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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 2/2004

concerning pre-accession aid

HAS SAPARD BEEN WELL MANAGED?

together with the Commission's replies

(pursuant to the second subparagraph of article 248(4) of the EC Treaty)

(2004/C 295/01)

CONTENTS

EXECUTIVE SUMMARY

I. The Special Accession Programme for Agriculture and Rural Development (Sapard) is the first external aid programme which is implemented in a decentralised manner. The objectives of the programme are to contribute to the implementation of the Community *acquis* and to solve problems for the adaptation of the agricultural sector and rural areas in the 10 countries which benefit from Sapard aid ([1]). These 10 countries are hereafter referred to as 'the Sapard countries'. Due to the large increase in the pre-accession budget, which for Sapard was to be managed by newly created structures under newly created rules, the Court performed an audit which aimed at answering the question: 'Has Sapard been well managed?' (see paragraphs 1 to 10).

II. The answer to that question is that management has been of mixed quality. Although there were substantial delays in getting Sapard under way some were caused by a failure on the part of the Commission to plan as early as possible. That said, the pace of the implementation of Sapard has increased but the main objectives had not been achieved by the end of 2003. There have been delays in implementation in most of the Sapard countries caused in part by a lack of guidance and advice from the Commission and the steep learning curve that the countries faced, and some measures have not been activated.

III. Large proportions of available funds remained unused and budgets were systematically over-estimated, because considerable time was needed to set up and implement Sapard. Detailed implementation principles and rules were not ready when the Council adopted the Sapard Regulation in June 1999. Systems needed to be set up in the Sapard countries, which took a long time in some cases, for which the Commission did not analyse the reasons. Since the start of Sapard in the countries concerned, heavy administrative procedures, stricter than required by the Sapard rules, have hampered a rapid and efficient implementation of the programme (see paragraphs 11 to 25).

IV. The Commission's option for decentralised implementation was correct given the likely large numbers of projects to be financed, but it under-estimated the time which would be needed for this to be done. Although the Commission organised seminars and had other contacts with Sapard countries, its decentralised management for Sapard does not guarantee that implementation problems are actively and systematically identified and followed up. Because of this, best practices were not applied in all the Sapard countries (see paragraphs 26 to 35).

V. In the first four years of implementation, only 323 million euro (14,8 %) of the available budget of 2 183 million euro was paid to final beneficiaries. Due to the low level of spending during the pre-accession period, which for 8 of 10 of the beneficiary countries is from 1 January 2000 until 1 May 2004, there has been only a minor contribution to the objectives defined for Sapard. For Bulgaria and Romania, for which the pre-accession period is foreseen to last until 1 January 2007, a much higher impact can be expected. In Poland, Sapard will pay at least 17,7 million euro in the form of VAT to the state budget which does not contribute to the objectives of Sapard (see paragraphs 36 to 40).

VI. The first results of completed projects show that the money for agricultural processing has generally been spent on projects which increase the quantity of agricultural production, more than on projects which improve the quality of agricultural production (meeting quality and health standards and protection of the environment) (see paragraphs 41 to 47).

VII. The Commission did not report on how well Sapard achieved its objectives, but instead focused on institution building. This has been positive, because Sapard could provide national administrations with hands-on experience for the management of EU funds after accession. However, for one of the most important measures after accession, agri-environment, the effect was limited (see paragraphs 48 to 57).

VIII. A requirement under Sapard is prior approval, by the Commission, based on its audits, of the systems set up by the countries concerned. This has ensured that well-defined systems with key controls were in place before any funds could be spent. This requirement is a key difference from comparable programmes in Member States, which can start with implementation without such audits or prior approval of the systems by the Commission (see paragraphs 58 to 60).

([1]) These 10 countries are: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia and Romania.

IX. The Court found for the Sapard systems that key concepts were included, that procedures were well-documented, that the systems which existed on paper were generally working in practice and that for most files reviewed the checking procedures were followed. A difficulty was that other related systems, which provided input to the Sapard systems but which did not receive prior approval by the Commission, were not of the same quality. This was in particular the case for the national checks on compliance with quality, health and environmental standards, which were found to be insufficient (see paragraphs 61 to 80).

X. Key implementation problems were that potential beneficiaries lacked own resources, had difficulties in obtaining credit and were faced with heavy administrative procedures. The result of this was that Sapard favoured the financially strong and the better organised with sufficient capital or access to loans. For smaller farms and firms which have the greatest efforts to make in meeting standards to modernise and increase efficiency, this was a major handicap (see paragraphs 81 to 97).

XI. The rules and the checks for private procurement and for general costs were insufficient. Effective checks to prevent the acceptance and payment of overstated invoices were not made (see paragraphs 98 to 109).

INTRODUCTION

What is Sapard?

1. The Luxembourg European Council of December 1997 took decisions to launch the enlargement process with the objective of preparing the applicant countries for accession to the Union. This included an enhanced pre-accession strategy intended to enable the countries of central and eastern Europe to eventually become members of the European Union and, to that end, to align themselves as far as possible with the Community *acquis* (1). As part of the pre-accession strategy, it was decided to increase substantially pre-accession aid: alongside the already existing Phare programme (2), it would comprise a structural instrument and aid for agriculture as from 2000.

2. Accordingly, the Special Accession Programme for Agriculture and Rural Development (Sapard) was launched on 1 January 2000. The Sapard Regulation (3) specifies that the objectives of the programme are to:

— contribute to the implementation of the *acquis communautaire* concerning the common agricultural policy and related policies,

— solve priority and specific problems for the sustainable adaptation of the agricultural sector and rural areas in the applicant countries.

3. The programme has been managed under Chapter 1 of Title B7 (Pre-accession strategy) of the budget (4). The amounts made available for the 10 Sapard countries for the years 2000-2003 were 2 183 million euro (5). Annex 1 provides a breakdown by country of this amount.

4. Sapard provides aid from EU and national funds of up to 50 % to agricultural producers (mainly for on-farm investments in agricultural machines) and processing plants (mainly for investments in equipment), the remaining part (50 % or more) being financed by the beneficiary (6). In the case of local communities (for rural development infrastructure such as local roads and sewage systems) the Sapard aid is up to 100 %. In all cases (whether the public aid granted is up to 50 % or 100 %), the EU contributes 75 % of the aid paid, while national co-financing provides the remaining 25 %.

5. Sapard is unique in the sense that it is the first external aid programme which is implemented in a decentralised manner. This latter aspect means that there is no *ex ante* approval by the Commission for project selection, tendering and contracting (7). Decentralised management in the Sapard countries has closely followed the systems set up in EU Member States, including the approval by the Commission of a 'Programme for Agriculture and

(1) Body of EU law setting out the common rights and obligations which bind the Member States of the European Union.

(2) The Phare programme is the first pre-accession instrument and was set up by Council Regulation (EEC) No 3906/1989 of 18 December 1989 (OJ L 375, 23.12.1989).

(3) Council Regulation (EC) No 1268/1999 of 21 June 1999 (OJ L 161, 26.6.1999) on Community support for pre-accession measures for agriculture and rural development in the applicant countries of central and eastern Europe in the pre-accession period.

(4) General budget of the European Union. As from 2004, Sapard is managed under Chapter 5 of title 5 (Agriculture and rural development) of the budget, and only includes new allocations for Bulgaria and Romania.

(5) Appropriations for commitment.

(6) The level of public aid is a function of the type of measure or project. For revenue-generating investments the normal maximum aid level is 50 % of the total eligible cost.

(7) As defined in Article 12 of Council Regulation (EC) No 1266/1999 of 21 June 1999 on coordinating aid to the applicant countries in the framework of the pre-accession strategy (OJ L 161, 26.6.1999).

Rural Development' for each Sapard country. The Sapard Regulation stipulates that the programmes should be based on plans drawn up by those countries, which should relate to the 15 measures defined in the Regulation.

6. There has been a concentration on those measures which focus on investments in agricultural processing (improving the processing and marketing of agricultural products, and investments in agricultural holdings) and those which develop rural areas (development and improvement of rural infrastructure). The Sapard countries granted these a higher priority than other possible measures such as those for agri-environment, forestry and afforestation to which they allocated only 4 % of all resources. *Annex 1* provides a breakdown by country of the allocation to the main type of measure and beneficiary.

7. Implementation and payment functions in the Sapard countries are the responsibility of the Sapard Agency. Potential beneficiaries send applications to local offices of this agency. A separate body in the Ministry of Finance, called the National Fund, requests and receives payments from the Commission, and makes funds available to the Sapard Agency.

How did we audit Sapard?

8. Due to the large increase in the pre-accession budget in general, which effectively doubled from 1999 to 2000 and which, for Sapard, was to be managed by newly created structures under newly created rules, the Court decided to perform an audit which aimed at answering the question: 'Has Sapard been well managed?' Three audit objectives were defined, which sought to review:

— the Commission's management and control systems for the programme,

— the quality of systems set up in the applicant Sapard countries, and

— project selection, approval and implementation by national and regional authorities.

These objectives allowed the Court to analyse whether the management and control systems were effective and applied reasonably or whether they were insufficient in their coverage.

9. Audits were carried out in the Commission (DG Agriculture) and in four Sapard countries (Bulgaria, Lithuania, Poland and Romania). Documentary checks were made for a sample of 76 projects, of which 42 were visited on the spot between November 2002 and September 2003. The projects in the sample covered the main measures implemented at the time of the audit, which themselves represented around 95 % of all contracts concluded and payments made in these four countries (1). In addition, key elements of the systems set up in the Sapard countries were reviewed. The staff of the Supreme Audit Institutions of the countries visited have worked with and accompanied the Court's auditors.

10. The audit of Sapard built on the results of previous audits, which had focused on the setting up of the programme and the Commission's analysis and monitoring of the Sapard systems, which have been published in the Court's Annual Reports (2). The main conclusions were that considerable time was used in setting up the Sapard instrument, in particular in clarifying and working out the details of the complex legal basis, and that the management and control systems foresaw insufficient checks in risk areas such as staffing, prevention of double funding, sound financial management, bank interest, and compliance with minimum standards for environment, hygiene and animal welfare.

STAGES IN THE IMPLEMENTATION OF SAPARD

Large proportions of available funds remained unused

11. The *diagram* shows the stages in the implementation of the Sapard programme from the first proposal for legislation until 31 December 2003. The boxes give information about when key steps were completed. The amounts indicated in section 'A' show the gap between the total Community financial contribution in the general budget (3) and the total amount for which contracts have been concluded with beneficiaries. The difference thus reflects the amount available in the budget which was not used by the Sapard countries because of the time needed to have their systems approved, and, following this, the delays in those countries arising from difficulties in implementation. The two main implementation problems are presented in paragraphs 81 to 95.

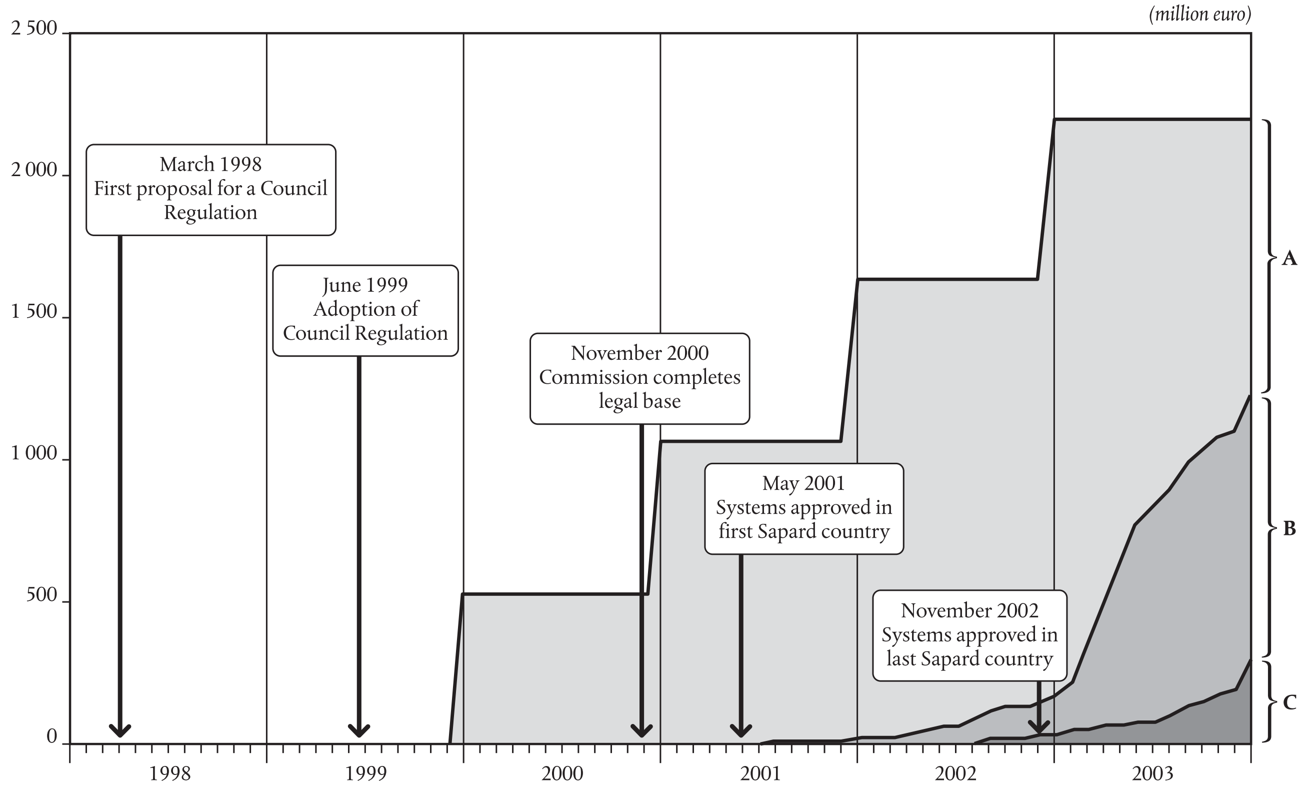
(1) The main measures are: investments in agricultural holdings, improving the processing and marketing of agricultural and fishery products, and development and improvement of rural infrastructure. This represents some 80 % of commitments made in all applicant countries.

(2) Court of Auditors Annual Reports concerning the financial year 2000 (OJ C 359, 15.12.2001) (paragraphs 6.41 to 6.53); 2001 (OJ C 295, 28.11.2002) (paragraphs 6.8 to 6.32); and 2002 (OJ C 286, 28.11.03) (paragraphs 8.23 to 8.31).

(3) Cumulative appropriations for commitment.

DIAGRAM

Implementation of Sapard 1998-2003



A = Amounts in the EU budget for which contracts were not signed.

B = Contracts concluded but not yet paid.

C = Amounts paid to beneficiaries.

Source : European Court of Auditors: payments and contracts as at 31 December 2003.

12. Section 'B' shows the amount of contracts concluded with final beneficiaries but which have not yet been paid. This reflects the time needed for the implementation of projects, which, for example for construction projects, can normally take more than a year, but also reflects administrative delays (see paragraph 16 et seq). Section 'C' shows the actual flow of funds to beneficiaries.

because of the time needed for setting up the programme

13. In June 1999, the Council adopted the Commission's proposal for a Regulation on Sapard. This set out a new and complex legal framework, which required further definition. It took the Commission seven months to set out the implementation principles; then six months to draft and adopt the detailed rules; then a further six months to draft, negotiate and adopt the agreements with the Sapard countries. Thus, the legal basis was finalised on 29 November 2000 [1]. By the end of March 2001, all countries had signed the agreements.

14. The Commission did not use the time available in the period between March 1998, when it proposed the Sapard Regulation [2], and June 1999, when it was adopted by the Council, to make further implementation preparations. This 15-month period could have been used to prepare detailed principles and rules which would have clarified the policy and accelerated implementation.

15. After completion of the legal framework in November 2000, the start of Sapard depended on the time needed to set up the systems by the Sapard countries. Some countries were quick: the Commission approved the systems for some of the measures in Bulgaria in May 2001. For others it took longer. Hungary did not start the implementation of some of the Sapard measures until 27 November 2002.

and because of delays in implementation by the Sapard countries

16. Since the start of Sapard in the countries concerned, heavy administrative procedures, stricter than required by the

(1) Further details are given in the Court's Annual Report concerning the financial year 2000, paragraphs 6.41 to 6.43.

(2) Proposal from the Commission for a Council Regulation (COM(98) 153 final, 19 March 1998).

Sapard rules, have hampered an efficient implementation of the programme. Below are some examples of the implementation problems found by the Court (see also paragraph 91 et seq).

17. Romania was the last-but-one Sapard country to have parts of its systems approved, but it was not well-prepared for applying the programme in August 2002. The time between receiving the application form and approving it took up to seven-and-a-half months. Since April 2003 the situation has improved because the Romanian authorities have changed certain procedures and increased the number of staff available to deal with these applications. Despite these delays, the large number of applications made it possible for the Romanian authorities to use all funds planned for rural infrastructure for the whole seven-year period (2000-2006).

18. Poland also received a large number of applications for this type of project. However, for administrative reasons not required by the Sapard rules, more than 250 million euro which were available were not used for more than one year (1). This hampered an efficient implementation of Sapard.

19. In Lithuania, the average time between submission of the project application and signature of the contract is 4,5 months. One of the main reasons for the delays in approving the applications is the lack of staff in the key unit which evaluates all project applications.

20. In Bulgaria, all checks made at local level are reperformed by the Sapard Agency at central level. This adds about one month to each project approval (thereby delaying project implementation) and about one month to each payment approval stage. Such double checks are necessary when systems are set up, but the need for them should be kept under review.

21. As will be seen in paragraph 35, the Commission has not looked actively for implementation problems such as the ones described above. Although in some cases the Commission has taken action by discussing the issue with the country concerned, this was not done systematically.

Key steps have not been analysed so that lessons can be learned

22. The Commission did not analyse the critical steps which delayed the setting up of the systems by the Sapard countries. This would have been good management practice. Such an analysis should include its own role and would have been useful, because Sapard countries could have taken into account success factors when setting up systems for the management of EU funds.

23. Later, the Commission also did not include such an analysis in the mid-term evaluation of the programme in each Sapard country. By including this element, success factors and constraints in putting in place the systems could have been identified, thereby assisting similar exercises in the future. An external evaluation was not launched to ensure that the experience gained from Sapard could be used in the future.

and budgets were systematically under-utilised

24. The Commission could not make accurate estimates of the amounts included for payments in the budgets for the first three years. Up to the end of 2002, it made 850,8 million euro available for payments, of which only 154,4 million euro (18 %) were used, while the other part was cancelled (2). The Commission noted that the payment estimates were uncertain because they depended on factors which were out of its control and there was no previous experience in managing external aid in a decentralised manner. Thus, the amounts could not be based on sufficiently detailed documentation and calculations.

25. Instead, other arguments were provided to justify the amounts, such as the need to give a positive signal that the Commission was confident that the countries concerned would be able to implement Sapard. There is a need to separate political will and economic reality but, as a consequence of an undue emphasis on the former, the Commission systematically overestimated the amounts for payments in the budget.

DECENTRALISED IMPLEMENTATION

was a choice by the Commission

26. Until June 1999, external aid required *ex ante* approval by the Commission for project selection, tendering and contracting. The legal basis for Sapard made it possible, for the first time, that such *ex ante* approvals for external aid could be waived. The Council did not stipulate that such a system of decentralised management must be used, but the Commission opted for this. The

(1) The reason for the delays is the following. Poland splits annual budgets into specific measures and, for the largest measures, to specific regions. Application rounds are launched for specific regional, annual allocations. This practice of linking projects to specific regional, annual allocations blocked the use of other available budgets. For rural development infrastructure, the allocation to the regions requires a decision by the Ministry of Agriculture, which was, for a large part of the funds, not done until 22 September 2003.

(2) The amount of 154,4 million euro cannot be compared with the diagram because it includes 139,7 million euro of advance payments made by the Commission to applicant countries and 0,1 million euro for seminars. These amounts are not shown in the diagram because they are not paid to final beneficiaries. The 154,4 million euro also includes 14,6 million euro of payments made by the Sapard agencies, from the advance payments, to final beneficiaries. These latter payments (adjusted by the Court for timing differences because the Commission books the payments on a cash basis) are shown as section 'C' in Figure 1.

Commission's option for decentralised implementation was correct given the likely large numbers of projects to be financed.

27. Since the Commission had not set out the methods for managing the programme either as part of its proposal for the Sapard Regulation in March 1998, or during the subsequent period, it needed to do this after the adoption of the Regulation in June 1999 by the Council. In January 2000, the Commission adopted a communication indicating that Sapard should be managed decentrally. The reasons given by the Commission as to why it decided upon decentralised implementation were:

— that it did not have the necessary technical and human resources to manage the expected large number of small projects,

— to prepare the Sapard countries for management of agricultural and rural development spending after accession.

but the lack of preparation by the Commission and the tight time frame led to difficulties with decentralisation

28. The Berlin European Council of March 1999 assumed that the accession of six new Member States, five of which were eligible for Sapard, might take place from 2002 onwards [1]. Since this meant for those five countries that Sapard would only be operational for two years, it was necessary to start the Sapard programme as soon as possible in order to have effect.

29. However, by opting for decentralised implementation the Commission had to provide a legal framework for making Sapard rules applicable in those countries. Then the Sapard countries needed to set up their systems, for which they had no previous experience. Given the complexity of the tasks, the Commission under-estimated the time which would be needed for this to be done.

30. Of the five countries, only Estonia (in June 2001) and Slovenia (in November 2001) had their systems approved by the Commission before 2002. The time taken did not result in a shortening of the implementation period for Sapard because the Gothenburg European Council of June 2001 set May 2004 as the accession date, due to protracted enlargement negotiations.

and the Commission's management was not always suited to Sapard countries' needs

31. In line with the principles of EU programmes in the Member States, the Sapard countries have full responsibility for the management of Sapard. The international agreements, signed between them and the Commission, assign the responsibility for day-to-day management, in particular identifying and addressing implementation problems, to the Sapard countries.

(1) Initially, accession was foreseen for six countries: Czech Republic, Estonia, Hungary, Poland, Slovenia (Sapard) and Cyprus (non-Sapard).

32. In the Commission's view, its responsibility under a system of decentralised management is to monitor the implementation of Sapard. The formal tools for this are through the negotiation of the programmes, analysis of annual implementation reports provided by the Sapard countries and the participation, in an advisory capacity, in each national Monitoring Committee, which meet twice a year [2].

33. The Commission assigned few staff to do this. On average less than the time of one official was allocated for managing the programme of a Sapard country [3]. For instance, a single official was responsible for overseeing the implementation of both the Romanian and the Bulgarian programmes amounting to 1 442 million euro of Community assistance.

34. The Commission's approach for managing the programme can be illustrated by the following. As part of the 2001 discharge, the European Parliament criticised the Commission for under-implementation of the Sapard budget, because payments to final beneficiaries were very low. The Commission replied that expenditure is essentially a function of how rapidly beneficiaries incur expenditure, which the Commission could not control. The Commission gave a commitment to speed up implementation, of which the main result was that letters were sent to beneficiary countries asking them what the Commission could do [4].

35. The Court's audit identified several areas where different practices are applied in the Sapard countries, some with good results but others which are counter-productive (see paragraphs 21, 39, 80, 90, 95, 103 and 109). The Commission has helped by the organisation of seminars and its daily contacts with the Sapard countries, but this does not guarantee that implementation problems are actively and systematically identified and that action is taken in order to ensure that the best practices are implemented in all 10 countries (see also paragraphs 85 and 86).

MAIN RESULTS OF SAPARD

Limited impact in 8 out of 10 countries

36. The Sapard Regulation established the framework for Community support for the pre-accession period. For 8 out of 10 of the beneficiary countries, this period is from 1 January 2000 until 1 May 2004. The expenditure paid to final beneficiaries up to 31 December 2003 was 323 million euro

(2) The other official ways to be informed reach the Commission at later stages: results of mid-term evaluation (by 31 December 2003) and final evaluation (by 31 December 2006).

(3) Commission staff involvement in audits is not considered as management in a strict sense and is discussed in paragraph 58.

(4) The Commission could not control the rate of commitments and payments because it did not want to change the fully decentralised management framework of Sapard and did not propose changes such as an additional measure for credit or guarantees.

(14,8 % of the available budget of 2 183 million euro), more than half of which was paid in the last quarter of 2003. Due to the low level of expenditure during the pre-accession period for these countries (see paragraphs 11 to 20), there has been only a minor contribution to the objectives defined in the Regulation before accession.

37. For Bulgaria and Romania, the European Council has set a target date for accession of 1 January 2007, provided that these countries meet the necessary requirements. For these countries, a much higher impact can be expected.

VAT included as eligible expenditure does not contribute to Sapard objectives

38. Under the international agreements concluded between the Commission and each Sapard country, VAT invoiced on equipment or services may not be charged as an eligible cost for reimbursement if any of the following conditions are fulfilled:

(a) if it is recoverable, refunded or offset by any means whatsoever;

(b) if it does not form part of the general taxation system, or

(c) if it bears disproportionately on any part of the programme.

39. The beneficiaries for the measure 'development and improvement of rural infrastructure' are local municipalities and the invoices for projects financed by this measure include VAT. In Poland, because VAT is not reimbursable, such VAT is charged to the project as an eligible cost. This is not the case in the other Sapard countries audited.

40. Based on the 2000-2003 allocations to Poland for the measure (270 million euro), and with VAT rates varying between 7 % and 22 %, depending on the supply concerned, the Court has estimated that the VAT will amount to at least 17,7 million euro. This VAT amount will be paid by Sapard to the state budget in which case it does not contribute to the objectives defined for the programme. To put it in perspective, it is equivalent to the average Community contribution in Poland for approximately 400 road modernisation projects or 2 000 farm improvement projects. The effect of allowing VAT as an eligible cost for financing in Poland but not in other Sapard countries is that not only are fewer projects undertaken but also the effective level of national co-financing is substantially reduced. Therefore, the impact of Sapard is substantially diminished in that country. This is disproportionate, and thus the expenditure is ineligible under the terms of (c) above. There is no evidence that the Commission took action, and it should investigate the full circumstances with a view to determining whether Poland should repay the VAT to the programme.

There was little contribution to achieving 'EU standards'

41. The Sapard Regulation stipulates in Article 4(3) that the countries concerned shall ensure that priority is given to improving market efficiency, quality and health standards and measures to create new employment in rural areas, in compliance with the provisions on the protection of the environment. The Court's audit found that 44 out of the 46 projects reviewed for the two measures 'investments in agricultural holdings' and 'improving the processing and marketing of agricultural products' increased or modernised production [1].

42. However, only two projects were implemented which had as the main objective the improvement of standards of the business. While it is true that the new, modern equipment itself fulfils EU standards, there was little evidence that, for the 24 Sapard projects for on-farm investments, there was any effect on the quality, health or environmental standards for the farm as a whole. Similarly for the 20 projects for processing plants reviewed, although there was an effect from the new equipment itself on the plant as a whole, this was not in terms of readiness of the whole establishment to EU standards.

43. The importance of this is underlined in the Commission's recent monitoring reports on the state of preparedness for EU membership [2]. In these reports, the Commission identified the current pace of upgrading the agri-food establishments in the Czech Republic, Hungary, Poland and Slovakia as an area of serious concern. For Poland it concluded that urgent progress was needed in public health and that immediate action was needed in order to implement the *acquis* by the date of accession.

44. The agri-food sector, to which 27 % of Sapard funds are allocated, also receives substantial amounts of foreign direct investments. In Poland, the sector attracts around 575 million euro of such investment per year, which is 10 times as much as the annual Sapard allocation [3]. The sector is one of the most dynamic of Polish industry. In such an environment, the financing of commercial investments should be left to the private sector. Sapard funding should concentrate on meeting EU standards.

45. Projects for the measure 'investments in agricultural holdings' typically involved the purchase of bigger, more modern and more powerful farm equipment, which had the effect of increasing production of the beneficiary holding. In some countries there was a strong concentration of these investments in the

(1) In total, 48 projects were reviewed for the two measures; however, in two cases the project had not advanced sufficiently to draw a conclusion on the main objective.

(2) Comprehensive monitoring reports of the European Commission on the state of preparedness for EU membership of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia, 5 November 2003.

(3) The revised EU allocation for 2000-2003 averages 57 million euro per year.

cereals sector. Investments in the milk and meat sector, where the need for compliance with EU standards is much higher, were low. After analysis of Sapard countries' annual reports submitted in June 2003, the Commission has also identified an imbalance.

46. Even if Sapard mainly concerned the purchase of equipment, it could still have contributed to upgrading to EU standards if procedures had been strictly applied. This was not the case: requirements and checks for minimum standards are defined in the national legislation. They are the same for all agricultural producers and processing plants, whether they have a Sapard project or not. The Court's audit found that hygiene and environmental checks by the national authorities were insufficient. Further details are provided in paragraphs 70 to 76.

47. Thus, when looking at the overall Sapard objective of implementation of the *acquis* concerning the common agricultural policy and related policies, the following can be concluded. Until the end of 2003, the money has generally been spent on projects which increase the quantity of agricultural production, more than on projects which improve the quality of agricultural production (meeting quality and health standards and protection of the environment).

Targets were not always clear

48. The Court's on-the-spot audits of the priority 'creation of employment in rural areas' revealed several cases where due to modernisation of equipment using Sapard investments fewer jobs were needed. However, the monitoring of Sapard did not take into account any negative effects on rural employment from investments in the agri-food sector. For the few projects where the number of jobs to be created was quantified, it was found that these were based on general intentions, which depended on the expected market developments rather than on the direct effect of the Sapard project.

49. Investments in rural development infrastructure have to take place in rural areas in order to be eligible. However, the Commission did not ensure that the projects were actually implemented in rural areas. Normally population density is the yardstick for defining rural areas. However, data was not available in certain countries, and the Commission approved the use of other criteria. This led to Sapard co-financing investments of very doubtful rural nature. Several cases were found where the area served by the project was, in effect, a suburb of a larger town. The true rural nature of the municipalities was not established. This is despite the fact that the gap between infrastructure facilities of urban and rural areas within Sapard countries is generally greater than between urban and rural areas in the present Member States.

and reporting on objectives and priorities by the Commission was not as required

50. Article 13 of the Sapard Regulation stipulates that the Commission shall present an annual report on the Community support granted, in which it shall outline, in particular, the progress made towards achieving the objectives set out. In order to do this, objective criteria for measuring the progress towards achieving objectives or the priorities of the Sapard Regulation, such as a summary of the main indicators set out in the Sapard programmes, should have been set out in the annual reports. This was not done.

51. The 2000, 2001 and 2002 annual reports from the Commission provide detailed and technical descriptions of actions taken by the Commission including progress in terms of setting up the systems and payments ([1]). However, these are only the means needed to achieve the objectives.

Four years after the start of the programme, the Commission has not established or communicated the extent to which the objectives set out for the programme have been achieved.

Institution building has been positive except for agri-environment

52. Despite the objectives and priority areas defined in the Council Regulation, the Commission views Sapard mainly as an institutional-building device to ensure the easy take-up of Community practices after accession. Thus, the Commission has stressed on various occasions, including in its annual reports, that the real contribution of Sapard is to facilitate implementation of necessary arrangements after accession.

53. However, Sapard should primarily be judged as to how well it has contributed to the objectives set when it was created. It must also be borne in mind that institution building is one of the objectives of the Phare programme and programmes for easy take-up of Community practices have been implemented through Phare management procedures and paid for by the Phare budget ([2]). In each of the countries visited around 6 million euro from Phare was used for pre-accession advisers, experts for programming and setting up and auditing the systems, pilot projects and computer equipment for and training of staff in the bodies which were implementing Sapard.

([1]) Sapard annual reports (Reports from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions) COM(2001) 241 final 3 July 2001, COM(2002) 434 final 30 July 2002, COM(2003) 582 final 7 October 2003.

([2]) In March 1997, the Commission decided to fully focus the Phare pre-accession instrument on preparing candidate countries for joining the EU. About 30 % of the annual Phare budget of around 1 500 million euro per year was allocated to institution building, in particular to introducing the objectives and procedures of the Structural Funds.

54. The institution-building effect of Sapard has been positive. Phare paid for and managed the institution building, while Sapard provided the opportunity of 'learning-by-doing'. Sapard could provide national administrations with hands-on experience for the management of EU funds because many procedures are the same (programming, implementation procedures, monitoring). The combined results of Phare and Sapard have been an achievement, because structures and systems which were virtually non-existent only a few years ago have been set up and were found to be both operational and generally effective. Paragraphs 61 to 65 provide further details on these systems.

55. However, institution building and learning-by-doing were not successful for the agri-environmental measure. This important rural development measure is the only one which is compulsory for Member States, and it is also the largest, representing 41 % of funds available for rural development under EAGGF Guarantee. The reform of the CAP also places increased importance on agricultural environment.

56. Due to the complexity of the agri-environment measure in general, and the fact that it was conceived as a pilot under Sapard, details were issued by the Commission to the Sapard countries only on 21 December 2001. These details required modifications to the Sapard Programmes which have been approved for each country and the setting up and approval of the relevant systems. This meant that the measure could not be implemented before the end of 2002. By December 2003, only the Czech Republic and Slovakia managed to do this. Hungary even removed the whole measure from Sapard. Poland suggested doing the same, but was convinced by the Commission of the relevance of keeping it. However, delays in working out the detailed implementation rules continued, and the measure was not implemented in Poland before it joined the EU.

57. The Commission defined for the agri-environment measure that the actions should have the objective of developing practical experience of agri-environment implementation at both the administrative and farm levels. This objective has not been met, because by December 2003, six out of eight beneficiary countries acceding in May 2004 had gained only limited experience of implementing this measure under Sapard.

ASSESSMENT OF SYSTEMS SET UP IN SAPARD COUNTRIES

Prior approval of the systems has ensured tight financial control systems

58. The Sapard legal basis required a decision from the Commission on decentralised management, based on an analysis of the management and control systems of the country concerned (known as conferral of management). As at December 2003, 17 Commission decisions were made for parts of the system approved in a country, each of which conferred management of aid on a provisional basis. Full conferral, which was envisaged after further verifications by the Commission and implementation of Commission recommendations, was not given. The Commission did not assume its responsibility to fully decentralise management. Indeed, the Commission did not define the criteria to be met to receive full conferral of management.

59. The legal basis also defined the minimum criteria and conditions for decentralised management, such as a well-defined system for managing the funds including effective internal control and the presence of adequate personnel. The Commission's analyses, in the form of system audits, have ensured that a well-defined system with key controls was in place before any funds could be spent ([1]).

60. Consequently, Sapard countries started project implementation (concluding contracts) after the Commission decision approving the systems, when all procedures, check lists and forms were approved. This situation is different in Member States, where Structural Funds expenditure for the period 2000-2006 was eligible from 1 January 2000 or, in certain circumstances, as soon as the first draft of the programming document was submitted to the Commission, without prior approval of the systems.

Systems were generally working in practice

61. The Sapard management and control systems have key elements in common with EU programmes. Structural Fund procedures are applied for programming, monitoring and evaluation. EAGGF Guarantee Fund procedures are used for the financial management, including the clearance of accounts procedure ([2]) and use of paying agencies.

62. The programming exercise, which was entirely new for Sapard countries, required them, *inter alia*, to describe the strategy, select priorities, describe the measures and indicate the financial resources to be used. Nonetheless, all Sapard programmes for agriculture and rural development were ready and approved by the Commission in the autumn of 2000. It took no longer to establish Sapard programmes than it took for Member States to have their Structural Fund programmes approved. Monitoring structures were also set up within an acceptable time.

63. The paying agencies set up in the Sapard countries for implementation of Sapard will in most cases be the paying agencies which will be used for the management of EU funds after accession. In Lithuania and Poland, the agencies will be managing both the Guarantee and Guidance sections of the EAGGF.

([1]) With the exception of certain elements, see paragraph 10.

([2]) This is the procedure under which the Commission decides whether expenditure made by CAP paying agencies should be definitively charged to the EU budget.

64. As in the Member States, internal audit units were operational in all paying agencies and the attestation of the accounts and reports on management and control systems were performed by operationally independent certifying bodies. The Court found that professional audits were performed.

65. The Court reviewed the procedure descriptions and checklists and checked 33 files to test that the systems worked as documented. Notwithstanding the weaknesses identified later in this report, the Court found for the Sapard systems that key concepts were included, that procedures were well documented, that the systems which existed on paper were generally working in practice and that for most files the checking procedures were followed.

but there was a lack of supporting elements in files

66. A common problem with the files reviewed in the four countries visited was a lack of documentation of checks. Check lists were completed but the files generally did not contain justifications or explanations to support the conclusions indicated by the assessors. Notably there were no notes or working papers setting out the tasks performed such as calculations, documents checked on the spot or people met on the spot etc. In the absence of such documents, the work of the second reviewer of the check list was limited to verifying that all boxes had been ticked, rather than carrying out a meaningful check. Since guidelines setting out how checks should be performed did not always exist, it was generally not possible for the Court's auditors to review what work was performed and to ascertain on what basis the boxes in the check lists were ticked as satisfactory.

67. An example of this was the lack of documentation for the analyses of business plans in Lithuania. Applicants have to submit business plans in support of their project. These plans indicate the viability of the business including the investment. The procedure in Lithuania requires the evaluator to analyse the business plans. However, there was little evidence of this analysis on file in the samples examined by the Court. This work is very technical and requires more than what is currently done: a tick in the box 'Yes', for example, signifies that 'the indexes and financial ratios of the farming activity correspond to the critical values established by the Minister of Agriculture.'

Sapard systems relied on other weaker systems

68. The Sapard systems need prior approval from the Commission which is based on audits. The same procedure does not, however, apply to systems which are directly related to and which provide input to the Sapard systems. Examples of this are recruitment procedures for staff and checks to examine minimum standards for hygiene, environment and animal welfare. These systems and procedures are not covered by the Commission's audits and prior approval of the systems.

69. The Sapard legal basis requires that adequate personnel, with suitable experience, must be available and assigned to the task [1]. Examination of the recruitment procedures in Bulgaria, Lithuania and Poland found that recently recruited staff were not recruited using transparent procedures and that personnel files did not contain any information on the procedure followed or documentation on the selection of the staff concerned. In Lithuania several cases were found where only one applicant applied for posts available in the Sapard Agency and the selection tests were routinely destroyed at their conclusion. There is thus no transparent procedure which guarantees that qualified people are selected, and that the systems are of the quality approved by the Commission.

70. Project applicants are required to comply with health and environmental standards, both prior to and after project implementation. As part of its decisions to decentralise management of aid, the Commission accepted the national checks on compliance with quality, health and environmental standards without reviewing who checked what, how or when. The Commission did not require the Sapard countries to provide such information as part of the Sapard procedures. The only check required by the Commission and actually performed by Sapard Agencies was the presence of certificates issued by the responsible public body.

71. In Romania, certificates of compliance with standards were issued by the environmental agency and the agency responsible for hygiene and health checks. Neither the Romanian authorities nor the Commission had assessed the basis for issuing these certificates. When the Court reviewed the latter, it found that what was checked, and how, was not documented. Inspection reports for Sapard projects were not always available and, if they were, they did not provide any details of the checks undertaken.

72. In Bulgaria, the national authorities check the requirement that the holding and the project meet the national environmental standards by the presence of a decision from the communal committee. This decision is based only on information provided by the beneficiary, and on-the-spot checks are not carried out to check this.

73. No information was available from the Commission or the national authorities on the extent of environmental checks performed in Sapard countries. In order to assess the sufficiency of what was checked and how, the Court requested meetings with representatives from the bodies which performed such inspections. In Poland, such details were not provided and consequently the Court can have no opinion on how Poland ensures compliance with the provisions on the protection of the environment as required by the Sapard Regulation.

74. Checks in Lithuania and Bulgaria on standards for the measure 'investments in agricultural holdings' were only carried out by the relevant agency before the project was approved, but

[1] Council Regulation (EC) No 1266/1999 of 21 June 1999 (OJ L 161, 26.6.1999) on coordinating aid to the applicant countries in the framework of the pre-accession strategy; Annex 1(iii).

not when it had been completed. It is important that such subsequent checks are performed and certificates issued if justified in order to ensure that national and EU standards have indeed been met by the end of the project.

75. Thus, for one of the projects visited on-the-spot in Lithuania, the Court found that manure was inappropriately stored, with a consequent risk of nitrate leakage and non-respect of EU standards. There had been a pre-approval check on the spot, but since then the number of cows had significantly increased. Checks prior to the payment to ensure that environmental standards had been respected were not made as required by the Sapard programmes.

76. Problems were also found concerning compliance with hygiene and health standards in Poland. For one of the projects reviewed by the Court, the purchase of new equipment for a milk processing plant, the report on progress to meet EU standards prepared by the veterinary authorities stated that the plant complied for 74 % with the standards. This report was not taken into account. Other checks were not made when the project was completed and paid, even though the requirement in the Polish programme that the whole enterprise should comply with EU standards was apparently not fulfilled.

and national rules on interest were in conflict with Sapard rules

77. As soon as the systems were approved, the Commission made advance payments to Sapard countries which could be used as working capital. Due to the time needed to start making payments to beneficiaries (see paragraph 16), these advance payments remained largely unused for the first year of Sapard implementation. The Commission required that normal commercial conditions should be obtained for such amounts which should respect a satisfactory level of security. The Court found that this was not the case, as higher interest rates could have been obtained with the same level of security in three of the four countries audited because national rules were applied.

78. In Bulgaria, different commercial banks were asked to offer conditions in order to select the bank which was to hold the Sapard accounts. After the Commission had made the advance payment, the Bulgarian authorities placed unused funds on time deposits. This best practice was not applied in Lithuania, Poland and Romania, where national legislation obliged the authorities to use the national bank. These banks offered lower interest rates than commercial banks, and funds could not be placed on time deposits.

79. The largest difference was found in Romania where approximately 650 000 euro more interest could have been earned up to the end of 2003 if available higher rates had been applied to unused Community funds. Problems were also noted in other countries, for instance in Poland, where the interest was booked on a sub account which was not interest-bearing.

80. Different practices were noted in the Sapard countries, and the Commission did not ensure that best practices were applied in all 10 countries.

IMPLEMENTATION PROBLEMS IN SAPARD COUNTRIES

Potential beneficiaries lack own resources and have difficulties in obtaining credit

81. For projects which do not generate substantial net revenues (such as local roads) the aid rate is up to 100 % as infrastructure is a necessary pre-condition for any development in rural areas. High numbers of applications were received for such projects, and the high rate of aid financing is one of the principle reasons frequently stated for this success. For all other projects, as the aid rate is limited to 50 %, beneficiaries are required to finance at least 50 % of the project costs from their own funds or through loans.

82. Sapard payments to beneficiaries must be based on declarations of expenditure incurred. This means that they have to pre-finance the expenditure, often for a period of several months, which is the time it takes for the Sapard Agency to handle the payment claim and make the payment. Heavy administrative procedures have prolonged this period (see paragraph 93).

83. An enquiry by the Sapard Agency amongst farmers and agricultural advisors in Poland investigated the main obstacles in applying for Sapard aid [1]. This showed that the three main difficulties were the high cost of bank credit, the requirement to pre-finance and the lack of own resources for the investment. The potential for Sapard is nevertheless high, which can be seen by the success of the Polish national aid scheme, under which the State provides loans to farmers of up to 80 % of the project. In 2002, more than 24 000 farmers were supported under this scheme, which is 10 times that of the Sapard programme [2].

84. Applicants have major problems in securing advance financing and complementary funding. This is mainly because of the lack of working and investment capital, combined with a restrictive credit policy of banks, which is exacerbated by an underdeveloped property market and banking system. This is a general problem in all Sapard countries, and has been one of the bottlenecks for implementing Sapard and one of the main reasons for lower-than-expected project implementation. The Sapard programme itself does not include the possibility of addressing this problem, and the countries have tried to solve this themselves in different ways.

(1) *Opinions on the Sapard Measure 2 programme expressed by Agricultural Advisory Centres and potential beneficiaries of the programme*, Warsaw, 30 November 2002.

(2) 2 377 contracts were signed with farmers in the period September 2002-November 2003.

85. The Bulgarian authorities were of the opinion that a credit scheme would help to solve these problems, and thus facilitate the implementation of Sapard. Consequently, a scheme which would provide credit to Sapard beneficiaries was approved, and 60 million euro was allocated to it in the 2003 national budget. The scheme was notified by the Bulgarian Minister of Agriculture to the Commission in June 2003. In its reply in July 2003, the Commission stated that it was of the opinion that the scheme might include certain elements of state aid and that in that case certain changes were required in order to respect competition rules [1]. Apart from questioning the financial details of the Bulgarian scheme by letter, no urgent assistance or advice was provided and, in the event, Bulgaria withdrew the proposal. Thus, the 60 million euro available to address a key implementation problem in Sapard was not used because the Commission did not actively follow up the problem.

86. Other countries have already implemented similar schemes, which were, however, not examined by the Commission. The Lithuanian authorities, for example, have set up a guarantee fund which issues guarantees to potential Sapard (and non-Sapard) beneficiaries for loans. Elements of this scheme might also be considered as state aid.

87. Romanian municipalities faced considerable difficulties in making payments to contractors, as the amounts concerned were frequently greater than their whole annual budget. The rules prevented the Sapard Agency from paying contractors' invoices directly. Faced with a similar situation, the Lithuanian Sapard Agency did make such payments directly to municipalities, thus violating the Sapard rules for an amount of around 1 million euro [2].

88. In order to reduce the financial burden of pre-financing on the beneficiary, Lithuania and Romania made interim payments to beneficiaries as projects progressed. This practice was not applied in all countries as this was considered to increase the administrative workload.

89. An additional problem which exists in Romania is the commitment for municipalities to bear maintenance costs after project completion which is a condition of eligibility for the measure concerned. Most projects concerned roads and the actual extent of this future commitment to maintenance was not properly calculated by the municipalities or questioned by the Sapard Agency. Even provisional figures were not known and when questioned by the Court's auditors the municipalities were unable to give a reasoned estimate or indicate how these costs might be realistically funded from their limited budgets. Most municipalities considered the question of maintenance as being of secondary importance. It was more important to have the project approved. The current system in Romania thus does not guarantee the sustainability of the investments which is a major weakness.

90. The Commission did not identify such implementation problems and so was unable to address them in a consistent manner. Because the Sapard programme itself does not have the means to solve them, ad hoc solutions were arrived at. The result was that different practices were adopted by the Sapard countries, some of which were good, while others violated the rules.

and there were heavy administrative procedures

91. After the first nine months of Sapard implementation in Poland, 977 applications were received, of which 472 (48 %) were rejected. An analysis of these figures showed that the main reason for rejection was that the applications were not prepared properly. The difficulties relate mainly to the large number of documents to be provided and the difficulty in obtaining them. The same problem was found in Bulgaria, which can be illustrated by one of the projects reviewed by the Court. For this relatively simple project for the purchase of a combine harvester and a plough, the number of pages in the application file was 2 477 and for the file with the payment request 601 pages. The relevance of some of these documents is not always clear, and there is a need to simplify the procedures and relieve the burden for beneficiaries, which will, in turn, speed up implementation.

92. Another example of this is that when the Sapard Agencies find that an application is incomplete, beneficiaries are given the opportunity to provide the missing documents. The time available for this is often insufficient. Consequently, the application is rejected. For instance, only one document was missing for the application for a project to upgrade a local road in Poland. This document, the budget for the following year, required a meeting of the municipality's Council, which could not be held within the time allowed. The project was rejected.

93. The length of time often taken for processing applications also discourages potential applicants. The delays in processing payment requests further extend the period of pre-financing and deter possible beneficiaries.

94. The time from the payment claim to the actual day of payment is two to three months for the countries visited. Apart from the time for evaluation of the payment claim the total time also includes the waiting time after the payment order has been prepared. In Poland, one farmer had to wait almost six months to be reimbursed because he completed the project before the expected completion date stated in his application. The Polish officials stated that they could not accept a payment request before the date forecast.

95. In all the cases where the Court identified that procedures cause difficulties in implementation, Sapard countries have applied stricter procedures than those required by the Commission. National management appeared unable to solve the problems, which were often due to rigid and unnecessary bureaucracy,

(1) A ceiling of 50 % of public aid from all sources cannot be exceeded. Since Bulgaria applied a grant rate of 50 %, any subsidy element in the grant scheme would exceed this ceiling.

(2) As at 31 March 2003.

even if they hampered an efficient implementation of Sapard. Furthermore, best practices were not applied, which hampered a more speedy implementation of Sapard.

which had as an effect that only financially strong beneficiaries are supported

96. Due to the requirement on beneficiaries to pre-finance projects and the heavy administrative procedures, the Sapard system favours the financially strong and the better organised with sufficient capital or access to loans. For smaller farms and firms which have the greatest efforts to make in meeting standards to modernise and increase efficiency this is a major handicap.

97. Based on the 13 farms visited on the spot by the Court in the four countries, the auditors found that the farmers generally prefinanced the project and financed their own contribution from their own resources, which other, poorer, farmers were unable to do. This was particularly the case in Lithuania, where this was a key element which has led to all the farmer beneficiaries visited being granted aid for more than one project.

ACTION REQUIRED BY THE COMMISSION

because insufficient rules and checks result in expenditure on general costs being misspent

98. Sapard rules allow that general costs of up to 12 % of total eligible costs may be charged to the project [1]. These costs can be architects', engineers' and consultants' fees, legal fees, feasibility studies and acquisition of patents and licences for preparing and implementing a project. To date, the general costs charged were largely for the costs of preparing beneficiaries' business plans. The highest amounts were found in Bulgaria and in Lithuania, where the relevant amount paid by the EU up to the end of 2003 is estimated by the Court to be 700 000 euro. In other countries very little was charged for business plans. The difference in the amounts charged between the countries should alone have led the Commission to examine this matter.

99. The risk related to these costs is high, in particular for consultancy costs for the preparation of business plans, because there is no direct relationship between the cost of the project (equipment etc.) and preparing a business plan, whether it relates to a small or large investment. Basing the reimbursement on a percentage of the project does not ensure economy. The risk is further increased because the rules allow that this expenditure is paid in cash. The Court's audit found that, despite this risk, there were insufficient checks for these costs. There was typically no justification or explanation for the amounts charged, and no checks were made that the costs were in relation to the services provided or indeed that the services were provided in the first place. It was merely ascertained that the maximum laid down was not exceeded and that appropriate supporting documentation (invoice and proof of payment) was present.

100. Thus, the Bulgarian Sapard Agency reported to the Monitoring Committee in 2003 that: 'there were cases of beneficiaries presenting counterfeit invoices from contractors, especially for consultancy services'. The Court believes that the 12 % limit is far too generous without further explanation by the beneficiary of why a fixed maximum amount for a business plan should be set, and that beneficiaries should be actively encouraged to use free or cheaper services provided by the agricultural advisory services in their own countries, which had been developed using Phare funding.

101. The Court identified problems in several of the projects reviewed. For instance, there were cases where beneficiaries applied for a second project, for which they again included the costs of a business plan, despite the fact that the second plan was almost identical to the first. There were even cases where the second project was a simple extension of the original project, and where the costs of the business plan exceeded those charged to the first project. In all cases the invoiced amount was paid without analysis by the Sapard Agencies.

102. In one example, the general costs for preparation of the business plan (15 400 euro) were paid to a consulting company which was owned by the wife of the manager of the company that had received Sapard aid. She was also a representative of that latter company, and was thus able to sign on that company's behalf to accept the business plan provided by her own consulting company. The payment order was signed by her husband. When the Court visited the project on the spot, the beneficiary could not demonstrate that the amount paid was justified by the services provided. In addition, the applicable procurement rules (see paragraph 108) were not applied. The costs had been accepted and paid in full by the Bulgarian Sapard Agency.

103. Despite the cases identified by the Court, the Commission has not thought it necessary to change the rules. It has not addressed this aspect either in its *ex ante* audits or in its follow-up audits, and the weaknesses identified were not detected by the Bulgarian or the Commission's audits [2]. The examples demonstrate that the Sapard rules and checks do not prevent the acceptance and payment of overstated invoices.

(1) Bulgaria reduced the general costs for the preparation of business plans to 5 %, and Romania in certain cases (for projects which do not include construction and for two measures only) to 3 % or 5 % depending on the measure.

(2) Since the expenditure was paid in 2002, the Commission had already carried out its clearance of account audit.

and there is a lack of assurance that money is well spent under private procurement rules

104. Around 60 % of the Sapard funds are used following a private procurement procedure. Apart from the general rule of respect of the principles of sound financial management, the applicable rules are simple. They require a beneficiary to obtain at least three quotations for the costs of any services, supplies and works costing more than 10 000 euros. The same rules apply also to large projects, which may be up to 5 million euro in the case of investments in processing plants.

105. The Court found that, despite the large amounts involved, insufficient checks were made. There were no checks on whether the offers were comparable, and whether the best offer was selected. Except in Bulgaria, where initial steps were being undertaken, there were no comparisons with reference prices, which would allow Sapard assistance to be limited if unjustified costs were claimed. The Commission's audits did not address this issue. That such checks are required is shown by the audit findings set out below.

106. The Court's analysis of the offers presented for 34 projects showed that in the majority of the cases the three offers were not comparable and therefore of little or no value (1). Beneficiaries are not required to specify in writing the details of the planned investment. Consequently, offers were generally received which were for different equipment specifications, or without such specifications at all, and there were large price differences. In addition, the offers did not always contain the information on the main determining factors which caused the beneficiary to select an offer. In cases where the offers were comparable, the cheapest offer was not always selected and no explanation or justification was provided. It was impossible in most cases to analyse whether the best offer was accepted and thereby to ensure sound financial management, in particular of economy and cost-effectiveness.

107. Around half of the beneficiaries encountered by the Court confirmed that the three-offer procedure was meaningless because they knew in advance which equipment they intended to buy. The other two offers were obtained purely to fulfil the requirement. For example, for a Sapard project to buy a tractor in Poland, the beneficiary had already decided which tractor she wanted to buy and from whom. In order to fulfil the three-offer requirement, she obtained two further identical offers (2) which purported to be from different sales points of another company. However, she had not considered buying from them, even though they were slightly cheaper, as they would not be able to provide after-sales service in the future.

(1) In the sample of projects reviewed by the Court, private procurement rules were applied to 34 projects. In 23 cases the offers were found to be not comparable.

(2) In the same handwriting and written with a purple pen.

108. Sometimes three offers were not obtained. In Bulgaria the procedure was not applied in respect of general costs, whereas in other countries it was. In Poland, several cases were found where one investment was broken down into several items each below 10 000 euro, thus avoiding the procedure. In other cases several different items each larger than 10 000 euro were combined in single offers.

109. The weaknesses identified by the Court were not detected by the Commission's audits nor by its management information system. Thus, the different practices noted between countries have not been addressed by the Commission. The examples demonstrate that the Sapard rules and checks do not prevent the acceptance and payment of overstated invoices. Better rules and checks are required, in particular for larger projects, both by the Sapard country and by the Commission.

CONCLUSIONS AND RECOMMENDATIONS

110. The Commission did not use the time available, before the adoption of the Sapard Regulation by the Council, to prepare for detailed implementation principles and rules. Thus, more time than necessary was used, after the adoption by the Council, to provide them.

111. After their adoption, in November 2000, the start of Sapard depended on the time needed by the countries to set up the systems. The Commission and the Sapard countries did not analyse why some countries were quick and why for others it took longer.

112. Heavy administrative procedures in the countries concerned, stricter than required by the Sapard rules, have hampered an efficient and effective implementation of the programme.

— The Commission should, for new expenditure programmes, use the time available before adoption of the legal basis by the legislative body to work out the detailed implementation procedures.

— The Commission should analyse the lessons learned from new programmes, in particular, in the case of Sapard, the setting up of decentralised systems, in order to be prepared for similar exercises in the future.

113. The Commission's application of a system of decentralised management has meant that it has not actively identified implementation problems, provided advice on addressing them nor monitored results. Moreover, staff resources were limited. Due to this, best practices were not applied in all countries, and practices which were counter-productive were not prevented, all of which hampered a quicker yet secure implementation of Sapard.

— Even in the case of decentralised management, the Commission should ensure that best practices are implemented in all beneficiary countries, and that sufficient resources are allocated to this task.

114. The Commission's proposals to the budgetary authority were not based on reliable and realisable budget forecasts of implementation.

— Whilst the Commission may wish to demonstrate to the countries that it has confidence in their respective abilities to implement the Sapard instrument, the political will should not be translated into unrealistic budget forecasts.

115. Sapard had as a positive effect that structures and systems which did not exist a few years ago were set up and function in the Sapard countries. Key elements of these systems will be used for the management of EU funds after accession.

116. Prior approval of the systems based on both the Sapard countries' and Commission audits has ensured that well-defined systems with key controls existed, at least on paper, before any funds could be spent. This is good practice. However, Member States may implement new legislation without such prior audits of the system.

— The Commission should consider whether *ex ante* audits and prior approval of new financial and management systems before money is spent would also be good practice for Member States.

117. Due to the low level of expenditure during the pre-accession period, there has been only a minor contribution to the objectives defined in the Sapard Regulation for 8 of the 10 beneficiary countries.

118. The first results of completed projects show that the money has generally been spent on projects which increase the quantity of agricultural production, and not on projects which improve the quality of agricultural production (meeting quality and health standards and protection of the environment).

— The Commission should address this imbalance and ensure that Sapard funds are used for projects which have as the main objective the improvement of standards for processing plants or farms as a whole.

119. The Court found that the rules and the checks for private procurement and for general costs were insufficient. Effective checks to prevent the acceptance and payment of overstated invoices were not made. Insufficient checks were also noted for compliance with standards for hygiene and the environment.

— The Commission should address this lack in rules and effective checks.

120. A key implementation problem was that potential beneficiaries lacked own resources and had difficulties in obtaining credit. Whilst the Sapard programme offers a large number of measures, it does not include the possibility to address this problem.

— For similar, future actions, the Commission should simplify the Sapard programme by reducing it to three or four key measures. The Commission should examine whether in that case a system of loans and guarantees could replace or supplement existing measures in order to address the problem of project financing.

121. So, 'Has Sapard been well managed?' The answer is that management has been of mixed quality. On the one hand, Sapard has allowed countries to gain 'hands-on' experience of operating an EU aid system, for which the Commission has been a driving force. On the other hand, this was not a primary aim of Sapard and the key objectives that had been set were not achieved, such as assisting in the Community *acquis* particularly those relating to environmental and health standards. This was due to avoidable delays in implementation, and as a consequence those countries joining in 2004 have not had the benefit of delivering aid for the measures approved, for the period of about four-and-a-half years from the beginning of 2000 to May 2004, which had been planned by the legislative authority. In addition, by early 2004, due to delays in setting up systems, the full range of measures that had been programmed (including agri-environment) has not been applied. The Commission under-estimated the problems that had to be faced by beneficiaries of financing their projects. This problem should have been identified at an early stage and solutions found in order to ensure that the available aid had maximum effect across all target beneficiaries.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 26 May 2004.

For the Court of Auditors

Juan Manuel FABRA VALLÉS

President

ANNEX 1

EU contribution 2000-2003 by country and by main type of beneficiary and measure

(in million euro)

Country	EU contribution for the period 2000-2003 [1]	Breakdown by main type of beneficiary and measure				
		Local communities Measure: development and improvement of rural infrastructure	Processing plants Measure: improving the processing and marketing of agricultural and fishery products	Farmers Measure: investments in agricultural holdings	Various Measures: agri-environment, forestry, afforestation	Various Measures: development and diversification of economic activities, technical assistance, training, and other
Bulgaria	218,8	10,8	75,8	62,1	13,9	56,3
Czech Republic	92,6	6,6	17,5	17,6	0,6	50,3
Estonia	50,9	6,4	9,7	21,7	0,4	12,7
Hungary	159,8	38,9	52,0	58,8	0,0	10,1
Latvia	91,7	5,5	25,2	32,0	5,3	23,7
Lithuania	125,2	18,2	39,1	51,2	3,2	13,5
Poland	708,2	270,0	227,7	126,2	9,2	75,1
Romania	632,4	280,5	111,0	74,6	57,5	108,9
Slovakia	76,8	13,2	25,5	21,0	2,3	14,8
Slovenia	26,6	3,1	10,5	9,2	0,0	3,8
Total	**2 183,0**	**653,3**	**593,9**	**474,4**	**92,4**	**369,1**
%	100 %	30 %	27 %	22 %	4 %	17 %

[1] Cumulative appropriations for commitment.
Source : European Court of Auditors, December 2003.

ANNEX 2

List of projects reviewed

M 1 — Investments in agricultural holdings

M 2 — Improving the processing and marketing of agricultural and fishery products

M 3 — Development and improvement of rural infrastructure

BULGARIA

Sample No	Measure			Project description	Visit on the spot (1)	Substantive test (2)	Compliance test (3)
	M 1	M 2	M 3 (4)				
1	v			Purchase of new equipment for a cereal farm including a tractor	v	v	v
2	v			Purchase of new equipment for a cereal farm including a combine harvester	v	v	v
3	v			Purchase of new equipment for a cereal farm including a combine harvester	v	v	v
4		v		Purchase of new equipment for a meat processing plant	v	v	v
5		v		Purchase of new equipment for a milk processing plant	v	v	v
6		v		Purchase of new equipment for a meat processing plant	v	v	v
7		v		Purchase of new equipment for a winery	v	v	
8	v			Purchase of new equipment for a cereal farm including a combine harvester	v	v	
9	v			Purchase of new equipment for a cereal farm including a combine harvester		v	
10	v			Purchase of new equipment for a cereal farm including a combine harvester		v	
11		v		Purchase of new equipment for a meat processing plant		v	
12		v		Purchase of new equipment for a fruit and vegetable processing plant		v	
13	v			Construction of storehouses and purchase of a silos for a cereal farm		v	
14	v			Purchase of new equipment for a cereal farm including a combine harvester		v	

(1) Visit on the spot to meet with the final beneficiary and to inspect the project.
(2) File review to check general costs, key procurement rules, objective and other key issues relating to the project.
(3) File review to check that the supervisory and control systems worked in practice.
(4) Systems for the measure were not approved at the time of the audit.

LITHUANIA

Sample No	Measure			Project description	Visit on the spot (1)	Substantive test (2)	Compliance test (3)
	M 1	M 2	M 3				
1	v			Modernisation works and purchase of new equipment for a dairy farm	v	v	v
2	v			Purchase of new equipment for a cereal farm	v	v	
3	v			Purchase of new equipment for a cereal farm	v	v	v
4	v			Purchase of new equipment for a pig farm		v	
5	v			Purchase of new equipment for a dairy farm	v	v	v
6	v			Purchase of new equipment for a dairy farm		v	v
7		v		Purchase of new equipment for a meat processing plant	v	v	v
8		v		Reconstruction works and purchase of new equipment for a meat processing plant		v	v
9			v	Construction of water and sewage infrastructure		v	v
10			v	Reconstruction of sewage infrastructure		v	v
11			v	Construction of sewage infrastructure	v	v	
12		v		Construction of a slaughterhouse	v		

(1) Visit on the spot to meet with the final beneficiary and to inspect the project.
(2) File review to check general costs, key procurement rules, objective and other key issues relating to the project.
(3) File review to check that the supervisory and control systems worked in practice.

POLAND

Sample No	Measure			Project description	Visit on the spot (1)	Substantive test (2)	Compliance test (3)
	M 1	M 2	M 3				
1		v		Purchase of new equipment for a milk processing plant	v	v	v
2		v		Purchase of new equipment for a milk processing plant	v	v	v
3		v		Purchase of new equipment for a fruit and mushroom processing plant	v	v	v
4		v		Purchase of new equipment for a milk processing plant	v	v	
5		v		Purchase of new equipment for a milk processing plant	v	v	
6		v		Construction works and purchase of new equipment for a poultry meat processing plant	v	v	v
7		v		Purchase of new equipment for a meat processing plant		v	
8		v		Installation of a ventilation system in a milk processing plant		v	
9		v		Purchase of new equipment for a fruit processing plant		v	
10		v		Purchase of new equipment for a meat processing plant		v	
11	v			Construction works at a mushroom farm		v	
12	v			Purchase of new equipment for a horticultural farm	v	v	v
13	v			Purchase of new equipment for a fruit farm	v	v	
14	v			Purchase of new equipment for a vegetable farm		v	
15	v			Purchase of new equipment for a dairy farm	v	v	v
16	v			Purchase of new equipment for a fruit farm		v	
17	v			Purchase of new equipment for a horticultural farm		v	
18	v			Purchase of new equipment for a fruit farm	v	v	v
19	v			Purchase of new equipment for a fruit farm	v	v	v
20	v			Purchase of new equipment for a fruit farm		v	
21			v	Sewage system construction		v	
22			v	Local road upgrading	v	v	v
23			v	Sewage system construction	v	v	
24			v	Local road upgrading		v	
25			v	Sewage system construction	v	v	
26			v	Local roads upgrading	v	v	v
27			v	Sewage system construction	v	v	v
28			v	Modernisation of a local sewage plant		v	
29			v	Local road upgrading		v	
30			v	Sewage system construction		v	

(1) Visit on the spot to meet with the final beneficiary and to inspect the project.
(2) File review to check general costs, key procurement rules, objective and other key issues relating to the project.
(3) File review to check that the supervisory and control systems worked in practice.

ROMANIA

Sample No	Measure			Project description	Visit on the spot (1)	Substantive test (2)	Compliance test (3)
	M 1 (4)	M 2	M 3				
1		v		Reconstruction works at a meat processing plant	v	v	v
2		v		Reconstruction works at a meat processing plant		v	
3		v		Reconstruction works at a meat processing plant	v	v	
4		v		Reconstruction works and purchase of new equipment for a meat processing plant	v	v	v
5		v		Reconstruction works and purchase of new equipment for a winery		v	
6			v	Local road upgrading		v	
7			v	Local road upgrading			
8			v	Installation of a water supply system	v	v	
9			v	Construction of sewage and waste water treatment station	v	v	v
10			v	Local road upgrading	v	v	v
11			v	Local road upgrading		v	
12			v	Local road upgrading		v	
13			v	Local road upgrading	v	v	v
14			v	Installation of a water supply system		v	
15			v	Installation of a water supply system	v	v	v
16			v	Construction of a water supply system		v	
17			v	Local road upgrading	v	v	v
18			v	Local road upgrading		v	
19			v	Local road upgrading	v	v	
20			v	Construction of extended water supply system	v	v	v

(1) Visit on the spot to meet with the final beneficiary and to inspect the project.
(2) File review to check general costs, key procurement rules, objective and other key issues relating to the project.
(3) File review to check that the supervisory and control systems worked in practice.
(4) Systems for the measure were not approved at the time of the audit.

TOTAL

76	**24**	**24**	**28**		**42**	**75**	**33**

THE COMMISSION'S REPLIES

EXECUTIVE SUMMARY

I.-II. The Commission welcomes the audit carried out on the implementation of the Sapard instrument.

The Commission considers, however, that a final analysis concerning the impact of the programme can be made only when it has been fully implemented.

While the main elements of the Commission's proposal on the Sapard Regulation (EC) No 1268/1999 were maintained, the text of the proposal was subject to ongoing discussions (as regards the budget headings under which the pre-accession instruments should be financed, including the financial implementing mechanisms) until the final stage of its adoption. As long as the legal uncertainty remained, the Commission was not in a position to draw up the final legal provisions for the implementing arrangements. These provisions were adopted by the Commission on 26 January 2000.

The approach was new and this was the first time external aid was managed on a fully decentralised basis. One main objective of Sapard is to contribute to the implementation of the *acquis*. An essential part of this is to assure a good administrative capacity able to perform the demanding tasks of rural development policy implementation according to the principles of sound financial management. This is also in line with the demand of the European Parliament, expressed in the European Parliament resolution accompanying the 1999 discharge, that 'effective protection of the Community's financial interest in the applicant countries should be an absolute priority in the next few years'.

The Commission is of the opinion that it has provided sufficient guidance and advice to the Sapard countries and has worked with them to prepare the setting up of the institutions and procedures. This has been done both through extensive assistance of experts from Member States through Phare twinning arrangements, and through ongoing exchange of information in the framework of seminars and fact-finding missions (see the Commission's Sapard Annual Report for 2000).

III. The Sapard budgets for 2000-2004 were drawn up on the basis of the most reliable information available at that time. The sizeable challenges posed by the need to set up an entirely new system and the lack of experience of the Sapard countries in this area meant that implementation took time, but in most cases no longer than could be reasonably expected, given experience from similar exercises in the Member States. The Commission is well aware of the reasons why it took longer in some countries to set up the administrative system for implementing Sapard.

Whenever it was made aware of 'heavy administrative procedures', the Commission advised the countries concerned by correspondence, during bilateral meetings and at the Monitoring Committee meetings. However, the exact procedural choice remains with the countries concerned. The Commission cannot prevent them from applying their own internal administrative arrangements as long as the Sapard rules are respected.

IV. The Commission's responsibility under a system of decentralised management is to monitor the implementation of Sapard.

As current events show money is flowing now at a regular pace in almost all Sapard countries, based on a reliable system which can be used as a basis for the programmes as Member States.

V. Payments made to final beneficiaries alone in 2003 amounted to EUR 288 million. By 31 December 2003, against the 2000-2003 allocation of EUR 2 183 million, total commitments to final beneficiaries amounted to EUR 1 214 million (56 %) while actual payments made to the beneficiaries totalled EUR 323 million (15 % of allocation). According to information received from the Sapard countries, at least seven out of eight countries due to join the EU will be able to contract all the available funds for the 2000-2003 period to final beneficiaries.

The rule on the eligibility of VAT for EU part-financing applies to the Sapard countries as well as to the Member States receiving support under the Structural Funds. Multi-annual Financing Agreement (MAFA) rules apply.

VI. The Commission considers that increasing production capacity at project level is compatible with improving standards and the need for restructuring to improve market efficiency.

VII. The Commission considers institution building as one of the fundamental elements of the *acquis* and a pre-condition for the responsible use of EU funds. The agri-environment measure was a facility for the Sapard countries to gain administrative experience through pilot actions and was not one of the most important measures needed to restructure the agricultural sector and prepare for accession.

IX. The Commission welcomes the Court's assessment that the Sapard system generally works in practice. The Commission recognises that there have been some problems with the controls on compliance with minimum standards and has made recommendations for improvements. On the basis of its audits up to March 2004, the Commission considers that the situation has improved since the Court's audit.

X. The Commission is aware of the problem of lack of own resources and of the difficulties in obtaining credit. To address this issue, the Commission, with the aid of Phare funds, is supporting a project to improve access to credit for SMEs in Sapard countries, which should help widen access to Sapard. This project has recently been extended with a specific sub-window focusing on credit institutions serving farmers and small rural businesses. It also encourages the candidate countries to use national credit schemes as far as they are respecting Community competition rules and aid intensities of the Sapard Regulation.

In order to facilitate the application of national credit schemes the Commission in its recent proposal for a modification of Regulation (EC) No 1268/1999 included a specific provision in this respect (see also reply to point 97).

XI. Although the Commission has also identified weaknesses in some cases and has made recommendations for improvements, it considers that the situation has improved since the Court's audit. Where necessary, these recommendations will be followed up under the clearance of accounts procedures.

INTRODUCTION

9. At the end of 2003 almost 13 000 projects were being implemented in the 10 Sapard countries.

10. The legal basis was designed so that Sapard countries would be working with arrangements similar to those used by Member States. See also the reply to points 13 and 14.

The management and inspection systems established by the competent authorities of the Sapard countries are subject to *ex ante*, before management of the funds is delegated, and ex *post* audits, through the clearance of accounts and compliance audits. These three types of audits, as required by the Multi-annual Financing Agreement (MAFA), form the basis of the system used to provide reasonable assurance as to the legality and regularity of expenditure charged to the Community budget. In this context, the Commission considers that the main risks are adequately covered.

STAGES IN THE IMPLEMENTATION OF SAPARD

11. The Sapard budgets for 2000-2004 were drawn up on the basis of the most reliable information available at that time. The sizeable challenges posed by the need to set up an entirely new system, and the lack of experience of the Sapard countries in this area, meant that implementation took time but in most cases no longer than could be reasonably expected.

Sapard, unlike the Structural Funds, could not build on a stock of projects already in the pipeline as at 1 January 2000. For the sake of sound financial management and the protection of the financial interests of the Community, Sapard projects are eligible for selection only after the adoption of the Decision on conferral of management.

13.-14. While the main elements of the Commission's proposal on the Sapard Regulation (EC) No 1268/1999 were maintained, the text of the proposal was subject to ongoing discussions (including discussions on budget headings) until the final stage of adoption of the Sapard Regulation. As long as the legal uncertainty remained, the Commission was not in a position to draw up the final legal provisions for the implementing arrangements.

Following adoption of the Regulation, a working group prepared the basic provisions for the financial management of Sapard within a few months. These were adopted by the Commission on 26 January 2000.

The reason for this strategy was the novelty of the approach and the fact that this was the first time external aid was managed on a fully decentralised basis. The detailed steps and the time required for elaborating and agreeing the financial implementing arrangements are outlined in the Commission's Sapard Annual Report 2000.

These steps involved the adoption of the implementing Regulation (adopted on 18 April 2000), the elaboration and adoption of the Multi-annual Financing Agreement (MAFA) and the 2000 Annual Financing Agreement (AFA) by the Commission (adopted on 29 November 2000), and the negotiation of bilateral agreements (MAFA and AFA) with each of the 10 Sapard countries (all agreements were signed between 18 December 2000 and end of March 2001).

16. The Commission has, on various occasions, advised Sapard countries to avoid unnecessary administrative procedures not required by the MAFA, where appropriate via seminars, meetings or letters.

The Sapard systems are designed by the national authorities not only on the basis of the accreditation criteria but also taking into account national legislation and their knowledge of the risk areas in their countries. Stricter rules are necessary in some situations to protect the financial interests of the Community (see point 20 concerning double checks).

17. The capacity of Romania to spend EU funds has been the subject of ongoing discussions and exchange of letters between the Commission and Romania. Although the Romanian Sapard Agency has committed a large amount, the Commission is closely monitoring the situation (because of the low uptake in terms of payments) and providing advice as appropriate to reduce bottlenecks and risks in the procedures.

18. The Commission has formally addressed this issue with Poland on several occasions, during bilateral meetings and at the Monitoring Committee meetings. For example, the Commission urged the Polish authorities to 'review the elements of Polish legislation which could slow down a smooth implementation of the programme'. However, the choice remains with the country concerned. The Commission cannot prevent Sapard countries from applying their own internal administrative arrangements as long as the Sapard rules are respected.

Notwithstanding the stricter national provisions for contracting and payments, Poland expects to commit all available funds for 2000-2003 to final beneficiaries.

19. The Lithuanian authorities acknowledge this situation and state that they recruited additional staff for project evaluation.

20. The Commission considered that these additional checks were essential to protect the financial interests of the Community.

21. The Commission refers to its reply to point 35.

22.-23. Although the Commission did not formally prepare such an analysis it actively monitored the implementation process and provided advice to the relevant agencies in the Sapard countries.

The Commission will consider including such an analysis in the synthesis evaluation planned in 2004, which will also summarise the findings of the mid-term evaluations.

The Commission agrees that such an analysis could be useful if similar exercises were to be prepared in the future.

24.-25. The budgets for the first three years were based on the most reliable but limited information available at the time. In this context the Commission reiterates its remarks to point 2.39 of the Court's 2002 Annual Report in which the reasons for the under-utilisation of the budgets are stated. One of the reasons for not fully utilising the budget was that greater priority was given to firm management of appropriations.

Payments made in 2003 under Sapard represent 61 % of the available payment appropriations in the 2003 budget. Payment applications received during the fourth quarter indicate that payment execution has now reached cruising speed.

DECENTRALISED IMPLEMENTATION

27. For the Commission it was essential for the Sapard countries to be able to gain experience of the management and control system used under EAGGF from running Sapard to protect the financial interests of the Community after accession when EAGGF expenditure in the new Member States is expected to be EUR 4 billion in 2005 and rising.

28.-30. Sapard was originally conceived as a seven-year programme, irrespective of the politically set targets for accession. For countries joining the EU during this seven-year period, Article 15 of Regulation (EC) No 1268/1999 sets out that Sapard countries shall not receive support on accession to the EU.

32.-33. The Commission considers that it has allocated a sufficient number of qualified staff, in the Sapard Unit as well as in the services responsible for overseeing the accreditation process and carrying out audits, to ensure proper monitoring and financial management and control of the use of Community funds in the Sapard countries.

Desk officers in the Commission Sapard unit are responsible, as a general rule, for only one programme of a Sapard country. Only very experienced and qualified Commission officials are responsible for two programmes. The Commission allocated more staff to Sapard than to the Member States programmes where in many cases desk officers are responsible for more than two programmes.

The most experienced staff member of the Commission's Sapard unit, together with the Deputy Head of Unit, monitored the Bulgaria and Romania Sapard programmes until the end of 2003.

34. The Commission could not give a 'commitment to speed up implementation' due to the reasons the Court rightly cites. Yet it offered to give any help to the Sapard countries which could speed up implementation, e.g. speedily adopting justified programme amendments, sending advice and interpretation letters, and conducting seminars. It also asked the countries to indicate possible opportunities to simplify the delivery system of Sapard without weakening the sound financial practices set up. All viable proposals were accepted via modifications to the MAFA or via changes in the relevant Regulations.

35. A key feature of the system set up is that the countries concerned first identify problems. In such instances the Commission has consistently provided guidance and advice to the Sapard countries. These actions have been described in detail in the Commission's Sapard 2000 to 2002 annual reports.

MAIN RESULTS OF SAPARD

36. By 31 December 2003, against the 2000-2003 allocation of EUR 2 183 million, the total commitment to final beneficiaries amounted to EUR 1 214 million (56 %), while actual payments made to beneficiaries totalled EUR 323 million (15 % of allocation). At this stage, in terms of the level of commitments made by the Sapard Agencies to the final beneficiaries, according to information received from the countries, at least seven countries out of the eight due to join the EU will be able to commit all available funds relating to the 2000-2003 period at the date of transition to the post-accession regime.

38.-40. The rule on the eligibility of VAT for EU part-financing applies to the Sapard countries as well as to the Member States receiving support under the Structural Funds.

The Commission will examine the impact of this after the programme has been completed. An assessment will be made in the framework of the clearance of accounts procedure, and the appropriate conclusions will be drawn.

41.-43. The Commission is of the opinion that this balance between measures in the programmes is consistent with the objectives of Sapard under Article 1(2) of Council Regulation (EC) No 1268/1999 already mentioned in point 2 of the report, with the provisions under Article 4(3), which provides that '… priority is given to measures to improve market efficiency, quality and health standards and measures to create employment in rural areas …', and with the commitments adopted in the Accession Partnership pursuant to Article 6 of Regulation (EC) No 1268/1999.

Article 4(3) of Regulation (EC) No 1268/1999 places the Sapard programmes on two pillars – market and employment. The objectives of Sapard as set out in Article 1 provide that these two pillars contribute to the 'implementation of the *acquis*' and to 'sustainable adaptation of the agricultural sector'.

The programmes approved by the Commission contain a well-balanced set of different measures which meet these conditions.

These measures were therefore considered, by both the Commission and the Sapard countries, to be ones that should be implemented as a priority, to assist in the restructuring of the agri-food sector and in the countries' preparation for the application of the *acquis*.

It is normal and inevitable that measures which can be directly linked to the sustainable adaptation of the agricultural sector, such as 'investments in agricultural holdings' and 'processing and marketing', modernise production methods and lead also in certain cases to an increase in production at project level. On the other hand, measures under 'diversification' are aimed at creating sustainable income possibilities outside agriculture. While the Court found little evidence of any effect on the quality, health or environmental standards, the Commission considers that increased or modernised production at project level is not incompatible with improvement of standards. All the entrepreneurs in the Sapard countries were well aware that continued profitability relies on meeting the minimum standards of the EU. All the new equipment meets these standards.

A final analysis can be made only after the programme is implemented in full.

44. The meeting of standards is not incompatible with commercial investment. Commercial investment normally sets the example for the private sector and thus serves as a pacesetter for rural development.

45. Investments in the milk and meat sector were low due to the depressed market situation in particular in key markets, like Russia. The first substantiated information on the implementation of a significant set of measures was included in the 2002 implementation reports from five countries and now in the mid-term evaluation reports for the 10 programmes.

Once the implementation reports were received, the Commission asked for more detailed information and advised countries to refocus the programmes whenever necessary.

46. The Commission services have also identified certain problems with the respect of minimum standards in the Sapard countries, and have made recommendations for improvements in systems and controls.

47. The Commission considers that increasing production capacity at project level is compatible with improving standards and the need for restructuring to improve market efficiency (see also replies to points 41 to 45).

48. See reply to point 41: the employment problem in rural areas cannot be seen separately from the other measures of a rural development plan.

The overall impact on job creation cannot be assessed by counting the number of jobs declared by project beneficiaries in their application form. This element can only be fully assessed in the evaluation studies, once the programme has been completed.

49. There is no commonly agreed definition of the term 'rural areas'. To confine this definition to 'population density' is not possible. Therefore, as in the Member States programmes, each of the Sapard programmes contains a definition of 'rural areas' according to the national standards of the country concerned.

For example, Bulgaria lays down in its programme that 'rural areas are the municipalities which do not have on their territory a town with population above 30 000 people and where the municipality population density is below 150 people per km^2. All settlements in the municipalities identified as rural areas are settlements belonging to rural areas.'

50.-51. The Commission considers it has reported on all relevant elements in its annual reports on Sapard implementation.

The Commission's annual Sapard report contains contributions made by the Sapard countries with an analysis of these assessments. The Commission will nevertheless consider how to take account of the Court's remarks in drafting future reports.

53. Phare provided assistance to the Sapard countries to set up structures able to implement the *acquis*, including implementing arrangements for Sapard. Yet the main task of setting up implementation systems to transfer EU funds was up to the management of Sapard through the procedures of conferral of management, accreditation of measures etc.

54. Expenditure available under EAGGF after accession made it essential that the Sapard countries gain experience in managing this type of measure.

55. The agri-environment measure was a facility for the Sapard countries to gain administrative experience through pilot actions, and was not one of the most important measures needed to restructure the agricultural sector and prepare for accession.

56. With the exception of Slovenia, which had already implemented an advanced national scheme, the complexity of the agri-environmental measures and their lack of experience meant that the Sapard countries were not able to present detailed agri-environmental measures at the same time as the rest of their programmes. In 2000 the Commission began to identify the main environmental key facts of each country and the relevant aspects available in each programme and to draft guidelines to support the Sapard countries. The guidance paper that emerged was the subject of a seminar in Brussels on 12 and 13 November 2001. The final formulation of this guidance paper was officially transmitted to all Sapard countries on 21 December 2001.

This allowed the approval of agri-environmental measures for six countries in 2002 and 2003, and conferral of management has been granted to the Czech Republic and Slovakia. Even if the conferral of management has not been granted to the other countries, the experience they gained is important because the approved schemes are transposable to the post-accession rural development programmes.

57. In the particular case of agri-environment, the objective was limited to avoid financing large agri-environment schemes which could have exhausted the Sapard budget without reaching their main objectives. For this reason, the Commission decided that this measure could be only applied at pilot level with the purpose of developing experience in agri-environment implementation.

Given the complexity of the measure, calculation of cost, income lost and premium, the Commission is of the opinion that the Sapard countries have gained valuable experience through the programming exercise and most countries are now in a good position to readily implement these measures under the new programmes.

ASSESSMENT OF SYSTEMS SET UP IN SAPARD COUNTRIES

58. The definitive delegation of management is not a priority for either the Commission or the candidate countries, as specified by Section A, Article 4(4) of the MAFA.

60. Prior approval of the systems by the Commission is required by Article 12 of Regulation (EC) No 1266/99.

63. The Commission has encouraged the Sapard countries to use the experience from the Sapard agency to set up their paying agency and welcomes the fact that they intend to do so.

66. Up to 31 March 2004, the Commission examined 107 files in eight Sapard countries and visited 36 projects on the spot. In some cases the Commission has also identified that the documentation of checks needs to be improved and has made appropriate recommendations. However, extensive evidence has been found of completed checklists and handwritten reports giving sufficient detail of the work performed. These results indicate that the situation is improving since the Court's audit.

67. The conformity audits performed by the Commission services found several examples of comprehensive verification of the economic viability.

The Commission considers that this is not a systematic problem for all Sapard countries, but will keep the matter under review.

69. The knowledge and skills of senior managers and other key managers in both the Sapard Agency and the regional offices were thoroughly checked during a number of interviews before the delegation of management was conferred. This gave the Commission reasonable assurance as to the abilities of staff. Following the Court's comments in its 2001 Annual Report (see point 6.19), the Commission has further stepped up the documentation on these checks (principally curriculum vitae, job descriptions, declarations of independence and impartiality).

The quality of the staff in place has enabled the accredited systems to operate in a way which may generally be regarded as satisfactory.

According to the Lithuanian authorities, the results of each public competition are recorded in protocols, which are archived for three years.

Nevertheless, for the Sapard countries the Commission will continue to follow up this issue.

70.-76. Checks on compliance with health and environmental standards, which are an integral part of the *acquis communautaire*, are the responsibility of the relevant national authorities. The countries involved verify the respect of minimum standards as part of their national controls, which are carried out independently of whether or not Sapard aid has been received.

In Lithuania, an applicant presents with the payment claim documents from these authorities confirming that the project implemented complies with all Community standards.

The Polish authorities have said that the investment supported by Sapard met all the relevant EU standards. However, the whole holding complied with only 74 % of the standards.

The Commission has also identified certain problems with the respect of minimum standards in the Sapard countries. They have made recommendations for improvements in systems and controls.

77.-79. In the Commission's view, the term 'normal commercial conditions' is best evaluated at national level. Although the Court may consider that higher interest rates could have been obtained in certain cases, it is primarily for the national authorities to decide upon the appropriate day-to-day arrangements. For the acceding countries, it is sometimes more important to gain security for their deposits rather than the highest yield.

80. As a normal procedure in the clearance of accounts, and in cases like this which do not call into question the completeness, accuracy and veracity of the accounts, the follow up of the Commission's recommendations by the certifying body as well as by the paying agency and the national fund are to be assessed the following year.

This will be done as part of the 2003 Sapard clearance of accounts.

IMPLEMENTATION PROBLEMS IN SAPARD COUNTRIES

81. According to information from the Sapard countries, at this stage a sufficient number of support applications has been received by the Sapard agencies (including measures with a maximum aid rate of 50 %) to commit in at least seven out of the eight acceding countries all available money for the 2000-2003 period at the date of transition to the post-accession regime. In Bulgaria the most recent information indicates that the full amount available during the whole 2000-2007 period of the programme under the measures concerning investments in agricultural holdings and in processing and marketing will soon have been committed.

82. The Commission advised the Sapard countries to also make interim payments on expenditure incurred, according to the progress of the project. It has also encouraged the Sapard agencies to shorten the interval between expenditure claims being registered and aid being paid.

83.-84. The mid-term evaluation reports of the programmes also confirm the analysis of the Court that, amongst other things, the lack of appropriations for part-financing may be one of the reasons for the initial slow absorption under the Sapard programmes. Poland has at this stage informed the Commission that it will not accept any further applications, as the number of registered projects already exceeds the amounts available under the programme (see point 36).

The Commission is aware of the problem highlighted and has discussed it with the international financing institutes and the applicant countries during the process of programming. The Commission, with the aid of Phare funds, is supporting a project to improve access to credit for SMEs in Sapard countries, which should help widen access to Sapard.

However, in its answer to point 2.41 of the Court's 2002 Annual Report the Commission referred to the problem that, even when credit is available, some beneficiaries cannot or are reluctant to take out mortgages on property, and other matters of unclear title of ownership, in particular of land, also play a part.

85. In its reply to the notification of this scheme the Commission asked for further details to give an opinion on the respect of the competition rules. According to the Bulgarian authorities the Sapard agency recently decided not to implement the scheme due to the difficulty of calculating the exact amount of state aid included in this scheme. Yet, based on the findings of the mid-term evaluation report, the Commission will urge Bulgaria to proceed with this scheme and to make it compatible with the Community competition rules.

In order to facilitate the application of national credit schemes the Commission, in its recent proposal for a modification of Regulation (EC) No 1268/1999, included a provision that by 'determining the rate of public aid account shall not be taken of national aid of a nature to facilitate access to credits granted without the benefit of any Community contribution provided under the present instrument'.

See also comments under point 82 concerning commitments in Bulgaria.

86. The Commission encourages the Sapard countries to use such schemes as long as they respect Community competition rules and aid intensities provided for in the Sapard Regulation.

87. In the interests of sound financial management the Commission agreed with the Sapard countries in the framework of MAFA not to pay the invoices directly to contractors but to reimburse expenditure borne by the final beneficiaries.

Romania has been advised to pay in instalments and has now introduced this possibility.

As soon as the Commission became aware of this problem it asked the Lithuanian authorities for more information.

According to the Lithuanian authorities, the Agency promptly collected confirmation documents (payment orders and bank statements) from all the municipalities that received support from the Sapard Programme. The financial risk to the Community has thus been addressed. Lithuania has now changed its system to comply with MAFA.

88. The Commission regrets very much that this practice was not applied in all countries. It strongly advised them on various occasions to use this facility but it is up to the Sapard countries to decide whether they wish to follow such advice.

89. The Commission will monitor the issue via the usual channels.

90. Whenever any of these problems became evident the Commission immediately provided the necessary advice and took appropriate steps to ensure that solutions were found. The ongoing discussion of the mid-term evaluation reports provides a further opportunity to react to these problems.

92. The Commission agrees that the period for providing missing documents must be long enough to cover the issue of new documents and the resubmission of documents with the necessary (supplementary) information. It will be up to the Sapard countries to define the adequate time period. The conclusions of the mid-term evaluation could be useful in defining this period.

93.-94. The Sapard countries generally experienced technical and procedural difficulties during the initial period of implementation resulting in delays in processing applications and payment claims. Although there are still certain problems in some countries, overall the situation has improved substantially.

95. Under the system of decentralised management the Commission's influence on the implementation procedures applied in the Sapard countries is limited.

Whenever necessary and possible the Commission gave advice on how to simplify and streamline procedures within the provisions laid down in the Sapard Regulations and in the MAFA. However, the countries themselves decide whether to follow this advice.

96.-97. A key criterion is that all beneficiaries must prove economic viability. Smaller, economically unviable farms will therefore not be targeted by the programme. This is a key element of the objective to help restructure the agricultural sector.

The Commission is aware of the problem of lack of own resources and of the difficulties in obtaining credit. It has discussed these issues with the international financing institutes and the Sapard countries during the process of programming and implementation. The Commission, with the aid of Phare funds, is supporting a project to improve access to credit for SMEs in Sapard countries, which should help widen access to Sapard. This project has recently been extended with a specific sub-window focusing on credit institutions serving farmers and small rural businesses. It also encourages the candidate countries to use such national credit schemes as far as they are respecting Community competition rules and aid intensities of the Sapard Regulation.

In order to facilitate the application of national credit schemes the Commission, in its recent proposal for an amendment of Regulation (EC) No 1268/1999, included a specific provision in this respect (see reply to point 85).

As at 31 March 2004, almost 13 000 projects are to be implemented by the Sapard countries.

ACTION REQUIRED BY THE COMMISSION BECAUSE

98.-103. The Commission has found that the level of expenditure on general costs is limited and that the problems mentioned by the Court are restricted to a few Sapard countries.

Following its conformity audit in Bulgaria, and in the light of the Court's observations, the Commission recommended to the national authorities to implement a system allowing them to check that the amounts paid for this purpose are within reasonable limits in absolute value, and proportionate to the services effectively supplied in comparison to average costs charged for similar services in Bulgaria. The Commission notes that the Bulgarian authorities have identified various problems themselves and have taken action to prevent undue payments.

The Commission agrees that in most cases a payment of 12 % of the total investment for general costs would be too high.

Regarding the particular case referred to in paragraph 103, the Commission is working on this and other cases identified by the Court to recover any amount unduly paid.

104.-109. The Commission insisted on including the 'three-offer' rule for the sake of sound financial management. These three offers should be reasonably comparable. However, this system is not in any way similar to public tendering. The beneficiary retains a free choice of supplier.

In certain circumstances it might be difficult to obtain three entirely comparable offers. For example the choice of machinery is often made on the basis of information regarding qualities and prices, which could be obtained from different sources (agricultural exhibitions, regional seminars, direct contacts with suppliers). Other issues which could influence the choice are previous experiences gained with a particular make, distance to the closest point of repair or service, reaction time or the price of spare parts after the expiry of the warranty period. The rule of submitting three quotations can provide some evidence that the final beneficiaries have searched for at least three alternatives on the basis of which a choice has been made.

The cost element is only one of the factors to be taken into account in assessing sound financial management. Both the quality of the goods purchased and the services provided, and securing the results expected in terms of the costs borne form part of this analysis. The Commission's opinion is that the provision of an adequate after-sales service, even though it cannot be part-financed, increases the life of the investment financed and is an acceptable justification for the choice of supplier. In the case of private beneficiaries, the Commission considers that, in addition to the three prices system, the fact that the beneficiaries have to bear part of the investment also helps meet the criteria of economy and cost/efficiency.

The Court's findings do not concern the acceptability of excessive invoices, i.e. an invoice where the price paid is excessive in terms of the value of the goods or service provided, which is not the case in this instance.

Conformity audits undertaken by the Commission revealed that comparison to reference prices is done, at least to some extent, in Bulgaria, Latvia, Slovenia and the Czech Republic. In countries where this was not done, the Commission has made appropriate recommendations.

Offers do not need to be entirely comparable under private purchasing. This does not mean that they are of little value. Nevertheless, the Commission agrees with the Court that a justification should always be received and examined if the beneficiary does not select the cheapest offer. In the cases where this procedure was not found to be fully or effectively in place recommendations for improvement have been made. However, in most cases the Commission has obtained evidence that justifications are given if the cheapest offer is not chosen. It will recommend that this is done by Sapard systematically.

In Bulgaria, the Court has identified one case where the general costs exceeded EUR 10 000 without three offers. As stated above, this case is subject to examination under the clearance of accounts procedure.

On the basis of its detailed examination of payments in eight Sapard countries so far, the Commission did not find widespread failures of the Sapard control and management system.

CONCLUSIONS AND RECOMMENDATIONS

110. While the main elements of the Commission's proposal on the Sapard Regulation (EC) No 1268/1999 were maintained, the text of the proposal was subject to ongoing discussions (including discussions on budget headings) until the final stage of adoption of the Sapard Regulation. As long as the legal uncertainty remained the Commission was not in a position to draw up the final legal provisions for the implementing arrangements.

Following adoption of the Regulation, a working group prepared the basic provisions for the financial management of Sapard within a few months. These were adopted by the Commission on 26 January 2000.

The reason for this strategy was the novelty of the approach and the fact that this was the first time external aid was managed on a fully decentralised basis. The detailed steps and the time required for elaborating and agreeing the financial implementing arrangements are outlined in the Commission's Sapard Annual Report 2000.

111. Although the Commission did not formally prepare such an analysis, it actively monitored the implementation process and provided advice to the relevant agencies in the Sapard Countries.

112. The Commission has, on various occasions, advised Sapard countries to avoid unnecessary administrative procedures not required by the MAFA, where appropriate via seminars, meetings or letters.

The Sapard systems are designed by the national authorities not only on the basis of the accreditation criteria but also taking into account national legislation and their knowledge of the risk areas in their countries. Stricter rules are necessary in some situations to protect the financial interests of the Community (see point 20 concerning double checks).

— The Commission agrees with the statement and believes it does follow this approach to the extent possible in the light of the development in the adoption of the legal basis.

— The Commission agrees that such an analysis could be useful if similar exercises were to be prepared in the future.

113. It is a key feature of the systems set up that it is for the Sapard countries to identify problems in the first instance. The Commission considers that it has allocated a sufficient number of qualified staff, in the Sapard Unit as well as in the services responsible for overseeing the accreditation process and carrying out audits, to ensure proper monitoring and financial management and control of the use of Community funds in the Sapard countries. The Commission has consistently provided guidance and advice to the Sapard countries. These actions have been described in detail in the Commission's Sapard annual reports for 2000 to 2002.

— The Commission is of the opinion that it has taken all reasonable steps to encourage best practice by providing advice to all countries, where appropriate, on specific issues raised and by liaison with each country via letters, seminars and bilateral meetings, as evidenced in the Commission's annual reports.

114. The budgets for the first three years were based on the most reliable, but limited, information available at the time. In this context the Commission reiterates its remarks to point 2.39 of the Court's Annual Report for 2002, in which the reasons for the under-utilisation of the budgets are stated. One of the major reasons for not fully utilising the budget was that greater priority was given to firm management of appropriations.

116. The current Regulations governing EAGGF Guarantee Section state clearly that the Member States are responsible for accrediting paying agencies.

Prior accreditation by the Commission would result in it taking responsibility for the systems established by the Member States. This runs counter to the principle of shared management in which the Member states implement Community policies and the Commission verifies the respect of these rules, with the possibility to make financial corrections in cases of non-respect.

The Commission remains confident that the current system remains effective.

117. A final and balanced analysis concerning the impact of the programme (and, in particular, achievement of the objectives) can only be made when the programme has been implemented in full.

118. The Commission considers that increasing production capacity at project level is compatible with improving standards and the need for restructuring to improve market efficiency.

The Commission is following up on the development in uptake through the monitoring data and the annual implementing reports. It followed the procedures provided for in Article 8(b) of the MAFA during the review of the five annual implementation reports due by the end of June 2003 to follow up on any imbalances or other developments where data indicated a tendency to deviate from the objectives identified in the programmes. The Commission will follow the same procedure during the review of the implementation reports due from all 10 countries by the end of June 2004.

119. Although the Commission has also identified weaknesses in some cases and has made recommendations for improvements, it considers, based on its own audits up to March 2004, that the position has improved since the Court's audit. Where necessary these recommendations will be followed up under the clearance of accounts procedures.

120. The Commission has taken an initiative to help address this problem through the Phare- funded project to improve access to credits for farmers and small rural businesses, and proposed modifications to the Sapard Regulation (EC) No 1268/1999 to facilitate the application of national credit schemes.

— The Commission agrees that a more limited number of key measures should be considered. It is however of the opinion that a system of loans and guarantees to replace or supplement existing measures should not be recommended. The provision proposed in the amendment of Regulation (EC) No 1268/1999 to facilitate the use of national credit schemes would, if approved by the Council, provide the necessary flexibility to the Sapard countries.

121. According to the Sapard regulation, the objectives of the programme are to contribute to the implementation of the *acquis communautaire* concerning the common agricultural policy and related policies, and to solve priority and specific problems for the sustainable adaptation of the agricultural sector and rural areas in the countries.

An essential part of the first objective is to establish a good administrative capacity enabling the demanding tasks of rural development policy implementation to be carried out according to the principles of sound financial management. This is in line with the European Parliament resolution accompanying the 1999 discharge.

The sizeable challenges posed by the need to set up an entirely new system, and the lack of experience of the Sapard countries in this area, meant that this process took time, but in most cases no longer than could be reasonably expected. The Commission is pleased to note that the Court considers that its decision to opt for a decentralised approach was correct, and that it found that the Sapard systems set up generally work well in practice.

The Commission believes that the large number of projects contracted (almost 13 000 already by the end of 2003) will contribute substantially to the achievement of the second objective. Nevertheless, a final and balanced analysis concerning the impact of the programme (and, in particular, achievement of the objectives) can only be made when the programme has been implemented in full.

Regarding measures still to be accredited, the Commission shares the Sapard countries' view that priority should be given to ensure efficient implementation of the measures already accredited to enhance financial absorption, before working on the accreditation of additional measures.

The agri-environment measure was a facility for the Sapard countries to gain administrative experience through pilot actions and was not one of the most important measures needed to restructure the agricultural sector and prepare for accession.

The Commission is aware of the problem facing small undertakings, namely lack of own resources, and of the difficulties in obtaining credit. A key criterion of Sapard is that all beneficiaries must prove economic viability. Smaller, economically unviable farms will therefore not be targeted by the programme. This is a key element of the objective to help restructure the agricultural sector. However, the Commission is supporting a project (with the aid of Phare funds) to improve access to credit for SMEs in Sapard countries, which should help widen access to Sapard.