

Special Report
in support of the Statement of Assurance
relating to the activities of the sixth and
seventh European Development Funds
for the financial year 1994

together with

the Commission's reply

TABLE OF CONTENTS

	Paragraph reference
1. CONDITIONS FOR PRODUCING THE STATEMENT OF ASSUR- ANCE	1.1 — 1.13
The Court's mandate	1.1 — 1.3
Accounts and transactions covered by the DAS	1.4 — 1.9
Audit methodology applied by the Court	1.10 — 1.13
2. PERFORMANCE OF THE AUDIT	2.1 — 2.8
Constraints on the audit work	2.3 — 2.6
Scope of the audit findings	2.7 — 2.8
3. AUDIT RESULTS	3.1 — 3.65
General conclusion	3.1 — 3.4
Main observations relating to the reliability of the accounts	3.2
Main observations relating to the legality and regularity of the underlying transactions	3.3 — 3.4
Detailed observations on the reliability of the accounts	3.5 — 3.46
Reliability of the financial statements	3.5 — 3.25
Accounting principles, methods and practices	3.5 — 3.8
Content and presentation of the year-end financial statements	3.9 — 3.11
Disparities between the accounts of the authorizing officer and those of the accounting officer	3.12 — 3.15
The EDFs' balance sheets	3.16 — 3.20
Explanations to be added to the financial statements	3.21 — 3.25
Revenue	3.26 — 3.28
Decisions (primary commitments)	3.29 — 3.33
Accounting principles and methods	3.29
Sleeping commitments	3.30 — 3.33
Contracts and comparable obligations (secondary commitments)	3.34 — 3.39
Omissions	3.35 — 3.36
Valuation at the time of initial recording	3.37
Valuation at the close of the financial year	3.38 — 3.39
Payments	3.40 — 3.46
Presentation of payments	3.40 — 3.42
Advances	3.43 — 3.46
Detailed observations on the legality and regularity of the underlying transactions	3.47 — 3.65
The EDFs' balance sheets	3.47 — 3.48
Revenue	3.49
Contributions from Member States	3.49
Decisions (primary commitments)	3.50 — 3.51
Contracts and comparable obligations (secondary commitments)	3.52 — 3.59
Sequence of authorization stages of secondary commitments	3.52 — 3.55
Eligibility	3.56 — 3.59
Payments	3.60 — 3.65
Eligibility of payments	3.60 — 3.65

**Special Report in support of the Statement of Assurance
relating to the activities of the Sixth and Seventh
European Development Funds
for the financial year 1994**

**1. CONDITIONS FOR PRODUCING
THE STATEMENT OF ASSURANCE**

The Court's mandate

1.1. The Treaty establishing the European Community has entrusted the Court of Auditors with the audit of the operations of the European Development Funds. In this context, 'the Court of Auditors shall provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and the regularity of the underlying transactions'. This document sets out the results of the work undertaken pursuant to this mandate in respect of the operations of the Sixth and Seventh EDFs relating to the financial year 1994.

1.2. The Statement of Assurance (DAS) consists in issuing an opinion as to whether:

- (a) the accounts (balance sheets and revenue and expenditure accounts), taken as a whole, are reliable, in so far as they faithfully reflect the assets, the year-end financial situation and the results of the transactions carried out during the financial year, in accordance with the provisions of the Treaties, the Financial Regulations and generally accepted accounting principles;
- (b) the underlying transactions are generally legal and regular in respect of all the provisions applicable in this area.

1.3. Since the EDFs' financial statements are presented cumulatively and because the first financial year for which the DAS has to be provided comes at a time when the EDFs to which it applies have been under way for several years, it should be noted that this DAS can relate only to the operations of the financial year 1994 and that the Court will not be able to provide a Statement of Assurance on the cumulative accounts of the EDFs until the Second Financial Protocol of Lomé IV, at present being negotiated, comes into effect.

*Accounts and transactions covered
by the DAS*

1.4. The European Development Funds (EDFs) are based, on the one hand, on international conventions agreed between the Member States of the European Union and seventy African, Caribbean and Pacific States⁽¹⁾, and, on the other, on the Council decisions relating to the association of twenty-four Overseas Countries and Territories (OCT) with the European Economic Community. The EDFs are constituted in accordance with the Internal Agreements on the financing and administration of the aid which the Community implements under these Conventions and Agreements⁽²⁾.

1.5. One of the main features of the EDFs relates to the arrangements for their financing. Firstly, the financing of the EDFs is separate from that of the European Communities' general budget and each Member State contributes to their financing according to a scale laid down by the Internal Agreements referred to in paragraph 1.4 above (see *Table 1*). Since these are Funds which are used up gradually, the appropriations allocated to them are not subject to the rule of annuality and do not run the risk of being cancelled.

1.6. Secondly, the EDFs do not include the funds mobilized by the European Investment Bank (EIB) from its own resources, even though the latter are provided for both by the Lomé Conventions and by the OCT Association Agreements (see *Table 2*). The Internal Agreements refer not only to the EDFs' ACP and OCT resources, but also to the amounts which the EIB is supposed to make available to them in the form of loans granted from its own resources, i.e. 1 120 Mio ECU to supplement the Sixth EDF and 1 225 Mio ECU to supplement the Seventh EDF⁽³⁾.

⁽¹⁾ For the Sixth and Seventh EDFs, the Third and Fourth Lomé Conventions respectively are involved.

⁽²⁾ For the Sixth EDF, the Internal Agreement of 19 February 1985, OJ L 86 of 31.3.1986; for the Seventh EDF, the Internal Agreement of 16 July 1990, OJ L 229 of 17.8.1991.

⁽³⁾ At 31 December 1994, the statements of the EIB's operations showed that 761,5 Mio ECU had been granted in subsidized loans to supplement the Sixth EDF and 717,9 Mio ECU of such loans to supplement the Seventh EDF.

Table 1 — Breakdown of the financing of the Sixth and Seventh EDFs by Member State

Member States	Sixth EDF		Seventh EDF	
	Mio ECU	%	Mio ECU	%
Belgium	296,94	3,96	433,23	3,96
Denmark	155,82	2,08	227,03	2,07
Germany	1 954,40	26,06	2 840,48	25,96
Greece	93,30	1,24	133,92	1,23
Spain	499,80	6,67	645,00	5,90
France	1 768,20	23,58	2 665,90	24,37
Ireland	41,30	0,55	60,03	0,55
Italy	943,80	12,59	1 417,77	12,96
Luxembourg	14,00	0,18	20,74	0,18
Netherlands	423,36	5,64	609,12	5,57
Portugal	66,15	0,88	96,14	0,88
United Kingdom	1 243,20	16,57	1 790,64	16,37
Total	7 500,27	100,00	10 940,00	100,00

Table 2 — Initial breakdown of the financing of the Lomé Conventions and the Association Agreements being implemented, at 31 December 1994*(Mio ECU)*

Conventions and Agreements	Total	EIB loans	EDFs, other financial instruments
Lomé Convention III	8 500	1 100	7 400
OCT Agreement 6th EDF	120	20	100
Total Sixth EDF	8 620	1 120	7 500
Lomé Convention IV	12 000	1 200	10 800
OCT Agreement 7th EDF	165	25	140
Total 7th EDF	12 165	1 225	10 940
Total 6th and 7th EDFs	20 785	2 345	18 440

1.7. The revenue and expenditure accounts submitted every year by the Commission show on the one hand the operations of the financial year and on the other cumulative statements of the revenue and expenditure recorded since each Fund came into force. Furthermore, although the Sixth Fund and the First Financial Protocol of the Seventh EDF each have a duration of five years, they are implemented over a longer period, which continues until the Commission considers that their state of implementation is sufficiently advanced. At this point, the unexpended balances still available are transferred to a subsequent Fund. Thus, at 31 December 1994, the accounts of the Sixth EDF included the unexpended balances of the Second, Third and Fourth EDFs (125,1 Mio ECU), whilst the Seventh EDF included the unexpended balances of the Fifth EDF (492,5 Mio ECU), which was closed in accounting terms at the end of 1993.

1.8. The accounts which have been examined are those published in the form of the Communication from the Commission to the Court of Auditors, Parliament and the Council under the reference COM(95)180 final of 5 May 1995.

1.9. With regard to the scope of the Statement of Assurance and the auditing standards applied, the Court refers the reader to its special report on the activities pertaining to the general budget for the financial year 1994.

Audit methodology applied by the Court

1.10. Owing to the direct nature of the Commission's management of the EDFs, and in view of the very precise financial implementation procedures laid down by the successive Lomé Conventions, as well as the presence in each recipient State of a Commission delegation responsible for monitoring their implementation, the audit of the operations of the financial year 1994 was carried out for the most part at the central departments of the Commission, which possess the supporting documents that make it possible for the legality and regularity of the underlying transactions to be checked through to the final recipient. As a supplement to this audit, questionnaires were sent either to third parties or to the Commission delegations.

1.11. Since the overall amounts of funding (allocations) of the EDFs are used up gradually as the development projects are implemented, the actual decrease in the capital of each Fund has to be confirmed, in relation to the projects actually carried out and evidenced as such in the financial statements. In so doing, the legality of the individual transactions has to be guaranteed, especially with regard to their eligibility, but also with regard to their regularity in terms of the implementing procedures.

1.12. In the light of this, the audit focused in particular on the amounts making up the EDFs' capital and assets at the end of 1994 and on the validity of the flow of expenditure and revenue corresponding to the implementation of the aid during the financial year 1994. In each case, close attention was paid to the situation shown by the year-end financial statements.

1.13. Table 3 shows in summary form the state of progress of the Sixth and Seventh EDFs, highlighting the amounts which should be available at the end of the financial year 1994 for new uses. The data shown here come from the Commission's accounts and are not the figures that would arise from accounts corrected in accordance with the audit findings.

2. PERFORMANCE OF THE AUDIT

2.1. Expenditure was checked by means of statistical sampling of the delegated appropriations (see paragraph 2.4(b)) and payments. For this purpose, the operations of the two EDFs still being implemented were combined and it was considered that each of them constituted part of the same whole. An overall materiality level of 57 Mio ECU ⁽⁴⁾ was selected, with a 95% degree of assurance, a level which led to a sample of 201 secondary commitments and 142 payments being examined.

2.2. In addition to examining the sample of expenditure, analytical review procedures were carried out on the 1994 decisions, the valuation of operations at the end of the financial year, sleeping commitments and revenue. Specific validation checks were also carried out on the allocations by financial instrument and by country, on the suspense accounts and the various asset and liability accounts. An entirely systematic control procedure has been applied to the bank accounts.

Constraints on the audit work

2.3. It is particularly difficult to monitor the financial resources that have been authorized for the EDFs. In respect of past financial years, the Court has already drawn the discharge authority's attention to the low

⁽⁴⁾ This level was selected in accordance with the volume of the transactions concerned and the resources available for the audit. It represents about 3% of the estimated amount of payments for the financial year 1994.

Table 3 — State of progress of the Sixth and Seventh EDFs as at 31.12.1994

(Mio ECU)

Resources and utilization	Sixth EDF	Seventh EDF	Total
Initial allocations	7 500,0	10 940,0	18 440,0
Resources collected	8 037,2	1 954,8	9 992,0
Resources still to be collected from the Member States	2,9	9 740,2	9 743,1
Transfers of resources to other EDFs	- 53,5	—	- 53,5
Net resources	7 986,6	11 695,0	19 681,6
Payments prior to 1994	5 687,3	1 790,0	7 477,3
1994 payments	449,2	1 332,4	1 781,6
Decisions still to be settled	1 380,4	4 112,0	5 492,4
Utilization	7 516,9	7 234,4	14 751,3
Balance available for new uses	469,7	4 460,6	4 930,3

degree of control in the management of the EDF appropriations⁽⁵⁾. In particular, it has recommended that the Financial Controller and the accounting officer be associated with this management so as to strengthen the internal control by means of greater separation of tasks, clearer procedures for authorizing movements and tighter accounting discipline.

2.4. The EDFs are implemented in accounting terms in three stages:

- (a) the recording of financing decisions taken by the Commission, often called primary commitments;
- (b) the recording in the accounts of contractual commitments with third parties, corresponding to appropriations whose implementation has been entrusted to the national authorizing officers of the ACP countries or the OCT; these operations are usually called secondary commitments;
- (c) the payments, which correspond to disbursements that are in theory final and which constitute the remuneration for work, supplies or services rendered.

⁽⁵⁾ Opinion on the Financial Regulation of the Seventh EDF (OJ C 113, 29.4.1991), Annual Reports 1991 (OJ C 330, 15.12.1992), 1992 (OJ C 309, 16.11.1993), 1993 (OJ C 327, 24.11.1994).

2.5. At the year-end, in order to establish the volume of the appropriations likely to be available for new uses, both the final payments disbursed since the beginning and the commitments of appropriations which still actually have to be settled should be subtracted from the capital of each EDF (see *Table 3*).

2.6. Since 1991, the Court of Auditors has endeavoured to show in its successive Annual Reports how the accounting principles and methods applied by the Commission have affected the estimates of the appropriations actually available. In 1994, by implementing a plan of action intended to reform certain accounting practices⁽⁶⁾, the Commission embarked on a process with the objective of making available year-end financial statements with a genuine informative value. The observations of this report show that it will still take some time before this aim can be achieved.

Scope of the audit findings

2.7. By using the results of all the checks carried out, it was possible to quantify the errors. With regard to the

⁽⁶⁾ See paragraph 15.1 of the Court of Auditors' Annual Report concerning the financial year 1993, OJ C 327 of 24.11.1994.

appropriations, decisions, revenue and financial statements, the audit work did not enable any statistical interpretation to be made and the conclusions are based only on the known errors. For errors relating to contracts and similar operations and to the payments examined as part of the sampling procedure, there has been no statistical estimation of those relating to the Stabex and structural adjustment financial instruments. In these cases, only the known errors were selected, as the size of the operations concerned was such that virtually all the movements of the financial year had been examined. By contrast, for the other financial instruments, the errors which have been encountered have been used in order to make a statistical estimate of the probable error affecting the underlying operations. The overall conclusions as to the reliability of the accounts and the legality and regularity of the underlying operations are based on all these results.

2.8. Between the closing of the 1994 accounts and the publication of the findings of the Court's audit, the Commission rectified the accounting errors which had been found. Because of the mechanisms for drawing up the accounts, these corrections were booked to the financial year 1995 and do not affect the financial statements published on 5 May 1995 pertaining to the financial year 1994.

3. AUDIT RESULTS

General conclusion

3.1. With regard to the reliability of the accounts and the legality and regularity of the underlying transactions, the Court is of the opinion that:

- (a) the EDF accounts as at 31 December 1994 imperfectly reflect the financial situation (available capital) and the operations of the EDFs that are being implemented because of certain accounting methods used and owing to a lack of information needed for proper understanding of certain figures (see paragraph 3.2);
- (b) in respect of the legality and regularity of the underlying transactions, most of the difficulties encountered stem from a legal framework which in some instances is ill-suited to the conditions under which the EDFs are implemented (see paragraphs 3.3 and 3.4).

Main observations relating to the reliability of the accounts

3.2. Despite the Commission's recent efforts, the accounts are still affected by the use of certain accounting practices and by the delays inherent in the accounting procedure:

- (a) the way in which the appropriations are presented lacks clarity and the absence of an analytical framework does not always enable immediate follow-up of the programmes decided on by the Budgetary Authority. No adequate explanation is given in the notes to the financial statements for appropriations which cannot be mobilized (174,5 Mio ECU) ⁽⁷⁾, a transfer of appropriations liable to be made up again (12 Mio ECU) ⁽⁸⁾ and the amount of appropriations to be restored (45,5 Mio ECU) ⁽⁹⁾. As the system for managing the appropriations lacked discipline, in 1994 it enabled 24 Mio ECU ⁽¹⁰⁾ of appropriations to be created without any grounds;
- (b) the primary commitments are underestimated in respect of recent transactions (75,4 Mio ECU) ⁽¹¹⁾;
- (c) the commitments remaining to be settled are overestimated because of delays in clearing old operations. Whereas the financial statements show balances for commitments to be closed of 68,2 Mio ECU, the Court's audit shows that this amount is markedly underestimated ⁽¹²⁾;
- (d) as a result of delays in accounting, the figures shown in the accounts for secondary commitments underestimate the true situation by 140 Mio ECU ⁽¹³⁾;
- (e) significant payments (at least 813 Mio ECU) ⁽¹⁴⁾ are made to the recipient States on bank accounts requiring two signatures, one of which must be the Commission's. The situation regarding the mobilization of the sums thus transferred, which is indicative of the degree of implementation of the aid, is not mentioned in the notes to the financial statements;
- (f) the accounting system treats the advances paid to contractors as definitive expenditure, but this situation is not explained in the notes to the financial statements ⁽¹⁵⁾;

⁽⁷⁾ Paragraphs 3.21; 3.23; 3.24.

⁽⁸⁾ Paragraph 3.22(a).

⁽⁹⁾ Paragraph 3.22(b).

⁽¹⁰⁾ Paragraph 3.15.

⁽¹¹⁾ Paragraphs 3.29(b), (c) and (d).

⁽¹²⁾ Paragraph 3.32.

⁽¹³⁾ Paragraphs 3.35 and 3.36.

⁽¹⁴⁾ Paragraphs 3.41 and 3.42.

⁽¹⁵⁾ Paragraphs 3.43 to 3.46.

- (g) owing to administrative delays, expenditure amounting to 35 Mio ECU ⁽¹⁶⁾ which should have been charged to development projects is included in the assets on the balance sheets of the EDFs. Furthermore, the cash accounts include 3,1 Mio ECU ⁽¹⁷⁾ the availability of which is uncertain (bank transfers not received and insolvent banks);
- (h) in addition to the known errors indicated in paragraph (g) above, the most likely amount of the substantial errors affecting the reliability of the accounts is estimated, from the results of the sampling procedure, at 31 Mio ECU for payments.

Main observations relating to the legality and regularity of the underlying transactions

3.3. As regards the underlying transactions, the regulations are not always applied strictly:

- (a) appropriations of 18,5 Mio ECU ⁽¹⁸⁾ were used in 1994 without having been transferred beforehand to the Stabex instrument;
- (b) supplementary financial support amounting to 13 Mio ECU ⁽¹⁹⁾, funded from the support for structural adjustment facility, was mobilized in accordance with a procedure reserved under the Convention for traditional development projects;
- (c) some transactions present difficulties as regards eligibility, by virtue of the origin of the financing (17 Mio ECU) ⁽²⁰⁾, or the fact that the transactions involved do not comply with either the financing agreements (5,3 Mio ECU) ⁽²¹⁾ or the tendering rules (2,2 Mio ECU) ⁽²²⁾;
- (d) the suspense accounts shown as balance-sheet assets include 6,1 Mio ECU ⁽²³⁾ of payments which are not backed up by supporting documents;
- (e) the payments relating to irregular commitments (paragraph 3.3(b)) are affected by the same flaws as those affecting these commitments (13 Mio ECU) ⁽²⁴⁾;

⁽¹⁶⁾ Paragraphs 3.47(a), (b), (e), (f).

⁽¹⁷⁾ Paragraph 3.18.

⁽¹⁸⁾ Paragraph 3.28.

⁽¹⁹⁾ Paragraph 3.50.

⁽²⁰⁾ Paragraph 3.57.

⁽²¹⁾ Paragraphs 3.56; 3.57; 3.58.

⁽²²⁾ Paragraph 3.59.

⁽²³⁾ Paragraph 3.48.

⁽²⁴⁾ Paragraph 3.63.

- (f) in addition to the known errors indicated in paragraphs (d) and (e) above, the most probable amount of the substantial errors affecting the legality and regularity ⁽²⁵⁾ of the payments of the financial year is estimated at 46 Mio ECU. The most probable value of the 1994 payments affected by the legal flaws whose direct impact on the amounts entered in the accounts cannot be quantified is estimated at 85 Mio ECU.

3.4. Many of the observations made in paragraph 3.3 stem for the most part from a regulatory framework which is in some instances ill-suited to the conditions under which the EDFs are implemented. Other areas, such as global authorizations (paragraph 3.29(a)), the conditions of eligibility for Stabex transfers (paragraph 3.51) and prior authorization in particular of operations concerning delegated appropriations (secondary commitments) (paragraphs 3.52 to 3.55), also need to be clarified.

Detailed observations on the reliability of the accounts

Reliability of the financial statements

Accounting principles, methods and practices

3.5. The accounting standards adopted for preparing the year-end financial statements have a crucial impact on the evaluation and, consequently, on the reliability of the accounts in so far as the latter must reflect faithfully the assets, the flow of operations and the actual financial situation. In this field, the EDF accounts still lack the consistency and discipline to be able to reflect the true economic situation faithfully.

3.6. The generally accepted accounting principles stipulate that the transactions and other operations of the financial year must be entered in the accounts and presented in accordance with their nature and with economic reality, and that regard for their legal appearance alone is not acceptable. The observations made repeatedly in this report ⁽²⁶⁾ illustrate the need for an improvement in the way in which this principle is applied.

3.7. The valuation methods must be consistent for all the financial instruments and be applied in the same

⁽²⁵⁾ An operation which, if it had not been affected by an error, would have led to expenditure of a different amount.

⁽²⁶⁾ Paragraphs 3.11; 3.21; 3.22; 3.40.

manner from one financial year to the next. Numerous observations ⁽²⁷⁾ indicate the existence of differences in the valuation methods applied to the various financial instruments, differences which are likely to distort the meaning of the total figures detailing the implementation of the EDFs overall (decisions, secondary commitments, payments).

3.8. For the sake of transparency, the accounting framework must enable immediate identification of the policies and programmes embarked upon. Once the accounting standards have been applied, if this framework does not allow the financial positions to be followed in their entirety in the accounts, then the financial statements must be clarified by means of precise explanatory notes. For the EDF, such notes are especially necessary, particularly in cases where the appropriations are administered jointly with either the EIB, ECHO or the ACP countries. Furthermore, decisions of a political nature which affect the rate of implementation of the EDFs must be made known to the user of the financial statements (see paragraph 3.33). Some observations in this report indicate a need for greater transparency in the financial statements ⁽²⁸⁾.

Content and presentation of the year-end financial statements

3.9. Document COM(95)180 final (see paragraph 1.8) contains various errors or omissions which undermine the informative value of the EDF financial statements as at 31 December 1994:

- (a) even though the EIB itself administers part of the EDF's non-programmable aid (risk capital and interest-rate subsidies), it does not submit to the Commission in time all the data which are needed for drawing up the year-end accounts (see paragraph 3.29(b)); moreover, the remarks concerning non-programmable aid (pages 21-25 of the document) make no reference to either risk capital or interest-rate subsidies;
- (b) with regard to non-programmable aid, although a remark is made concerning aid for refugees in paragraph VI.3, no similar mention is made of emergency aid despite, in particular, the size of the amounts mobilized in response to the crisis which hit Rwanda in 1994 ⁽²⁹⁾;

⁽²⁷⁾ Paragraphs 3.26; 3.27; 3.29; 3.36; 3.37; 3.38.

⁽²⁸⁾ Paragraphs 3.9; 3.10; 3.11; 3.16/17; 3.18; 3.21; 3.22; 3.23; 3.24; 3.25; 3.28; 3.29; 3.31/32; 3.40; 3.45.

⁽²⁹⁾ It should be noted that the operations are conducted by departments outside DG VIII (ECHO).

- (c) although the risk capital partly finances temporary acquisitions of holdings in financial undertakings or institutions, the EDF accounts provide no indication of the extent of such holdings;
- (d) even though it is stated on page 9 of the document that the Council decided in 1993 to allocate 100 Mio ECU to a new rehabilitation programme, on page 12 reference is made, without explanation, to projects under way amounting to 520 Mio ECU, with no distinction being made between EDF appropriations and appropriations entered in the general budget;
- (e) the figures given on page 16 of the document in respect of decisions concerning interest on Stabex funds are incorrect ⁽³⁰⁾;
- (f) the remarks concerning Sysmin in paragraph VI.2 of the document omit the appropriations and operations connected with the OCT (2,5 Mio ECU);
- (g) the figures presented in support of the remark concerning the support for structural adjustment (page 27 of the document) are incomplete ⁽³¹⁾;
- (h) there is no comment on the implementation of regional cooperation, despite the volume of finance concerned and the specific difficulties involved in its mobilization.

3.10. The EDFs' revenue and expenditure accounts are presented according to the financial instruments, which correspond to the way in which the resources recorded in the Conventions and the internal financial agreements are broken down. In order to assess the true state of the implementation of Community aid, however, it has to be possible to monitor the total amounts of funding in terms of the policies and aims pursued. However, the way in which the EDFs' financial statements are currently presented does not make this possible, in particular as regards the subsidies and where several financial instruments are used for one and the same aim or programme. This is true in particular for the Cross-Border Initiative ⁽³²⁾ (60 Mio ECU), for the support for structural adjustment (1 162,5 Mio ECU ⁽³³⁾) and for the rehabilitation programme; the amounts of funding earmarked for the latter two policies do not appear clearly in the accounts.

⁽³⁰⁾ It should read 60,9 Mio ECU instead of 84 Mio ECU for Stabex interest.

⁽³¹⁾ For the Sixth and Seventh EDFs, the decisions involve 1 162,5 Mio ECU, the financing from the SAF (Structural Adjustment Facility) amounts to 913,9 Mio ECU, and the financing from the NIPs to 248,6 Mio ECU.

⁽³²⁾ Cross-Border Initiative (CBI), implemented in Eastern Africa to stimulate regional integration.

⁽³³⁾ Appropriations committed at 31.12.1994 from the resources of the Sixth and Seventh EDFs.

3.11. The measures to fight AIDS under the Sixth EDF are presented in the financial statements under a separate heading, but this does not exist for the Seventh EDF. As a result, the measures to fight AIDS financed under the Seventh EDF are not readily identifiable, despite the existence of Note VI.5 to the year-end financial statements for 1994 which refers to the creation of an allocation amounting to 50 Mio ECU. For the purposes of continuity of methods and consistency of the financial statements, the accounts of the Seventh EDF should disclose the measures to combat AIDS separately.

Disparities between the accounts of the authorizing officer and those of the accounting officer

3.12. At 31 December 1994, the resources available for each Fund as shown on the balance sheet drawn up by the accounting officer differ from the allocations shown in the accounts of the authorizing officer:

Table 4 — Disparities between the accounting officer's and the authorizing officer's accounts

(Mio ECU)

Resources and allocations	Sixth EDF	Seventh EDF
Resources according to the balance sheet at 31.12.1994	7 986,6	11 695,0
Allocations drawn up by the authorizing officer at 31.12.1994	7 884,1	11 816,2
Disparities	+ 102,5	- 121,2

3.13. For the Sixth EDF, the difference can be explained as follows:

- (a) the authorizing officer did not enter in the accounts all the bank interest received in 1994, but which had been taken into account as EDF resources by the accounting officer (+ 21,8 Mio ECU);
- (b) bank interest prior to 1994, which was credited to the Sixth EDF by the accounting officer, was credited to the Seventh EDF by the authorizing officer (-46,0 Mio ECU);
- (c) the accounting officer did not alter the resources available following a transfer of appropriations (Sysmin and Sixth EDF interest-rate subsidies) to Seventh EDF emergency aid (+ 126,7 Mio ECU).

3.14. For the Seventh EDF, the disparity is due to:

- (a) bank interest for the financial year 1994 credited by the accounting officer to the Sixth EDF and by the authorizing officer to the Seventh EDF (-16,5 Mio ECU);

- (b) the addition by the authorizing officer (see paragraph 3.15), but without any supporting documents, of bank interest under Stabex ⁽³⁴⁾ (-23,9 Mio ECU);

- (c) the bank interest prior to 1994 mentioned in paragraph 3.13(b) above (+ 46,0 Mio ECU);

- (d) the transfer of Sysmin appropriations and Sixth EDF interest-rate subsidies referred to in paragraph 3.13(c) above (-126,7 Mio ECU);

- (e) a discrepancy, which has never been corrected, of -0,1 Mio ECU relating to a paying agent account in Algeria, opened at the time of the First EDF.

3.15. Whilst most of the disparities which have been found are mismatches between the EDFs due to poor management of the accounting procedure for appropriations, the situation regarding Stabex interest is more worrying from the point of view of the regularity of the transactions, in that it involves appropriations being created without any grounds (23,9 Mio ECU). In this instance, systematic checking of movements of appropriations by a department independent of that of the EDF chief authorizing officer would probably have prevented these errors.

The EDFs' balance sheets

3.16. The balance sheet of the Sixth EDF includes 34,7 Mio ECU of expenditure to be regularized. This sum actually comprises 41,6 Mio ECU of such expenditure, and 6,9 Mio ECU of revenue received, but awaiting final booking in the accounts.

3.17. In the balance sheet, the suspense account should have been broken down into its various component parts, on the one hand by making a clear distinction between revenue and expenditure awaiting clearance, and on the other by disclosing the payments of advances and the payments to third parties separately from the expenditure.

3.18. Of the EDF's bank assets of 631,5 Mio ECU, 3,1 Mio ECU relate to sums lost or whose recovery is uncertain. These sums should be detailed as such, and shown separately from other assets in the balance sheet,

⁽³⁴⁾ See in this respect the Court of Auditors' Special Report No 2/95, paragraph 3.11, OJ C 167 of 3.7.1995.

and the EDF accounting officer should either initiate the recovery procedure or record the losses incurred ⁽³⁵⁾.

3.19. The advances paid in respect of scholarships amount to 15,3 Mio ECU and can be divided into three groups:

- (a) 1,7 Mio ECU paid by the delegations in the ACP countries and corresponding to old operations, the validity of which has not been confirmed recently by these delegations;
- (b) 7,4 Mio ECU paid to paying agencies in the Member States, with no reconciliation having been made with the actual sums received and recorded by these agencies;
- (c) 6,2 Mio ECU paid to the European Association for Cooperation (EAC) which could not be confirmed owing to the unavailability of the accounts of this body on time.

3.20. These three types of operations require the Commission's departments to carry out a comprehensive control the accounts in order to confirm the actual amounts recorded therein.

Explanations to be added to the financial statements

3.21. Somalia's failure to ratify the Fourth Lomé Convention is the cause of some difficulties in the management of appropriations. Despite the fact that, under the terms of Article 360 of the Convention, Somalia is no longer able to ratify Lomé IV, the appropriations which were allocated to Somalia for its indicative programme, i.e. 111 Mio ECU, were transferred in January 1995 (a few days before the closure of the financial year 1994) to a 'non distributable' reserve account. In the financial statements, this blockage of funds has not been brought to the attention of the discharge authorities. Indeed, the corresponding appropriations, despite being blocked, are disclosed with other reserves which can be mobilized.

3.22. The EDF's financial statements are also affected by a transfer and the use of appropriations to be made available again, operations which have been carried out without their temporary nature or their extent being indicated:

- (a) on 8 July 1994 an appropriation of 12 Mio ECU was transferred from aid for refugees to emergency aid,

⁽³⁵⁾ Guinea (Conakry): 0,03 Mio ECU; Somalia: 0,21 Mio ECU; Zaire: 2,8 Mio ECU.

pending a decision by the Council of Ministers to increase the emergency aid appropriations, and with the firm intention of making these appropriations available again. Although the decision was taken 17 days later, on 25 July 1994, for an amount of 150 Mio ECU, the 12 Mio ECU have not been returned to the aid for refugees;

- (b) as Somalia could not benefit from the use of Seventh EDF appropriations, the emergency operations undertaken there were financed, once the Sixth EDF appropriations were used up, from the resources of Somalia's Lomé III indicative programme, on the understanding that these funds would subsequently be replenished by Lomé IV resources. The amount of these Sixth EDF appropriations to be made available again, totalling 45,5 Mio ECU, is not disclosed in the financial statements at 31 December 1994.

3.23. Since the end of December 1991, 28,54 Mio ECU have been frozen on the Sixth EDF's allocation accounts for the Special Programme to assist certain heavily indebted countries south of the Sahara ⁽³⁶⁾. Although these appropriations have been intended since 1987 for rapid disbursement and their use is in reality similar to that of the Seventh EDF's support for structural adjustment appropriations, they are recorded in the financial statements amongst the Sixth EDF subsidies without any distinction being made.

3.24. For the support for structural adjustment operations in Tanzania, 35 Mio ECU in appropriations which were blocked because of a lack of progress in the reform process undertaken by the government are not highlighted in the financial statements.

3.25. Two groups of operations, for whose management the Commission is partly responsible, are large enough to be disclosed in the year-end financial statements:

- (a) cash at bank made available to the Commission for certain co-financing operations. At 31.12.1994, the sums on deposit amounted to 22,1 Mio ECU;
- (b) the Commission participates, in conjunction with the ACP countries, in the management of the counterpart funds created as a result of the EDF grants (especially for Stabex and structural adjustment). The amounts concerned are estimated at 255,6 Mio ECU at 31.12.1994 by the 47 delegations which replied to the Court's questionnaire.

⁽³⁶⁾ See the Court of Auditors' Special Report No 2/94 on the import programmes carried out under the Sixth EDF, paragraph 3.2, OJ C 97 of 6.4.1994.

Revenue

3.26. Of the 32,1 Mio ECU in bank interest credited as revenue in the accounts for the financial year 1994, 8,2 Mio ECU had, in fact, been received between June 1989 and August 1990. The lateness of these entries is due to shortcomings of an administrative nature in the division of responsibilities between the Commission's departments.

3.27. Furthermore, 4,7 Mio ECU of bank interest received was still shown in suspense accounts ⁽³⁷⁾ as it had not yet been approved by the Financial Controller, whilst 1 Mio ECU in interest received or owed by third parties had not been entered in the accounts.

3.28. Within the Seventh EDF itself, the situation regarding bank interest is unbalanced on two counts. Whereas the authorizing officer noted that 79,4 Mio ECU in Stabex interest had been used, the accounting officer noted use of only 26,8 Mio ECU. Furthermore, as the actual amount of the interest earned under the Seventh EDF is only 60,9 Mio ECU, at the end of 1994 the authorizing officer had *de facto*, and without any authorization, used 18,5 Mio ECU of the Stabex tranche for the 1994 year of application ⁽³⁸⁾.

Decisions (primary commitments)

Accounting principles and methods

3.29. The principles and methods applied by the Commission for taking into account primary commitments are usually reliable as the financing decisions are normally recorded for their full amount and without significant delay. Four sizeable exceptions have, however, been found:

(a) firstly, with regard to certain global decisions provided for in Article 25 of the internal financial agreement ⁽³⁹⁾, no primary commitment at global level is recorded for the Commission's decisions. It is only at a later stage, when the individual operations have been identified, that the primary commitments corresponding to each project are entered. This

⁽³⁷⁾ At the end of 1994 these accounts were presented as part of the revenue for the financial year, whereas at the end of 1993 they had been included in the operations to be regularized shown on the balance sheet.

⁽³⁸⁾ Available for use in July 1995 according to the provisions of Article 207 of the Fourth Lomé Convention.

⁽³⁹⁾ These decisions relate to programmes for training, micro-projects, trade promotion and technical cooperation, or to sets of measures of a limited scale in a given sector, OJ L 229 of 17.8.1991.

practice overestimates the situation of the appropriations actually available for new operations. At the end of December 1994, the authorizations of this kind which had not been re-transcribed in the Seventh EDF's accounts amounted to 54,03 Mio ECU ⁽⁴⁰⁾. The situation relating to the appropriations of the Sixth EDF is not known. At the very least, the balance of the global authorizations being implemented should be indicated in the notes to the financial statements;

- (b) secondly, with regard to the operations undertaken at the initiative of the EIB ⁽⁴¹⁾, the EDF's accounts are updated only after considerable delays and without a procedure enabling the Commission to guarantee the validity of the EDF's accounts. At the end of 1994, it was thus found that nine of the fifteen financing decisions taken by the EIB's Board of Directors between October and December 1994 were not taken into account. The appropriations available for new operations are therefore overestimated by about 62,5 Mio ECU ⁽⁴²⁾;
- (c) thirdly, an older interest-rate subsidy for 9,15 Mio ECU was not entered in the accounts;
- (d) lastly, for a project to assist the Turks and Caicos Islands, a financing decision for 3,7 Mio ECU, taken on 20 December 1994, was not included in the year-end accounts.

Sleeping commitments

3.30. In the 1994 financial statements, the Commission refers for the first time to the existence of sleeping operations. This is in itself a considerable step forward, as this phenomenon is an old one and the amounts at stake are substantial, without any systematic joint ACP-EEC procedure ever having been introduced to remedy this once and for all. The Commission states that there are 57,9 Mio ECU of overestimated commitments for the Sixth EDF and 10,3 Mio ECU for the Seventh EDF (COM(95) 180 final, pages 83 and 84).

3.31. The audit controls, which were structured in accordance with an analysis by stages, show that this estimate minimizes the volume of the appropriations which have been frozen. Thus, with regard to only primary commitments for which there has not been any

⁽⁴⁰⁾ To this should be added the balance of 6,29 Mio ECU from a global authorization of 10 Mio ECU made on 12.7.1994 by the EIB from the Seventh EDF resources which it manages.

⁽⁴¹⁾ Risk capital and interest-rate subsidies.

⁽⁴²⁾ I.e. 50,5 Mio ECU for risk capital and 12 Mio ECU for interest-rate subsidies.

movement during the last three years, the sums involved amounted to 46,8 Mio ECU for the Sixth EDF ⁽⁴³⁾ and 33,5 Mio ECU for the Seventh EDF ⁽⁴⁴⁾. As regards the contracts for which no payments have been made for three years (since the end of 1991), their balance is 42,9 Mio ECU ⁽⁴⁵⁾ for the Sixth EDF (it is too early to make this analysis for the Seventh EDF). The emergency-aid operations and the refugee-aid operations, because of their rapid implementation, require additional analysis: the contracts for which there have been no payments since the end of 1992 show a balance of 2,8 Mio ECU, and that of the contracts without payment since 31 August 1993 is 2 Mio ECU.

3.32. Without counting the other operations which have been completed since 31 August 1993 but which are not yet closed, there are thus about 128 Mio ECU which are likely to be decommitted. This situation may be partly due to the fact that the Commission departments (except for ECHO) usually wait for all the contracts of a project to be closed, and for the national authorizing officer concerned to give his approval before considering decommitting surplus appropriations. In the frequent cases where no action is taken by the national authorizing officer, no decommitment procedure was applied before the end of the financial year 1994.

3.33 In this connection, apart from regional cooperation, there are nine countries for which a special analysis ought to be made because of the high number of cases found: Sudan, Togo, Zaire, Kenya, Malawi, Zimbabwe, Ethiopia, Liberia and Congo. In future, it would be advisable for the EDF's financial statements to indicate clearly the countries with which cooperation has been suspended and those with which it has been slowed down, as these situations offer some explanation for the very slow rate of utilization of the appropriations.

Contracts and comparable obligations (secondary commitments) ⁽⁴⁶⁾

3.34. Several of the Commission's accounting methods or practices have a considerable effect on the valuation of secondary commitments. They stem from delays in the accounting entries, shortcomings in the computerized accounting systems, or practices which undermine the strictness of the accounting management and valuation.

⁽⁴³⁾ Including 19 projects, involving 38,2 Mio ECU, which have not had any secondary commitments since they were opened between September 1987 and December 1990.

⁽⁴⁴⁾ Of which 31,7 Mio ECU in Stabex transfers to Sudan, a country with which cooperation has been suspended indefinitely.

⁽⁴⁵⁾ This includes 69 contracts, involving 24,3 Mio ECU, for which there have been no payments at all.

⁽⁴⁶⁾ In the financial statements, reference is made to this stage of the implementation under the heading "delegated appropriations".

Omissions

3.35. It transpires firstly that 18 of the 25 loan contracts, representing 126,3 Mio ECU, which the EIB notified to the Commission as having been signed for the last quarter of 1994 were not entered in the year-end accounts. For several years, the Court has regularly been pointing out such omissions to the Commission.

3.36. Two year-end accounting re-bookings have resulted in an omission of 14 Mio ECU at the closure, with the deductions being entered under the financial year 1994 and the additions being made under the financial year 1995. Credit and debit movements which are, obviously, part of the same series of entries relating to the same financial year. Such inconsistencies would be avoided if the concept of accounting entries were better applied.

Valuation at the time of initial recording

3.37. Even though the financing agreements as a rule include an amount set aside for covering unknown factors and price revisions, the Commission has taken up the habit of recording the accounting commitments for contracts for amounts higher than the legal commitments. This practice has been commented on repeatedly by the Court in the past ⁽⁴⁷⁾. Of the operations examined, the excessive secondary commitments thus recorded in the accounts amounted to 12,3 Mio ECU.

Valuation at the close of the financial year

3.38. There is no revaluation of the secondary commitments still to be settled at the year-end in cases where they have to be paid in a currency other than the ecu. In the context of the general budget, the Commission has, however, considered that the fluctuations were of a sufficient scale to justify a computerized revaluation procedure. There is no reason to consider that the situation of the EDFs is fundamentally different and that the same currency fluctuations do not affect the reliability of the valuations in the same way. A correct revaluation would in certain cases ⁽⁴⁸⁾ require the calculation to be

⁽⁴⁷⁾ Annual Report concerning the financial year 1989, paragraph 13.9, OJ C 313 of 12.12.1990; Annual Report concerning the financial year 1993, paragraph 15.44, OJ C 327 of 24.11.1994.

⁽⁴⁸⁾ In particular, contracts for works and certain contracts for services.

broken down according to the amounts corresponding to the various contractual currencies for payment. If this phenomenon is processed statistically on the basis of the secondary commitments of the sample, this leads to the excessive commitments being valued at 36 Mio ECU and the insufficient commitments being valued at 35 Mio ECU (the most probable value).

3.39. Another accounting practice that affects the valuation of secondary commitments is that relating to the considerable delays in the closure of operations even though the true situation of the operations is known. At the closure, the decommitments thus deferred which were found in the sample amounted to 1,1 Mio ECU.

Payments

Presentation of payments

3.40. For the Stabex transfers and the support for structural adjustment operations, the procedures laid down in the regulations in respect of the implementation of appropriations result in the payments being presented in a way which, because of special procedures applied to these financial instruments, gives a poor reflection of the operations carried out ⁽⁴⁹⁾.

3.41. Since the system of mutual obligation frameworks ⁽⁵⁰⁾ for mobilizing Stabex transfers was introduced by the Fourth Lomé Convention, the sums from the EDF have been paid into bank accounts, mostly in Europe, held in the name of the recipient countries ⁽⁵¹⁾. These sums remain in these accounts for as long as it takes the recipient country and the Commission to agree upon a programme of measures and until the prerequisite conditions for mobilization have all been met. Whereas under the other EDF expenditure headings, payment establishes the final utilization of financial resources following implementation of the measures, in the case of Stabex transfers the payment recorded by the EDF is initially merely a payment of funds into an intermediate bank account, which gives no indication of the true degree of implementation of the subsidies. At 31 December 1994, the sums thus deposited in bank accounts in Europe amounted to 739,8 Mio ECU, without the year-end financial statements, however, making any mention of this situation.

⁽⁴⁹⁾ See Special Report No 2/95 on Stabex in the context of the Fourth Lomé Convention, paragraph 3.4; OJ C 167 of 3.7.1995.

⁽⁵⁰⁾ Article 210 of the Fourth Lomé Convention.

⁽⁵¹⁾ These accounts operate on the principle of two signatures being required, i.e. that of the recipient country and that of a Commission representative.

3.42. As for structural adjustment, the Commission does not apply the provisions of Article 250(3) of the Fourth Lomé Convention, which stipulate that the funds remitted to the recipient authorities are cash advances until these authorities have submitted justification of their use. Furthermore, in many cases the sums transferred to bank accounts in Europe in the first instance boost the exchange reserves of the recipient countries, and are subsequently, in many cases, converted into counterpart funds in local currency, which must then enable the financing of targeted budgetary support. The counterpart funds thus constituted then pass through, frequently over a prolonged period, to bank accounts requiring two signatures held in the recipient States in readiness for mobilization. This situation is not reflected in the EDF financial statements. If the Budgetary Authority does not have information concerning the bank accounts thus opened, it cannot obtain a numerical estimate of the actual state of progress of the operations. In the case of eight of the delegations which replied to the questionnaire sent to them by the Court, the unused sums (in ecu) at 31 December 1994 in the accounts held in Europe amounted to 73,5 Mio ECU.

Advances

3.43. Many contracts provide for the payment of advances prior to commencement of the work, the delivery of supplies or the provision of services. Such advance payments are distinct from the payments on account made during performance of the contract on the basis of the work actually carried out.

3.44. The advances usually paid for the various operations are as follows:

- (a) works contracts: 10% of the contract value;
- (b) supplies contracts: 60% of the value of the supplies;
- (c) work-programme cost estimates: 50% of the value of a year's expenditure;
- (d) services contracts: 20% of the contract value;
- (e) scholarships: up to 100% of the amount of the scholarship ⁽⁵²⁾;

⁽⁵²⁾ The advances paid to bodies responsible for administering certain scholarships are recorded in the EDF balance sheet until they are cleared (see paragraphs 3.19 and 3.20).

- (f) emergency aid and refugee aid: 50% (generally) or 80% (supply-based contracts) of the value of the contract;
- (g) structural adjustment: 100% of the payment until the documents proving utilization are submitted prior to payment of the next tranche.

3.45. The Commission makes it a principle to regard these advances as being equivalent to definitive operations, which leads to the use of these appropriations being presented in an inflated manner, which is not made clear in the financial statements. Strict accounting control of the advances would be required in order to present the following for each financial year: the amount of the advances at the beginning, the amount paid and that recovered during the financial year, and the balance upon its closure. During the financial year 1995, the EDF chief authorizing officer's departments have been taking steps to enable them to indicate the situation regarding advances in the EDF accounts from the end of 1995 onwards.

3.46. At the end of 1994, the accounting system's mechanism for identifying advance payments was unreliable and could not be used to ascertain the situation of such payments. A direct result of this weakness is the errors detected during the clearance of the advances when subsequent payments are made (see paragraph 3.60). Another consequence is that payments made provisionally, which need to be monitored and cleared at a later date, are not entered as such in the accounts. In one of the cases in the sample, the payment, entered as definitive expenditure, relates to a charge liable to be repaid to the contractor by the ACP country, and then to the EDF by the contractor. In this respect, it would have been necessary to issue a proposal for a recovery order within the meaning of Article 15(1) of the Financial Regulation.

Detailed observations on the legality and regularity of the underlying transactions

The EDFs' balance sheets

3.47. Included in the expenditure to be regularized which is entered on the balance sheet of the Sixth EDF are:

- (a) payments in respect of 169 operations amounting to 1,4 Mio ECU, for which the Commission has no supporting documents; there is also an amount of 1 Mio ECU comprising 25 unidentified accounting transactions;

- (b) payments in respect of about a hundred transactions, mostly old, accounting for 3,7 Mio ECU, which cannot be charged definitively because the transactions have not been authorized; most of these payments were made by the paying agents of ACP countries;
- (c) a sum of 0,8 Mio ECU representing advances which were outside the scope of the contracts and were paid out of the EDF's cash balances in favour of some Member States which co-financed projects in conjunction with the EDF;
- (d) a revaluation gain at the end of 1994 on bank accounts opened in a currency other than the ecu (1,4 Mio ECU);
- (e) year-end payments made on EDF banks but not yet recorded individually (12,7 Mio ECU);
- (f) recent expenditure awaiting regularization amounting to 16,5 Mio ECU.

3.48. For example, transactions not supported by satisfactory documents, amounting to 6,1 Mio ECU, are shown in the suspense accounts. These transactions should be taken into account for the final discharge which the Commission must grant to the EDF's accounting officer, according to the provisions of Article 43 of the Financial Regulation for the Seventh EDF.

Revenue

Contributions from Member States

3.49. The contributions from Member States called up by the Commission in 1994 amounted to 596,5 Mio ECU under the Sixth EDF and 1 200 Mio ECU under the Seventh EDF. These contributions were on the whole paid, with the exception of 133 000 ECU still owed by Germany, and 89 000 ECU by Portugal. Despite the reminders sent to the debtor States by the EDF accounting officer, these sums had still not been paid by the end of the financial year. The provisions of Article 1(5) of the Financial Regulation for the Seventh EDF concerning the imposition of late payment interest on unpaid contributions have not been applied by the Commission.

Decisions (primary commitments)

3.50. The primary commitments relating to the structural adjustment support programmes of Burkina Faso, Mali and Papua New-Guinea have been increased by 7,6, 3,7 and 1,7 Mio ECU respectively (20%, 14% and 20%; i.e. a total of 13 Mio ECU), on the basis of Articles 292 and 311 of the Fourth Lomé Convention and of Article 62 of its Financial Regulation. The application of these provisions to structural adjustment⁽⁵³⁾ does not strictly comply with the procedures provided for in Article 292(1) of the Convention, which restricts additional financing to programmes and projects of the classic type. These additional commitments should not have been authorized in this form, as, without new financing agreements submitted to the EDF Committee, the increases could not be charged to the structural adjustment instrument.

3.51. Of the Stabex commitments examined, some do not satisfy the Lomé Convention's eligibility conditions (103 Mio ECU) as the statistical data used to calculate the EDF contribution are incomplete (six countries) or are submitted late (two countries)⁽⁵⁴⁾.

Contracts and comparable obligations (secondary commitments)

Sequence of authorization stages of secondary commitments

3.52. For many of the operations which originate in the ACP States, the principle of prior authorization, which is supposed to enable the effective application of the provisions of Article 19 of the Financial Regulation for the Seventh EDF, is not followed. This is largely due to the fact that, for the purposes of simplification, the way in which the work of the Commission departments has been organized cannot fully comply with the stipulations laid down in the Regulations. This being the case, the Financial Controller is presented with a *fait accompli*, which, above all, diminishes the importance of his approval.

3.53. This applies in particular to all of the emergency-aid contracts examined, since the commitment proposals are always drawn up by ECHO on the basis of contracts which have already been signed. The same is also true of

⁽⁵³⁾ A similar observation was made in respect of the sectoral import programmes of the Sixth EDF in paragraphs 4.30 to 4.33 of Special Report No 2/94, OJ C 97 of 6.4.1994.

⁽⁵⁴⁾ Article 199(3) of the Fourth Lomé Convention.

the majority of the work-programme cost estimates agreed with the authorities of the recipient countries and territories, and of numerous works, supplies and services contracts concluded on the spot between the national authorities and the contractors.

3.54. In the sample, these operations represented 112,9 Mio ECU. There are also cases where approval is given after the services have been provided (0,7 Mio ECU), or even after payment has been made (15,4 Mio ECU).

3.55. The Court considers that the primary commitment (decision) is not the appropriate level for implementing the provisions of Article 19(1)(c) and (d) of the Financial Regulation with regard to verifying that:

- (a) "the expenditure is... in conformity with the provisions applicable to the management of the EDF, and with all measures taken in implementation of these provisions, in particular, the general and special conditions of the financing agreement relating to the operation";
- (b) "the principles of sound financial management have been applied".

In order to eliminate the ambiguities of this situation, there is a need to recognize, in the regulations, the existence of an accounting commitment at the secondary level, which would clarify the procedures that the Commission, of its own accord, applies to a large number of its operations.

Eligibility

3.56. Because advances paid previously have been used for unauthorized purposes, the expenditure covered by the final tranche of the subsidy granted to the ACP-EEC Cultural Foundation (0,74 Mio ECU) ought not to have been financed by the EDF. The Financial Controller issued a negative opinion concerning this commitment, but nevertheless granted it his approval.

3.57. In the case of two supplies contracts in the sample, the eligibility of a significant proportion of the goods stipulated in the contract was not established with regard to the financing agreement (0,8 Mio ECU out of 2 Mio ECU committed). Moreover, a commitment of 17 Mio ECU out of Sysmin appropriations, transferred from the Fifth EDF for the construction of a sewerage system in

Jamaica, does not comply with the provisions of the Second Lomé Convention ⁽⁵⁵⁾.

3.58. The contracts concluded by ECHO with the NGOs cover, in principle, properly identified expenditure for a fixed period. In many cases ECHO agrees to extend the duration of its partners' contracts. In the sample, two of these extensions are obviously motivated by the fact that the contractor could not charge the estimated expenditure to the contract, either because it was financed from another source, or because it had not been incurred. The eligibility of the expenditure covered by these extensions (3,8 Mio ECU) has not been established in accordance with the Commission decisions on which the conclusion of the initial contracts was based.

3.59. Shortcomings were noted in the invitation-to-tender procedures for one supplies contract and for one emergency-aid contract. In the first case (1,6 Mio ECU), the most advantageous bid was rejected for a technical reason not stipulated in the call for tenders, even though the Commission's central departments objected. In the second case, the actual invitation-to-tender conditions themselves could not be laid down because the requests sent to the potential contractors were not very specific (0,6 Mio ECU).

Payments

Eligibility of payments

3.60. The contracts stipulate not only the terms of payment of the advances, but also the procedure for their subsequent recovery. Two of the payments examined, relating to works contracts, and two others concerning work-programme cost estimates, are too high because the advances paid previously were not recovered. The amount unduly paid is 1,2 Mio ECU, or 74% of the sum of these four payments.

⁽⁵⁵⁾ See the Annual Report concerning the financial year 1993, paragraph 15.96, OJ C 327 of 24.11.1994.

3.61. In another case, the amount paid as a lump-sum advance was 20%, whereas the general conditions applicable to EDF works contracts (Article 46) restrict these contractual advances to 10%. The excess paid thus amounts to 0,32 Mio ECU.

3.62. The final balance of one emergency-aid contract was reimbursed in full, even though the implementation report revealed that the quantities stipulated in the contract had not been distributed in full, basically because the food products had proved to be unfit for consumption. Since no explanation was given as to the reasons for this loss, the unjustified proportion of the payment amounted to 0,2 Mio ECU, or 38% of the amount paid.

3.63. The supplementary commitments referred to in paragraph 3.50, which relate to the additional support for structural adjustment granted to three ACP countries, were settled in full in 1994 (13 Mio ECU). The eligibility of the payments is just as questionable as that of the commitments to which they relate.

3.64. The Stabex payments for the financial year based on commitments which do not meet the eligibility conditions stated in the Lomé Convention amount to 65,5 Mio ECU (see paragraph 3.51).

3.65. In the case of three works contracts in the sample, payments were made in respect of price revisions (0,67 Mio ECU) without the Commission departments having been able to check the validity of the revisions, either because of the unusual way in which they were calculated, or because of the inadequacy of the supporting documents submitted by the contractors. The documentation submitted by the delegations at the Court's request in May 1995 did not make it possible to carry out adequate checks. In one case, the delegation considers that the payment made is provisional and that settlement will follow at a later date, and will probably be accompanied by a recovery of the funds. The Commission should stress to the national authorizing officers that when contracts are negotiated, they should select only price-revision mechanisms which are sufficiently clear to be applied and checked without risk of ambiguity. With this in mind, standard price-revision clauses should be prescribed for contractors to the EDF.

This Report was adopted by the Court of Auditors in Luxembourg at its meeting of 9 November 1995.

For the Court of Auditors
André J. MIDDELHOEK
President

Commission's reply

3. AUDIT RESULTS

General conclusion

3.1. (a) Reliability of the accounts

As the Court itself makes clear, a number of the points criticized by the Court relate to presentation rather than substance.

The Court is requested to note that the EDF accounting officer's responsibilities will be extended from treasury and cash management to cover appropriations accounting in order to ensure full coherence and independence of the EDF accounting function, as is the case with the general budget.

Furthermore, the accounting and authorizing officers have taken steps to close the accounts on an intermediate basis so that a comparative examination of the accounts of the two departments can be carried out before the end of the year.

Lastly, the Commission would stress that it is implementing an action plan to improve the quality of the EDF accounts.

3.1. (b) Legality and regularity of the underlying transactions

The Commission is aware that some aspects of the rules are in need of improvement. It therefore proposes that improvements be made as part of the review of the internal agreement and the Financial Regulation for the Eighth EDF.

Main observations relating to the reliability of the accounts

3.2. (a) Presentation of appropriations in the financial statements

The Commission believes that the financial statements correctly show the transactions to which the Court refers. Only the amount drawn on the Sixth EDF National Indicative Programme (NIP) for Somalia to finance emergency aid (point 3.22. (b): ECU 45,5 million) is not presented with comments on the operation in the financial statements.

The financial statements do in fact show the non-mobilizable appropriations for the Somalia NIP (point 3.21: ECU 111 million), although there is no explicit accompanying comment. In the case of structural adjustment in Tanzania (point 3.24), there was a commitment of ECU 35 million for which a financing agreement was signed at the end of 1994, when the country was eligible. The Commission cannot, however, show in the financial statements that the country is ineligible at closure, as that is a situation which may change at any time.

In the other cases, the actual facts of the transactions do not fit the form of presentation requested by the Court:

— *the appropriations under the special programme for the heavily indebted sub-Saharan countries are mobilizable for other development operations (point 3.23: ECU 28,5 million), having regard to the timetable for implementation (1988-89) and to the allocation of the funds to the National Indicative Programmes of the ACP countries concerned,*

— *in view of the uncertainty as to whether the transfer of ECU 12 million to emergency aid would be offset, the Commission does not think there was any point mentioning it in the financial statements (point 3.22. (a)).*

The Commission is, however, aware that the comments on the financial statements could be improved to provide the

reader with more comprehensive information about EDF implementation, and it undertakes to make progress in that direction.

Management of appropriations

The Commission noted a mistake involving a double entry of ECU 24 million which was corrected in 1995, after the accounts were closed (point 3.15).

3.2. (b) Underestimation of commitments

The underestimation is due basically to delay in booking EIB operations (point 3.29. (b) and (c): ECU 71,7 million).

All the transactions cited by the Court were booked in 1995 after the accounts were closed (except for a single decision in the process of being booked in November 1995).

3.2. (c) Overestimation of commitments

In the financial statements the Commission showed the amount of the so-called dormant commitments (point 3.30).

These figures were arrived at by a method of analysis which evaluates, project by project, the amounts which are actually likely to be decommitted. The Commission intends to refine this method. Steps have been taken to decommit the amounts concerned.

In the Commission's view, the Court includes among dormant commitments various amounts which still constitute legal obligations for the Commission (e.g. Stabex transfers for Sudan).

3.2. (d) Contracts and comparable obligations

The delays in entering contracts relate exclusively to EIB operations (point 3.35: ECU 126 million). The second case (point 3.36: ECU 14 million) concerns a problem involving rebooking at the time of closure of the accounts.

Fourteen of the 18 transactions mentioned by the Court were booked in 1995 after the accounts were closed. At the end of October 1995, the Commission was waiting for the other four contracts so that they could be booked.

3.2. (e) Stabex and structural adjustment payments

The Commission stresses that the double signature system for ACP countries' accounts into which Stabex and structural adjustment payments are made enables the Commission to monitor them, but the funds themselves cease to be the property of the EDF (points 3.41 and 3.42).

However, the Commission undertakes to show, in the financial statements, the amounts in the recipient countries' bank accounts at the close of the financial year.

3.2. (f) Advances

The Commission will incorporate information about advances to contractors in forthcoming financial statements (points 3.43 and 3.46). The EDF accounting software has been adapted so that advances will be booked from June 1995 onwards.

3.2. (g) See the answers to paragraph 3.47 for § 1 and to point 3.18 for § 2.

Main observations concerning the legality and regularity of the underlying transactions

3.3. (a) Primary commitments

The Commission considers that the transfer was carried out properly in 1995. The operation followed on from an earlier Council decision to transfer ECU 125 million in capital to the Stabex fund. The interest which would normally have accrued on that amount was also transferred in 1995 as part of the reconciliation of the accounts carried out after the close of the financial year.

3.3. (b) Additions to structural adjustment funds

Financing decisions for structural adjustment programmes financed from national indicative programmes may be increased by decision of the chief authorizing officer where the overrun is not above 20% of the original commitment (Article 292 of the Convention and Article 62 of the Financial Regulation).

As there is no comparable procedure applying to structural adjustment programmes financed from the structural adjustment facility, the Commission applies the above procedure by analogy.

3.3. (c) Contracts and comparable obligations

Apart from the first case referred to in point 3.59 (ECU 1,6 million), the cases referred to by the Court are regarded as eligible by the Commission:

- *the waste water treatment project in Jamaica was eligible for financing by Sysmin under the Second and Fourth Lomé Conventions (point 3.57: ECU 17 million),*
- *competitive procedures were applied in respect of the emergency aid contract mentioned (point 3.59: ECU 0,6 million),*
- *the other operations financed related to items covered by the original decisions (point 3.58: ECU 3,8 million for emergency aid to Rwanda) or were consistent either with the financing agreement (point 3.57: ECU 0,1 million) or with subsequent documents amending it (point 3.57: ECU 1,4 million).*

Thus the Commission acknowledges one problem relating to an invitation to tender worth ECU 1,6 million out of the ECU 24,5 million in transactions whose eligibility the Court questions.

3.3. (d) See answer to paragraph 3.48.

3.3. (e) Additions to structural adjustment funds

The Commission explains in paragraph 3.3. (b) how it makes up for the lack of a specific procedure for increasing the amounts allowed to structural adjustment programmes financed from the structural adjustment facility.

3.4. *The Commission is aware that the rules are in need of improvement in certain areas.*

Proposals are being made for improvements as part of the review of the Internal Agreement and will also be incorporated into the draft Financial Regulation for the Eighth EDF.

Detailed observations on the reliability of the accounts

Reliability of the financial statements

Content and presentation of the year-end financial statements

3.9. *Most of the additional information which the Court would like to have included in the financial statements is available in the report on aid at end-1994 (ref. DE 81 - August 1995). The Commission will publish this document earlier in the year in future.*

(a) *The Commission will include the information supplied by the EIB about the EDF instruments which it manages (risk capital and interest-rate subsidies) in the comments on the financial statements.*

(b) *The Commission will include information about emergency aid in the comments on the financial statements.*

(c) *The Commission will discuss with the EIB the possibility of including in the EDF financial statements information about acquisitions of holdings in financial undertakings.*

(d) *In future the Commission will make a distinction between EDF appropriations and appropriations in the general budget allocated to the rehabilitation programme.*

(e) *The Commission's reply on Stabex will be found in paragraph 3.15. The figures mentioned have been corrected.*

(f) *The Commission will include the figures relating to Sysmin operations in the OCTs in the next financial year.*

(h) *The Commission will include information about the implementation of regional cooperation in the comments on the financial statements.*

3.10. *The Commission strives for complete transparency about the aims of development aid. Each year, therefore, it*

produces reports (particularly those laid down in Article 327 of the Lomé Convention) describing policy developments and informing third parties about actual progress in the implementation of Community aid.

The purpose of financial statements is merely to show how much of the capital in each fund has been taken up and what use has been made of the financial instruments set up by the Conventions, with explanatory comments.

The allocations shown in the financial statements must therefore tally only with the budget headings laid down by the Financial Protocol. The sums referred to by the Court are not new allocations but arise out of policies which entail financing decisions. At present quantitative developments along the various policy lines can be traced through the statistical encryption in the EDF accounting system (OLAS).

3.11. *The following point warrants an explanation:*

Under both the Sixth and the Seventh EDFs measures to combat AIDS financed by the allocation for subsidies are covered by financing decisions and are booked as commitments. The table of Seventh EDF revenue and expenditure, rightly, does not show how much was spent on measures to combat AIDS (only expenditure by allocation is shown).

It was not necessary to enter a separate line in the financial statements for the Sixth EDF to show measures to combat AIDS. This point will be taken into account when the financial statements for the Sixth EDF in 1995 are produced.

Disparities between the accounts of the authorizing officer and those of the accounting officer

3.12 – 3.14. *The disparities between the two sets of accounts were reconciled by the Commission, and a number of corrections were notified to the Court at the time of the audit as a result. All the points raised were corrected once the procedure for checking movements of appropriations had been set in motion by the EDF accounting officer. These corrections were not entered under 1994 as they were made in 1995.*

To avoid a recurrence of this problem, an interim audit will be carried out at the end of October with a view to entering the results under 1995 wherever possible.

3.15. *Stabex interest of ECU 23,9 million was booked twice, to the Seventh and the Sixth EDFs. The error was discovered by the Commission after the accounts had been closed and was reported to the Court by Note No 49378 of 13 June 1995. The requisite corrections were made at the beginning of June 1995.*

The EDF's balance sheets

3.16 – 3.17. *The amount in the balance sheet for items 'under verification' represents the sum of all operations which have started to be booked but have not yet been finally charged to the projects concerned.*

There are many different types of movement entered under this heading (e.g. exchange differences, transfers between projects and local payments) and they are final-booked only after the last department involved has acted.

As there are so many such movements, and as they are temporary, only one account per country is used for booking them.

3.18. *Bank account balances identified by the Court as being difficult to recover have not yet been classified as 'losses'. Once all means of recovering them in whole or in part have been exhausted, the authorizing officer and the accounting officer will put forward a joint proposal to write them off.*

3.19 – 3.20. *In the area of scholarship management, in 1994 the Commission was able to reduce the quantity of sums to be justified. The allocation of additional staff resources (in the last quarter of 1995 and the first quarter of 1996) to the clearing of old accounts will enable the work done so far to be continued.*

A new contract will be agreed with the agencies in the Member States whereby the advance will be fixed in accordance with the expenditure estimates for the coming financial year and renewed in line with the supporting documents accepted (once a year at most).

Furthermore, a system of prior input in the EDF accounting system has been developed and is to be installed in the agencies in the Member States.

Advances are cleared on production of evidence of expenditure. However, the control mechanism will be reviewed when the prior entry system has been established and an on-the-spot audit may be considered.

Transactions not mentioned in the financial statements

3.21. *The financial statements (Annex XII.6, footnote 3) show that the funds earmarked for the NIP for Somalia were transferred to the reserve because that country had not ratified the Convention. Pending a decision by the contracting parties, which alone are empowered to release the funds (under Article 232 of the Lomé Convention), the resources concerned were not shown as being available.*

3.22.

(a) *In the first case, the Commission applied Article 2 (b) of the Financial Protocol to Lomé IV, which allows transfers of appropriations between Article 254 (emergency aid) and Article 255 (aid for refugees) of the Convention, which is exactly what happened in the accounting operation in question: the allocation for aid for refugees was transferred to the emergency aid allocation (page 51 of the financial statements and explanatory note No 4, page 56).*

In the Commission's view, there is no obligation to offset the transfer, and the original intention of its departments to do so was thwarted by the inadequacy of the appropriations under the emergency aid heading, well before the end of 1994.

(b) *In the second case, the operation described was carried out in two stages:*

(1) *the Council authorized the Commission to use Somalia's NIP funds under the Fifth and Sixth EDFs for humanitarian operations (as was shown in the accounts);*

(2) *the Council said that it proposed to replenish the NIPs from other, unspecified EDF resources.*

The EDF financial statements state clearly (paragraph VI.3, page 23) that in the case of Somalia the NIP resources not used under Lomé III were allocated to emergency and refugee aid operations and would be made up from other EDF resources in due course. Only the amount used is not shown.

3.23. *The special programme to assist certain heavily indebted sub-Saharan countries was due for implementation in the 1988-89 period. The financial statements for 1994 therefore properly show the balance of the appropriations concerned (and the corresponding sub-appropriations created to facilitate management monitoring) as being available among the Sixth EDF grants. Moreover, the funds in question are allocated to the National Indicative Programmes of the ACP countries concerned.*

The Commission would stress that these appropriations could not be treated as equivalent to structural adjustment appropriations. They were grants and were therefore subject to the same decision-making procedures.

3.24. *A third structural adjustment support programme for Tanzania, worth ECU 35 million, was adopted in July 1994; the Convention was signed at the end of 1994. As the country has no longer been eligible since that date, payment of the first instalment of aid has been suspended until such time as the conditions for eligibility are once again met. The fact that the appropriations are blocked is shown in the financial statements by the existence of a ECU 35 million commitment. In any case it would not be for the Commission to say that the country is ineligible in the financial statements, as that situation can change at any time.*

3.25.

(a) *The Commission will contact the authorities concerned with a view to examining the possibility of a report on the co-financing operations referred to by the Court. The funds concerned are not EDF funds, however.*

(b) *The Commission agrees to show, in the financial statements, detailed figures for the counterpart funds released as a result of EDF aid, especially Stabex and structural adjustment. Even if the use of these funds is controlled by the Commission, however, they are no longer EDF cash resources, since the corresponding sums have been transferred for good and are therefore shown as outgoings from the Funds.*

Revenue

3.26. *The ECU 8,2 million actually collected in 1989-90 and regularized in 1994 represented a batch of accounting entries drawn up at the same time as a change in procedure which was made at that time, i.e. the booking of interest to an 'interest subject to verification' account, whereas before it was booked immediately to the account containing interest on deposited funds. Since 1994 interest has been booked once a quarter.*

3.27. *There is clearly nothing unusual about a balance being left over at the end of the year, given that interest collected is regularized every quarter. The balance is monitored and explained in detail; a copy of the explanation has been passed on to the Court of Auditors. As for the ECU 1 million in interest received or owed, it was booked in 1995, since the bank sent notice of the interest scales after the accounts for the year had been closed or because the value date assigned was in 1995. The papers relating to the case were not received until 1995 either.*

3.28. *At the end of 1994 there was still a backlog of entries relating to the use of Stabex interest waiting to be booked in*

the cash accounts. The authorizing officer noted an amount of ECU 79,3 million used, broken down as follows:

Year of implementation	Interest used
1990	8 678 080
1991	17 768 604
1992	30 378 624
1993	22 500 000
Total	79 325 308

The EDF accounting officer only took account of the amounts for the 1990 and 1991 years of application and of ECU 378 624 from the 1992 year of application.

Decisions (primary commitments)

Accounting principles and methods

3.29.

(a) The Commission distinguishes between the multiannual programmes mentioned in Article 290 of the Lomé IV Convention, and global authorizations. In the first case a primary commitment is made. Examples of these multiannual programmes are the Multiannual Training Programme (Zimbabwe) and the Multiannual Micro-project Programmes. In the second case (global authorizations), the EDF Committee authorizes the Commission to take future financing decisions without referring to the EDF Committee. These global authorizations do not mention the specific financing sources (some are excluded), thus no formal primary commitment can be prepared.

However, in order to monitor the evolution of these global authorizations, they will in future be registered in the accounting system. It is expected that this can be carried out during 1996. The Commission therefore undertakes to show in the financial statements the balance of global authorizations being used.

(b) Primary commitments for EIB operations are made on the basis of a letter of notification from the Bank to the Commission. The deadlines by which the Bank must send these letters vary, which leads to accounting delays.

The Commission has already set up a system for centralizing, registering and monitoring documents received, to prevent any delays attributable to the Commission.

In the short term, as regards the closing of accounts, the system now in place and a reconciliation procedure involving the EIB will make it possible to discover what decisions the EIB has taken, so that they can be booked to the appropriate accounting period. In the case of interest rate subsidies, however, if the amount involved is to be committed solely on the basis of the relevant decision, an estimate should be made.

In the medium term, the system of prior entry of primary commitments by the EIB should help prevent this kind of problem, in that all decisions will be temporarily registered in the OLAS accounting system before the Commission receives the supporting documents (for purposes of finalization).

(c) The ECU 9,15 million interest-rate subsidy was in the process of being booked when the accounts were closed but the booking was not finalized (as the approvals required for it to be definitively incorporated in the financial statements were still pending).

Sleeping commitments

3.30 – 3.32 – 3.33. The Commission pays special attention to so-called dormant appropriations and is not convinced that the figures it gives in the financial statements underestimate their size to any significant degree.

Out of a total ECU 156,5 million in primary commitments (Sixth and Seventh EDFs), ECU 88,3 million represents capital sums committed by the Commission for projects currently under way which cannot therefore be decommitted. The remaining ECU 68,2 million represents outstanding balances which can be decommitted.

The Court of Auditors regarded the ECU 31,7 million in Stabex transfers for Sudan (footnote 55) as dormant commitments. These cannot, however, be decommitted as they represent a legal obligation on the EDF which the financial statements have to show.

The Commission agrees that contracts should be closed as a routine practice and will press ahead with its efforts in that area. It would stress, however, that closing contracts will

not release any appropriations additional to those already mentioned in the financial statements, as the Commission's breakdown relates to primary commitment balances minus payments.

Instructions have been given that when a national authorizing officer does not take a timely decision concerning the closure of a project, Delegations should send a note to the NAO stating that if no answer is received within a certain time limit (two to three weeks) confirming or blocking a closure, Delegations will assume the tacit agreement of the NAO to the closure. This procedure was applied in 1994.

In future financial statements the Commission will be in a position to meet the Court's wishes by stating the countries with which cooperation has been officially suspended.

Contracts and comparable obligations (secondary commitments)

3.34. Where the EDF is concerned, the Commission's legal commitment towards a third party (an ACP State) is given when the decision to finance a project is taken. A so-called 'primary' financial commitment is given in advance as stipulated in Article 17 of the EDF Financial Regulation. Contracts entered into with third parties by the ACP countries for the implementation of projects (secondary commitments) are legal commitments towards the contractors on the part of the ACP country concerned.

The Commission has to satisfy itself that the financial side of EDF projects is properly implemented. It therefore takes responsibility for the contracts required for the implementation of the projects. This is not a new legal obligation but a confirmation, operation by operation, of the legal undertaking given at the time of the financing decision. From the contractor's point of view, the assumption of responsibility by the Commission is an assurance that EDF financing will be forthcoming, but it is also in effect a preliminary check by the Commission into project implementation.

Omissions

3.35. Fourteen of the 18 loan contracts (risk capital) were registered by the Commission as soon as the copy of the contract had been received from the EIB after the

accounts were closed. The Commission is aware that the time taken for them to arrive is often too long and has set up the following arrangements:

- in the short term, for the closing of accounts, a procedure involving regular consultation with the EIB to obtain notification of contracts signed but not booked so that they can be booked to the appropriate accounting period,
- in the medium term, a system involving prior entry of contracts by the EIB so that all contracts are immediately recorded in the accounting system, before the Commission receives the supporting documents (for finalization).

3.36. On 31 January 1995 two secondary decommitments were made so that on the same day two new secondary commitments could be made in respect of the same projects. The object of the exercise, for Jamaica, was to use the grants before the special loans. The two decommitments were finalized on 2 February 1995, before closure, but the two new secondary commitments were finalized on 10 February 1995 (more approvals had to be obtained), after closure.

Estimates at the time of initial recording

3.37. The provisions in respect of contracts does not duplicate the 'contingencies' item for financing agreements. There are two levels of set-aside of appropriations but they are not cumulative, as the second level (contract) is a subdivision of the first (project).

Where a contract is concerned, payments of all sums contractually due under the contract (legal commitments) must be covered, including price reviews, quantity fluctuations and alterations for works, and exchange rate fluctuations, which are estimated amounts (provisions).

Estimates at the close of the financial year

3.38. The Commission acknowledges that the system designed to make up for the fact that there is no re-estimation of contracts at year-end leads to a minor and justifiable overestimation of ECU 1 million.

The problem arises only with contracts and comparable agreements denominated in national currencies and not in terms of commitments, which are always accounted for in ECU. To deal with the problem of currency fluctuations affecting contracts, a provision is built in when the contract is booked (as an estimate). Given the number of operations involved (some 10 000 per year), the Commission is

looking at ways of automatically reestimating contracts at market value.

3.39. See the first part of the answer to paragraph 3.30.

The Commission is aware of the time lapse between the closure of operations and the clearance of outstanding balances.

A global operation was carried out to clear the outstanding balances of appropriations for emergency aid measures under the Seventh EDF. Others are carried out as dossiers are closed. A list of decommitments to be carried out in respect of Sixth EDF operations has been drawn up and the accounting operations are in the pipeline.

Payments

Presentation of payments

3.40. In the case of Stabex (paragraph 3.41) and structural adjustment support (point 3.42), the sums transferred to recipient countries cease to be part of the EDF's cash holdings. The relevant sums have been transferred for good and are therefore, rightly, shown as expenditure by the funds.

3.41. Transfers of Stabex funds take place as soon as the transfer agreement has been signed as provided for in Article 211 of the Lomé Convention. What is involved is compensation for loss of export earnings.

The sums transferred are not simply an internal cash movement. Even though the Commission retains some say in the use of the funds (through an action programme which has to be drawn up jointly by the Commission and the recipient country), the money involved no longer belongs to the EDF but is the property of the recipient country, a situation which is accurately reflected in the financial statements.

However, the Commission will show the amounts on the recipient countries' bank accounts at year-end in the EDF financial statements.

3.42. Structural adjustment support is primarily balance of payments aid designed to help the country strike a new balance between its foreign exchange resources and its

outgoings, in other words to pay for its imports of goods and services, service its foreign debt commitments and reconstitute a reasonable level of foreign exchange reserves.

When the Commission transfers funds as structural adjustment support, they naturally serve to increase the recipient country's foreign-exchange reserves. The recipient country has to sell its foreign currency (in return for its national currency) to the private or public sector so that the latter can import products (under an import programme subject to rules laid down by the Commission).

The constitution of counterpart funds is one effect of the instruments used to make foreign currency available, i.e. the import programmes.

The counterpart funds thus created belong to the recipient country and their use is one element in the structural adjustment programme negotiated between the Commission and that country. They are usually allocated to targeted budget support operations agreed jointly with the Commission.

In practice the Commission uses these counterpart funds as an important lever with which to redirect public spending, particularly towards the priority social sectors and the maintenance of basic infrastructure, in a framework of voluntary restructuring of the whole of the public and semi-public sectors.

As what is involved is aid for the balance of payments, the action which generates the expenditure is the actual disbursement. This takes place when the country's exchange reserves rise, i.e. when the central bank receives the foreign currency in the case of a foreign-exchange programme, or when the products arrive in the country without any foreign currency going out of the central bank in the case of a programme of imports in kind.

This being so, the Commission avails itself of Article 250 (cash advance and separate accounting) only where there is a high risk of poor management by the central bank.

Advances

3.43 – 3.44 – 3.45. Advances are indeed now registered in the on-line accounting system (OLAS) in the currency in which they have been transferred.

This new element was introduced into OLAS in June 1995. All new advances are registered as of that date. Within the limits of existing capacity, advances transferred before June 1995 will also be registered accordingly.

A problem, of course, is that there is a possibility that not all the backlog might be treated by the end of 1995. Nevertheless, where possible, the Commission will try to incorporate information about outstanding advances in the balance sheet and results for 1995. A more complete picture can be given at the end of 1996 (Position at the beginning of 1996, Changes during 1996, Position at the end of 1996).

3.46. *Even if the Court thinks the machinery for identifying advances was not satisfactory at the end of 1994, that does not mean there was a risk of loss. The Commission shows under paragraph 3.60 that there was no need to recover the advances in the cases referred to by the Court.*

In the other case considered by the Court (project 6 TA 48/1), the payment was correctly booked as final as it was made in accordance with the contract, which included provision for meeting the cost of the expropriation allowances item. The financing agreement between Tanzania and the Commission, however, provided that Tanzania should meet the cost of that item. It is therefore planned to recover all the costs paid in respect of expropriation allowances at the end of the contract and recovery orders against Tanzania will be drawn up for this purpose as and when payments under that item are made to the contractor.

Detailed observations on the legality and regularity of the underlying transactions

The EDF's balance sheets

3.47. *Responsibility for managing the EDF is divided between the Commission in Brussels and the Delegations in the ACP countries, as regards both the level of authorization and the running of certain bank accounts (ACP paying agents' accounts); consequently, all expenditure to be regularized requires action from several departments. As long as approval by the last department involved, making booking final, has not been given, the transactions concerned remain in the suspense accounts.*

(a) and (b) These were payments authorized and carried out by the Delegations for which the supporting documents were not passed on to the Commission in Brussels or were so only in part. The EDF accounting and authorizing officers send regular reminders to the Delegations in an attempt to solve this type of problem.

(c) These were payments made by the Delegate from the paying agent's account for co-financed projects. The sums concerned are recovered from the co-financing accounts once the supporting documents have been received in Brussels.

(d) This was a revaluation of bank balances at year-end which requires action by the authorizing officer and the financial controller before it can be final-booked.

(e) Details of payments made by the Delegations in December were not received until after closure. A global entry was made for each ACP bank to reflect, as far as possible, the real liquidity position at 31 December.

Points (c), (d), (e) and (f) are normal consequences of the closure procedure.

3.48. *Transactions not supported by documents are referred to in paragraphs 3.50 (a) and (b) and concern operations managed by Commission Delegates. Commission departments are doing their best to trace the missing documents in the Delegations. If they are not found, the authorizing and accounting officers will make a proposal for a clearance operation.*

The Authority which gives a discharge to the accounting officer will itself decide on what factors it should base its decision.

Revenue

Contributions from Member States

3.49. *It is true that the Commission has not required the Member States to pay interest on late payment, since the contributions in question are at present under discussion with the countries concerned.*

Decisions (primary commitments)

3.50. *Financing decisions for structural adjustment programmes financed from national indicative programmes may be increased by decision of the chief authorizing officer*

where the overrun is up to 20% of the original commitment (Article 292 of the Convention and Article 62 of the Financial Regulation).

As there is no comparable procedure applying to structural adjustment programmes financed from the structural adjustment instrument, the Commission applies the above procedure by analogy.

3.51. The Commission considers that all the Stabex commitments examined meet the eligibility conditions. In the case of the two which arrived after the deadline, there were special circumstances which warranted their being processed in the normal way.

It is true that some statistics transmitted by 31 March each year are occasionally incomplete or call for further information from the department concerned. In such cases the Convention requires the Commission to investigate the case.

Contracts and comparable obligations (secondary commitments)

Sequence of the stages of authorization of commitments

Preamble

Financing decisions by the Commission correspond to actual commitments in the public accounting sense (called primary commitments in the EDF) since they are the first commitment by the EDF towards a third party (the recipient ACP countries).

Contracts entered into by the ACP countries are registered in terms of delegated appropriations (called secondary commitments in the EDF).

Delegated appropriations are merely a project management tool and enable payments to be monitored. They do not constitute commitments within the meaning of the Financial Regulation.

3.52. For the reasons stated in the preamble, the Commission does not think there is a case for applying the

principle of prior authorization to the registering of contracts concluded by ACP countries.

The principle of prior authorization laid down in Article 17 of the Financial Regulation is fully complied with in that financial control gives its approval in advance to all commitments based on financing decisions (primary commitments). The importance of the financial controller's approval is therefore not diminished. His function is not to give prior authorization for operations carried out by the ACP countries; he carries out *ex post* checks on such delegated appropriations, responsibility for the implementation of which is assigned to the national authorizing officers by the Lomé Convention.

3.53. Operations put together by ECHO are without exception subject to approval by the Commission after the opinions of the departments concerned have been canvassed and prior approval has been given by the financial controller. The commitments are, in fact, established before the contracts are concluded with the NGOs concerned.

3.54. The Commission considers that the operations referred to by the Court are covered by a prior financial commitment (a primary commitment corresponding to the financing decision) and therefore by approval from the financial controller.

3.55. The Commission considers that the financing decisions relating to the projects correspond to the notion of a commitment as defined in Article 17 (2) of the Financial Regulation, which stipulates that 'decisions taken by the Commission in accordance with the provisions authorizing it to grant financial aid from the EDF shall constitute commitments of expenditure'.

Article 44 of the Financial Regulation also states that the commitments to be charged to the EDF are those covered by financing decisions taken by the Commission.

The Commission admits that the wording of the Financial Regulation governing the EDF is not always suited to the decentralized management of appropriations.

It will therefore make proposals, when drafting the Financial Regulation for the Eighth EDF, to make the provisions clearer in this area while at the same time moving nearer to the philosophy of the Financial Regulation on the general budget.

Eligibility

3.56. As early as 1993 the financial controller delivered a negative opinion on the draft programme of activities of the

ACP-EEC Foundation for Cultural Cooperation, for which a subsidy of ECU 7 750 000 was being requested.

He maintained his negative stance in 1994, when he opposed, in particular, the high level of the planned allowances. Lastly, following an external audit and negotiations with officials of the Foundation, a proposal for a substantially lower level of financing (ECU 738 806) was drawn up, designed to clear the Foundation's financial position followed by complete Community disengagement from the Foundation. On 21 April 1994 the proposal was submitted to the EDF Committee, which gave a favourable opinion. Before being submitted, the proposal had not been referred to financial control, which informed the Commission that it was still critical of the proposal and pressed for all the Foundation's financial obligations to be examined and evaluated with the greatest care, in view of the interconnections in this particular case between Belgian and Community law, so that final and indisputable clearance could be given. Having weighed up all the factors in the case, the Commission took a favourable decision on the proposal on 1 June 1994 (Min(94)1204, 2 June 1994) and the financial controller gave his approval to the relevant commitment proposal.

The Commission considers that the sum in question was eligible for financing by the EDF for the following reasons:

- nearly half (ECU 330 000) of the amount was to go towards financing the remaining cultural cooperation activities provided for in Title XI (Articles 139 to 149) of the Fourth Lomé Convention and which the Foundation had undertaken to finance,*
- the rest was to go to terminating the lease agreement and employment contracts, deemed too costly by the Court itself, of an institutional structure, the ACP-EEC Foundation for Cultural Cooperation, expressly recognized by Article 141 of Lomé IV as 'having the task of contributing to the implementation of the objectives' of Title XI. Under Annex XXII to Lomé IV, the Community had undertaken to make a financial contribution available to the institutional structure in question, no distinction being made between the types of expenditure in which the Foundation would engage.*

3.57.

(1) Financing agreement No 4026/SU allows ECU 743 000 for agricultural inputs, the object of tender No 3775, lot No 1, whereas the contract awarded was worth ECU 1 400 088.

This discrepancy can be explained as follows:

The financing agreement, signed in April 1987, was intended to cover the agricultural seasons over a five-year period from 1987-88 to 1991-92. Considering that by 1992 a balance of ECU 3 680 000 remained under financial commitment, a thorough reorientation of the project activities was initiated within the Government of Sudan to ensure project sustainability after donor phasing was phased out.

To this end a Memorandum of Understanding was signed in August 1992 by

— the supervisor, Ministry of Agriculture,

— the NAO, Ministry of Finance and Economic Planning

and

— in June 1993 by the representative of the EC Delegation,

in order to support the official request for an extension of the project implementation period comprised in the initial financing agreement.

Since the NAO has, according to Article 227 (5) (a) of the Third Lomé Convention, the statutory powers, during the execution of operations and subject to the requirement to inform the Delegate, to decide on technical adjustments and alterations in matters of detail, so long as they do not affect the technical solution adopted and remain within the limits of the reserve for adjustments, the Memorandum is considered as a valid document modifying the financing agreement.

In addition, the chief authorizing officer has been informed of the development and has given his agreement to the 30-month extension based on the objectives laid down in the Memorandum.

The Memorandum summarizes the EDF funding required for the reoriented project components and refers to the annual work programme and budget estimate for 1993-94, where a total of ECU 804 000 has been earmarked for agricultural inputs. Since the draft tender documents were submitted under the extension phase covered by the Memorandum coming into force in June 1993, the items of tender No 3775 (lot 1) are partly covered by the balance for agricultural inputs left from the financing agreement (i.e. ECU 396 350) and partly by the amount allocated under

the work programme, which results in a total available for agricultural inputs of ECU 1 200 350.

Unfortunately, the prices quoted for this tender were rather on the high side, due to the deteriorating political situation at the tender submission period (February-April 1994). In view of the fact that the contract for lot No 1 has been awarded for an amount of ECU 1 400 088, it must be admitted that the budget reserved for agricultural inputs has been exceeded by about ECU 200 000.

A modification of the memorandum/cost estimate was not, however, envisaged, since by that time it had already become obvious that EC-Sudan relations were deteriorating to the point that no new actions were to be undertaken.

(2) In the second case (7.TA.10.8), the Commission feels that the Court is placing a very restrictive interpretation on the financing agreement. The fact that the financing agreement makes no explicit provision for the purchase of an item does not mean that that item is not eligible under the agreement.

In the case in point, the herbicide is a subsidiary element compared with the equipment provided for in the financing agreement. The contract for the purchase of weed-killing equipment concluded after an international invitation to tender comprises, in addition to the equipment itself, the frame, fittings, spare parts and herbicide, all of these being needed to operate the equipment.

(3) Regarding the ECU 17 million in commitments against Sysmin appropriations, the Commission considers that historically Jamaica has always been dependent on tropical agriculture and bauxite extraction. It was decided to make it eligible for Sysmin financing in 1987 to support the bauxite industry but, as production has risen, the funds have been reoriented to support economic diversification measures in the spirit of Article 49 of the Second Lomé Convention, which states that the purpose of Sysmin appropriations is to '(contribute) towards the creation of a more solid basis for the development of the ACP States whose economies are largely dependent on the mining sectors'.

ECU 25 million was accordingly allocated to projects for the construction of a sewerage system and the treatment of waste water from Negril and Ocho Rios with a view to supporting the emerging tourism industry, which is now the principal source of foreign exchange.

The financing agreement mobilizing Lomé II appropriations was signed on 22 April 1994, following agreement by the EDF Committee, in the spirit of the opportunities opened up by the Fourth Lomé Convention, which stipulates that Sysmin appropriations may be used to broaden the basis for economic growth. What is more, part of it (ECU 15 million) was financed from Lomé IV funds.

3.58. *The contracts entered into by ECHO had to be suspended following the events in Rwanda in April 1994.*

As there was an urgent need to continue supplying humanitarian aid in the region, the Commission considered it appropriate to use funds available with its partners quickly rather than making de-commitments, waiting for the funds to be recovered and launching a fresh decision procedure to help the same humanitarian agencies working in the same zone, that of the Great Lakes.

For the sake of speed and efficiency the Commission preferred to extend the validity of the operational contracts.

This was not a departure from the Commission's original decision, as the point was to keep up the supply of aid to the same groups of people in distress.

3.59. *Regarding the second case (7 ANG.32.14), the measure was in line with the procedure provided for in Article 254 of Lomé IV, which lays down that 'the detailed rules for the allocation and implementation of emergency assistance shall be the subject of emergency and flexible procedures'. It was linked to another operation to supply agricultural equipment and is part of a humanitarian plan to help the people of Angola approved by the EDF Committee on 4 February 1994.*

Direct understanding was the approach chosen because of the difficult conditions in Angola at the time, requiring security for the operation and a guarantee of quality control by an undertaking known for its expertise.

Various supply tenders from local operators and other European operators were considered. Once they had all been studied, with a background of experience of other food aid operations entrusted to FOCOEX, the Commission opted to award the contract to that particular organization, especially as the transport costs were low.

Payments

Eligibility of payments

3.60. *In the case of programme estimates, there are no rules for recovering advances, except that documents in support of all advances must be produced once the operation is over. When supporting documents are submitted by the body in charge of running a project, the Delegation decides whether to pay all the supported costs or to deduct all or part of the earlier advance, depending on projected expenditure and the amount in the cash advance account.*

Whether the two payments relating to the works contract were regular depends on the interpretation of the contract; this stipulates that reimbursement of advances shall begin when the sums due under the contract reach 60% and 50% (of the flat-rate advance and the advance on equipment and plant respectively). The sums due were considered by the Commission to be those relating to work actually done, and with the two payments in question the contract implementation cost came to 38,8%. The advance on the contract was recovered in full against ensuing payments.

3.61. *The payment by the Commission was in conformity with the contract, which provides for a 20% advance (see tender addendum 2 to the contract). Ten per cent was paid as a start-up advance and 10% when the equipment arrived at the site.*

3.62. *Study of emergency aid contract 7.LBR.23.1 produces no grounds for blaming the partner for the poor quality of the delivered product. There was therefore no reason to refuse to wind up the case so that final payment could be made.*

Although the food products were not distributed in full, as they proved to be unfit for consumption, the Delegate on the spot was unable to determine what was chiefly to blame: the NGO or the situation at the time, which prevented distribution on security grounds and therefore caused the products, which were perishable, to deteriorate.

The file on the operation does not refer to this, but officials on the spot sometimes reach understandings with NGOs, which then take upon themselves to replace products which are unfit for consumption.

3.63. *Financing decisions relating to structural adjustment programmes financed from national indicative programmes may be increased by decision of the chief authorizing officer where the overrun is up to 20% of the original commitment (Article 292 of the Convention and Article 62 of the Financial Regulation). As there is no comparable procedure applying to structural adjustment programmes financed from the structural adjustment facility, the Commission applies the above procedure by analogy.*

3.64. *For the reasons given under paragraph 3.51, the Commission takes the view that the commitments referred to, and therefore the payments as well, met the eligibility conditions laid down by the Convention.*

3.65. *In the first and third cases, the Commission considers that the lack of adequate documentation in the payment file about the weightings used for the price review does not affect the regularity of the payment. Checks are being carried out on the spot to ascertain whether the price review was calculated on a sound basis.*

As regards the second case, the Commission considers that where works contracts are concerned intermediate payments are an estimate of costs due which can be corrected by adjusting the next payment rather than final payment for one stage of the works. The situation referred to by the Court was therefore rectified by adjusting the next payment.

Given the variety of projects financed by the EDF it is not reasonable to assume that a standard price revision clause could be adopted and enforced.

The risks and factors which must be taken into account are peculiar to every project, depending on the nature of the works, the duration of the contract, the location of the project and so on. Only the design engineer can identify such risks and factors with a sufficient degree of certainty. On the other hand, it is up to the contracting authority to determine if it is willing to assume some of the risks through a price review, or if such risks are transferred to the contractor through the absence of a price review but with higher prices up front.

In approving price review formulas Commission departments take certain principles into account, as follows:

- (1) *a clear distinction must be made between national costs and foreign costs, and payments in national currency*

versus payments in foreign countries. For that purpose, two separate price review formulas with specific variables are required;

cost factors incorporated into the contract prices (mobilization, overheads and profits etc.) are not to be influenced by a price review;

(2) a percentage of the contract cost must be neutralized and not subject to review. This is because the contractor is allowed to apply for advance payments and certain

(3) price reviews must discourage the contractor from allowing undue delays to occur in the performance of the contract.