the EIF gives a global guarantee directly to the lending institution, which gives loans to SMEs. In most cases, the EIF gives counter-guarantees on guarantees given by the intermediaries to banks. If the SME as final beneficiary does not pay back the loan, the intermediary will reimburse the bank. The intermediary is then partially reimbursed by the EIF. The budgetary allocation (see **Figure 8.2**) is to cover the full cost of the facility, including the EIF's guarantee losses and any other eligible costs or expenses of the

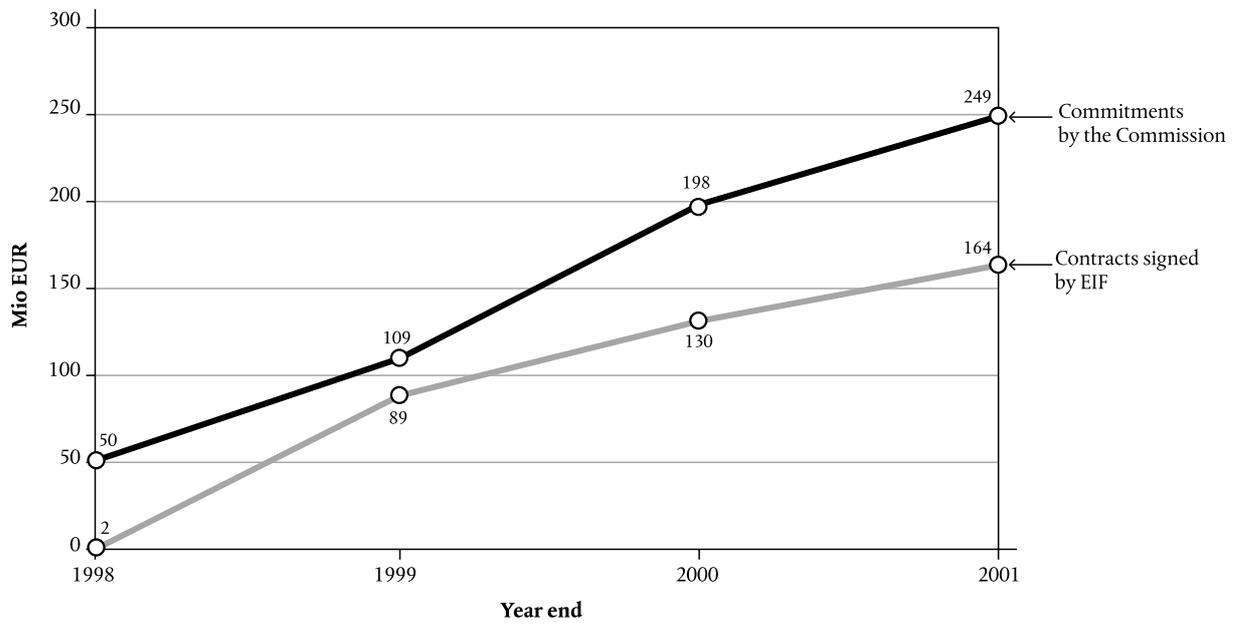
THE COMMISSION'S REPLIES

8.21. *The revised fee structure is, in line with the Court's remarks, linked on the one side to the take-up of the scheme (based on amounts committed and number of agreements signed by the EIF), and on the other to the monitoring of and reporting on the investments made (based on outstanding commitments). While not affecting the maximum amount of remuneration payable to the EIF over the full life of the facility, this will make the calculation more transparent and relevant to the work carried out by the EIF.*

Given the more refined nature of the principles governing the new fee structure, the corresponding calculations needed to determine the fees are necessarily more sophisticated.

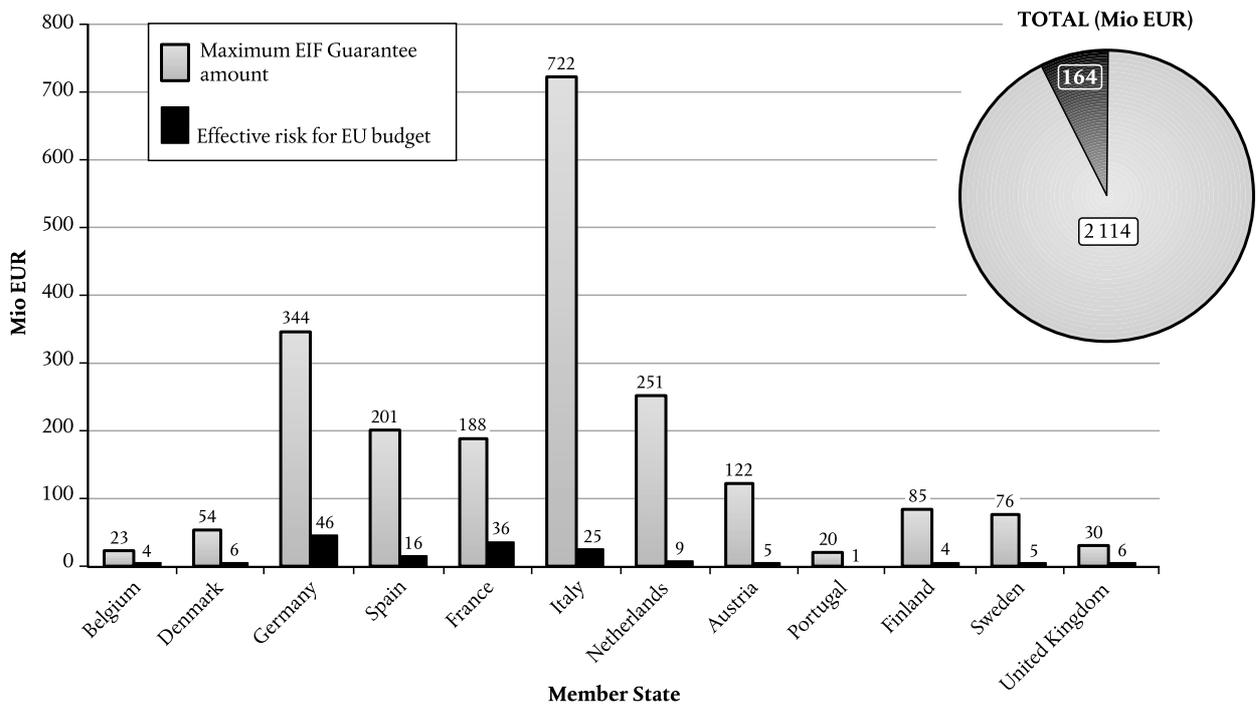
⁽²²⁾ There are more than 19 million SMEs in the European Union. 86 935 SMEs were benefiting from the SME Guarantee facility at the end of 2001. According to preliminary data transmitted by the EIF to the Commission in February 2002, the number of employees of these 86 935 SMEs stood at about 385 000 at the end of 2001.

Figure 8.2 — SME Guarantee facility — Accumulated commitments and EIF contracts as at 31 December 2001



Source: Commission/EIF.

Figure 8.3 — Guarantee amounts in favour of intermediaries compared with effective risks for the EU budget, situation as at 31 December 2001



Source: EIF/Commission.

THE COURT'S OBSERVATIONS

facility. However, the cost of the facility to the Community budget is capped ⁽²³⁾ (see **Figure 8.3**). Thus it may not under any circumstances exceed the budgetary allocations made available to the EIF ⁽²⁴⁾.

Target distribution to the Member States is not yet achieved

8.23. The appropriations committed by the Commission from 1998 to 2001 amount to a total of 248,9 million euro. Out of these resources the EIF had contracted 163,9 million euro with intermediaries at the end of 2001. No contracts had been signed for Greece, Ireland and Luxembourg. In the United Kingdom there is a big gap between target and the commitment because a suitable contractor has not yet been found.

Insufficient visibility of the facility

8.24. Intermediaries were obliged in their contracts with the EIF to include in all promotional material an indication that they are supported by an EU-facility. Many SMEs benefiting from the SME Guarantee facility were informed neither about the existence of the EU support, nor about the Court's right to verify the regularity of the guarantee procedure.

⁽²³⁾ Example: intermediary 'X' gets a guarantee volume of 100 guarantees from the EIF and gives 100 guarantees, each of 1 million euro, to 100 different banks. The EIF states in that context that it will not pay more than a maximum amount of 5 million euro i.e. the cap amount. After two years 'X' has made demands for 4 million euro and is reimbursed. Suppose that in the following years, 'X' has to pay, following further bankruptcies, another 20 million euro. Then 'X' will only be reimbursed with 1 million by the EIF because it has reached the cap of 5 million. In the light of the future 'Basel II' Agreement, only the small cap amount will count as effective guarantees given to the intermediaries. For more information on the Agreement and the Basel Committee, see the Bank of International Settlement's website:

<http://www.bis.org/publ/bcbsca.htm>

⁽²⁴⁾ Article 5 of Council Decision 98/347/EC.

THE COMMISSION'S REPLIES

8.23. As for ETF Start-up, the EIF made considerable efforts to achieve a broad geographic distribution and has succeeded to date in finding suitable intermediaries in 12 Member States.

As regards the United Kingdom, discussions with the British Banking Association as well as with some leading banks did not lead to meaningful results. The selected intermediary in UK was chosen after consultation with the relevant national authorities.

Finally, the Commission refers to its reply concerning geographic distribution under point 8.18, that is applicable also to SME Guarantee.

8.24. The Commission agrees with the Court that the visibility of the EU support should be ensured by every intermediary.

The new MAP guidelines of the Facility require the intermediary to ensure that each beneficiary is made aware in writing of the origin of this support.

Concerning the audit access clause, all intermediaries and SMEs chosen by the Court provided all information requested. The EIF has included the obligation as regards the audit clause in the standard terms that have been signed with each intermediary. However, it is acknowledged that the audit clause was not transposed in some agreements between intermediaries and SMEs.

In addition, the EIF has sent several reminders to the intermediaries concerning these two issues.

The EIF is requested to monitor this.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Priority for signing contracts with public schemes

8.25. The Council Decision focused on the objective of promoting better access to financing for SMEs (i.e., reducing banks' reluctance to fund SMEs). The Commission and the EIF implemented the measure focusing on increasing the volume of the existing guarantee schemes. Wherever available ⁽²⁵⁾, the EIF gave priority to signing contracts with public schemes that can also benefit from support through the national public budgets. For those public schemes, the contribution from the EU-budget is welcome but not substantial. Under the Council Decision ⁽²⁴⁾, it would however also be possible to support any other risk-sharing SME instruments made available by the EIB or other appropriate financial institutions.

No verification on State aid to beneficiaries

8.26. Neither the Commission nor the EIF were aware that, in certain cases ⁽²⁶⁾, SMEs were benefiting from both the SME Guarantee facility and the European Structural Funds (ERDF).

8.25. *The Council Decision refers to existing guarantee schemes of which the EIF made an analysis. Based on this analysis and discussions with the authorities in the Member States it was felt that the most efficient way to implement the facility was via the existing, mainly national guarantee institutions.*

In line with the Council requirements, the EIF consulted national authorities prior to the selection process of intermediaries. In countries where national public schemes were not operational, like in Italy or in Greece, the EIF has launched a call for expression of interest in order to select the most suitable financial intermediaries. National guarantee schemes in most countries are public schemes.

8.26. *The Community's State aid rules place on Member States the responsibility to ensure that the aid awards to individual beneficiaries under various public aid schemes comply with the eligibility conditions and aid limits laid down in those rules and in the Commission's decisions approving the aid schemes. In the majority of cases enforcement is not practicable at any other than Member State level, as aid to be counted towards the limits in terms of percentages or (de minimis) amounts can legitimately come from different sources and at different times. As regards the implementation of measures which are partly financed by Community funds, Commission's task is mainly to ensure that the necessary monitoring systems to control the level of aid awards to individual projects are in place and operate satisfactorily. It does of course check on individual cases in connection with audits and in response to complaints. The Commission would refer to its answer to points 3.86 to 3.88 of the Court's report for the year 2000.*

⁽²⁵⁾ Germany, Spain, France.

⁽²⁶⁾ In two of the Member States (Austria and Portugal) visited by the Court.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Late reporting on employment data

8.27. The fiduciary and management agreement obliges the EIF to deliver its annual report by 30 September, at the latest, including factual data on employment as well as an estimation for the future. Therefore, the EIF's annual reports to the Commission arrive too late to be included in the Commission's reports to Parliament and to the Council.

8.27. *There is a very long chain of participants in the implementation of these programmes involving (after the approval by the budgetary authority), the Commission, the EIF, the financial intermediaries and the final SME beneficiaries. As a result, it is only possible to report in the year following the year under review facts pertaining to the EIF and the intermediaries, i.e. budgetary facts such as commitments and payments, geographical distribution concerning contracts with financial intermediaries, and levels of utilisation by financial intermediaries.*

For detailed information pertaining to the final beneficiaries the annual report must refer to information gathered by the intermediaries during the year under review and pertaining to the previous year. This covers information on employment at SME level.

Finally, the Commission considers that only overall evaluation (currently being carried out) can provide relevant information as regards job-creation effects throughout the Community.

Best practices not sufficiently established

8.28. The intermediaries in the Member States have strengths and weaknesses in their rules, programmes and procedures. Appropriate market research has not been carried out to establish best practices, although the Council stated that intermediaries should be selected in conformity with best business and market practice in a fair and a transparent manner ⁽²⁷⁾ having regard to:

- (a) the effect on the volume of debt finance made available to SMEs; and/or
- (b) the effect on access to debt finance by SMEs; and/or
- (c) the effect on risk-taking in SME lending by the intermediary concerned.

8.28. *At the end of 1997 and beginning of 1998 the EIF carried out a thorough analysis concerning the guarantee schemes operating in the Member States. The EIF carried out an extensive market research and it met with the national authorities that are best placed to advise on existing national schemes and ensure respect of subsidiarity principle. Furthermore, the EIF contacted and visited all relevant guarantee schemes in the Member States. Based on such discussions, standard information sheets were compiled. In a second stage, more detailed project sheets were prepared.*

As a confirmation, the EIF was in a position to advise two Member States as to the design and implementation of new guarantee systems.

In addition the EIF organised a conference where all intermediaries were given the opportunity to exchange best market practice.

⁽²⁷⁾ Annex III(2) to Council Decision 98/347/EC.

THE COURT'S OBSERVATIONS

The EIF fees lack objective basis

8.29. The fees for 2001 amounted to 1,97 million euro, which is below 0,1 % (10 basis points (bp)) of the theoretical EIF guarantee amount, but 1,2 % (120 bp) of the upper limit of the budgetary commitments made to financial intermediaries of 164 million euro (see **Figure 8.3** and footnote 23). These fees merely cover administration, as the EIF takes — unlike the banking industry — no credit risk. The Court reiterates the observations in paragraph 8.20 that the fee amount was not based on any analysis.

Conclusions and recommendations

8.30. The Court is aware of the difficulties inherent in the implementation of the schemes audited. A fair balance has to be struck between potentially profitable uses for the funds and requirements owing to the character of these funds as public money intended to be for public interest objectives used. Nevertheless, the Court recalls that:

- (a) the implementation of the ETF Start-up facility is still slow;
- (b) difficulties remain in establishing the ETF Start-up, and to a lesser extent the SME Guarantee facility equitably throughout the Community.

8.31. In accordance to the above the Court recommends that the Commission and the EIF should study the way to find remedies for the weakness observed by the Court in the speed and the extension of the schemes' implementation.

THE COMMISSION'S REPLIES

8.29. *The fee rate negotiated with the EIF is justified by:*

- *the challenge of implementing a number of new instruments across an extended number of eligible countries (EEA/EFTA and accession countries);*
- *the large number of guarantees to be issued, including with new intermediaries in participating countries, resulting in substantial work at all stages of the implementation process (market research, origination, selection of suitable intermediaries, negotiation and closing).*

This is not comparable to the tasks of any national guarantee scheme.

The guaranteed portfolio has already reached more than 100 000 loans, with consequences on the servicing costs of the portfolio (database maintenance, reporting), as well as on the risk management (payment demands, monitoring, etc.). As regards 2001, the fees paid were below 10 bp (EUR 1,971 m in relation to the EIF guarantee amount).

8.30 to 8.31. *While recognising that programme implementation is an ongoing process and that there is always scope for improvements, the Commission and the EIF consider that procedures put in place to implement ETF Start-up and the SME Guarantee facility are appropriate and have proven to work.*

The cooperation with trustees, like the EIF, not only entails a professional management of the instruments under mandate, but also enables the Commission to deepen its knowledge on market needs for policy purposes.

The EIF in turn delegates the investment and credit assessment regarding final beneficiary SMEs to financial intermediaries such as venture-capital funds, incubators and guarantee institutions. This delegation system allows the Commission and the EIF to benefit from the significant experience developed by these market operators.

The SME Guarantee facility has established itself as an effective instrument reaching a sizeable population of SMEs active in a wide range of different activities.

THE COURT'S OBSERVATIONS

8.32. The Court also draws attention to the fact that the management fees paid to the EIF should be clear and appropriate for the services provided.

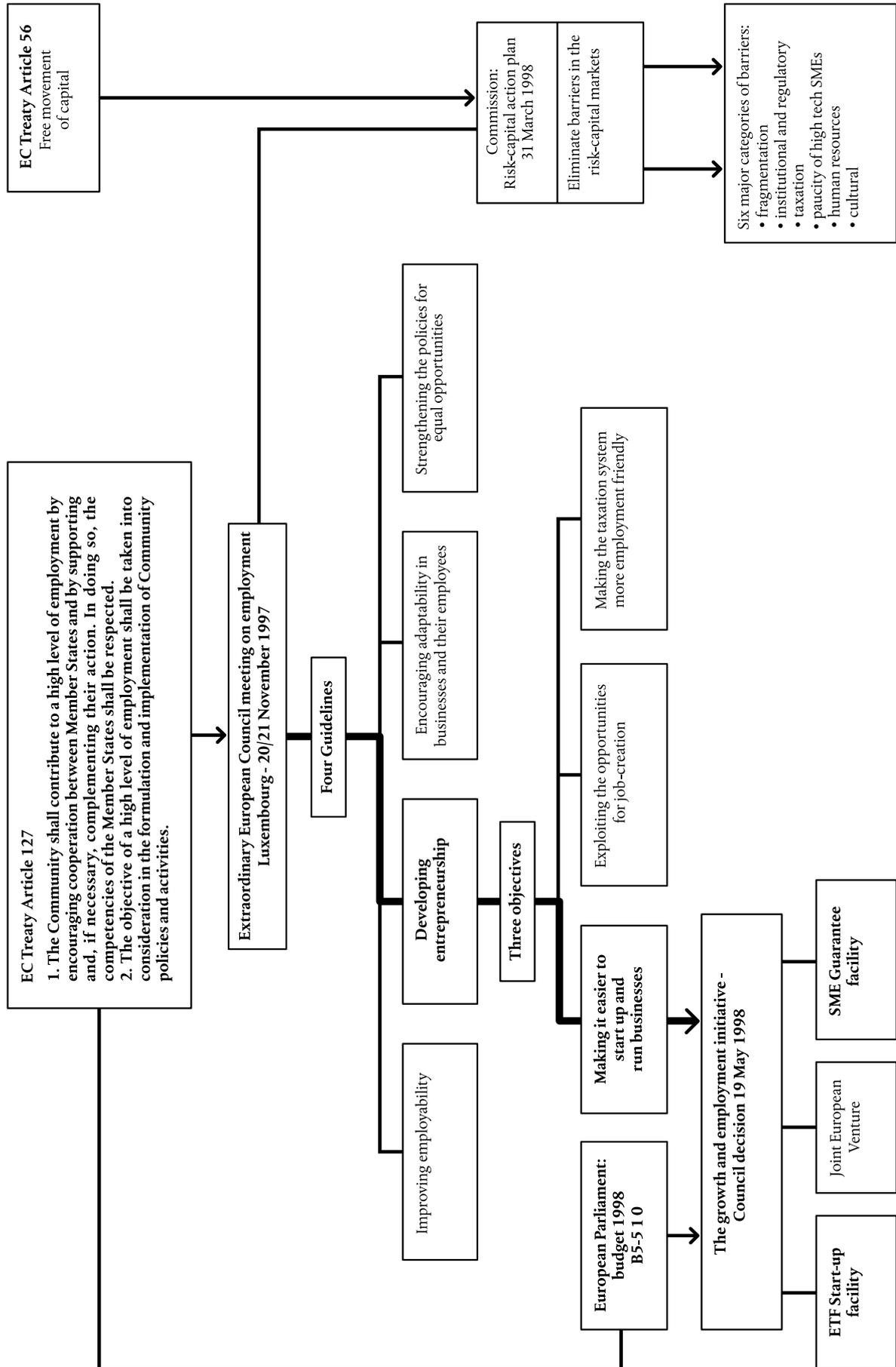
THE COMMISSION'S REPLIES

The differences in the take-up of the facilities were identified by the Commission at an early stage and largely taken into account in defining the framework for implementation of the MAP. The new MAP proposes modifications and extensions of the ETF Start-up facility and the SME Guarantee facility and introduces a new action, the Seed capital action. All three actions are to be managed by the EIF and aim to address recognised market failures in order to improve SMEs' access to finance.

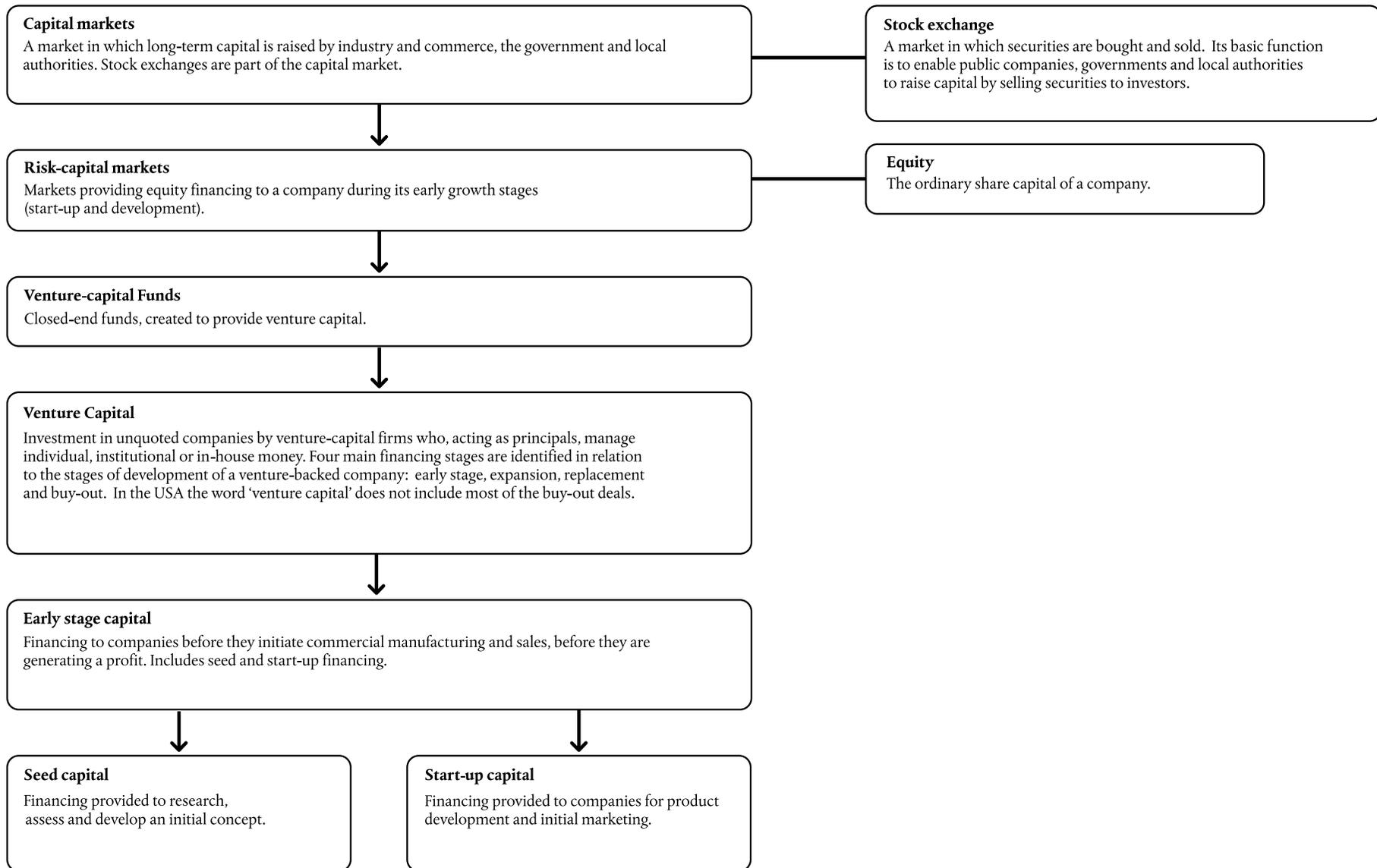
As regards the geographic distribution of the instruments, the Commission considers it appropriate to seek within the context of the MAP a balanced global geographical distribution for all the financial instruments together, reflecting the characteristics of the different markets.

8.32. *With regard to the ETF Start-up facility, the Commission negotiated in December 2001 with the EIF a revised fee structure. Fees are now clearly linked on the one side to the take-up of the scheme (based on amounts committed and number of agreements signed by the EIF), and on the other to the monitoring of and reporting on the investments made (based on outstanding commitments).*

Annex 8.1



Annex 8.2 — Glossary of terms used



Source: Annex III to the communication from the commission to European Parliament and to Council — Progress report on the risk capital action plan (COM(2000) 658 final).

CHAPTER 9

The Statement of Assurance and supporting information

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STATEMENT OF ASSURANCE

I. The European Court of Auditors ('the Court') has examined the consolidated accounts of the European Communities for the financial year ended 31 December 2001. The accounts consist of the consolidated revenue and expenditure account and balance sheet as well as 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 own audit policies and standards. These adapt generally accepted international standards to the Community context. The audit comprised an appropriate range of procedures designed to examine, on a test basis, evidence relating to the amounts and disclosures in the consolidated accounts and to 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 this audit the Court obtained a reasonable basis for the opinion expressed below. The scope of the Court's opinion is restricted as regards own resources (see paragraphs 1.23, 1.35 and 1.37) and external action (see paragraph 5.14).

*
* *

Reliability of the accounts

III. Except for the effects of the observations summarised in indents (a) to (d) below and the remark made in paragraph IV, the Court is of the opinion that the accounts of the financial year closed on 31 December 2001, as published in the Official Journal, faithfully reflect the Communities' revenue and expenditure for the year and their financial position at the year-end:

- (a) overstatement by 148,7 million euro of provisions paid to the Member States in respect of agricultural intervention stocks (see paragraph 9.12);
- (b) entry without adequate justification under 'Sundry debtors' of 980 million euro relating to cash transfers in third countries (see paragraph 9.25);
- (c) provision of 564 million euro set up on doubtful bases in respect of the cost of dismantling the Joint Research Centre's nuclear installations (see paragraph 9.31);
- (d) overstatement of commitments still outstanding by about 1 318 million euro (see paragraph 9.32).

⁽¹⁾ Volume IV of the documents was submitted by the Commission to the European Parliament, the Council and the Court on the official date of 1 May 2002 (SEC(2002) 406-FR).

⁽²⁾ Article 248 of the EC Treaty, Article 160c of the Euratom Treaty and Article 45c of the ECSC Treaty with regard to the ECSC's former administrative budget, which was incorporated into the general budget by the Merger Treaty of 8 April 1965.

IV. The Court emphasises that most of its reservations and observations are matters that regularly recur. These weaknesses stem to a large extent from the Community accounting system which was not designed to provide an assurance that the various components of the Communities' assets have all been recorded. The Court considers that urgent in-depth action in the Commission's departments to cope with the risks arising from the shortcomings in the accounting system is required (see paragraphs 9.6 to 9.8).

Legality and regularity of the underlying transactions

V. As regards revenue, the errors affecting own resources found in the course of the audit are not significant (see paragraph 9.37).

Except in the field of administrative expenditure (see paragraph 9.47) the audit revealed, as regards payments, the persistence of errors affecting their amount, the reality or eligibility of the underlying transactions (see paragraphs 9.38 to 9.46).

In view of the results of the audit, the Court is of the opinion that the transactions underlying the financial statements, taken as a whole, are legal and regular in respect of revenue, commitments and administrative expenditure; however it still cannot provide this assurance in respect of the other payments.

10 October 2002

Juan Manuel FABRA VALLÉS
President

European Court of Auditors
12, rue Alcide De Gasperi, L-1615 Luxembourg

THE COURT'S OBSERVATIONS

INFORMATION IN SUPPORT OF THE SOA

Introduction

9.1. Pursuant to Article 248 of the Treaty, the Court of Auditors provides the European Parliament and the Council with a Statement of Assurance concerning the reliability of the accounts and the legality and regularity of the underlying transactions (SOA).

9.2. The aim of the work on the reliability of the accounts of the European Communities is to obtain a reasonable assurance that all the revenue, expenditure, assets and liabilities have been entered in the accounts properly and that the financial statements faithfully reflect the financial position at the end of the year.

9.3. The aim of the work on the legality and regularity of the underlying transactions is to obtain enough evidence of a direct or indirect nature to prove that the underlying transactions are in accordance with the regulations or contractual provisions in force and that the amounts involved in these transactions have been correctly calculated.

9.4. For the financial year 2001, particular attention was paid to the following when examining the legality and regularity of the transactions:

- (a) the process of reform at the Commission, in particular its financial management aspects (see paragraph 9.48 et seq.);
- (b) an analysis of the transactions (see paragraphs 9.36 to 9.47).

9.5. This examination was supplemented by an analysis of several sectoral management systems, the conclusions from which have been set out in the preceding chapters devoted to the various headings of the financial perspective.

*Reliability of the accounts***Accounting principles and practices**

9.6. Since the first Statement of Assurance (SOA) in respect of the financial year 1994, the Court has repeated its reservations in respect of the reliability of the accounts. These reservations most often have their roots

9.6 to 9.8. THE COMMISSION'S REPLIES

The Commission recognises the accounting problems still present as highlighted by the Court. A reform of accounting

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in the weaknesses of the accounting system and in the low level of awareness in the Commission's operational DGs with regard to questions concerning records and accounting controls. The reservations contained in the Director-General of Budgets' declaration confirm the Court's findings, but nevertheless no precise plan of action accompanied by a realistic timetable has been proposed to remedy the situation.

9.7. In the absence of a comprehensive accounting system, the year-end financial statements are drawn up largely on the basis of records which are not part of the accounts (see paragraphs 9.22, 9.24, 9.27 and 9.29). The evaluations established during this procedure are not linked to the entries in the budget from which they are derived and the central accounts departments are not always able to guarantee that they are accurate ⁽³⁾. In addition, the accounting system, which is based, to a large extent, on cash accounting principles, does not enable a distinction to be made between administrative expenditure and capital expenditure, between final payments and payments on account or advances, or even total debts and receivables to be determined.

9.8. For several years, the Commission, aware of these numerous shortcomings, has been developing a new accounting framework which complies with the principles of accruals-based accounting. Nevertheless, the new Financial Regulation ⁽⁴⁾ states that the reformed accounting system will only gradually be brought in and that it will not be fully operational until the financial year 2005. A draft action plan was submitted in June 2001 ⁽⁵⁾. The steps set out in it should enable a solution to be found for the main deficiencies which the Court has been highlighting for several years. By the end of May 2002, no start had been made on implementing this action plan, which has remained at the draft stage. The deadline for adopting the new Financial

will be launched as a matter of urgency. The Commission is strongly committed to the modernisation of the accounting system. By the end of 2002 the Commission will take a decision on the options for development, the proposed calendar for implementation and the projected costs and allocation of resources.

Furthermore, given that the new Financial Regulation requires the production of accrual accounts by 2005, urgent and wide-ranging action is necessary to ensure that the Commission has the necessary rules and procedures in place.

A new accounting framework is necessary to enable the Commission both to meet the requirements of the new Financial Regulation and to conform with current best practice. The framework must change on several fronts:

- *evolution towards an integrated system of accounting which contains all the information necessary for drawing up the accounts and from which all accounting data are drawn directly,*
- *respect of generally accepted accounting principles; the Commission now fully complies with the cash-based accounting standards, which have constituted the traditional accounting standards used by the public sector. The new accounting framework has to conform with generally accepted accounting principles for the production of accrual-based accounts,*
- *improvement of the financial statements so that they give an accurate picture of assets and liabilities, the financial situation, budget implementation, the entity's outturn and the cash flow for the year.*

The reform of accounting is a major exercise and will require considerable time, effort, expertise and financial resources to put in place. The aim is for the detailed development of both the accounting framework and the system to be launched in 2003 with the relevant testing and implementation phases beginning in 2004. In particular, the question of implementing accrual accounting principles will be examined in detail to identify the accounting treatment of each type of transaction for each different service or activity.

⁽³⁾ See the Annual accounts of the European Communities, Volume IV, p. 5, 'Development of the European Communities' accounting system' and the reservation in the declaration accompanying the Budget DG's annual report.

⁽⁴⁾ See Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1).

⁽⁵⁾ See the Annual Report concerning the financial year 2000, paragraph 9.32.

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Regulation is no justification for these delays in implementation. In short, the provisions of the Financial Regulation will not be sufficient, in themselves, to make up for the present shortcomings in the accounting system and a good many practical measures need to be taken.

Scope of consolidation

9.9. The Commission has stated its intention of adjusting the scope of consolidation to bring it into line with international standards⁽⁶⁾. For 2001, this scope excluded, in particular, the European Agency for Reconstruction and the European Training Foundation, which both implement the Commission's aid programmes in the field of external action. Excluding these bodies affects the picture that is given of the consolidated financial position. If the Agency had been consolidated, the 105 million euro shown under 'Sundry debtors' would have appeared under 'Cash'.

Observations concerning the consolidated statements on the implementation of the budget

The making available of own resources

9.10. The Court cannot express an opinion on a sum of around 1 230 million euro representing import duties collected in Germany in 2001 under the deferred-payment system (see paragraph 1.35). The fact is that shortcomings in the computer system and the internal control procedures, plus the lack of an audit trail, meant that the Court was unable to obtain assurance that all the own resources had been correctly made available to the Commission (see paragraph 1.24).

The move towards accrual accounting will be supported by a parallel development in the functionality of the computerised accounting system. Several options have to be considered. Whatever the solution adopted, it is clear that the objective should be to ensure the reliability and quality of financial data as well as their security from unauthorised access or intervention.

On a regular basis, the Commission will inform the discharge authority and the European Court of Auditors of the progress made in this exercise.

9.9. THE COMMISSION'S REPLIES

The new Financial Regulation adopted in June 2002 requires that Commission extend its scope of consolidation to include the agencies.

9.10. THE COMMISSION'S REPLIES

In its replies to the report paragraphs cited by the Court the Commission undertakes to examine, as part of its inspection programme for 2003, the new computerised system now introduced by Germany. The results of this inspection will be used to further examine the credibility of the own resources information provided previously and, where appropriate, financial corrections may follow.

⁽⁶⁾ Annual accounts of the European Communities, financial year 2001, Volume IV (SEC(2002) 406-EN), p. 6.

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Negative expenditure (revenue)

9.11. For the financial year 2001, negative expenditure for agriculture amounted to 2 804 million euro (3 798 million euro in 2000 ⁽⁷⁾ and 3 058 in 1999 ⁽⁷⁾). The Court considers, as already stated in its Opinion No 1/2001 ⁽⁸⁾, that the agricultural revenue shown in the budget as negative expenditure should be entered in the general statement of revenue.

Expenditure (commitments and payments)

Agricultural expenditure

9.12. At the closure of each financial year, the Commission applies an additional depreciation of agricultural stocks on the basis of the estimated prices of their disposal on the market, assessed on the date of the stock inventory (30 September ⁽⁹⁾). As the Court has already pointed out in its report concerning the financial year 1999 ⁽¹⁰⁾, this second depreciation is groundless. At 31 December 2001, the Commission estimates, in the off-balance-sheet commitments, that the provision for depreciation paid to the Member States was overstated by 148,72 million euro.

9.11. THE COMMISSION'S REPLIES

The current regulatory framework for negative agricultural expenditure does not allow this revenue to be treated as miscellaneous revenue (see in particular Article 102(4) and 102(5) of the 1977 Financial Regulation).

The new Financial Regulation adopted by the Council on 25 June 2002, which comes into force on 1 January 2003, maintains negative agricultural expenditure until 31 December 2006.

9.12. THE COMMISSION'S REPLIES

As the Court of Auditors points out, the additional depreciation of agricultural stocks is based on the estimated prices of their disposal on the market.

This estimate, which is carried out by the Commission in September, takes account of all the relevant data on the agricultural markets available at the time.

On the other hand, the closing figures at 31 December 2001 include the market forecasts available in February 2002, so there is actually a six-month gap between the two selling price estimates.

During this period, there may be considerable fluctuations in the expected selling price for some products (for example, cereals and milk products) depending on events in the world markets, which are rarely stable.

These are the same reference prices that the Commission uses for the sake of transparency when drawing up the letter of amendment to the preliminary draft budget.

⁽⁷⁾ See:

- the Annual Report concerning the financial year 2000, paragraph 2.12,
- the Annual Report concerning the financial year 1999, paragraph 2.10.

⁽⁸⁾ Opinion No 1/2001, paragraph 29 (OJ C 55, 21.2.2001).

⁽⁹⁾ Article 8 of Council Regulation (EEC) No 1883/78, which serves as the basis for the Community depreciation of stocks in public intervention, stipulates in paragraph 2 that the depreciation must correspond at the most to the difference between the purchase price and the estimated disposal price. The depreciation can be divided up into depreciation upon purchase (first depreciation) and additional depreciation.

⁽¹⁰⁾ Annual Report concerning the financial year 1999, paragraph 8.9.

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Structural operations

9.13. In its Annual Report concerning the financial year 2000 ⁽¹¹⁾, the Court pointed out that, in the area of structural operations, decisions concerning the 2000 to 2006 programmes were not recorded under budgetary commitments (1 034 million euro corresponding to the 2000 tranche of 16 programmes). These commitments were entered in the accounts in 2001 and charged against the appropriations carried over. In the same way, decisions taken in December 2001 covering a total of 8,2 million euro are to be found under the off-balance-sheet commitments since they were not entered in the accounts under the commitments for the financial year 2001.

9.14. In conformity with the regulations, the commitments in the area of structural operations show only the annual tranches which have fallen due or are being implemented. The legal commitments for subsequent annual tranches (approximately 170 200 million euro for structural operations and 1 830 million euro for ISPA) are shown under the off-balance-sheet commitments. For all other areas of expenditure, the regulations make no provision for any distinction between legal commitments and budgetary commitments. These differences in the methods used for entering commitments in the accounts, which, moreover, are not clearly indicated in the explanatory notes to the financial statements concerning the implementation of the budget, undermine the consistency of the financial statements. As pointed out in the Court's Opinion No 2/2001 on the recasting of the Financial Regulation ⁽¹²⁾, the provision whereby commitments may be broken down into annual instalments (tranches) is incompatible with the definition of differentiated appropriations in the context of multiannual measures and does not allow all the expenditure decisions that have actually been taken to be fully recorded.

9.13. THE COMMISSION'S REPLIES

The Court states that legal commitments were entered into without the corresponding budgetary commitments being made. This results from different practices in the adoption procedures for programmes.

In these circumstances, it is to be expected that commitments not yet entered in the accounts should be shown in the off-balance-sheet commitments.

When legal commitments were not covered by budgetary commitments at the end of the financial year, the only alternative to carrying over appropriations would have been to leave the legal commitments not covered by budgetary commitments — which would have been unacceptable — or to carry out a revision of the financial perspective.

9.14. THE COMMISSION'S REPLIES

The new Financial Regulation explicitly provides for the system of commitments by instalments (tranches).

The Commission considers that the system is very useful for promoting better financial and budgetary management of multiannual measures for significant amounts which may require adjustments during implementation, such as the Structural Funds programmes or Cohesion Fund and ISPA projects.

⁽¹¹⁾ Annual Report concerning the financial year 2000, paragraphs 3.28 and 9.16.

⁽¹²⁾ Opinion No 2/2001 on a proposal for a Council Regulation on the Financial Regulation applicable to the general budget of the European Communities, paragraphs 6, 29 and 30 (OJ C 162, 5.6.2001).

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External action

9.15. In the case of the international agreements in the fisheries sector, the legal commitments exceeded the appropriations available for 2001 by 610 million euro. Likewise, for the other external actions, the legal commitments exceeded the appropriations available by 239 million euro. These amounts are shown under the off-balance-sheet commitments.

9.16. Legal commitments relating to the financial protocols with Mediterranean third countries totalled 159 million euro ⁽¹³⁾. Some of these protocols were concluded more than 20 years ago ⁽¹⁴⁾ and commitment appropriations are no longer allocated to the budget headings concerned. This being the case, the Commission should initiate the negotiation procedure for winding up these protocols and also the accounting commitments still in abeyance.

9.15. THE COMMISSION'S REPLIES

The international agreements in the fisheries sector and certain agreements in the field of external relations are legal frameworks which run over several years but define on a yearly basis the obligations of each of the parties (Community — non-member countries). The financial obligation of the Community is clearly broken down into annual instalments in the basic text (financial protocol). For this reason, in a given financial year, the Commission only makes the commitments for the relevant instalment.

As the Commission is aware of the Court's repeated observations and wishes to act in all openness, the Commission has been including in the off-balance-sheet commitments since 1997 all amounts for which commitments have not yet been made in respect of legal obligations under existing agreements.

The new Financial Regulation provides, both under Title I 'General provisions' and Title II 'Implementation of the budget' for the possibility of annual instalments for commitments where the action extends over several financial years, as long as the basic instrument provides for this, as it does in the case of the international fisheries agreements

9.16. THE COMMISSION'S REPLIES

The EUR 159 million referred to by the Court is the difference between the total amount for all the protocols (EUR 2 112 million) and the amount for budgetary commitments made since 1978 (EUR 1 953 million).

Only payment appropriations to cover outstanding commitments are entered under the budget headings for these protocols. Projects funded under the latter are being wound up satisfactorily each year and the pace was stepped up considerably in 2001 (27 projects wound up with a total value of EUR 31 million).

⁽¹³⁾ Chapter B7-4 0.

⁽¹⁴⁾ Commitments for the 1970s and 1980s.

THE COURT'S OBSERVATIONS

Observations concerning items on the consolidated balance sheet

9.17. The total of the consolidated balance sheet for the financial year 2001 shows an increase of 76 % compared with the total for the previous financial year. This increase is mainly due to a change in the accounting policy applied by the Commission in respect of pension rights. This change in method comes in the wake of an observation by the Court ⁽¹⁵⁾, asking for the annual liability representing the rights acquired during the financial year to be deducted from the economic result. However, the Commission does not record this expenditure, as it has entered the total amount of the potential debt for pensions in the financial statements for a single financial year and, in compensation, has entered revenue for the same amount, thus neutralising the impact on the economic result. In so doing, it is not complying with the Court's request. At the time, moreover, the Commission considered that a thorough accounting analysis ⁽¹⁶⁾ was required. The Court is consequently of the opinion that it would be useful for the Commission to continue its analysis of the way in which the pensions scheme is treated in the accounts, bearing in mind the Community context.

Fixed assets

9.18. With regard to tangible assets, the Commission stressed in its reply to an observation in the Court's report concerning the financial year 2000 ⁽¹⁷⁾ that the accounting and consolidation manual was 'designed to establish a uniform set of rules for accounting and presenting the accounts of the European institutions'. An examination of the accounts at the end of the financial year 2001 showed several instances where failings pointed out in the past were still occurring in spite of the improvements that were found.

9.17. THE COMMISSION'S REPLIES

For several years now, the Commission has been supplying detailed information on pension rights in the Annex to the annual accounts (in the off-balance-sheet commitments). A major step forward was made in the 2001 accounts, when the provisions for pension rights were entered for the first time as liabilities in the accounts, although no IPSAS ⁽¹⁾ rule has been introduced to date.

The Commission feels that the method used is correct, but is nevertheless willing to discuss with the Court the best method of entering pension rights in the financial statements. As indicated in the comments on the balance sheet, the Commission entered in the budget an allocation for pension rights equivalent to the estimated amount of the rights accrued by staff until 31 December 2001 (EUR 15,3 billion) via the result of the adjustments.

At the same time, it also established a debt payable by the Member States using the result of the adjustments, since the Member States are collectively liable for paying these sums. Moreover, the surplus of contributions over expenditure for the year is reimbursed annually to the Member States.

As part of the reform, the Commission has made several proposals concerning the pension scheme, including the carrying out of a feasibility study on the possible setting-up of a pensions fund. This study, which is still under way, will estimate the financial impact of such a step and will enable the potential financial impact on the accounts of the institutions to be assessed.

9.18. THE EUROPEAN PARLIAMENT'S REPLIES

Owing to an oversight at the time of preparation of the financial statements, the footnote to the balance sheet omitted to mention that an estimated amount had been used. If the definitive value of the building is not known by the end of 2002, the text of the relevant footnote will include a comment that the cost is estimated. As negotiations relating to the definitive cost of the buildings are ongoing, it is not considered appropriate to disclose in the footnotes to the balance sheet

⁽¹⁵⁾ Annual Report concerning the financial year 2000, paragraph 7.6.

⁽¹⁶⁾ See the Commission's reply to paragraph 7.6 of the Annual Report concerning the financial year 2000.

⁽¹⁷⁾ Annual Report concerning the financial year 2000, paragraph 9.28.

⁽¹⁾ IPSAS: international public sector accounting standards.

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9.19. These shortcomings concern the failure to regularise the differences found between the Council's physical inventory and its records of fixed assets, physical checks on movable property which are still incomplete at the Joint Research Centre for the sites other than Ispra, the lack of physical checks at the Economic and Social Committee and at the Committee of the Regions, where entries include items which have been disposed of (see paragraphs 7.8 and 7.15). For the European Parliament, the notes to the balance sheet fail to indicate either that the value of one of its buildings is being contested or the fact that Commission Regulation (EC) No 2909/2000 has not been applied to calculate the depreciation of special equipment (see paragraph 7.7). All these practices limit the significance of the accounting entries shown on the Communities' consolidated balance sheet.

an amount of contested costs as this may prejudice the European Parliament's position in current negotiations. The exact nature of the special equipment referred to in the Court of Auditors' sector letter is currently the subject of investigation. Detailed information on the breakdown of the assets under this item is being sought from SERS, the current owner of the building. The outcome of these efforts should enable the institution to ascertain whether it is appropriate to continue to apply the depreciation rate of 25 % to the special equipment item, in line with the recommendations of the Court of Auditors and in accordance with Commission Regulation (EC) No 2909/2000.

9.18. THE COMMISSION'S REPLIES

The accounting and consolidation manual and the regulation on the accounting management of the European Communities' non-financial fixed assets have improved the reliability of information on non-financial fixed assets through harmonisation of the rules on valuation and accounting methods, although some discrepancies still remain and will be corrected in the future.

9.18. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

See comments on point 7.15.

9.18. THE COMMITTEE OF THE REGIONS' REPLIES

See comments on point 7.15.

9.19. THE COMMISSION'S REPLIES

- *The Council has decided to give the highest priority to the drawing-up of a physical inventory so as to improve the reliability of the accounts. In view of the size and complexity of the operation and the reconciliation work which is under way, these will continue until the end of 2002, together with the studies on improving inventory management systems and procedures. The supplementary work carried out after the Court's audit has already significantly reduced the discrepancies between the physical inventory and the accounts.*
- *The physical control of assets outside Ispra was indeed not completed in 2001. For other sites (Brussels, Geel, Petten, Karlsruhe and Seville) this control will be completed by the end of 2002.*

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— *The Economic and Social Committee and the Committee of Regions accept the need to ensure that the inventory rules are strictly applied in future. A physical stock-take is now well under way and will be finished before the end of 2002.*

— *The European Parliament admits that it omitted to specify in the explanatory notes to the balance sheet that the value shown for the building in question was an estimate. If the value of the building has not been fixed by 31 December 2002, Parliament will indicate this clearly in the explanatory notes to the 2002 annual accounts.*

As regards the depreciation of special equipment, the current owner of the building is being consulted about the precise nature of these goods. The information obtained will allow the institution to determine whether it is appropriate to continue to apply a depreciation rate of 25 % to this equipment.

Participations and loans granted from the budget

9.20. ECIP (European Community Investment Partners) is a Financial Instrument created during the 1980s to support joint ventures founded by companies established within the Community and companies in developing countries (ACP ⁽¹⁸⁾, Latin America and Asia). The Court considers that the Commission's accounts do not give a true picture of this Instrument's situation for the following reasons:

- (a) participations in the joint ventures (22,9 million euro) have not been evaluated by the Commission, which does not know the real position of each of them;
- (b) the Commission has created a provision of 49 million euro for depreciation of the long-term and short-term loans, but it is unable to explain the gross amount of 67,6 million euro to which this provision, which was entered in the accounts on 31 December 2001, applies.

9.20. THE COMMISSION'S REPLIES

The Commission has made progress in the field of accounting and reporting, although some problems are still to be ironed out.

It should be emphasised that most of the activities of the European Community Investment Partners (ECIP) will be wound up, recovered or converted into a definitive subsidy before the end of 2002. The programme cannot be definitively wound up until the last joint venture has been completed.

The Commission will make a more thorough examination of the status of this instrument and the relevant recovery orders.

⁽¹⁸⁾ African, Caribbean and Pacific States.

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9.21. Recovery orders for a total of 21,3 million euro were issued in 2000 and 2001 but the Commission has no information on the exact position as regards repayments on the loans it has granted. Some of the repayments were collected in 2000 but were not entered in the accounts until 2001. Other recovery orders issued in 2001 were not collected until 2002, and, for the rest of the recovery orders, it is not possible to determine whether they have been collected or not.

9.22. Furthermore, in the field of external action, certain Community programmes and measures provide for the possibility of co-financing or giving support in the form of loans or participations in the capital of companies or Funds. The Commission was not able to provide a complete list of these operations, which should, in principle, be shown in the financial statements.

Amounts receivable

Traditional own resources

9.23. As at 31 December 2001, the total balance on the separate accounts, known as the B accounts (see paragraphs 1.25 and 1.26), after deduction of collection costs ⁽¹⁹⁾, was 2 119,4 million euro. The net figure shown on the Commission's balance sheet is 538 million euro, after application of a value adjustment of 1 581,4 million euro. The fact that the latter exists is an admission that there is doubt about full recovery of many of the amounts receivable entered in the B accounts. Because of the lack of detailed information about the amounts in question, the accuracy of this value adjustment cannot be confirmed.

EAGGF-Guarantee

9.24. A number of certifying bodies have expressed concern as to whether the figures for debtors reported by the paying agencies are complete and accurate. The total value of established debt stood at 2 263 million euro at the end of the financial year 2001. The Commission has created a provision for doubtful debts amounting to 1 641 million euro. This amount is considerably higher than the amount reported by the paying agencies in the Member States.

9.22. THE COMMISSION'S REPLIES

The Commission is drawing up a comprehensive list of these programmes. The questionnaire sent in September 2002 to all departments in connection with the modernisation project also contains a question on this subject.

9.23. THE COMMISSION'S REPLIES

The recovery of amounts entered in the separate account (the 'B' account) is doubtful but not impossible.

Following an observation by the Court of Auditors, the Commission itself determines the amount of the correction, in accordance with the principle of prudence, based on two recovery ratios: a flat-rate ratio based on recovery statistics over the previous five years and a ratio based on an individual analysis of certain current cases.

9.24. THE COMMISSION'S REPLIES

The situation with respect to the completeness and accuracy of debtors is improving each year. The Commission is continuing its efforts to ensure that debtors are properly managed and recovered.

Where the Commission, on the basis of its own enquiries and experience, did not consider that the provisions given by the paying agencies were sufficient it substituted its own judgement. It particularly took account of the accounting concept of prudence.

⁽¹⁹⁾ 10 %, as prescribed by Article 2(3) of Council Decision 94/728/EC, Euratom of 31 October 1994 on the system of the European Communities' own resources.

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External action

9.25. As at 31 December 2001, the total shown in the balance sheet under sundry debtors for the amounts held by financial intermediaries (980 million euro, including 73 million euro of interest) comes from a non-accounting record. The procedure that is followed does not enable the Commission to demonstrate the justification for the sums thus entered in the accounts. Consequently, the declarations by the Directors-General of the Enlargement DG and the EuropeAid Cooperation Office include reservations concerning the reliability of the estimates in their fields which amount to 685 million euro. These uncertainties stem from the lack of an accounting system which would allow the sums paid by the Commission to the financial intermediaries to be monitored in respect of their actual use by the projects and measures concerned. To rectify this situation, the Commission must set up an accounting system of this kind. Furthermore, it should demand certification, by an independent auditor, of the data forwarded at the end of the financial year by the financial intermediaries.

9.26. In March 1999, the Commission was obliged to issue a recovery order for 3,05 million euro to a bank which had failed to implement the payments due to one of the Commission's partners in the field of external aid (Balkan region) in accordance with the provisions. Although the debt existed and was due and payable, the Commission has undertaken no action since that date in respect of the bank, with which the Commission and the Reconstruction Agency continue to do significant business.

Yield on advances and payments on account made to third parties

9.27. The interest yielded by the advances and payments on account is not always notified to the Commission by the financial intermediaries. Where it is notified, it is not always recorded as budgetary revenue. At 31 December 2001, interest on the funds held by the financial intermediaries known at central level (see paragraph 9.25) amounted to 73 million euro, of which

9.25. THE COMMISSION'S REPLIES

As the Court points out, non-accounting records are inherent to the Commission's current accounting system and are necessary for drawing up the annual accounts.

The Commission wishes to highlight the enormous amount of work carried out by the various Directorates-General in order to draw up the list of financial intermediaries. This work will be useful for the changeover to integrated accounting as all the relevant information will already have been collected. From that point onwards, the use of non-accounting records will be minimal as the recently adopted new Financial Regulation requires that prefinancing payments be identified.

The balances received from the national authorities are certified by them, and as such are reasonably reliable. Nevertheless the Commission will consider whether controls in this area can be strengthened.

9.26. THE COMMISSION'S REPLIES

As the Court points out, several payments by the Commission to an NGO operating in the field of external aid did not reach their intended recipient. At the time, the Commission issued a recovery order against the bank which had received instructions to carry out the payment. The bank contested the Commission's position. As the funds were not recovered, the Commission has since been trying to gather information on the spot (in Bosnia) to establish where the responsibility lies (NGO/bank). As a result of the Court's observations, the Commission has restarted action against the bank and will follow it up with the appropriate measures.

9.27. THE COMMISSION'S REPLIES

The Commission will ensure that such interest is entered in the accounts on a regular basis and will regularise the past situation.

The new Financial Regulation requires that estimates of amounts receivable be drawn up when prefinancing payments

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only 28 million euro were recorded as budgetary revenue. When the sums received in this way are allocated to measures or programmes, they are not automatically recorded as budgetary expenditure. It follows from this that the accounts do not reflect the whole of the Community contribution.

Disposable assets

Imprest accounts under the Mediterranean protocols

9.28. The total on the imprest accounts held with banks in respect of the financial protocols with Mediterranean third countries (21,4 million euro as at 31 December 2001) is overestimated by 11,2 million-euro because expenditure carried out before 31 December 2001 was not entered in the accounts.

Bank accounts

9.29. In 2000, the Commission opened three bank accounts with the Central Bank of Jordan. These accounts were intended to meet the needs of three MEDA programmes. The funds paid into these accounts were regarded as expenditure by the authorising department concerned at the Commission. On 31 December 2001, the deposits on these accounts totalled 639 927 euro. Apart from the fact that these amounts had been classed, in advance, as the equivalent of budgetary expenditure, they were not shown under disposable assets on the Commission's balance sheet as the accounting officer was not aware the accounts had been opened. Such practices are contrary to the most elementary principles of internal control and the Commission should forbid them from being used by its authorising officers by sub-delegation.

are made and that interest yielded by funds which remain the property of the European Communities be entered in the budget as miscellaneous revenue.

This new provision will ensure that the interest yielded by Community funds is accounted for more rigorously from 1 January 2003.

Furthermore, the Commission will spell out in the new implementing rules for the new Financial regulation, which will be applicable as from 1 January 2003, that interest arising from prefinancing of actions under the preaccession Instruments is not to be considered the property of the Commission.

9.28. THE COMMISSION'S REPLIES

The overestimate of EUR 11,2 million relates to the regularisation operations still to be carried out at 31 December 2001. Most of this amount concerns countries involved in the first wave of devolution. As devolution started at the beginning of January 2002, priority was given to the payments to be made (follow-up of payment deadlines), with regularisation taking second place. This state of affairs has since been rectified.

In any event, with the exception of EUR 0,3 million, the situation referred to by the Court was regularised at the beginning of September 2002. The Commission will see that most of the expenditure incurred during the year in question is regularised.

9.29. THE COMMISSION'S REPLIES

The Commission will take all the necessary steps to ensure the correct implementation of the Financial Regulation so that this situation does not occur again.

The funds paid into these accounts were regarded as expenditure since they were to be transferred to recipients.

THE COURT'S OBSERVATIONS

Provisions for risks and liabilities

9.30. A provision for liabilities of 15 300 million euro was entered in the consolidated balance sheet as at 31 December 2001 ⁽²⁰⁾ in respect of pensions to be paid to staff of the Community institutions. This amount is based on an actuarial study made in 1997. In his report the actuary recommended, at the time, that complete re-evaluations of the liability should be carried out at regular intervals in view of the scale of the amounts involved. Since 1997, the Commission's departments have re-evaluated the liability themselves using a simplified model. In the absence of a recent, comprehensive actuarial evaluation, the reliability of the amount entered cannot be verified (see paragraph 9.17).

9.31. A provision of 564 million euro for risks and liabilities was entered in the consolidated balance sheet as at 31 December 2001 to cover the cost of dismantling the JRC's installations, the activities of which have ceased (374 million euro) or are still in progress (190 million euro). Apart from the fact that the cost of deploying the JRC's own staff (estimated at between 75 and 100 million euro) was not included in this provision, the amount of the provision is the result of an internal evaluation by the JRC. Until the technical evaluation on which it is based has been the subject of an independent examination involving consultation of the parties involved, its probative value will remain limited.

Off-balance-sheet commitments

9.32. Commitments against differentiated appropriations still outstanding at 31 December 2001 totalled 86 760 million euro. Of these, commitments still outstanding for more than two years accounted for 28 840 million euro, of which 9 790 million euro had not been the subject of any payment during the last two years. Of the latter amount, the Court considers that some 1 318,2 million euro (13 %) no longer represent an obligation to make payments.

9.30. THE COMMISSION'S REPLIES

For the calculation of pension rights, the Commission employs an expert to carry out a full actuarial study every five years. The next one is scheduled for 2003. Besides this five-yearly analysis, the figures are adjusted every year, using the method suggested by the expert, on the basis of changes in rates.

9.31. THE COMMISSION'S REPLIES

The Commission took a first step by entering in the 2001 budget a provision for risks and liabilities to cover the dismantling of the entire JRC installations, based on a study carried out by the Commission.

A contract will be placed with an external evaluator. It is hoped that the first draft report of the evaluation will be available by the end of January 2003.

⁽²⁰⁾ The long-term assets include an identical amount on the assets side of the balance sheet in order to establish the fact that in reality the liability has to be borne by the Member States.

THE COURT'S OBSERVATIONS

9.33. The action plan to eliminate abnormal outstanding commitments, solely for the budget headings identified in the Annex to the Joint Declaration ⁽²¹⁾ (estimated at 3 500 million euro as at 31 December 2001 out of a total of 11 600 million euro in potentially abnormal commitments), only led to the Commission's decommitting approximately 97 million euro (of a total examined of about 1 000 million euro) in the course of the first four months of the financial year 2002.

9.34. With regard to the ERDF, the EAGGF Guidance, the FIFG and the ESF, the Court again found that the commitments outstanding for the period 1994 to 1999 and the previous periods no longer had any grounds for existence because they concerned:

- (a) files which had already been closed and for which the unused balance had not been decommitted;
- (b) cases in which closure had not been carried out but where it had been established that a part of the commitment was no longer necessary, in particular where claims for payment were less than the remainder to be settled;
- (c) measures decided before 1994 for which there had been no claim for final payment by 31 March 2001 and for which automatic decommitments should have been made on 30 September 2001, in accordance with the provisions of Regulation (EC) No 1260/1999, for 11 % of the 5 32,5 million euro in commitments which were still open at 31 December, i.e. 56,1 million euro (see paragraphs 3.53 to 3.55);
- (d) measures for which closure was suspended because of legal proceedings in respect of that part for which a partial closure could have been made.

9.33. THE COMMISSION'S REPLIES

For the budget headings identified in the Declaration, the EUR 97 million in decommitments reflect only part of the effort made by the Commission to review the outstanding commitments under these lines. During the period mentioned by the Court, the Commission paid some EUR 147 million against these outstanding commitments; a further EUR 745 million in commitments was examined, but the Commission services considered that they should remain open for various reasons – contract still valid, awaiting final report, legal dispute ongoing, etc. At the end of April 2002, the Commission had reviewed one quarter of all the commitments to be examined. The report also shows that the rate of examination is planned to accelerate by the end of 2002. The action plan aims at examining all potentially abnormal RAL by the end of 2003.

9.34. THE COMMISSION'S REPLIES

For general points, please see the answers to points 3.27 to 3.29, 3.53 and 3.55.

- (a) *The specific cases highlighted by the Court will be regularised as soon as possible.*
- (b) *The Commission tries to adjust systematically the amount of outstanding commitments to the maximum amount of payments it might be asked to make. It would point out, however, that most of the cases from before 1994 are the subject of litigation or legal proceedings which would not allow the decommitments desired by the Court to be carried out with certainty.*
- (c) *As regards this point, please see the Commission's reply to point 3.55.*
- (d) *The Commission does not adjust systematically the amount of outstanding commitments as individual files are closed because of the administrative costs that would be involved.*

⁽²¹⁾ Joint Declaration of the Parliament, the Council and the Commission of 20 November 2001 on an action plan to eliminate abnormal outstanding commitments.

THE COURT'S OBSERVATIONS

9.35. A financial risk concerning a lease was neither shown under the off-balance-sheet commitments nor mentioned in the explanatory notes to the balance sheet (see paragraph 7.11).

Legality and regularity of the underlying transactions

9.36. One of the features of the way the general budget of the European Union is implemented is the coexistence of several types of management which are very different in nature. They range from the centralised management of the Commission authorising officers to the large number of local beneficiaries who are very scattered geographically and in terms of their function. Between the two are several types of national or regional decentralised management. In the areas of agricultural policy and structural operations, which accounted for 80 % of the budget in 2001 (payments), the Community measures are managed, on the ground, by national and regional authorities and bodies. In the areas of internal policies and external action (14 % ⁽²²⁾), the Commission manages the funds directly, making use of the services of numerous intermediaries in Europe and elsewhere in the world. Lastly, the Community institutions all manage their own administrative expenditure (6 %) directly.

Own resources

9.37. For own resources, bearing in mind the restrictions on the audit scope (see paragraphs 1.23, 1.24 and 1.37), the Court, as for the previous financial years, considers the transactions underlying the revenue that has been collected to be legal and regular. Nevertheless, where traditional resources are concerned, the Member States should improve their national instructions in respect of the control regime for customs warehouses. As regards the VAT and GNP balances, the Commission should present the actual data in the revenue and expenditure account. Furthermore, for the correction in favour of the United Kingdom, the Commission should provide the essential information concerning the basic data and the calculation operations (see paragraphs 1.19, 1.20 and 1.38 to 1.40).

9.35. THE COMMISSION'S REPLIES

Negotiations with the owner are still under way. If the situation is not resolved by the end of 2002, the Commission will show this financial risk in the annual accounts.

9.37. THE COMMISSION'S REPLIES

In its replies to Chapter 1 of this report the Commission outlined its activities under the Customs 2002 project which should help Member States to make the improvements recommended by the Court. The Commission also indicated its intention to make the changes recommended for VAT/GNP in the next presentation of the accounts and to look for an opportunity to include more data on the UK correction in the accounting tables.

⁽²²⁾ Including preaccession aid (2 %).

THE COURT'S OBSERVATIONS

Common agricultural policy

9.38. The observations set out in Chapter 2 show that errors exist in the declarations made by the farmers and other aid recipients. The monitoring systems bring to light and rectify many errors. However, they still allow a significant level of error to persist in the legality and regularity of the underlying transactions. A comparison between the audit findings of the Court and those of the IACS inspection reports supplied by the Member States indicates that the latter tend to underestimate the overall rate of error found (see paragraph 2.19). The fact is that the consolidated summaries of the IACS inspection reports, although constituting an important information tool, do not distinguish between the results of checks based on risks and results arising from random checks (see paragraph 2.44). Furthermore, verifying the veracity of the facts declared by the aid recipients in their payment claims is excluded from the tasks of the certifying bodies (see paragraph 2.54).

Structural operations

9.39. The examination of the transactions showed that, for the part of the management process taking place outside the Commission, the latter did not yet have sufficiently relevant and exact overall information to assess the legality and regularity of the transactions in the Member States.

9.38. THE COMMISSION'S REPLIES

The current regulations require the certifying bodies to check that the accounts are complete and correct and check the internal control system. This is an integral part of the reform of the system of clearance of accounts which was, in fact, welcomed by the Court (see Special Report No 22/2000). Verification of the accuracy of the facts declared by the beneficiaries in their requests for payment is expressly excluded from the tasks of these bodies.

The Member States are required as laid down in Article 17(3) of Regulation (EEC) No 3887/92 and Article 52 of Regulation (EC) No 2419/2001 to send to the Commission no later than 31 March (for arable crops) and 31 August (for animal premiums) each year a report covering the previous calendar year. For this purpose the Commission services have produced questionnaires in which, for the arable crops sector, Member States are required to report separately the results of cases selected on a risk and random basis. For animal premiums, although Member States are not required to distinguish between random and risk-based checks, this has indeed been examined regularly, as appropriate in the context of audits. In respect of both sectors, the aim is to ensure that the selection of farmers for on-the-spot checks is representative as provided by Regulation (EEC) No 3887/92.

Furthermore, Article 19(1) of Regulation (EC) No 2419/2001, applicable as from 1 January 2002, provides that Member States 'shall select randomly between 20 % and 25 % of the minimum number of farmers to be subject to on-the-spot checks'. This regulatory requirement will further ensure the achieving of properly based audit conclusions.

9.39. THE COMMISSION'S REPLIES

Given the decentralised management of the Structural Funds by the Member States, the Commission seeks to ensure that the systems in place generate sufficient information to provide it with reasonable assurance as to the eligibility of the expenditure declared.

In the closure of 1994 to 1999 programmes the basis for the assurance of the legality and regularity of the operations co-financed will be the closure statements submitted, which the Commission services will check carefully. For the 2000 to 2006 period, as well as closure declarations and the findings of the audit work required under Regulation (EC) No 438/2001, the Commission will have the assurance provided by expenditure declarations certified by the paying authority.

THE COURT'S OBSERVATIONS

9.40. The examination of the transactions at Commission level also showed that errors which do not have any direct impact on the budget frequently occur. These include delays concerning payments ⁽²³⁾ and delays concerning the approval of programmes.

9.41. The observations in Chapter 3 indicate that errors still persist in the expenditure declarations submitted by the Member States in respect of interim payments relating to the period 1994 to 1999 (see paragraph 3.59 to 3.61), closures of the period 1994 to 1996 for Objective 2 (see paragraph 3.64) and, lastly, interim payments relating to the new programming period 2000 to 2006 (see paragraph 3.76). For the latter, ineligible expenditure similar to that of the previous periods was found, despite the management and control arrangements specified in the regulations having been strengthened (see paragraph 9.91).

Internal policies

9.42. The examination of the transactions showed that it was only in a limited number of cases that the Commission had sufficient data to assess the legality and regularity of the underlying transactions.

9.40. THE COMMISSION'S REPLIES

Some of the delays concerning payments noted by the Court were due to objective circumstances. However, in order to observe the time limits set by the rules, steps have been taken to improve the administrative structure in charge of payments in 2002.

The delays in the approval of programmes were mainly due to the tighter requirements imposed to ensure compliance with the Community rules or to improve the quality of operations. As a result decisions tended to take longer than the five months stipulated in Article 28(1) of Regulation (EC) No 1260/1999. However, there the time limit is qualified by the proviso that 'all the requirements of this Regulation are fulfilled'.

9.41. THE COMMISSION'S REPLIES

The Commission will ensure that the errors detected by the Court, which the Commission acknowledges, are corrected as swiftly as possible.

9.42. THE COMMISSION'S REPLIES

With regard to the evaluation of the legality and regularity of the underlying transactions, the Commission makes a distinction between the controls at the Commission level and at the final beneficiary level. At the Commission level, for example, within the Research area, a comprehensive set of procedures, both financial and operational are in place, supervision arrangements such as checklists, reporting, etc. are used extensively and control mechanisms are applied rigorously for the assessment of the underlying transactions. Audits of beneficiaries to assess the legality and regularity of the underlying transactions have increased and will continue to do so.

⁽²³⁾ Despite the fact that the White Paper on reforming the Commission provides for a specific action in this area.

THE COURT'S OBSERVATIONS

9.43. The observations in Chapter 4 relating to indirect measures under the fifth framework programme for research and technological development (42 % of internal policies) highlight the persistence of errors in the declarations of costs submitted by the contractors (see paragraphs 4.41 and 4.44). The *a posteriori* checks carried out by external auditors under the fourth framework programme confirm this conclusion (see paragraph 4.59). For the TEN-T programme (8 % of internal policies) the transactions underlying the payments were legal and regular, except as regards the studies (see paragraphs 4.27 and 4.29).

9.44. Although the White Paper makes provision for a specific action in this respect, at Commission level a significant number of payments are made late.

External action

9.45. The examination of the transactions showed that, for the part of the management process that takes place outside the Commission, the latter did not always have sufficient data to assess the legality and regularity of the underlying transactions.

9.46. The observations in Chapter 5 on humanitarian aid and food aid (25 % of the area, see paragraph 5.14) highlight the existence of errors at local level and of problems with the application of control procedures by the implementing partners (intermediaries) who are called upon to manage the aid (see paragraphs 5.50 to 5.52).

9.43. THE COMMISSION'S REPLIES

The Commission agrees that errors in the cost statements continue to be an important issue, even if the new audit strategy implemented since 2000 does not yet make it possible to measure the changes in the situation. The Commission will continue to reinforce its efforts to reduce such errors, both in the implementation of the fifth framework programme and with a view to the sixth framework programme (see replies to points 4.47 to 4.50).

With regard to the TEN-T studies, the problems identified by the Court concern a difference in interpretation of the definition of eligible costs. The Commission is committed to improving the clarity of the definitions in order to avoid this type of disagreement in future (see point 4.29).

9.44. THE COMMISSION'S REPLIES

The Commission agrees that the payment time objectives are not always reached yet. However, in order to improve the situation the Commission has put in place an initiative, which includes detailed monitoring and reporting of payment times.

A major improvement in terms of reducing the time to payment should emanate from the audit certificates accompanying the cost statements, currently in a pilot phase but expected to be widely used in the sixth framework programme.

9.45. THE COMMISSION'S REPLIES

The Commission accepts that certain issues still need attention and is already taking the necessary measures. See also replies to points 5.50 to 5.52.

9.46. THE COMMISSION'S REPLIES

The Commission has already taken the necessary measures to tighten procedural and accounting checks on the various projects, in particular with NGOs. This policy is now applied systematically for all new contracts awarded or calls for proposals.

In respect of humanitarian aid, the Commission takes note of the Court's conclusion and will review the cases cited. It considers that the measures undertaken in the context of the reform of financial management will address the problems identified (see also replies to points 5.50 to 5.52).

THE COURT'S OBSERVATIONS

Administrative expenditure

9.47. As regards administrative expenditure, in addition to an audit based, *inter alia*, on an overall survey of the entire general budget, a specific examination was made of the salaries paid by the Commission and the European Parliament, which account for about 38 % of payments in this area. The evaluation of the internal control system and the results of the substantive tests did not reveal any difficulties concerning the legality and regularity of the transactions underlying the payments (see Chapter 7).

Reform of the Commission's internal control system

9.48. In January 2000, the European Parliament⁽²⁴⁾ invited the Commission to undertake a reform of its management. Accordingly, on 5 April 2000, the Commission presented its White Paper 'Reforming the Commission'⁽²⁵⁾, one of the main strategies of which is a reorganisation of the internal audit, management and financial control. This was the aspect on which the Court focused its enquiries in the context of the SOA for the financial year 2001. As regards the financial year 2001, however, the reform could not yet have any impact on the Court's audit approach because its implementation was too recent (see paragraph 9.70).

Main aspects of the reform

9.49. Chapter V of the White Paper entitled 'Audit, financial management and control' sets out the new arrangements for internal control. In particular, it provides for:

- (a) the creation of a Central Financial Service (CFS) under the Budget Directorate-General;
- (b) the setting-up of an Internal Audit Service (IAS) under the responsibility of the Vice-President for Reform and backed up by an Audit Progress Board (APB);
- (c) the setting-up of internal audit structures (audit capabilities) in each Directorate-General;
- (d) the Financial Controller's *ex ante* approval to be retained provisionally, pending a revision of the Financial Regulation.

⁽²⁴⁾ Resolution of 19 January 2000.

⁽²⁵⁾ COM(2000) 200 final of 5.4.2000.

THE COURT'S OBSERVATIONS

9.50. The reform undertaken by the Commission is a thorough one and is based on the COSO ⁽²⁶⁾ objectives. It should bear fruit in the years to come. The keystone of this reform is the principle of the responsibility of the Commission Directors-General. The latter must henceforth put in place effective internal control systems which meet minimum standards defined by the CFS.

9.51. Under action 82 of the White Paper, each Director-General is required to publish an annual activity report (AAR) and sign a declaration confirming, amongst other things, that the internal control procedures applied by his/her departments give him/her adequate assurance as to the legality and regularity of the underlying operations.

Matters concerning some of the procedures of the reform

9.52. At this stage, three aspects could usefully be altered to some extent in order to make the whole process more coherent in practical terms.

Timetable for the submission of declarations and reports

9.53. The declarations of the Directors-General and the Commission's summary report are spontaneous expressions of opinion ⁽²⁷⁾ which the external auditor (the Court) cannot disregard in the context of its Statement of Assurance. However, the dates set by the Commission for submitting these declarations are incompatible with the timetable for the Annual Report laid down by the Financial Regulation. The reports of the Directors-General are the basis for the synthesis report which the Commission sends to the European Parliament, the Council and the Court (see paragraphs 9.94 to 9.100) at the end of July, despite the fact that, according to Article 88(1) of the Financial Regulation, the Court is required to send the observations likely to be included in its Annual Report to the Commission by 15 July at the latest ⁽²⁸⁾.

9.53-9.54. THE COMMISSION'S REPLIES

The Commission acknowledges that in the first year of annual reports and declarations it was impossible to keep to the timetable initially laid down in the Charter for authorising officers by delegation (communication of 27 June 2001). Under action 10 of the synthesis report ⁽²⁾ the Commission intends to examine the methodology and guidelines for the coming financial year and will, on that occasion, take the first step towards establishing the timetable.

⁽²⁶⁾ Coso is a voluntary private-sector organisation dedicated to improving the quality of financial reporting through business ethics, effective internal controls and corporate governance.

⁽²⁷⁾ Management representations.

⁽²⁸⁾ Article 88a of the Financial Regulation, in conjunction with Article 88 thereof, stipulates that the Court must present the SOA to the European Parliament and the Council at the same time as the Annual Report (by 30 November at the latest). For practical reasons, since 1994 the SOA has formed an integral part of the Annual Report.

⁽²⁾ Action 10: The Secretariat-General, in collaboration with the Budget DG, the Personnel and administration DG and the Internal audit service, will review and enhance before end of 2002 the methodology and guidance for producing the Annual Reports for 2002, paying particular attention to the question of materiality, the definition of the scope of potential reservations to be included in the accompanying declarations, and the handling of cross delegations.

THE COURT'S OBSERVATIONS

9.54. This timetable therefore does not enable the Court to make a detailed examination under proper conditions of the declarations and reports submitted both by the authorising officers and by the Commission itself. The deadline set by the Charter for authorising officers by delegation for the submission of annual reports (15 March) would be much more suitable. The alterations to the timetable provided for by the new Financial Regulation make it even more necessary for the Commission to review the deadlines for the submission of the declarations and annual reports by its departments.

The Audit Progress Board

9.55. The APB examines the reports of the IAS and must monitor the implementation of its recommendations. It is the guarantor of the IAS' independence and is made up of five members, four of whom are Members of the Commission. The external member was appointed by the Commission on a proposal from the other four members of the APB.

9.56. The APB is chaired by the Commissioner responsible for the budget, which runs contrary to the usual rules forbidding the chairman of an audit board from playing a role, in the organisation, that is likely to give rise to a confusion of interests.

Taking into account of the systems of the Member States and the third countries

9.57. The European Union's budget is implemented largely on a decentralised basis, depending on the case (see paragraph 9.36).

9.56. THE COMMISSION'S REPLIES

The responsibilities of the Audit Progress Committee are not the same as those of an 'audit committee' in the public or private sector. In the start-up phase the Committee's primary focus has been on the work of the Internal audit service, particularly to ensure that the service's reports receive adequate follow-up by the auditees. For instance, the Committee does not have a role in examining the financial statements of the Commission, a role which a 'traditional' audit committee in the private sector would have.

The chairmanship and the vice-chairmanship of the Committee was decided explicitly by the Commission to be attributed to the Commissioner for the Budget and the Commissioner for Reform, as these two, by virtue of their portfolios, have the strongest interests in improving financial management performance. In cases where an audit covers a Directorate-General under the direct responsibility of a member of the Committee, the member does not chair the point.

THE COURT'S OBSERVATIONS

9.58. Splitting up the implementation of the budget makes the control of the legality and regularity of the underlying transactions a complicated matter. The Commission, which, under Article 274 of the EC Treaty, is responsible for implementing the budget, is in fact dependent on the good cooperation of the third parties on whom it calls.

9.59. Even though the White Paper points out that, given 'the size and complexity of its financial operations, the Commission needs an assurance that financial risks are being properly managed', in practice the Commission's reform fails to take proper account of the complexity of the decentralised management. Whereas the White Paper specifies that the Commission 'needs an overall strategy that permits ongoing monitoring of the operation of its internal control systems and of controls on expenditure funded from the EU budget, revenue or own resources' ⁽²⁹⁾, the measures planned for this purpose mainly cover aspects of the Commission's internal management.

9.60. For the decentralised forms of management, the Charter for authorising officers by delegation ⁽³⁰⁾ requires the activity reports to include a description of the measures taken to:

- (a) determine the extent to which the Member States have set up management and control systems giving reasonable assurance as to the legality and regularity of the underlying transactions;
- (b) verify the validity of the amounts declared;
- (c) make financial corrections in cases where the Member States' control procedures have proved to be defective.

⁽²⁹⁾ COM(2000) 200 final, 5.4.2000, p. 64.

⁽³⁰⁾ SEC (2000)2203/5 of 13.12.2000. See also the Charter of tasks and responsibilities of authorising officers by sub-delegation.

9.59-9.60. THE COMMISSION'S REPLIES

The Commission considers that the current provisions concerning responsibility for the decentralised management of Community funds are unsatisfactory. In its synthesis report, the Commission therefore put forward two specific actions in this area. Under action 4 ⁽³⁾, the aim is to clarify the respective responsibilities and competence of the Commission and the Council as regards management, control and supervision of the Structural Funds. Action 12 ⁽⁴⁾ of the synthesis report is intended to spell out more precisely the scope of authorising officers' responsibilities in these areas so that Directors-General can take appropriate action in the event of uncertainties or where problems are discovered.

⁽³⁾ Action 4: The Commission will seek to clarify with the Council its share of responsibility in meeting the objectives established for the shared management of the Structural Funds. The Commission will also make proposals in order to align its monitoring and control powers to its responsibilities.

⁽⁴⁾ Action 12: The Budget DG, in collaboration with the Personnel and administration DG and the departments concerned, will analyse this problem by March 2003. It will make a proposal to the Commission on the scope of the responsibilities of the Authorising Officer in each domain where shared management applies. This should enable Directors-General to take the appropriate measures in case of uncertainties or identified problems.

THE COURT'S OBSERVATIONS

9.61. Nevertheless, any reservations expressed by the authorising officers in their declarations are supposed to relate to deficiencies found within each Directorate-General. Only in exceptional circumstances may external factors be mentioned. It has been stressed, however, that the Director-General is still responsible for the internal measures to be taken to minimise the impact of external constraints ⁽³¹⁾.

9.62. Ambiguities concerning the question of whether particular aspects of the decentralised management are taken into account are also evident in the internal control standards. For example, Standard No 17 requires each Directorate-General to implement certain provisions regarding supervision, in particular *ex post* control of a sample of transactions. It makes no reference to the Member States' control systems. Similarly, it does not deal with the question of external audits carried out by the Commission, in particular in the external action area.

State of progress of the reform

Original timetable

9.63. Originally, the actions set out in Chapter V of the White Paper were supposed to be implemented by July 2001 ⁽³²⁾, and between April 2001 and December 2002 the IAS was to carry out a series of checks focusing on the management and control systems in all the DGs.

Actions carried out within the time limits

9.64. During the first stage of the reform, the Commission obtained (in May 2000) an amendment to the Financial Regulation whereby internal audit and financial control were separated. Furthermore, it embarked on a general recasting of the Financial Regulation. The latter is due to come into force at the beginning of 2003.

9.61-9.62. THE COMMISSION'S REPLIES

Standard 17 lays down procedures for supervision of internal control in the Directorate-General and also deals with adapting control systems in the Member States to the requirements of Community legislation. Along the same lines, the Charter indicates that the authorising officer must also monitor actions managed outside his/her structure. Some Directors-General expressed specific reservations concerning the management of funds by third parties. Thus it is not a question of an ambiguous declaration.

⁽³¹⁾ This ambiguous statement was made by the Methodology Group in the 'Guidelines on the declaration of the authorising officer by delegation and its reservations in the context of the annual activity report'.

⁽³²⁾ Action 91 providing for the training of staff not responsible for financial management and control is due to be carried out during the period September 2001 to July 2002.

THE COURT'S OBSERVATIONS

Several documents essential to a proper understanding of the role of the officers involved ⁽³³⁾ were, moreover, adopted in the last quarter of 2000. Lastly, the Commission's Directorates-General undertook a self-assessment of their own implementation of the internal control standards. The results of this were used to reorganise the financial circuits and to improve the management, control and audit capabilities.

Delays in implementation

Setting-up of new departments

9.65. Difficulties in recruiting skilled staff and the vagaries of the administrative arrangements resulted in some of the new departments not yet being fully operational by the end of 2001. This was the case for the CFS, the IAS and the internal audit structures ⁽³⁴⁾ of the various Directorates-General.

Internal control standards

9.66. The deadlines for introducing certain internal control standards, which were originally fixed for the end of 2001, were extended to dates ranging, on the whole, between March and December 2002 ⁽³⁵⁾. The postponement of the introduction of the internal audit capabilities until the end of 2002 is likely to restrict the scope of the Directors-General's declarations in the coming financial years.

9.65. THE COMMISSION'S REPLIES

Whilst the overall staffing of the Internal audit service (IAS) grew steadily during 2001, it had not reached its target level at the end of 2001, mainly because of a lack of candidates for auditor posts having an appropriate professional profile. The same could be observed for the internal audit capabilities (IACs), as in 2001 most of the departments were still putting in place their internal control systems because of lack of sufficient resources. Two internal audit open competitions had been launched by the Commission at A 4/A 5 and A 6/A 7 level to assist with recruitment to both the IAS and the IACs.

9.66. THE COMMISSION'S REPLIES

The introduction of internal control standards has been under way since 2000. For authorising departments the deadline as regards priority standards for financial management was 30 June 2001.

The impact of the delay in setting up the internal audit structures must be viewed in proportion. The latter are only one of many sources of information for the Director-General; on the other hand, this year a good many of them were able to offer the benefit of their advice and experience in the process of drafting the annual activity reports.

⁽³³⁾ The IAS Charter (action 68); the APB Charter (Action 71); Communication on the conditions for creating an audit capability in each DG of the Commission (Action 81); Charter for authorising officers by delegation and Charter for authorising officers by sub-delegation (Action 63); Guidance Note on the segregation of duties and financial circuits (Action 79). The Charter for accounting officers and for assistant accounting officers (Action 63) was not adopted until November 2001.

⁽³⁴⁾ Audit capabilities.

⁽³⁵⁾ For example: Standard No 3: 'Staff competence'; Standard No 4: 'Staff performance'; Standard No 5: 'Sensitive functions'; Standard No 11: 'Risk analysis and management'; Standard No 22: 'Internal audit capability'.

THE COURT'S OBSERVATIONS

Recoveries

9.67. The deadline for Action 96 of the White Paper on more effective management of the recovery of unduly paid funds (see paragraph 9.26) was set for July 2000. In December 2000 the Commission adopted a communication ⁽³⁶⁾ laying down the principles for a reform of its procedures and an action plan for this purpose consisting of operational decentralisation and greater support for its Legal Service. In the wake of administrative difficulties, the deadline was deferred until 30 June 2002.

Control functions

9.68. Action 78 of the White Paper emphasises that the Directorates-General's description of their management and financial control systems plus the reports from the audit capabilities and from the IAS provide the CFS with the information it needs to oversee the implementation of the Commission's minimum internal control standards. It is up to the CFS to update these standards when necessary.

9.67. THE COMMISSION'S REPLIES

With a view to more effective management in recovering funds paid unduly in the area of expenditure directly managed, the Commission communication of December 2000 redefined the roles of the various actors and spelt out improvements in terms of computer aids and procedures.

The operational decentralisation of the debit note to authorising departments will apply from 1 January 2003, when the new Financial Regulation, the implementing rules, and the internal procedure provisions concerning recovery come into force.

In 2002 further improvements were put in place:

- on the computer side, the first stage in improving monitoring was completed,*
- more staff were assigned to recovery; coordination of dossiers at the recovery stage has also been centralised,*
- OLAF set up a new unit to monitor the financial aspect of irregularities.*

A new Commission communication on improving the recovery of debts arising from direct and indirect management of Community expenditure is due to be approved by the Commission before the end of 2002.

⁽³⁶⁾ SEC(2000) 2204/3 of 12.12.2000.

THE COURT'S OBSERVATIONS

9.69. Because of the delays affecting some aspects of the reform, audit reports have become rare. By the end of 2001, neither the IAS nor the internal audit capabilities had performed in-depth audits on the introduction of the internal control standards. By the end of 2001, the CFS, which does not carry out any checks itself, had not yet been able to fully discharge its duties of supervising the application of the minimum internal control standards.

9.70. In general, there is nothing exceptional about the delays that have been noted. In most cases, they stem from an unrealistic timetable and a grave underestimation of difficulties which are nevertheless wholly foreseeable, since they involve administrative and technical constraints.

The Commission's summary report (24 July 2002)

Annual activity reports and declarations of the Directors-General

9.71. The declarations of the Directors-General constitute a step forward that is likely to have an impact on the Court's audit approach. It is thus important for the scope of these declarations to be free from any ambiguities, especially as regards the handling of material failings in the Member States, third countries and at final beneficiary level (see paragraphs 9.57 to 9.62 and 9.86), and for the procedures leading up to them to be sufficiently transparent to allow the external auditor to examine their validity. This is not yet the case. The submission of activity reports and declarations by the Directors-General in respect of the financial year 2001

9.69. THE COMMISSION'S REPLIES

Control standards are gradually being implemented. The Central financial service (CFS) assists Commission departments and supervises their implementation. In particular this has entailed a revision of the standards adopted by the Commission at the end of 2001.

The internal control standards, the annual activity reports and the declarations by departments were the necessary baseline for the Internal audit service (IAS) to start in-depth audits. Pending their availability, the IAS looked first at the reform process itself and secondly at some specific areas of risks or subjects for which there was a management request for review. The audit and review carried out enabled the service to gain in experience, to make a preliminary survey of the institution and its control environment and to identify the major systemic issues and risks affecting it.

9.70. THE COMMISSION'S REPLIES

The initial objectives were indeed very ambitious, especially in view of the shortage of specialist staff for audit and control. The lack of availability of these specialised profiles in due time, has been recognised by the Commission in its synthesis report (see action 14⁽⁵⁾).

9.71. THE COMMISSION'S REPLIES

In its synthesis report the Commission put forward a series of actions to improve the quality of the annual activity reports, particularly on aspects relating to the shared management of Community funds and on ways of providing support for drafting the reports.

⁽⁵⁾ Action 14: The Personnel and administration DG will review as soon as possible in 2002 profiles for new recruitments needed by services in financial management and related issues, compare these with the current competitions programme in this area and launch additional open competitions as appropriate. In this respect, the Personnel and administration DG will draw up a plan to be executed by the new European Personnel Selection Office, EPSO, as from early 2003. As an interim measure, the recruitment of temporary agents on vacant permanent posts will be extended up to the point at which sufficiently long reserve lists for the related competitions will be exploitable.

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represents an experiment which has several aspects that could be improved. It is only as of 2002 that these reports and declarations could, if need be, form one of the cornerstones of the Court's Statement of Assurance.

Drafting process

Insufficient back-up

9.72. For the financial year 2001, the Directors-General had to submit their activity reports and declarations without having had the benefit of being able to rely on fully operational reformed structures. The procedures to be followed, the standards to be complied with and the terminology to be used had only just been adopted ⁽³⁷⁾ and it was not always possible for the central departments to back up the work of the 36 Directorates-General.

9.73. Because of this late preparation, the guidelines were not always interpreted in a harmonised manner. Moreover, it was not possible to organise an initial analysis of the drafts which had been drawn up in order to identify errors, inconsistencies and contradictions between the declarations of the various Directorates-General and to make the requisite amendments. The period of respite offered by the decision to defer full presentation of the first reports and declarations for a year could have been put to better use to ensure the back-up and give the necessary support to the Commission's authorising officers by delegation.

The reports and declarations do not, however, constitute a statement of assurance in the sense of the Court's statement and do not follow the same methodology. They were designed to ensure the accountability of Directors-General as well as the Commission as regards the administrative management of its departments.

9.72. THE COMMISSION'S REPLIES

The Commission has made a substantial effort in reforming its management systems. This is an initial exercise covering all Commission departments and forms part of the introduction of the new activity-based management system. Nevertheless the Commission believes that the corrective measures initiated by its synthesis report may already help substantially to improve the shortcomings noted.

The methodology review (see action 10) and, above all, the experience of this exercise should make it possible to harmonise procedures. Nevertheless the declarations will never be entirely harmonised as account has to be taken of the specific nature of different Commission departments.

9.73. THE COMMISSION'S REPLIES

The Commission took advantage of the one-year postponement of 'full' presentation of the reports by drawing up for each Directorate-General a report on the implementation of internal control standards, especially financial management, as at 30 June 2001.

⁽³⁷⁾ On 27 June 2001 the Commission adopted a communication on the annual reports and declarations of the Directors-General which lays down that the annual activity reports for 2001 are to be submitted by 1 May 2002 at the latest. On 9 January 2002, a circular on the annual activity reports for 2001 defined the systems for gathering the necessary data. It was not until 9 April 2002, i.e. three weeks before the deadline, that guidelines were adopted for helping the Directorates-General to prepare their declarations, if need be together with reservations, and provisionally laying down the concepts, terminology and scope of the declaration and the reservations.

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Lack of precision in the rules

9.74. According to the guidelines, the Directors-General, in their declarations, express their reasonable assurance that there are neither systemic weaknesses in the internal control systems nor particular problems which could have a material effect on the legality and regularity of the transactions of the financial year.

9.75. Materiality is defined in the guidelines as any condition that has caused or is likely to cause errors, inefficiencies, irregularities or fraud or other adversities of such importance as to force senior managers to undertake immediate corrective action to mitigate the associated risk and possible consequent damages to the organisation. In such cases, the declaration should include reservations.

9.76. Several examples attached to the guidelines were intended to clarify the definitions. However, without sufficient experience, only a rigorous analysis of the phenomena to be covered and an in-depth discussion of their classification could have guaranteed consistent treatment in all the activity reports and declarations. Because the practical guidelines were issued late, it was not possible to organise harmonisation measures of this kind.

Content of the declarations and annual activity reports

Reservations undermining the positive assurance

9.77. For 2001, the 36 Directors-General concerned all confirm that they have reasonable assurance that the control procedures put in place give the necessary guarantees as to the legality and regularity of the underlying transactions. However, 22 of these declarations contain reservations which highlight difficulties that are serious enough for the Commission itself to want to find a remedy by undertaking an action plan (see paragraph 9.96). The very broad spectrum of measures envisaged undermines the assurance given by the Directors-General's declarations.

9.78. Seventeen Directors-General confirm that they have reasonable assurance that the control procedures put in place give the necessary guarantees as to the legality and regularity of the underlying transactions

9.75 and 9.76. THE COMMISSION'S REPLIES

The Commission identified several problems in its synthesis report, in particular as regards the methodological aspects and the guidelines for drafting annual activity reports and declarations. To remedy them, the Commission launched specific measures (see action 10) to clarify the definition and scope of reservations (concept of materiality).

9.77 to 9.79. THE COMMISSION'S REPLIES

In the Commission's view, the declarations made by the various Directors-General, though qualified by some reservations, indicate a reasonable degree of assurance on their part.

In the context of this exercise, issuing a reservation shows that the problem has been identified and that the Directorate-General undertakes to remedy it through action plans. In many cases they reflect concerns or uncertainties still to be verified regarding certain transactions or systems; this does not mean that all the underlying operations are necessarily covered by the reservations expressed.

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but also declare that they do not have the necessary information concerning the functioning of these systems. Indeed, in some cases, they explain that the systems in place have major shortcomings.

9.79. The following examples serve to illustrate this problem:

(a) for the Social Fund, the Employment DG considers that it does not have reasonable assurance of the sound functioning of the Member States' systems for the programming period 2000 to 2006 with regard to the legality and regularity of the underlying transactions;

(b) the Agriculture, Information society and Energy and transport DGs qualify their declarations with several notable reservations, but nevertheless do not specify the share of expenditure to which these reservations relate.

Inadequate or obscure reservations

9.80. Six of the annual activity reports and declarations do not distinguish in any way between reservations and observations⁽³⁸⁾, and the observations contained in some of the declarations are in fact reservations. For example, for the Regional policy DG it is stated that the audits under way concerning the programming period 2000 to 2006 for the ERDF, the Cohesion Fund and ISPA offer only a limited and uncertain assurance, without this actually constituting a reservation. Furthermore, it is either impossible or else very difficult to assess the significance of the reservations or observations because of the lack of information on the true or estimated impact of the problems cited (see paragraph 9.79b)).

(a) *The planned number of preventive audits for 2001 of DG EMPL concerning a first evaluation of the descriptions of management and control systems (Article 5 of Regulation (EC) No 438/2001) had to be reduced mainly because of missing descriptions or late transmission of these descriptions.*

The declaration by the authorising officer by delegation concerning the 2001 annual activity report states that this situation is also due to operational and recruitment problems in the audit and control service in DG EMPL. As the situation has improved, all the Member States will have undergone at least one preventive audit by DG EMPL in 2002.

(b) *The Court's finding is primarily due to the fact that this was the first year that every Director-General had to produce a declaration. In its synthesis report, the Commission acknowledges that in view of the results of this initial exercise, a more harmonised approach is needed, especially as regards the scope of reservations. Action 10 will make it possible to pursue this approach.*

9.80. THE COMMISSION'S REPLIES

DG REGIO accepts that the observation referred to by the Court is in the nature of a reservation, as is clear from the explanations in the body of the activity report. The gravity of the 'reservation' is qualified by the confidence that the lack of reasonable assurance is a temporary situation. The amount of funding affected is roughly quantified in the explanations underlying the Director-General's declaration, in terms of the numbers of programmes desk-checked and audited on the spot in the case of ERDF and of audits carried out for the Cohesion Fund and ISPA, the assumption being that for programmes or countries not covered by such checks the assurance provided must be partial.

⁽³⁸⁾ Whereas a reservation qualifies the assurance given for a particular aspect of the management, observations focus on a specific aspect of the management that one wishes to highlight.

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9.81. Furthermore, the annual activity reports often contain information concerning risks which are outside the scope of the checks and for which no reservation has been issued in the declaration. ECHO's annual activity report, for example, points out areas in need of improvement (tendering procedures, quality of the accounting and checks carried out by the partner NGOs). These various aspects are not included in the reservations.

Inconsistencies

9.82. Some matters which concern most of the Directorates-General are not treated consistently. For example, the shortage of skilled staff, the lack of assurance given by the audit structures (audit capabilities) and the non-compliance with internal control standards have in some cases been cited as a reservation and in other cases merely mentioned in an observation or a comment in the activity report without its being apparent how the difficulties pointed out differ in terms of their importance.

9.83. As regards the research and technological development (RTD) framework programmes, the Energy and transport DG has issued a reservation as to whether the present checks on expenditure declarations are able to satisfactorily reduce the risks of overpayment, emphasising that no joint solution to this question has been found by the various Directorates-General concerned. This question is also taken up in a reservation issued by the Information society and Enterprise DGs. By contrast, the Research DG states in its annual activity report that, in respect of the fourth framework programme, the results of its audits confirm that the system is reasonably reliable. Nevertheless, of the 232 audits performed, 155 revealed over-declarations of costs by contractors (see Table 4.8).

9.81. THE COMMISSION'S REPLIES

According to the guidelines on the declaration of the authorising officer by delegation and the reservations in the annual report, reservations relate to shortcomings concerning internal controls within the DG/service which limit the authorising Officer by delegation in signing a declaration with reasonable assurance. When ECHO mentions that many of the humanitarian organisations (NGOs) could improve the quality of financial accounting and controls and also that NGO partners sometimes have difficulties in respecting EC procurement rules as they are not adapted to the circumstances of humanitarian aid, it is referring to controls operated by the intermediaries responsible for implementing the operations and not to the internal controls within the DG.

9.82. THE COMMISSION'S REPLIES

The Commission considers that the methodology review (see action 10) and, above all, the experience gained from the exercise should make it possible to harmonise procedures. On the other hand, the declarations will never be entirely harmonised, as account has to be taken of the specific nature of different Commission departments.

9.83. THE COMMISSION'S REPLIES

In the annual activity reports by DGs RTD, INFSO, TREN and ENTR, similar difficulties were found regarding the problem of application of contractual provisions by beneficiaries when presenting their cost statements. To deal with this, measures have been taken to strengthen control mechanisms by applying an audit strategy with the aim of auditing around 10 % of contractors under a framework programme cadre and exploring the avenue of cost certification. To achieve further improvements a specific action to address these problems has been adopted by the Commission in the synthesis report of the annual activity reports.

The Commission undertakes to harmonise the approach even further as regards the annual reports and the declarations by Directors-General, where the situations are comparable. As for the discrepancies noted by the Court in the field of research, these, too, are due to circumstances that are not entirely comparable.

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9.84. The Budget DG for its part has issued reservations on the financial information systems, on the accounts and financial statements and on the debt-recovery process which are supposed to cover the problems encountered in the other Directorates-General. In so doing, the Budget DG wanted to take on responsibility for the accounting data attached to the activity reports of the Directorates-General.

9.85. Most of the activity reports and declarations thus make no mention of the difficulties affecting the accounting data, especially as regards the recording of the Communities' assets and liabilities. This situation may give rise to misunderstandings because readers of the various activity reports and declarations are not systematically informed about the Budget DG's general reservation. The situation is further complicated by the fact that some of the activity reports and declarations do contain reservations, observations or comments concerning the problems in question.

Inadequate handling of external difficulties

9.86. In application of the principles described in paragraphs 9.57 to 9.62, most of the declarations relate only to areas which come under the direct responsibility of the Commission, without this being explicitly mentioned in the declaration itself. For example, there is an ambiguity due to the fact that the declaration relating to the Agriculture DG seems to cover all the budget, whereas in his declaration the Director-General refers to his report in which he specifies that he is focusing on the areas that belong more directly under his control (see paragraph 9.79(b)).

Thus DG RTD entered no reservation regarding the difficulties referred to, making the point that it carries out its activities in a representative control and audit environment providing a reliable picture of the situation.

9.84 and 9.85. THE COMMISSION'S REPLIES

Concerning the three reservations made by the Budget DG, only the one concerning the consistency of accounting data had any implications for the declarations by other Directors-General; the Directors-General themselves took the view, in the process of drawing up their declarations, that it was more appropriate to reflect this problem via a general reservation from the Budget DG, in view of its responsibilities in this area.

- *The reservation on the financial statements is indeed of major interest for the Commission as a whole but does not fall within the competence of Directorates-General. There is therefore no reason to mention it in any declaration other than that of the Director-General for Budgets.*
- *The reservation on the recovery process concerns the stages of the process that occur internally within DG Budget. It does not concern the other Directorates-General.*

9.86. THE COMMISSION'S REPLIES

The declaration by the Director-General of DG AGRI gives an assurance as regards the correct functioning of his department and in particular on the reliability of his internal control system. This includes the controls carried out by the Directorate for Audit of agricultural expenditure on expenditure managed by the Member States and candidate countries, known as 'indirect expenditure'. The declaration therefore does indeed cover the entire budget.

It covers the areas of monitoring and control that are the responsibility of the Director-General. In other words, the declaration does not cover the control and management responsibilities assigned by existing legislation to the Member States as regards indirect expenditure.

DG AGRI considers there is no ambiguity.

The allocation of responsibilities for shared management between the Director-General and the beneficiary States is described in the specific legislation and reproduced in the charter for authorising officers by delegation.

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9.87. Even though the EuropeAid Cooperation Office's annual activity report stresses that the external audit function must be swiftly and substantially strengthened in order to obtain better control of operations both at the head office and in the delegations, the declaration does not contain any reservation on this point.

Lack of information on the action plans

9.88. The practical guidelines require that the declarations contain a brief description of the nature of the reservations and a summary of the proposed solutions. More detailed information on the reservations (problems, impact and action plan) must be presented in Chapter 4 of the annual activity report. For 2001, only a minority of the declarations contain an action plan describing remedies being considered for each of the problems identified.

9.89. The exercise of submitting annual activity reports and declarations will help to improve the internal control systems in so far as the Commission departments will implement the various action plans that have been announced (see paragraphs 9.96 and 9.97).

Consistency with the Court's audit findings

9.90. The standard formula used in the declaration explains that reasonable assurance is based, amongst other things, on lessons learnt from the Court of Auditors' reports on financial years prior to that of the declaration in question. It is only in a minority of cases that the Court's main findings concerning specific areas have been the subject of a reservation.

9.91. In its Special Report No 10/2001⁽³⁹⁾ on the implementation of Regulation (EC) No 2064/97⁽⁴⁰⁾ by the Commission and the Member States, the Court concluded, for example, that, unless prompt action was taken to ensure correct application of the Regulation by Member States, the Commission would not have sufficient, reliable information to form the basis upon which to close the various forms of assistance. These observations were repeated in the Court's Annual Report concerning the financial year 2000⁽⁴¹⁾. Despite these observations, the Directorates-General responsible for the management of the Structural Funds have not issued any reservations covering this matter.

⁽³⁹⁾ OJ C 314, 8.11.2001.

⁽⁴⁰⁾ OJ L 290, 23.10.1997, p. 1.

⁽⁴¹⁾ Annual Report concerning the financial year 2000, paragraphs 3.44 to 3.56.

9.87. THE COMMISSION'S REPLIES

An action programme to boost external audit activities and procedures has been adopted by AIDCO.

9.88. THE COMMISSION'S REPLIES

In its synthesis report the Commission put forward a series of actions with a clear timetable to cover the reservations common to several DGs or weaknesses found when drawing up the synthesis report.

The last of these (action 18⁽⁶⁾) calls on Commission departments, by September 2002, to include action plans in the annual management plans for 2002, with explicit provision for a monitoring procedure.

9.91. THE COMMISSION'S REPLIES

A substantial audit activity was undertaken in 2001 relating to the application of Regulation (EC) No 2064/97 by the Member States in order to ensure that there would be an adequate basis for closure of interventions for the period 1994 to 1999.

⁽⁶⁾ Action 18: AAR action plans will, by September 2002, be included in the annual management plans for 2002. These action plans will be translated into the annual management plans for 2003 as appropriate. Progress will be monitored by the Commissioner responsible and will be reviewed in the next annual report exercises.

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The conclusions of the Internal audit service

9.92. At the end of July 2002, the IAS submitted an evaluation of the annual activity reports and the declarations made by the Commission's authorising officers by delegation. This evaluation relates not to the substance of the declarations but to the application, by the departments, of the methods adopted by the Commission. It would thus be improper to regard its conclusions, which in some instances contain criticisms, as being an audit opinion on the overall legality and regularity of the Commission's transactions. Many of the recommendations made in this report (which strives to be transparent) have been incorporated into the synthesis of the declarations which the Commission has sent to the European Parliament and the Council ⁽⁴²⁾.

9.93. Three observations from the report merit highlighting:

- (a) the fact that it would be of benefit to the Commission to adopt a 'cascade' procedure for drawing up the declarations, whereby each person responsible would supply the hierarchical step immediately above with a declaration for the area of activity that concerned him;
- (b) the very diverse way in which the declarations are presented and above all the great variety in the range of both the observations and the reservations. This situation makes it difficult for the conclusions expressed by the authorising officers by delegation to be consolidated in any logical manner;
- (c) the ambiguities of the declarations for sectors where management is shared with the Member States point to reluctance on the part of the authorising officers by delegation to commit themselves regarding transactions over which they do not consider they have control.

9.93. THE COMMISSION'S REPLIES

- (a) *The methodology adopted by the Commission for drawing up the declarations rests on the principle of centralising information at the top of the hierarchy. The Director-General makes his/her personal assessment on the basis of the information directly available to him/her, but also, of course, on the basis of the information supplied by his/her department. However, in this first exercise the cascade process was not retained.*
- (b) *The Commission realises that there was some lack of uniformity, due mainly to the innovative and recent nature of the exercise. To deal with this the synthesis report includes action No 10, which aims to improve 'the methodology and guidance for producing the annual reports for 2002, paying particular attention to the question of materiality, to the definition of the scope of potential reservations to be included in the accompanying declarations'.*

As regards consolidation of the conclusions, the Commission would like to emphasise that this is precisely the purpose of its synthesis report, showing up the Commission's main achievements and shortcomings, analysing the current state of progress on reform and defining 18 actions to be implemented.

- (c) *The charter for authorising officers by delegation clearly states that the authorising officer must also monitor action managed outside his/her structure. Some declarations contained clear reservations concerning the management of funds by third parties. Actions 4 and 12 of the synthesis report provide for more far-reaching measures in this respect.*

⁽⁴²⁾ Synthesis of the annual activity reports and declarations of the Directors-General and Heads of Service, COM(2002) 426 final of 24.7.2002.

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The Commission's synthesis

9.94. The Commission's report concerns all aspects of the reform that has been set in motion with the publication of the White Paper. The following observations are restricted to the aspects that relate to financial management in the broad sense of the term.

9.95. Whilst the Commission emphasises that the introduction of the annual activity reports and the Directors-General's declarations does improve transparency and accountability, it also finds that, despite the progress that has been made, 'there remains much to be done to make the financial management improvements long-lasting' ⁽⁴³⁾.

9.96. With a view to making matters clear, the Commission expresses its willingness to find a solution for a number of difficulties that have been identified by undertaking an 18-point action plan which supplements the action plans announced by the Directors-General in their annual reports. Of the questions requiring urgent action, the most noteworthy are:

- (a) rationalisation of the mechanisms for financing indirect actions (action 1);
- (b) clarification of responsibilities in the shared management of the Structural Funds (actions 4 and 12);
- (c) enhancement of the methodology and clarification of the scope of the declarations made by the Directors-General ⁽⁴⁴⁾ (action 10);
- (d) strengthening of the effectiveness of the supervisory functions of internal control at the various levels of management (actions 8 and 13);
- (e) modernisation of the accounting framework (action 16).

⁽⁴³⁾ Synthesis report, page 16.

⁽⁴⁴⁾ In this respect, part 5 of the synthesis report provides an accurate overall view of the situation, unlike the conclusions, which are still ambiguous as regards the scope of the declarations.

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9.97. Of the questions which the report does not tackle clearly enough, the following should be singled out:

- (a) with regard to actions 6 and 18 concerning the back-up given to the operational services by the central services, the need for centralised monitoring of the action plans that have been undertaken both at Directorate-General level and by the institution as a whole in respect of the application of minimum standards of internal control ⁽⁴⁵⁾;
- (b) the role of the central accounting system, Sincom II, which ought to have been highlighted in action 7 on the 'interoperability' of the information systems and in action 17 on the future core financial information systems. The fact is that the Commission cannot account for its operations properly unless it has the assurance that the relevant data from the many management systems used by its authorising officers by delegation are correctly reflected in the central accounting system;
- (c) the link between risk analysis and the scope of the declarations, which would benefit from being better established by making distinctions by domain according to the type of management used for the activities (direct management or shared management). Since the Commission states that the Directors-General's reports 'suggest that there is some uncertainty about how to assess and manage risks and indeed how to consider them in relation to the overall declaration' ⁽⁴⁶⁾, a specific action would have been useful as a supplement to actions 4 and 10 ⁽⁴⁷⁾;

9.97. THE COMMISSION'S REPLIES

- (a) *The last action in the synthesis report (No 18) calls on Commission departments, by September 2002, to include action plans in the annual management plans for 2002. It also provides for progress to be monitored by the Commissioner responsible and reviewed in the next annual report exercises. The synthesis report for 2002 will also take stock of implementation of actions in the 2001 report.*
- (b) *The Commission has launched a reform of the accounting system which is studying the actions necessary to implement the requirements of the new Financial Regulation. As part of this work, the Commission is also considering the computer systems options to support this development. The Commission has been examining the coherence of the subsystems forming the central accounting system. It will study how to use the lessons learned in order to examine the coherence between the central and local systems.*
- (c) *The Commission believes that actions 4 and 10 are likely to meet the Court's observations since they will deal with the risk-assessment aspects and the scope of declarations.*

⁽⁴⁵⁾ In this connection, see paragraph 4.2 of the synthesis report.

⁽⁴⁶⁾ COM(2002) 426 final of 24.7.2002, paragraph 4.1.2, page 21.

⁽⁴⁷⁾ Action 4 seeks to clarify the respective responsibilities of the Commission and the Member States as regards the shared management of the Structural Funds, whereas under action 10 particular attention should be given to the scope of reservations to be included in the declarations of the Directors-General.

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(d) the way reservations are confused with observations, because the services have failed to take a consistent approach⁽⁴⁸⁾. Far from dispelling inconsistencies, this hotchpotch tends to undermine the value of the conclusions because it leads to matters that differ widely in nature and scope being considered as having equal importance. In so doing, the statistics supplied are not only likely to be poorly interpreted but also to distort the picture of the situation.

General conclusion

9.98. The Commission's synthesis report quite plainly constitutes an unprecedented degree of openness as regards its accountability for its management. The fact that the shortcomings disclosed in this report are very often accompanied by the stated intention to draw up and implement action plans to remedy the weaknesses that have been detected bears witness to the Commission's commitment to improving the protection of the Communities' financial interests.

9.99. With future discharges in mind, there is still a need to remove the ambiguities which are encumbering the declarations of the Directors-General, as not all the parties involved in this process have perceived their role in the same way. It is a fact that, in certain cases, the authorising officers by delegation have directly linked their declarations to the increased responsibility which the reform has given them and that, in formulating their reservations, they have sought to restrict this responsibility to the aspects of management over which they have direct control, in particular in the shared-management areas⁽⁴⁹⁾.

(d) In its synthesis report, the Commission identified some methodological problems. The various approaches or interpretations taken by departments when qualifying their declarations show that further effort is needed in terms of methodology. The Commission believes that action 10 should produce substantial results in this area by clarifying the definition and scope of reservations (principle of materiality).

9.99. THE COMMISSION'S REPLIES

The Commission considers that Directors-General have fulfilled their responsibilities in identifying existing weaknesses and have proposed action plans to deal with them⁽⁷⁾.

The Commission will endeavour in future to limit the ambiguities and shortcomings in its synthesis report through the action plans that are put in place (see point 9.100).

⁽⁴⁸⁾ Paragraph 5.1 of the synthesis report. The Commission considers that 'a more consistent approach to the process and to ensuring that the declarations reflect as accurately as possible the real situation will be necessary'.

⁽⁴⁹⁾ In this respect, several Directors-General have emphasised the fact that they were not in charge of their services for the entire duration of the financial year 2001 and that they could not make any commitments on behalf of their predecessors.

It should also be emphasised that, even where they directly supervise the delegated management procedures, as is the case for the clearance of the EAGGF accounts, they do not give an assurance.

⁽⁷⁾ The declaration of the Director-General for AGRI also covers activity relating to the clearance of the EAGGF accounts, as indicated in the reply to the Court's comment in point 9.89.

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9.100. For 2001, the high number of reservations which are due to the risks run and whose extent remains uncertain (see paragraph 9.79(b)) makes it difficult to give a reasoned appraisal of the Commission's management as a whole. This being so, the Commission's conclusions remain ambiguous ⁽⁵⁰⁾ and are not such as to enable the Court to consider them as one of the bases for its own Statement of Assurance (see paragraph 9.71).

9.100. THE COMMISSION'S REPLIES

In their declarations, authorising officers gave a reasonable assurance that the control procedures set up offer the necessary guarantees as to the legality and regularity of the underlying operations, though accompanying their declarations by reservations:

- *some of these are due to shortcomings in the control systems,*
- *others were due to running-in problems with the system of declarations,*
- *others simply highlight real risks (clearly those relating to external aid and, to a lesser extent, to other areas with decentralised management).*

The Commission is determined to resolve the problems encountered and to reduce the risks to acceptable level, as witness its action plans.

⁽⁵⁰⁾ In paragraph 6 of the report the situation is described as 'generally positive' despite the profusion of risks and shortcomings encountered in most areas.