

REPORT**on the annual accounts of the European Agency for Reconstruction for the financial year 2003,
together with the Agency's replies**

(2005/C 41/02)

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INTRODUCTION

1. The European Agency for Reconstruction (hereinafter called 'the Agency') was set up pursuant to Council Regulation (EC) No 1628/96 ⁽¹⁾. This regulation was replaced by Council Regulation (EC) No 2667/2000 ⁽²⁾. The Agency, which was set up in February 2000, was initially responsible for managing the EU's aid programmes in Kosovo. Following two extensions to its mandate in 2001 and 2002, its operations now also cover Serbia-and-Montenegro and the Former Yugoslav Republic of Macedonia. The Agency's head office is in Thessaloniki and it has operational centres in Belgrade, Podgorica, Pristina and Skopje. It implements programmes to foster institution-building and good governance, to promote the development of a market economy and essential infrastructure and to consolidate civil society. *Table 1* summarises the Agency's powers and activities based on information provided by the Agency itself.

THE COURT'S OPINION

2. The Court of Auditors has examined the Agency's annual accounts for the financial year ended 31 December 2003 and the underlying transactions. The Court performed its audit in accordance with its auditing policies and standards. These are based on international standards adapted to the Community context. The Court has thus obtained a reasonable assurance in support of the following opinions.

Reliability of the accounts

3. In the Court's opinion, the Agency's accounts do not present a true and fair view of the Agency's actual economic and financial situation (see paragraphs 8 and 10).

Legality and regularity of the underlying transactions

4. Owing to the lack of the requisite information on the final use of funds entrusted by the Agency to external bodies (both national and international), the Court is unable to express an opinion on the legality and regularity of the underlying transactions for payments of 21,4 million euros made in 2003 (see paragraph 15). For the remainder and except for the qualifications set out in paragraphs 5 and 6 below, the Court is of the opinion that the transactions underlying the Agency's annual accounts were legal and regular.

5. As far as payments are concerned, the Court noted errors relating to the validity of supporting documents, the observance of contractual provisions and delegations of public authority powers (see paragraph 13).

6. With regard to procurement, the Court noted, for one out of five of the operations it has examined, procedural anomalies that call into question the respect of the principle of equality of opportunity between tenderers (see paragraph 14).

OBSERVATIONS

7. The implementation of the appropriations for the financial year 2003 and of the appropriations carried over from the previous financial year is shown in *Table 2*. The Agency's revenue and expenditure account and balance sheet for the financial year 2003 are presented in summary form in *Tables 3 and 4* ⁽³⁾.

8. Article 1 of the Agency's Financial Regulation stipulates that its budget should be authorised according to the principle of differentiated appropriations, which distinguishes between commitment appropriations and payment appropriations. Article 3 of this same regulation lays down that total revenue should cover total payments, which implies that the budget should be shown to balance and that implementation should be as close as possible to equilibrium. In practice, however, the Agency's budget as adopted by the Governing Board does not observe the principle of differentiated appropriations, as a result of which the Agency presents as expenditure not only payments for the period charged to the appropriations for the financial year but also all the outstanding payments in respect of commitments for the financial year ⁽⁴⁾, irrespective of the extent to which these commitments have been implemented. The accounting out-turn for the financial year therefore bears no relation to the economic reality of the Agency's operations. The cumulative deficit as at 31 December 2003, i.e. 140,95 million euro, is thus largely artificial since it is due to outstanding commitments concerning economic transactions which have not yet been implemented.

9. In 2003 the Agency's accounting system still exhibited serious weaknesses. For example, the general accounts were still being kept on a single-entry basis despite all the risks of error that involves for the integrity of the data and in spite of the fact that Article 55 of the Agency's Financial Regulation lays down that the accounts should be kept on a double-entry basis.

⁽¹⁾ OJ L 204, 14.8.1996, p. 1.

⁽²⁾ OJ L 306, 7.12.2000, p. 7.

⁽³⁾ All of the tables in this report were drawn up on the basis of the most exact values possible for the data used. For presentational purposes, the figures were rounded up or down, which may produce minor differences in the totals. A dash indicates a non-existent or nil value and 0,0 indicates a value below the rounding threshold.

⁽⁴⁾ Payments made during the financial year against outstanding payments from previous years are not considered as expenditure in the Agency's revenue and expenditure account.

10. Despite the observation made by the Court in its report concerning the financial year 2002 ⁽¹⁾, funds paid out to financial intermediaries under loan programmes have not been entered on the assets side of the balance sheet. The use made of these funds is merely the subject of an information note in the report annexed to the accounts ⁽²⁾. Since its creation, the Agency has paid out 52,4 million euro ⁽³⁾ under these programmes. Moreover, various programmes which were still being implemented in 2003 provide for the management of funds by contractors to the Agency. The funds thus paid out, which have been identified by the Court, amounted to 43,38 million euro. In both cases, the balances still available at the end of the financial year 2003 should have appeared on the assets side of the Agency's balance sheet.

11. The efforts made by the Agency to improve its budgetary, financial and accounting management should be stepped up with a view to the consolidation of the Agency's accounts with those of the Community institutions, which will take place as from the financial year 2005 ⁽⁴⁾. The Agency's budget must in fact be adopted in the form provided for by its Financial Regulation (see paragraph 8) and the accounting rules governing the revenue and expenditure must be brought into line with the principles governing accruals-based accounting.

12. The management of one financial body which the Agency had set up in Kosovo, the management of which had been entrusted to an external consultant, was characterised by significant shortcomings (e.g. defective accounts, inadequate analysis of borrower-related risk, inadequate documentation provided in support of loan applications). The Agency's supervision was not sufficient to identify these shortcomings and take the necessary corrective action as swiftly as possible.

13. Anomalies were noted in respect of payments made in 2003. In some cases they arise from failure to observe either contractual provisions or payment conditions (invalid, even inadequate, supporting documents). In other cases, most of the

anomalies are due to the fact that the acts against which the payments were made do not comply with the rules governing the delegation of public authority powers and/or those governing the amendments of contracts already concluded. These anomalies show that the Agency should improve its supervision of procedures relating to the commitment and validation of expenditure.

14. Anomalies likely to affect decisions to award contracts were also noted. For example, some tenderers were sidelined for administrative or technical reasons which were disputable or were inadequately substantiated. In other cases, project managers were replaced shortly after the start of the implementation of the contract by persons who did not have the same qualifications as those which enabled the tenderer to win the contract. In order to reduce the risk of errors, the Agency should strengthen its system of internal control by rigorously selecting the staff responsible for evaluating tenders and by checking that the evaluation committees clearly substantiate their decisions.

15. In several cases, the Agency concluded agreements with public or semi-public, national or international, third parties. In all these cases, it should ensure a more rigorous application of the existing mechanisms in order to ensure that these bodies provide it with the requisite information to assess the legality and regularity of the underlying transactions.

16. In its report concerning the financial year 2002 ⁽⁵⁾, the Court stressed the excessive number of authorising officers by delegation and sub-delegation. At the end of 2003, there were 45 for Title III and 11 for Titles I and II, i.e. 56 as compared with 67 in June 2003. Moreover, no limit is placed on the number and length of delegations. The Agency should continue its efforts to reduce the number of delegations.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 8 and 9 December 2004.

For the Court of Auditors
Juan Manuel FABRA VALLÉS
President

⁽¹⁾ See paragraph 14 of the report concerning the financial year 2002 (OJ C 319, 30.12.2003, p. 1).

⁽²⁾ This is the case of the counterpart funds and of the funds disbursed via loan mechanisms or credit lines.

⁽³⁾ Estimate before the necessary adjustments were made.

⁽⁴⁾ See recitals Nos 32, 35, 48 and 49 of the financial regulation applicable to the general budget of the European Communities, Council Regulation (EC, Euratom) No 1605/2002, OJ L 248, 16.9.2002, p. 1.

⁽⁵⁾ See paragraph 15 of the report concerning the financial year 2002.

Table 1
European Agency for Reconstruction (Thessaloniki)

| Areas of EU responsibility according to the Treaty | The Agency's powers as defined in Council Regulation (EC) No 2667/2000 | | | Governance | Resources made available to the Agency (data for 2002) | Activities and services provided in 2003 |
|---|---|---|---|--|--|--|
| Objectives | Application | Tasks | Governing Board | Final budget | Geographical distribution of operating expenditure in 2003. | |
| <p>The Community shall carry out, within its spheres of competence, economic, financial and technical cooperation measures with third countries. Such measures shall be complementary to those carried out by the Member States and consistent with the development policy of the Community.</p> <p>(Article 181 A)</p> | <p>The Agency manages the principal aid programmes in Serbia-and-Montenegro (Republic of Serbia, Kosovo and Republic of Montenegro) and in the Former Yugoslav Republic of Macedonia (FYROM). Beneficiaries may include States, bodies under UN administration, federated, regional and local bodies, public and semi-public bodies, both sides of industry, business support organisations, cooperatives, mutual companies, charities, foundations and NGOs.</p> | <ul style="list-style-type: none"> — To advise the Commission of priority needs; — To devise programmes for reconstruction and the return of refugees and displaced persons; — To take every possible step to implement EU assistance. | <p>Comprises one representative from each Member State, two representatives from the Commission and an observer from the European Investment Bank.</p> <p>Director</p> <p>Appointed by the Governing Board on a proposal from the Commission.</p> <p>Operational centres in Belgrade, Pristina, Podgorica and Skopje with a high level of management autonomy.</p> <p>External control</p> <p>Court of Auditors</p> <p>Discharge authority</p> <p>the Parliament following a recommendation from the Council.</p> | <p>358,6 million euro (495,9 million euro) including an EU grant of: 97,4 % (92,5 %)</p> <p>Staff as at 31 December 2003:</p> <p>120 (122) posts listed in the establishment plan</p> <p>posts occupied: 94 (101)</p> <p>other posts — local staff: 201 (195) posts, of which 173 (176) were occupied</p> <p>Total staff: 267 (277)</p> <p>responsible for</p> <p>operational tasks: 140 (136)</p> <p>administrative tasks: 97 (107)</p> <p>mixed tasks: 30 (34)</p> | <ul style="list-style-type: none"> — Kosovo: 139 million euro. — Serbia: 109 million euro. — Montenegro: 19 million euro. — FYROM: 36 million euro. — Total: 302 million euro. | |

Source: Information supplied by the Agency.

Table 2
European Agency for Reconstruction — Implementation of the budget for the financial year 2003

| Revenue | | Expenditure | | | | | | | | | | | |
|-------------------|--|------------------|-----------------------------|--------------------------|--------------|-------------|--------------|------------|------------------------|--|--------------|---------------|-------------------------|
| Source of revenue | Revenue entered in the final budget for the financial year | Revenue received | Allocation of expenditure | Available appropriations | | | | | | Appropriations carried over from the previous financial year | | | |
| | | | | entered | committed | paid | carried over | cancelled | balance for commitment | commitments carried over | paid | cancelled (1) | outstanding commitments |
| Community grants | 349,3 | 270,0 | Title I | 19,2 | 17,3 | 17,0 | 0,3 | 1,9 | — | 0,2 | 0,1 | 0,1 | — |
| | | | Staff | | | | | | | | | | |
| Other grants | 4,0 | 28,4 | Title II | 7,6 | 6,5 | 5,3 | 1,2 | 1,1 | — | 2,0 | 2,0 | 0,1 | — |
| | | | Administration | | | | | | | | | | |
| Other revenue | 5,3 | 5,5 | Title III | 331,8 | 182,0 | 29,8 | 152,2 | — | 149,7 | 338,2 | 227,6 | 30,6 | 79,9 |
| | | | Operating activities | | | | | | | | | | |
| Total | 358,6 | 303,9 | Total | 358,6 | 205,8 | 52,1 | 153,7 | 3,0 | 149,7 | 340,4 | 229,7 | 30,8 | 79,9 |
| | | | Outstanding commitments (1) | 233,5 | 153,0 | 39,8 | 113,2 | 2,5 | 78,0 | | | | |
| | | | Total | 592,1 | 358,7 | 91,9 | 266,9 | 5,5 | 227,8 | 340,4 | 229,7 | 30,8 | 79,9 |

(1) The amount of appropriations which were carried over from the previous financial year and which were cancelled in 2003 (30,6 million euro) correspond to decommitments. The corresponding appropriations were made available again and added to the commitments outstanding at the beginning of the financial year.

NB: Discrepancies in totals are due to the effects of rounding.

Source: The Agency's data — These tables summarise the data provided by the Agency in its own accounts.

Table 3

European Agency for Reconstruction — Revenue and expenditure account for the financial years 2003 and 2002

(1 000 euro)

| | 2003 | 2002 |
|--|------------------|------------------|
| Revenue | | |
| Commission grants | 275 280 | 462 804 |
| Financial revenue | 3 955 | 5 978 |
| Miscellaneous revenue | 1 517 | 495 |
| Counterpart funds | 379 | 497 |
| Contributions from third parties | 28 034 | 500 |
| Total revenue (a) | 309 164 | 470 274 |
| Expenditure | | |
| <i>Staff — Title I of the budget</i> | | |
| Payments | 17 027 | 17 771 |
| Appropriations carried over | 306 | 206 |
| <i>Administration — Title II of the budget</i> | | |
| Payments | 5 261 | 6 211 |
| Appropriations carried over | 1 215 | 2 037 |
| <i>Operating activities — Title III of the budget</i> | | |
| Payments | 69 565 | 138 512 |
| Appropriations carried over | 265 352 | 293 106 |
| Total expenditure (b) | 358 725 | 457 844 |
| Outturn for the financial year (a–b) ⁽¹⁾ | – 49 560 | 12 430 |
| Balance carried over from the previous financial year | – 112 908 | – 73 127 |
| Payments on the Commission's behalf | – 5 231 | – 25 407 |
| Payments to be made on the Commission's behalf | – 515 | 0 |
| Cancellations of appropriations carried over from previous financial years | 30 649 | 5 463 |
| N–1 appropriations carried over which lapse (Titles I and II) | 146 | 135 |
| Complement: 2001 appropriations carried over | 0 | – 32 423 |
| Financial revenue to be repaid | – 3 955 | 0 |
| Counterpart fund adjustments | 400 | 0 |
| Exchange-rate differences | 23 | 22 |
| Balance for the financial year | – 140 951 | – 112 908 |

⁽¹⁾ Calculated according to the principles laid down in Article 15 of Council Regulation (EC, Euratom) 1150/2000 of 22 May 2000 (OJ L 130, 31.5.2000, p. 8).

NB: Any discrepancies in totals are due to the effects of rounding.

Source: The Agency's data — These tables summarise the data provided by the Agency in its own accounts.

Table 4

European Agency for Reconstruction — Balance sheet at 31 December 2003 and 31 December 2002

(1 000 euro)

| Assets | 2003 | 2002 | Liabilities | 2003 | 2002 |
|-------------------------------------|----------------|----------------|---|------------------|------------------|
| Fixed assets | | | Fixed capital | | |
| Fixed assets at cost ⁽¹⁾ | 3 877 | 3 400 | Own capital ⁽¹⁾ | 1 771 | 1 960 |
| Depreciation ⁽¹⁾ | - 2 106 | - 1 440 | Balance for the financial year | - 140 951 | - 112 908 |
| Subtotal | 1 771 | 1 960 | Subtotal | - 139 180 | - 110 948 |
| Current assets | | | Current liabilities | | |
| Sundry accounts receivable | 56 | 58 | Automatic carry-overs of appropriations (Title III) | 345 271 | 338 112 |
| Advances | 57 | 53 | Automatic carry-overs of appropriations (Titles I and II) | 1 521 | 2 244 |
| Recoverable VAT | 23 | 26 | Sundry accounts payable | 5 002 | 49 |
| Subtotal | 135 | 137 | Subtotal | 351 794 | 340 405 |
| Cash accounts | | | | | |
| Bank accounts | 210 664 | 227 307 | | | |
| Cash | 44 | 53 | | | |
| Subtotal | 210 708 | 227 360 | | | |
| Total | 212 614 | 229 457 | Total | 212 614 | 229 457 |

⁽¹⁾ Fixed assets at cost and depreciation for financial year 2002 have been recalculated according to the methods followed for financial year 2003.

NB: Any discrepancies in totals are due to the effects of rounding.

Source: The Agency's data — These tables summarise the data provided by the Agency in its own accounts.

REPLIES OF THE AGENCY

8. As the Agency does not dispose of an own budget line in the EC budget, the annual budgetary procedure takes place exclusively within its Governing Board, under the guidance of the Commission. In that context, the Agency presents its draft budget as differentiated appropriations, accompanied by 'likely schedules of payments vis-à-vis commitments', in full accordance with the Commission's practice. Such differentiation is not visible, however, when its annual budget is published in the special OJ issue for the Agencies, as the common format used there is that of non-differentiated appropriations applicable to most Agencies. The Agency has now taken steps for clarifying the financial presentation of its operations. The resulting consolidated revenue and expenditure account for the whole period will be completed for 2004 and used for the opening balance 2005 in order to comply with the ABAC approach.

9. The Agency has fully overcome the weaknesses mentioned by the Court and now uses a computerised double entry general accounting system along with the budgetary tool SI2. During the first half of 2004 the accounting data of 2003 were introduced in that accounting tool and the final accounts for 2003 were established on that basis. The integrity (completeness and reliability) of the data presented using the previous system were confirmed in that context.

10. The amount of EUR 52,4 million represents the cumulative total of payments made to all these intermediaries since 2000. Of this, only EUR 15 million have been paid to bodies created by the Agency (EUR 3,71 million in 2003). The transitional ownership clause for the funds used by the Agency essentially preserved the Community interests until the funds could be safely transferred to the managing authorities. The Agency will integrate the value of these funds and report on their use in its financial statements as from 2004. Of the 12 'special funds', three had been closed before the end of 2003; the outstanding balance of the remaining funds was EUR 5,87 million at 31.12.03 and is almost fully liquidated at the end of 2004.

11. In 2003, the Agency Accountant post was considerably upgraded, an internal controller recruited, new accounting tools acquired, the finance and general ledger services reorganised and the system of delegations reviewed. In 2004, the Agency continued its efforts to further improve its financial management system, in particular through enhancing its accounting service.

12. This body was created in 2000 in an immediate post-war situation where no banking system was in place. As conditions on the ground improved progressively, improvements were introduced in the management of this office. In fact the EAR, as part of its active supervision of the programme, commissioned an audit in 2002 (the report of which is the basis for the Court's observations), which included a review of the management of the fund. It is true that the EAR reacted with a certain delay. This was due to the late transmission of the audit report. On the basis of the findings the EAR instructed the consultants to take corrective action.

13. For the first category of findings mentioned by the Court, the Agency has made payments to public organisations in conditions different to those foreseen in the contract. This was done to better harmonise the timing of payments to the cash flow needs and the internal rules of the organisations concerned and thus avoid delays in project implementation. In other cases, the Agency has considered the technical and financial information provided by the contractor to be in substance equivalent to the submissions formally requested by the contract. In addition, in a few cases, due to local laws and conditions, it was impossible for the Agency to obtain supporting documents of EU standard. The second category which constitutes the majority of the Court's findings, concerns procurement agent contracts. This type of contract is no longer used since the entry into force of the new Financial Regulation on 1 January 2003. Some of these contracts are already terminated and the outstanding balance of the others is now being liquidated. The EAR approach has always been to ensure efficient project management (in often difficult and urgent conditions) while respecting the applicable rules. The recommendations made by the Court are however duly noted. A special effort will be made to ensure that the contractual conditions of payments are respected.

14. The great majority of the Court's findings relate to tenders and evaluations carried out before 2003. In some cases the Agency accepted an interpretation of the EC rules by the Evaluation Committees in a different way to that understood by the Court. This in effect led to the exclusion of some companies. As regards the replacement of team leaders leaving a project, a situation which occurs occasionally despite the will of the Agency, the EAR considers that in practice, the proposed new expert was equally able to implement the contract efficiently. The Agency appoints as members of the evaluation committees not only its experienced staff in the field, but also independent experts or competent persons designated by the national authorities concerned. Central monitoring and guidance is now provided by the Senior Procurement Advisor recruited in 2004 in view of further improving the relevant internal control system.

15. This observation concerns grant agreements with UNMIK and other international organisations, signed before 2003 in line with the practice of the Commission (EC rules). When the Agency has been aware of problems with the implementation of a grant, corrective measures have been taken in concert with the beneficiary and after clarification of the disputed issues. In the light of the observation made by the Court, in future, the Agency will monitor more closely the implementation of these grants.

16. The process of reduction of the number of delegations was initiated in 2003 as evidenced by the Court's remark. It was completed in February 2004, and there are since then only 20 delegations and sub-delegations in total, which allow for proper implementation of the adapted workflow (financial circuit).