

# COURT OF AUDITORS



In accordance with the provisions of the Treaties (Article 45c(4) of the ECSC Treaty, Article 248(4) of the EC Treaty and Article 160c(4) of the EAEC Treaty) and the Financial Regulation of 21 December 1997 (Article 88), as last amended by Council Regulation (EC, ECSC, Euratom) No 762/2001 of 9 April 2001 and the Financial Regulation of 16 June 1998 applicable to development finance cooperation under the fourth ACP-EC Convention, the Court of Auditors of the European Communities, at its meeting of 10 October 2001, adopted its

## ANNUAL REPORT concerning the financial year 2000

(2001/C 359/01)

The report, together with the institutions' replies to the Court's observations, was transmitted to the authorities responsible for giving discharge and to the other institutions.

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## GENERAL INTRODUCTION

0.1. The overall structure and format of this Annual Report is similar to that of last year. Separate chapters deal with revenue and each of the expenditure areas that fall under the headings of the financial perspective. There is a new Chapter 6 dealing with pre-accession aid for which a separate financial perspective heading exists from 2000 onwards. The concluding chapter contains and explains the Statement of Assurance. The Court's observations concerning the activities of the sixth, seventh and eighth European Development Funds are presented separately.

0.2. The chapters dealing with revenue and the financial perspective expenditure areas <sup>(1)</sup> contain sections dealing with budgetary management, the specific appraisal in the context of the Statement of Assurance, and the follow-up of previous observations of the Court in annual and special reports. A new element this year is that the principal findings and recommendations in the special reports adopted by the Court since the last discharge are summarised in the chapters. This means that the Annual Report this year contains all the principal findings and recommendations concerning the implementation of the general budget and the European Development Funds that the Court has published since the last discharge.

0.3. In agreement with the suggestion by the European Parliament in the 1999 discharge resolution, the Court is publishing the replies of the Commission, and, where appropriate, the other institutions, alongside the text of the Court.

### *The Court's work covers a wide range of European Union activities*

0.4. In addition to its work on the Annual Report, the Court has adopted 18 special reports covering a wide range of European Union activities <sup>(2)</sup>. One concerns own resources, seven deal with different aspects of the

common agricultural policy, three concern the implementation of structural measures, one is in the field of internal policies, five concern external actions financed from the general budget, including the common foreign and security policy, and one deals with the European Development Funds.

### *There are some positive findings*

0.5. The results of the Court's audits indicate significant positive findings. For example, in the agricultural area the reformed clearance-of-accounts system and the integrated administrative and control system have contributed to improved, if not yet fully satisfactory, management of large amounts of EU funds, and the milk quota regime has restricted production to the target level. The Commission's strategy for dealing with BSE is basically sound. With regard to structural measures, the URBAN Community initiative has helped the implementation of many urban development projects and has enabled local authorities to access European Union funds. In the external actions area the work of the Agency charged with the reconstruction of Kosovo was both efficient and economical. The Tacis cross-border cooperation programme is an instrument which has the potential to play a useful role in addressing issues relating to the new eastern border following the next accession.

### *But often major objectives are not achieved, and evaluation of results is inadequate*

0.6. However, it was also found that major objectives had not been achieved, or only limited progress had been made. Further, it was frequently found that there was either insufficient or no evaluation by the Commission of the achievement of objectives. In many instances, for example the URBAN Community initiative and the structural measures to improve employment, the objectives of the programmes themselves were poorly defined. In such circumstances the Commission is not able to assess whether expenditure is worthwhile, and what changes are needed in order to use European Union funds more efficiently and effectively. The Commission's reform programme is increasing the focus on results and performance measurement, within a resource allocation framework reflecting predetermined priorities and defined objectives. The Court's findings on recent programmes show that the Commission still faces major challenges in this area.

<sup>(1)</sup> Except for Chapter 6, which, as a new one, follows a different structure.

<sup>(2)</sup> A full list of the reports and opinions adopted by the Court in each of the last five years appears in Annex II to this report.

### *Weaknesses persist in checks of Community operations*

0.7. Persistent weaknesses were found in Member States' checking of Community operations concerning programmes with management shared between the Commission and the Member States. This was the case for IACS<sup>(3)</sup>, export refunds, and the control regulation for structural measures. The results of the audit in the context of the Statement of Assurance covering the agricultural and structural measures areas again confirmed this. Improving the control arrangements in the Member States is central to ensuring the correct use of European Union funds. It is also important if the Court is to place at least some reliance for its own audit purposes on the checks carried out by the various audit and supervisory services in the Commission, and in the Member States.

### *Further simplification and harmonisation of rules is still needed*

0.8. The Court repeatedly observed that simplification of regulatory provisions and harmonisation of systems and procedures across Member States would facilitate better management, reduce administrative costs, and ease the burden on beneficiaries of aid. Major efforts have been made in various areas of European Union policies over the past decade to simplify the rules, and there has been undoubtedly progress in some areas, which the Court has commented on. The reports show, however, that despite these efforts, there remain significant problems. For example in the fruit and vegetables common market organisation, one of the purposes of the 1996 reform was to simplify the scheme. Despite simplification in some areas the continued complexity of the regulations has resulted in measures within the operational programmes which are inappropriate and inconsistent<sup>(4)</sup>.

### *Some of the Court's proposals for strengthening financial management and control have been taken up by the Commission*

0.9. The Court has adopted seven opinions since the last Annual Report, of which four have been published in the Official Journal<sup>(5)</sup>. The most significant of these is Opinion No 2/2001<sup>(6)</sup> on the Commission's pro-

<sup>(3)</sup> Integrated administrative and control system.

<sup>(4)</sup> See paragraphs 2.146 to 2.150 of this report.

<sup>(5)</sup> See Annex II to this report.

<sup>(6)</sup> OJ C 162, 5.6.2001.

posal for recasting the Financial Regulation which is one of the most essential elements of the Commission reform programme. The revised proposal of the Commission<sup>(7)</sup> has taken up a number of the suggestions in the Court's opinion, notably to clarify or strengthen the provisions relating to methods of implementation of the budget, advance payments, procurement, presentation of the accounts, and the offices.

0.10. The Court also particularly welcomes the introduction of new provisions intended to contribute to the establishment of a coherent legal framework in the field of budgetary execution based on the primacy of the Financial Regulation, the absence of which has been criticised by the Court on many occasions in the past<sup>(8)</sup>.

### *But the Court's opinion on other important matters of principle has not been followed*

0.11. However, the Court's position has not been followed on certain important matters of principle, on which its opinion is clear, notably:

- the making of budgetary, and legal, commitments in artificial annual instalments, which means that all specific expenditure decisions taken during a given financial year are not exhaustively recorded in that year, and adds greatly to the complexity of financial management,
- the inadequate definition of the professional and financial responsibility of authorising officers for serious errors leading to losses to the budget or damage to the financial interests of the Community,
- the inclusion of provisions regarding the powers of the Court which could be interpreted restrictively by auditees,
- the derogations for specific fields, such as the supplementary period for EAGGF-Guarantee payments and the making of Structural Funds appropriations available again),

<sup>(7)</sup> These comments are based on the draft revised proposal as at 10 October 2001, date of the formal adoption of the Court's Annual Report.

<sup>(8)</sup> Most recently in its Opinions No 4/97 (paragraph 12) and No 2/2001 (paragraph 73).

— various matters which have a marginal financial impact but which make management systems complex and may lead to confusion when financial statements are read, such as the carrying-over of unused appropriations from one year to another, and maintaining the negative reserve.

0.12. The Court is continuing to monitor other aspects of the reform process. It would, however, be premature for the Court to attempt any overall assessment of the process, given that changes in financial management and control have only recently taken effect, and that decisions on aspects of staff management have yet to be reached.

*The budget surplus in 2000 was the largest ever recorded*

0.13. A particular feature of budget implementation in 2000 was the emergence of a very large surplus of revenue over expenditure, amounting to 11,6 billion euro. This surplus amounted to more than 14 % of final payment expenditure. The main factors which led to this situation were a higher revenue yield than budgeted (<sup>9</sup>) and lower payments on structural measures, in particular those for the 2000 to 2006 programming period (<sup>10</sup>).

0.14. It has not been the Commission's practice to propose in a supplementary and amending budget adjustments to budgeted revenue and expenditure when it becomes apparent that a large surplus such as that in 2000 is emerging. Carrying such a large surplus forward into the following year significantly distorts the revenue position for the following year. Information was available in sufficient time for adjustments to be made to the revenue side of the budget to reduce the surplus significantly, but this was not done. The Court, in Chapter 1, recommends that the Commission examine how it can better use the supplementary and amending budget procedure to avoid excessive budget surpluses.

*Further improvements are needed in the information provided by the Commission analysing budget management*

0.15. In order for the budget authority and others to be able to assess how well the budget is being managed, sufficient reliable information analysing budget management is essential. Accordingly, in the last few years

the Court has been paying more attention to the quality of the information presented by the Commission on the management of the budget in Volume 1, Part 2 of the 'Revenue and expenditure account'. As a result of the Court's observations the Commission committed itself to substantially improving the quality and consistency across the budget headings of the information presented. It is now devoting more resources to this, and improving the way in which information is generated and compiled. The comments of the Court in the various chapters of this report indicate that progress has been made, but that further efforts are needed. Questions which require further attention concern, for example, the levels at which the analysis should be done, how much detail should be provided, the need not just to identify what has happened in terms of variances, budget transfers, etc., but also to provide brief explanations for the key underlying developments, and how to ensure a consistent approach across the different budget areas.

*The extent and effectiveness of action taken by the Commission to follow the Court's observations varies*

0.16. The Court, responding to the wishes of the discharge authority, has continued to follow up the observations in previous annual and special reports. The main purpose of this is to review what action has been taken, principally by the Commission, in response to the observations of the Court, the recommendations of the Council and the resolutions of the European Parliament.

0.17. In all of the subjects examined, some action has been taken. The extent and effectiveness of the action, however, varies considerably. In general, the Commission, in particular where it agreed with the earlier observations and propositions, has adopted measures designed to respond to them and to improve the situation. In some cases corrective action has been slow, in others insufficient staff or financial resources have been allocated to achieve the desired level of improvement (for example, nuclear safety within the Phare and Tacis countries (<sup>11</sup>)). In the agricultural measures examined by the Court (common market organisations for sheep and goatmeat and for fruit and vegetables, and export refunds) a number of modifications have been made to the arrangements, but many of the problems previously

(<sup>9</sup>) See paragraph 1.4 of this report.

(<sup>10</sup>) See paragraphs 3.8 and 3.17 of this report.

(<sup>11</sup>) See Chapter 5, paragraphs 5.45 to 5.76.

noted by the Court have not been addressed, or, if they have been addressed, still persist. This shows that effecting improvements in the management and control of complex programmes involving many organisations at different levels is difficult and takes time. Structural rigidities have often to be overcome, and in the areas of shared or decentralised management, which account for more than 80 % of the general budget, the Commission has to obtain action from others.

0.18. Notwithstanding that achieving change can be difficult, the Commission should ensure that it takes all the measures within its power to implement the recommendations of the Court and the discharge authority.

0.19. Sometimes action is not taken because the Court's recommendations are not accepted. A particular case concerns one of the Court's recommendations to all institutions in its Special Report No 5/2000 on the Court of Justice's expenditure on buildings. The recommendation that the Communities should look into the advantages of direct borrowing to finance the construction of their buildings resulted in the Commission including the possibility of such an option in its proposal to amend the Financial Regulation. This was, however, not taken up<sup>(12)</sup>. As a result, several institutions continue to finance their property purchases by means of 'special purpose vehicles' which have the same principal characteristics as loans, but are less transparent and cost more than if they had been contracted directly. It is regrettable that the institutions have to resort to such arrangements for this purpose.

*Progress has been slow in reorganising the European Union's anti-fraud work*

0.20. The Court's Special Report No 8/98 concerning the Commission departments specifically involved in the fight against fraud contributed significantly to the debate which led to the replacement of the then-existing anti-fraud unit (UCLAF) with the European Anti-fraud Office (OLAF). In early 2001, as part of its follow-up work, the Court reviewed progress. The new arrangements for OLAF provide a more appropriate adminis-

(12) The Court made a similar proposal in its opinion submitted to the Intergovernmental Conference prior to the amendment of the Community Treaties in Nice, which was also not taken up.

trative framework, with greater independence for the Office than its predecessor. The Office also has a legal basis for investigations, and procedures are being improved. Staffing has increased more slowly than foreseen<sup>(13)</sup>. The main difficulties have, however, subsequently been resolved. Databases and management information criticised in Special Report No 8/98 have only begun to be improved since the Court's review, and there is a need to modify the staff rules and procedures to facilitate investigations within the institutions.

0.21. The Office now needs to plan its work so as to concentrate on areas of activity under the first pillar which concern the responsibility of the Commission, or the other Institutions, and where there is direct risk to the budget. It also needs a period of stability: the investigation units of the Commission have been reorganised twice in seven years, and it is necessary to allow the new arrangements time to settle down.

0.22. The Court continues to work closely with OLAF. It has established formal procedures to ensure that the relations between the two organisations are efficient and effective. It has also established a constructive dialogue with the committee established to supervise the work of OLAF.

*Statements of Assurance*

0.23. With regard to the *Statement of Assurance concerning the general budget* (see Chapter 9), except for the effects of certain matters contained in the statement, the Court is of the opinion that the revised accounts for the financial year ended 31 December 2000 as published in the Official Journal<sup>(14)</sup> reflect reliably the Communities' revenue and expenditure for the year and the financial situation at the end of the year.

0.24. As far as the legality and regularity of underlying transactions are concerned, the audit of the principal management and control systems applicable to

(13) See paragraphs 7.43 to 7.45.

(14) Volume IV of the documents was submitted by the Commission to the European Parliament and Council and to the Court at the official date of 1 May 2001 (shortly available in the Official Journal; available on the site: [http://europa.eu.int/eur-lex/fr/com/cpi\\_index\\_en.html](http://europa.eu.int/eur-lex/fr/com/cpi_index_en.html)).

agriculture and structural measures revealed weaknesses in the functioning of control procedures aiming to secure the legality and regularity of the transactions.

The audit of operational expenditure revealed an unacceptable incidence of error affecting the amount of the payments or the reality or the eligibility of the underlying transactions.

In view of all the results of its audit, the Court is of the opinion that the transactions underlying the financial statements, taken as a whole, are legal and regular in respect of revenue, commitments and administrative expenditure but declines to provide this assurance in respect of the other payments.

0.25. With regard to the *Statement of Assurance concerning the European Development Funds* (see Chapter II of the report on the activities of the European Development Funds), the Court is of the opinion that, except for certain items set out in the statement, the financial statements and the revenue and expenditure accounts for the financial year 2000 reliably reflect the revenue and expenditure of the sixth, seventh and eighth EDFs for the financial year and their financial situation at the end of the year.

0.26. As far as the legality and regularity of the underlying transactions are concerned, the Court is of the opinion that, in light of the findings set out in the statement, the transactions underlying the financial statements of the sixth, seventh, and eighth EDFs for the financial year ended 31 December 2000 are, taken as a whole, legal and regular.



## **REPORT ON THE ACTIVITIES FINANCED FROM THE GENERAL BUDGET**



## CHAPTER 1

**Own resources**

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## THE COURT'S OBSERVATIONS

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## INTRODUCTION

1.1. In the area of traditional own resources, the Court's audit for the purpose of preparing the Statement of Assurance (DAS) concentrated on the establishment and recovery of customs duties, the implementation of Community legislation on anti-dumping measures and the information available concerning the protection of the Community's financial interests. In addition, the Court presented observations on the customs value of imported goods in Special Report No 23/2000 (¹).

1.2. For the VAT own resource, the audit concentrated on the arrangements for the protection of the Community's financial interests. For the GNP own resource, the audit covered the Commission's procedures ensuring the quality of the GNP statistics.

## BUDGETARY MANAGEMENT

*Budgetary implementation*

1.3. **Table 1.1** summarises Community revenue for the financial year 2000 and **Graph 1.1** shows the distribution of the different types of revenue. **Graph 1.2** illustrates the evolution of actual revenue over the period 1989 to 2000.

1.4. **Table 1.1** shows that the following significant changes occurred between revenue shown in the initial budget and actual revenue:

(a) collected gross customs duties (²) amounted to 14 568,3 million euro, whereas only 12 300 million euro had been forecast. The VAT resource for the current financial year reached 34 187,6 million euro, whereas only 32 554,6 million euro was shown in the initial budget. Both underestimations resulted mainly from the use of too low a forecast of economic growth in the European Union in 1999 and 2000 for the establishment of the initial budget;

(¹) OJ C 84, 14.3.2001.

(²) The resources specified in Article 2(1)(a) and (b) of Council Decision 94/728/EC, Euratom of 31 October 1994 on the system of the European Communities' own resources (OJ L 293, 12.11.1994, p. 9).

## THE COURT'S OBSERVATIONS

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(b) the developments mentioned under (a) together with the surplus from the financial year 1999 of 3 209,1 million euro led to a large decrease in the GNP resource, which was 43 049,8 million euro in the initial budget and was reduced to 37 253,2 million euro in actual revenue;

(c) total actual revenue was 92 724,4 million euro (as against 89 440,6 million euro in the final budget) and total expenditure reached only 81 105,3 million euro. Consequently, the budget was no longer balanced. A resulting surplus of about 11 619,1 million euro (highest surplus in the last decade) will necessarily become part of the revenue available in the financial year 2001. This will lead to significant

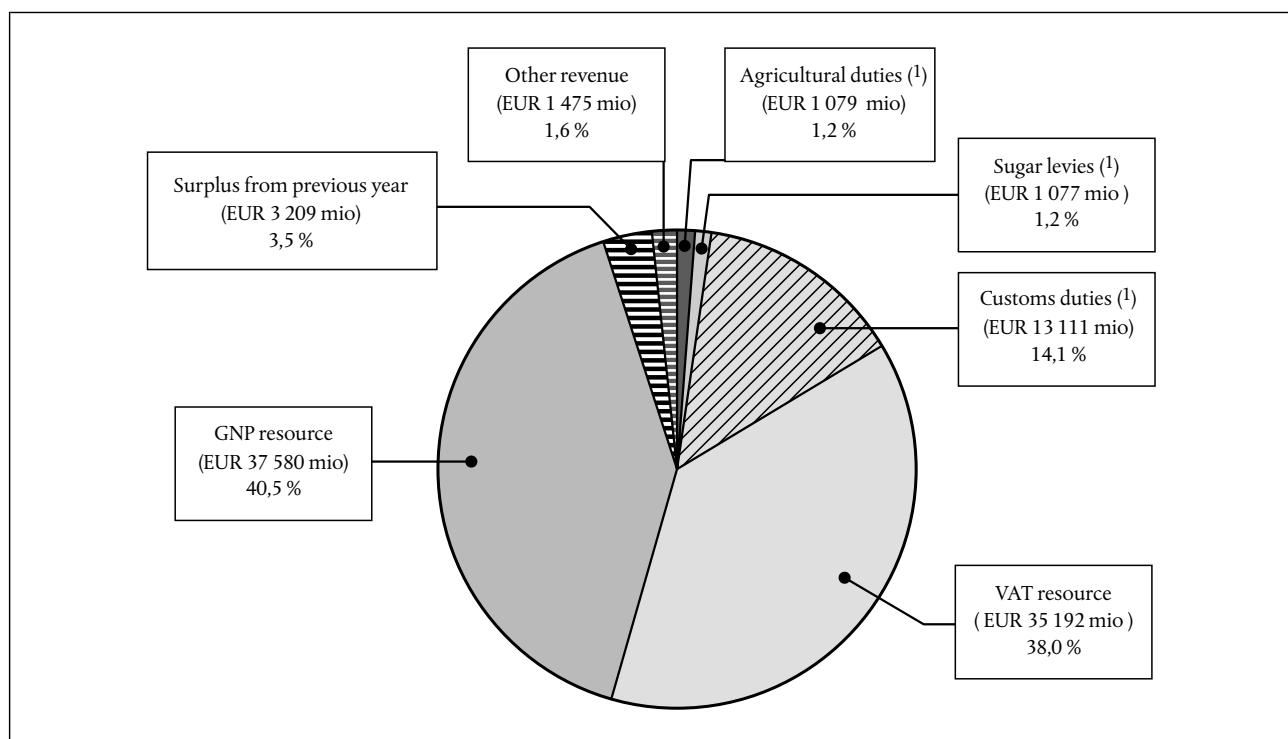
**1.4. (c)** *In future the Commission will endeavour to provide a more thorough analysis of the origin of the surplus.*

**Table 1.1 — Revenue for the financial years 1999 and 2000**

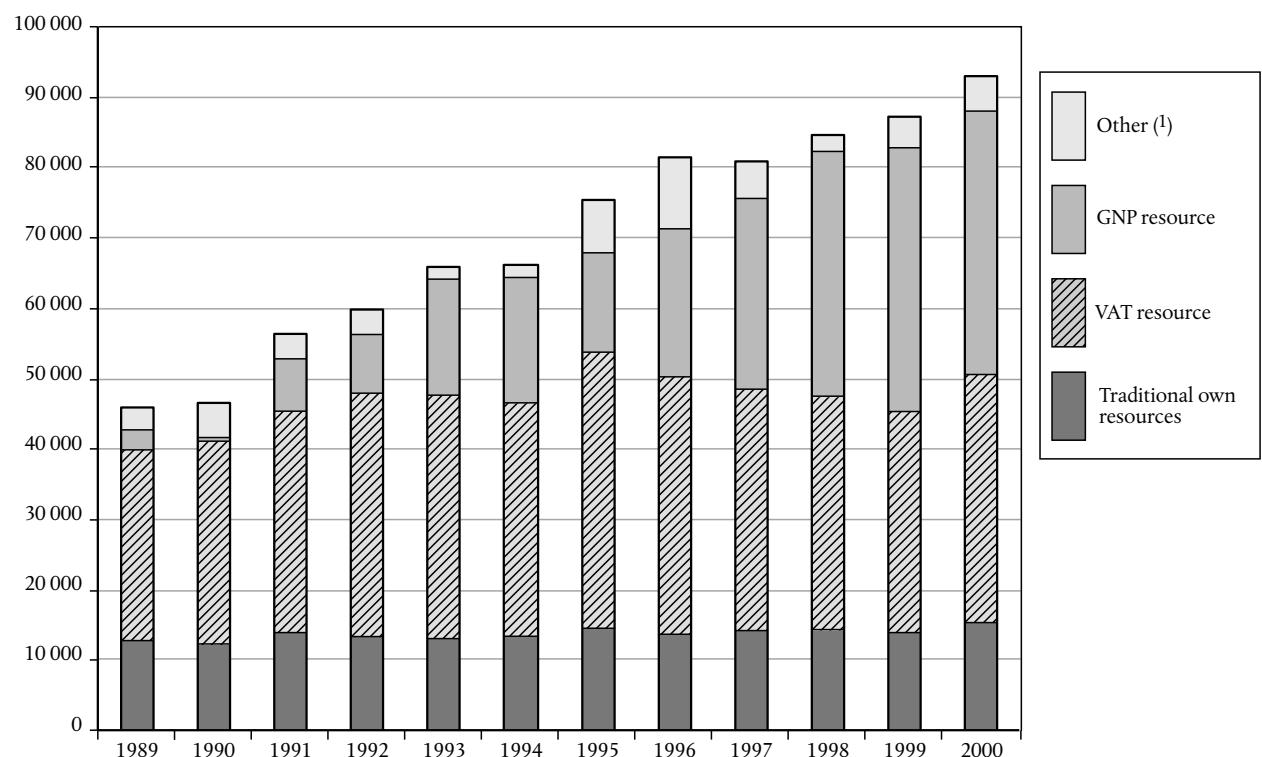
(Mio EUR)

Type of revenue and corresponding budget heading	Actual revenue in 1999	Development of the budget 2000		Actual revenue in 2000	% change (1999 to 2000)
		Initial budget	Final budget		
	(a)	(b)	(c)	(d)	(e) = [(d)–(a)]/(a)
1. Traditional own resources					
— Agricultural duties (Chapter 1 0)	13 857,6	13 108,4	13 703,7	15 267,2	10,2
— Sugar and isoglucose levies (Chapter 1 1)	1 187,3	1 102,2	1 102,2	1 198,4	0,9
— Customs duties (Chapter 1 2)	1 203,5	1 162,7	1 162,7	1 196,8	– 0,6
— Collection expenses (Chapter 1 9)	13 006,5	12 300,0	12 961,4	14 568,3	12,0
	– 1 539,7	– 1 456,5	– 1 522,6	– 1 696,3	10,2
2. VAT resource	31 332,3	32 554,6	34 048,6	35 192,5	12,3
— VAT resource from the current financial year (Chapter 1 3)	31 381,6	32 554,6	34 048,6	34 187,6	
— Balances from previous years (Chapter 3 1)	– 49,3	p.m.	p.m.	1 004,9	
3. GNP resource	37 512,0	43 049,8	37 805,1	37 580,5	0,2
— GNP resource from the current financial year (Chapter 1 4)	37 011,7	43 049,8	37 805,1	37 253,2	
— Balances from previous years (Chapter 3 2)	500,3	p.m.	p.m.	327,3	
4. Budgetary imbalances	– 169,2	0,0	0,0	– 70,9	– 58,1
— UK correction (Chapters 1 5)	– 167,8	0,0	0,0	– 70,8	
— Final calculation of UK correction (Chapter 3 5)	– 1,4	0,0	p.m.	– 0,1	
5. Other revenue	4 375,4	674,1	3 883,2	4 755,3	8,7
— Surplus from previous financial year (Chapter 3 0)	3 022,2	p.m.	3 209,1	3 209,1	6,2
— Refunds to Member States (Chapter 3 3)	0,0	p.m.	p.m.	0,0	
— Miscellaneous revenues (Titles 4 to 9)	1 353,2	674,1	674,1	1 546,2	14,3
<b>Grand total</b>	<b>86 908,1</b>	<b>89 387,0</b>	<b>89 440,6</b>	<b>92 724,4</b>	<b>6,7</b>

Source: Budget 2000, and 1999 and 2000 revenue and expenditure accounts.

**Graph 1.1 — Breakdown of actual revenue (2000)**

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

**Graph 1.2 — Evolution of sources of actual revenue 1989 to 2000 (Mio EUR)**

(<sup>1</sup>) Surplus from previous financial year and miscellaneous.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

changes regarding revenue in a supplementary and amending budget in 2001 since the first estimation of the surplus in the initial budget for 2001 is 900 million euro. The Commission, however, does not present in Volume I a thorough analysis of the origin of the surplus <sup>(3)</sup>, notwithstanding the significance of this element in the budgetary outcome.

1.5. The increase of actual revenue in 2000 (+ 6,7 %) was considerable, mainly due to the strong economic expansion. GNP in value for 2000 largely exceeded the GNP figure used in the latest version available of the financial perspectives 2000 to 2006 (January 2001). This factor alone would make the appropriations for payments change from 1,12 % of GNP to around 1,10 %.

1.6. **Graph 1.2** illustrates how the GNP resource has grown in importance since 1989 and became more than 40 % of the revenue in 2000. It will continue to grow as a result of the new own resources Decision <sup>(4)</sup>.

1.7. The Court recommends that the Commission examines how it can better take into account, during its budget process for the year, underspending of appropriations for payment and the unexpected evolution of revenue, notably within the context of a supplementary and amending budget.

1.7. *The Commission monitors actual revenue throughout the annual budget process. After consulting the Member States within the Advisory Committee on Own Resources, the forecasts for traditional own resources and the VAT/GNP bases are regularly adjusted in spring, for the first time, by an amending budget. In autumn, if necessary, the Commission enters an initial estimate of the foreseeable balance for the year, based on the information available, in a letter of amendment to the PDB.*

<sup>(3)</sup> The Court has reviewed the information presented by the Commission in volume I of the revenue and expenditure account. This volume provides a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the actual revenue. This review did not seek to provide assurance as to the reliability of these explanations. Rather it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

<sup>(4)</sup> Council Decision 2000/597/EC, Euratom of 29 September 2000 on the system of the European Communities' own resources (OJ L 253, 7.10.2000, p. 42).

## THE COURT'S OBSERVATIONS

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*The budgetary presentation of own resources*

1.8. The Court found, in connection with the 2000 budgetary analysis, that the quality of the budget information published, in terms of legibility and transparency, particularly that sent to the budgetary authority, is not always satisfactory.

1.9. With regard to the management of supplementary and amending budgets, the Court found that the time limits for publication in the Official Journal laid down in the Financial Regulation are not adhered to. On occasion, the information presented does not enable changes that have taken place to be traced in the proper manner.

1.10. The Court recommends:

- (a) a review of the budgetary presentations concerning own resources and of the nomenclature currently applied;
- (b) improved planning of the use of supplementary and amending budgets.

**1.9.** *The Commission will ensure that the provisions of the Financial Regulation on deadlines for the publication of supplementary and amending budgets are complied with.*

**1.10.**

- (a)** *The Commission intends to act on the Court of Auditors' recommendation and to submit amendments to the budgetary authority regarding the budget presentation of own resources.*
- (b)** *The Commission will strive as far as possible to limit the number of supplementary and amending budgets, which should be submitted only in the event of unavoidable, exceptional or unforeseen circumstances, as specified in Article 15 of the Financial Regulation. The Commission is, however, required, once the accounts have been closed, to submit an SAB in order to include the previous year's out-turn in the budget for a given year.*

## SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

*Introduction*

1.11. The Statement of Assurance does not cover duties that are evaded since they do not reach the accounts. In order to take this problem further into consideration, the Court has:

- (a) taken account of the work of other auditors, notably that done by Commission services;
- (b) reviewed the arrangements to identifying, reporting and monitoring fraud and irregularity, in the context of protecting the Communities' financial interests (see paragraphs 1.53 to 1.68 and 1.75 to 1.92).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*Traditional own resources*

1.12. The objective of the Court's audit work was to ensure that duties entered in the accounts had been established accurately and in a timely manner, and that the accounting procedures were reliable. In addition to the audit of transactions, the Court also made an in-depth audit of the management and collection of anti-dumping duties, where the incentive to evasion is particularly high (see paragraphs 1.21 to 1.52).

**Audit of transactions**

1.13. The Court audited import duty receipts, drawn from the Commission's accounts, which included items from 11 Member States. The audit was limited to examination of documents available to the Member States' customs authorities for clearance of customs transactions.

1.14. Import duty is established by Member States' customs authorities and is entered in national accounting systems, from which it is identified and made available to the Commission; it is therefore important that these systems should be reliable and auditable. In Germany, three different and only partly coordinated accounting systems exist for customs entries, and much of the processing is manual.

1.15. Established entitlements for which no security has been provided, and those which have been challenged and might be subject to change, need not be made available but may instead be entered by the Member States in separate accounts (the B accounts). Each Member State provides a quarterly statement of its B accounts to the Commission. The balances are included in the balance sheet under 'Amounts owed by Member States' (VII. B.2.c) (see paragraph 9.6 on the provision calculated by the Commission).

1.16. The total balance standing in B accounts increased by 4,3 %, from 2 168,7 million euro at 31 December 1999 to 2 261,6 million euro at 31 December 2000. The increase is less than half the average annual increase in the period 1990 to 1999. Since the quarterly statements for the Commission require only a report of aggregate changes, without analysis of the B account balance by age or otherwise, Member States are free simply to aggregate totals reported by local offices, without making any central or local analysis of what

## THE COURT'S OBSERVATIONS

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types and number of cases make up the balance. It is not known how many individual entries there are. A few entries are large: 532,7 million euro (some 23 % of the total balance) represents the customs debts arising from the investigations of New Zealand butter imports <sup>(5)</sup>; these debts have been challenged and the matter is before the courts in the United Kingdom. More typical large items are two 1995 entries made by Belgium, which relate to cigarette smuggling in 1993 and together total 29,4 million euro (1,3 % of the total).

1.17. In 2000, as in previous years <sup>(6)</sup>, problems were found with the maintenance of the B accounts in several Member States. In Germany, the accounting centralisation procedures for B accounts are manual and do not include sufficient checks to give assurance of reliability. Cases were found where established amounts had not been entered (United Kingdom), or had not been adjusted following court decisions (Belgium). In the Netherlands, procedures are now being revised to ensure that the rules applied fully reflect the legal requirements. In Finland, the B account is overstated by at least 0,75 million euro, representing a calculation of the potential duty on seized goods; however, the customs debts on these goods have been extinguished by the acts of seizure and confiscation. In a number of Member States (Belgium, Denmark, Germany), entries are routinely made in the B accounts for secured customs debts arising from undischarged transit operations, regardless of whether there has been a formal appeal. This is in breach of the regulation, which requires that secured amounts should be made available.

1.18. Part of the B account balance is highly likely to be irrecoverable. The regulation prescribes a write-off procedure for use where it appears that recovery is

**1.17.** *The Commission agrees that the current separate accounting system based at local level can lead to errors, mostly one-off but some systematic, resulting from erroneous interpretation of Article 6 of Regulation (EC, Euratom) No 1150/00. The Commission takes appropriate action to remedy matters and continues to offer guidance to Member States on how to operate the procedure.*

*Turning to the Member States specifically mentioned, a Commission survey in Germany of 282 cases reported as write-offs revealed that more than half had not been given the correct accounting treatment. Appropriate advice to improve matters has been given. The Commission also found weaknesses in the Danish, Netherlands and UK systems. Negotiations are in progress regarding the required changes to their procedures. As a result of a request from the Commission, the Finnish authorities changed their system earlier this year. As negotiations with Belgium have so far proved unsuccessful, the Commission has started infringement proceedings.*

<sup>(5)</sup> Special Report No 4/98 on importation at reduced rate of levy into the Community and disposal of New Zealand milk products and Swiss cheese (OJ C 127, 24.4.1998 and OJ C 191, 18.6.1998).

<sup>(6)</sup> See Annual Report concerning the financial year 1999, paragraphs 1.12 to 1.16; Annual Report concerning the financial year 1998, paragraph 1.10; Statement of Assurance concerning activities financed from the general budget for the financial year 1997, paragraphs 8.13 and 8.14 (OJ C 349, 17.11.1998); Statement of Assurance concerning activities financed from the general budget for the financial year 1996, paragraphs 19.6 and 19.7 (OJ C 348, 18.11.1997).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

impossible in the long term for reasons which cannot be attributed to the Member States, but does not define any criteria or time limits by which a Member State must so deem a debt.

1.19. The Commission has submitted a proposal (7) for a regulation that would provide for removal from the B account of amounts deemed irrecoverable after a period of five years from the date of notification or of the final judicial decision. As long as the Council has not adopted such a regulation, the B account balance will continue to contain many amounts which are de facto irrecoverable. In the Court's view no useful purpose is served by maintaining items in the B account indefinitely if they are not likely to be recovered, and it therefore considers that such amendments to the regulation should be made.

1.20. The minor errors found in the course of the audit of transactions do not materially affect the import duty shown in the revenue and expenditure account, nor the legality and regularity of the collection of the amounts shown in that account.

### **Anti-dumping measures of the European Union**

#### Introduction

1.21. European Community rules concerning anti-dumping (8) measures were established in 1968 (9). Since

(7) Amended proposal for a Council Regulation (EC, Euratom) amending Council Regulation (EEC, Euratom) No 1552/89 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources — COM(98) 0209 final (OJ C 150, 16.5.1998, p. 20).

(8) Besides anti-dumping measures, Community legislation also provides for countervailing measures against subsidies granted by third countries for exports to the Community. In the present report the term 'anti-dumping' measures is intended as comprising also the 'countervailing measures', whose contents, application procedures and effects are very similar to those of the 'anti-dumping' measures.

(9) Council Regulation (EEC) No 459/68 of 5 April 1968 (OJ L 93, 17.4.1968, p. 1).

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## COMMISSION'S REPLIES

then, the regulatory framework has been modified <sup>(10)</sup> in order to comply with the development of the international agreements in the context of the General Agreement on Tariffs and Trade (GATT) <sup>(11)</sup>.

1.22. According to the provisions of Council Regulation (EC) No 384/96, the basic Regulation on anti-dumping, a product is considered to be dumped if its export price to the Community is lower than the normal selling price in the exporting country. An anti-dumping duty can be applied if there is injury to the Community industry, if there is a causal link to the dumping and if the measure is in the European Union interest <sup>(12)</sup>.

1.23. Anti-dumping duties are own resources of the Community and are collected by customs authorities in the same way as normal customs duties. Some 139 million euro of anti-dumping duties were collected, all over the Community, during the budget year 2000. At the end of the year, 70 products originating from 38 countries were subject to definitive anti-dumping measures.

1.24. The procedure leading to the adoption of an anti-dumping measure starts with a written complaint by a natural or legal person acting on behalf of the Community industry affected. The complaint must include

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<sup>(10)</sup> As regards anti-dumping measures, Council Regulation (EC) No 384/96 of 22 December 1995 (OJ L 56, 6.3.1996, p. 1) and, as regards countervailing measures against subsidies, Council Regulation (EC) No 2026/97 of 6 October 1997 (OJ L 288, 21.10.1997, p. 1) apply. For products covered by the European Coal and Steel Community (ECSC) specific rules are laid down in Commission Decisions No 2277/96/ECSC of 28 November 1996 (OJ L 308, 29.11.1996, p. 11) and No 1889/98/ECSC of 3 September 1998 (OJ L 245, 4.9.1998, p. 3). The outlines of both Decisions follow the basic Council Regulations.

<sup>(11)</sup> Concerning anti-dumping measures: 'Agreement on implementation of Article VI of the General Agreement on Tariffs and Trade 1994'; concerning countervailing measures against subsidies 'Agreement on subsidies and countervailing measures'. The World Trade Organisation (WTO), established in 1995, constitutes the international administrative framework for the enforcement of the GATT agreements.

<sup>(12)</sup> Anti-dumping duties are set up to bridge the gap between the dumped and normal export prices at a level adequate to remove the injury to the domestic industry.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

evidence about the dumping, the injury and the causal link between the two. On the grounds of the complaint the Commission decides within 45 days about the opening of an investigation, which has to be concluded within 15 months. After 60 days, and not later than nine months, from the opening of the investigation, the Commission can impose *provisional* anti-dumping duties, applicable for a maximum period of nine months and always covered by a guarantee. Where at the end of its investigation, the Commission considers that dumping and consequent injury exist and an intervention corresponds to the Community interest, it proposes the imposition of *definitive* anti-dumping duties through a Council regulation. Anti-dumping duties can be imposed *retroactively* (see paragraph 1.41) on the condition that the customs authorities have been informed of this possibility in due time (<sup>13</sup>).

1.25. An investigation may be concluded without the imposition of anti-dumping duties if the exporters undertake to avoid dumping prices. The Commission can accept the exporters' undertakings if it is satisfied that they eliminate the dumping. For reasons relating to the protection of commercial interests, the detailed content of the undertakings (minimum prices and/or maximum quantities for exports to the Community) is known only to the Commission. The Essen European Council of 9 and 10 December 1994 instructed the Commission, as regards candidate countries for accession, to accept undertakings, when possible, rather than to impose anti-dumping duties (<sup>14</sup>).

1.26. The Court's audit of the management of anti-dumping measures was carried out at the Commission and in eight Member States (<sup>15</sup>). It also included discussions with representatives from the industries concerned about the practicability and effectiveness of anti-dumping measures.

**1.25.** *The key parameters of undertakings are kept confidential not only to protect the commercial interests of the exporters, but also to avoid that the proposed undertakings and their enforcement lead to anti-competitive behaviour.*

(<sup>13</sup>) The registration of imports has to be requested by a specific Commission regulation.

(<sup>14</sup>) The conclusions of the Essen European Council provide that the Commission '... will give, on a case-by-case basis, where appropriate, a clear preference to price undertakings, rather than duties in order to conclude anti-dumping cases where injury is found'.

(<sup>15</sup>) Belgium, Germany, Spain, France, Italy, the Netherlands, Sweden and the United Kingdom.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## Audit findings

*Management and control of the anti-dumping measures*

## Anti-dumping database

1.27. According to Article 14(6) of the basic Regulation, Member States are requested to report to the Commission every month on the import trade in products subject to investigation or to measures and on the amount of duties collected. Using Member States' reports the Commission set up in 1997 a database known as 'database 14/6'. This database, if reliable, could be used for monitoring anti-dumping measures and assessing their effects, as well as for cross-checking the amounts declared by the Member States in their monthly statements of own resources accounts <sup>(16)</sup>.

1.28. The Court compared the amounts reported by Member States for the database 14/6 with the amounts reported in the monthly statements of the own resources accounts. Significant differences were found for all Member States. These differences result from objective factors, such as different methods of data collection <sup>(17)</sup> and different reporting periods <sup>(18)</sup>, but mainly from misunderstandings or errors.

1.29. The biggest difference concerns Germany, where in 1999 24 million euro of anti-dumping duties was collected and accounted for, but 188,8 million euro reported for the database 14/6. This was partly due to

**1.28.** Based on a comparison between the two data sources mentioned in this paragraph the Commission confirms the Court's findings. The discrepancies found were investigated during last year's inspection visits. Insofar as the differences, caused by misunderstandings, these were addressed with the Member States concerned. However, the Commission considers that as one system needs to include topical data on both provisional as well as definitive duties and the other only information on recovered definitive duties reported in line with accounting timescales the differences, although apparently significant, will always prove inconclusive.

**1.29.** The Commission confirms the Court's findings and would add that as the design of the German reporting form contributed to the confusion, the authorities have been asked to change it.

<sup>(16)</sup> The monthly statements are forwarded according to Commission Decision 97/245/EC, Euratom of 20 March 1997 laying down the arrangements for the transmission of information to the Commission by the Member States under the Communities' own resources system (OJ L 97, 12.4.1997, p. 12).

<sup>(17)</sup> The database 14/6 must be quickly available, it does not include corrections made at a later date. Furthermore database 14/6 shall include provisional (guarantees) and definitive anti-dumping duties while for own resources only cashed anti-dumping duties are recorded.

<sup>(18)</sup> For example the database 14/6 for month 'n' will reflect the transactions for that month, these do not reach the Commissions financial statements until month 'n + 2'.

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the fact that in a number of cases customs officers indicated in the database 14/6 reports, instead of the amount of duty collected, the figure relating to the weight in kilograms of the imported goods. These errors were not noted because no reconciliation was made in Germany between the customs records on anti-dumping duties collected and the manual reporting system used for the database 14/6.

1.30. Because of unreliable data and the lack of a reconciliation, either at Member States or Commission level, only a limited use of the 14/6 database was possible up to the date of the Court's audit.

Insufficient specific controls on imports subject to anti-dumping duties

1.31. As an anti-dumping duty is much higher than a normal customs duty<sup>(19)</sup>, a rather high risk exists that importers will try to avoid it through incorrect declarations regarding the country of origin or the characteristics of the goods, the tariff heading applicable, the producer or exporter, the import price if a minimum price is set. The particular risks linked to import declarations related to goods subject to anti-dumping duties should be analysed by the customs authorities and the use of specific control tools and methods envisaged.

1.32. Due to the extremely high number of import operations and to the economic necessity of ensuring smooth international trade, most customs declarations are accepted without control or on the grounds of a simple *prima facie* examination of the documents

(19) For example, the rate of the anti-dumping duty on imports of tube or pipe fittings from the People's Republic of China or Taiwan (Council Regulations (EC) No 584/96 and (EC) No 763/2000) is 58,6 %, where the customs duty rate is 3,7 %.

**1.30.** *The Commission can confirm that the reliability of the 14/6 database at the time of the Court's audit was still limited. Nevertheless available data were being used, for various applications, notably the monitoring of undertakings. In addition, the Commission services have produced new guidelines, which came into effect on 1 January 2001. The considerable efforts made over the past two years to improve the quality of the data are now beginning to pay off.*

*It is important to keep in mind the size of the task at hand, which is to check and integrate into the database submissions from 15 Member States made on a monthly basis for a total of tens of thousands of transactions.*

**1.31. to 1.34.** *Within the concept of risk management anti-dumping must be qualified as a specific area of attention. In 1997 the Commission has drafted, in cooperation with the Member States, and published 'A Guide to risk analysis and customs controls'. In chapter 3, subsection 3 of this guide, specific risk indicators for goods subject to anti-dumping and countervailing duties are defined. These indicators are supposed to cover the risks indicated by the Court's audit.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

presented by the importer. A specific treatment of customs declarations related to anti-dumping duties can only be assured if a selection of a substantial number of transactions for adequate specific controls (physical examination of the goods, laboratory analysis, verification of the authenticity of documents, etc.) is possible. When a computer system recording all customs declarations exists, the selection can be made using automatic earmarks (filters) resulting from a risk analysis. In this case, the customs official dealing with an earmarked declaration is informed of the fact that the declaration presents particular risks and needs a specific control.

1.33. The Court's audit showed that in Germany the customs administration does not have a comprehensive computer system for the clearance and recording of all import declarations. This weakness is not compensated otherwise: there is still no operational central unit for risk analysis and the customs offices are not adequately informed about the characteristics of imports subject to anti-dumping duties.

1.34. The quality of the customs control depends of course on an effective and adequate use of the available tools. In Belgium, France and Spain it was noted that in some cases the filters applied did not adequately cover specific risks linked to the importation of goods subject to anti-dumping measures. In the United Kingdom the number of errors and omissions found during the Court's audit showed insufficient use of available tools.

## Determination of the import price

1.35. The 'net, free-at-Community-frontier price' is the basis for the calculation of *ad valorem* duties and for the control of minimum import prices. Article 147 of the Regulation implementing the Community Customs Code<sup>(20)</sup> lays down that, in case of successive sales before customs valuation (including sales within the EU customs territory), the import price to be taken into account is normally the price set for the last sale before

**1.33.** *The Commission agrees that all national administrations need to continually improve their operational infrastructure, preferably by increasing the use of information technology, particularly in the field of risk analysis.*

**1.34.** *The anomalies mentioned by the Court are being followed up by the Commission which will take any necessary corrective action.*

*It should also be noted that numerous activities are under way under the Customs 2002 programme to promote a Community approach to risk management. Forming part of the Risk Analysis implementation plan and building on the earlier work, these activities include developing risk indicators for the customs processes of entry, import, export and transit.*

**1.35. to 1.36.** *The Commission wishes to stress that, pending a definitive view on this question, provisional guidance was given to Member States on several occasions by the Commission Services.*

<sup>(20)</sup> Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of the Community Customs Code (OJ L 253, 11.10.1993, p. 1).

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entry for free circulation of the goods, supposed to be the highest selling price. By applying the successive sales rule it could be possible to increase the import price up to the level of the minimum price, thus avoiding anti-dumping duties.

1.36. Germany, the Netherlands and the United Kingdom asked the Commission for guidance in the application of the successive sales rule to anti-dumping matters, but at the time of the audit the Commission had not yet expressed a definitive opinion on this subject.

## Differentiated anti-dumping duties

1.37. The rate of an anti-dumping duty can be differentiated according to the individual exporter or producer concerned. Particular problems arise if the exporters and producers benefiting from a more favourable duty rate are not clearly identified in the wording of the regulations. An example of such problems is Council Regulation (EC) No 1567/97 of 1 August 1997 imposing a definitive anti-dumping duty on imports of leather handbags originating in the People's Republic of China (21). This Regulation establishes differentiated anti-dumping duties for handbags produced in Chinese factories by a number of companies not incorporated under the law of the People's Republic of China.

1.38. Uncertainties about the real owners of the Chinese factories, the correct spelling of Chinese company names and the coincidence of the companies shown in the export documents with companies with slightly different names mentioned in the Regulation were serious obstacles to effective customs controls.

**1.37 to 1.38.** *The Commission wishes to clarify the specific conditions under which anti-dumping policy must be applied. The application of anti-dumping duties, including those concerning individual exporters, must be carried out on the basis of the relevant Regulation. In most cases this is a straightforward affair and companies entitled to an individual duty can be easily identified on the basis of the import documents. As regards the specific case mentioned, which dates back to 1997, difficulties arose from the particular corporate structure of the exporting producers (mainly the fact that several producers incorporated in Hong Kong produced in the People's Republic of China through manufacturing branches without a legal personality under the Law of the People's Republic of China), which had to be reflected in the regulations imposing measures, in addition to linguistic problems (such as the transliteration of Chinese names).*

*In any event, continued efforts have been carried out in order to improve the clarity of anti-dumping Regulations. When necessary, the addresses of individual companies are provided in the Regulation in order to make identification easier.*

(21) OJ L 208, 2.8.1997, p. 31. The list of companies for which differentiated anti-dumping duties apply was extended and modified several times:

- (a) Council Regulation (EC) No 2380/98 (OJ L 296, 5.11.1998, p. 1);
- (b) Council Regulation (EC) No 175/2000 (OJ L 22, 27.1.2000, p. 25);
- (c) Council Regulation (EC) No 133/2001 (OJ L 23, 25.1.2001, p. 9).

## THE COURT'S OBSERVATIONS

1.39. In one case where the exporter's name did not coincide with the name stated in the regulation, the German customs first requested anti-dumping duties. Later on the duties were paid back upon presentation by the importer of the photocopy of a confidential letter sent by the Commission to a Belgian lawyer, who, apparently, had sought clarification about the identity of one of the firms benefiting from reduced duty rates. This letter explained the links between the beneficiary of the reduced duty explicitly mentioned in the Regulation, the manufacturing factory and a parent company marketing the handbags.

## COMMISSION'S REPLIES

1.39. The Commission points out that the granting of a reduced duty rate to the exporter in question was justified and wishes to clarify the situation. The German customs levied the countrywide duty rate on imports from an exporter entitled to a reduced duty rate because the relevant sales documentation did not identify the company with its full name, as it appeared in the relevant Regulation. The exporter requested the Commission to confirm that it actually benefited from the reduced duty rate. After verifying the relevant documentation, the Commission provided this confirmation which, following the usual practice, was sent to the Brussels-based legal representative of the exporter. This confirmation was then sent by the exporter to the German customs via the importer of the goods with a request to benefit from the applicable reduced duty rate. The Commission acknowledges that contrary to its usual practice, no copy of its correspondence with the exporter was sent to the customs authorities directly.

1.40. For the sake of a correct, uniform and effective enforcement of the anti-dumping measures, the decisions taken by customs should be based on the wording of the Council Regulations. If the Commission considers that certain provisions allow a broader interpretation than that resulting from their strict wording, it should officially inform all national customs administrations, so as to ensure an equal treatment of all importers. In any case, the Commission should care for a clear formulation of anti-dumping regulations, permitting effective customs controls.

1.40. The Commission makes available to the Member States, via the TARIC, data related to the anti-dumping legislation published, in order to ensure the uniform and simultaneous application of the anti-dumping measures.

The Commission seeks to obtain clear legal provisions. In addition, the Commission services provide clarification on the applicable texts upon request by the Member States.

## Retroactive collection of anti-dumping duties on registered imports

1.41. The retroactive collection of anti-dumping duties on registered imports is, for customs officials, an unusual procedure. The Community Customs Code makes a specific reference to the collection of provisional anti-dumping duties <sup>(22)</sup>. However, no reference at all is made by the Community Customs Code to the much more sensitive situation of retroactive anti-dumping duties. Although the anti-dumping Regulations constitute a sufficient legal basis for the retroactive collection of anti-dumping duties, a mention in the Community Customs Code, and, in particular, the definition of a specific deadline for the recovery (as it has been done for the provisional anti-dumping duties) would make customs officials attentive to this particular situation.

1.41. It is true that the Community Customs Code makes no reference to the retroactive collection of anti-dumping duties in the cases to which the Court of Auditors refers. In such situations, however, the specific provisions of the code applicable to the retroactive processing of import duties are applicable. So, in accordance with Article 220(1) of the Code, where import duties have not been entered in the accounts or have been entered for less than the amount legally owed, the amount of duty to be recovered or which remains to be recovered must be entered in the accounts within two days of the date on which the customs authorities become aware of the situation and are in a position to calculate the amount legally owed and to determine the debtor. The amount of duty payable must be communicated to the debtor within the time limit set in Article 221 of the Code.

<sup>(22)</sup> Article 218(2) of Council Regulation No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L 302, 19.10.1992, p. 1).

Since there is a general rule on deadlines for payment, it is not necessary to set a specific deadline for this type of import duty. Nonetheless, the Customs Code Committee, together with the Member States, will look into the advisability of establishing a specific deadline, as it may be necessary to amend the Community Customs Code.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

1.42. Problems were noted in most Member States visited by the Court concerning cases where anti-dumping duties had to be collected retroactively on registered imports. The most relevant are the following:

- (a) in Germany, as no computerised recording system of all import declarations exists, customs offices register imports by putting aside a copy of the import declaration. This procedure does not guarantee completeness: overlooked transactions or lost documents would never be identifiable;
- (b) in the port of Hamburg (Germany), registration for refillable lighters<sup>(23)</sup> had not been made. The error was detected by customs only several months after the imposition of the anti-dumping duties. In the meantime some of the importers had gone bankrupt and some others could not be found at the given address. At the time of the audit, the collection of anti-dumping duties for some 1,1 million euro was still pending;
- (c) in the port of Antwerp (Belgium), imports of refillable lighters subject to retroactive duties were not selected and extracted from the database recording all customs declarations. The Court estimates that because of this failure some 1,7 million euro of definitive anti-dumping duties have still to be collected;
- (d) in Sweden, because of a misunderstanding on the distribution of responsibilities between central and regional offices, duties for about 0,1 million euro were not collected;
- (e) in Southampton (United Kingdom), due to failures in the registration procedure, the retroactive collection of duties on imports of handbags from China started only shortly before the audit visit of the Court. The collection of outstanding anti-dumping duties for about 0,4 million euro was still in progress at the time of the Court's audit.

## 1.42.

- (a) *The Commission is aware of the administrative risks inherent in the German system and has repeatedly requested computerisation.*
- (b) to (e) *The Commission is investigating these matters and will take any necessary measures, including the imposition of interest on late establishment if appropriate.*

<sup>(23)</sup> Commission Regulation (EC) No 971/98 of 7 May 1998 (OJ L 135, 8.5.1998, p. 38). The definitive anti-dumping duty for registered lighters was imposed by Council Regulation (EC) No 192/1999 of 25 January 1999 (OJ L 22, 29.1.1999, p.1).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## Insufficient follow-up to mutual assistance messages

1.43. Specific rules on 'mutual assistance' between national and European administrations (24) request the Member States to inform the Commission on goods suspected of having been the object of breaches of customs legislation, on methods and practices used to breach customs rules, and on shortcomings or gaps noted when applying customs legislation. Information on cases needing coordinated enquiries and interventions by several national administrations is diffused to the Member States by OLAF (25) as 'mutual assistance messages'.

1.44. Shortcomings in the follow-up to these messages have been noted in the United Kingdom, in Germany and in Belgium. In the United Kingdom only three of ten recent mutual assistance messages examined by the Court's auditors had been adequately followed up. This was due as well to administrative deficiencies as to a general limitation of enquiries to cases where potential revenue at risk exceeds one million pounds sterling (about 1,6 million euro). In Germany, it is not possible to identify all customs offices through which suspected irregular imports could have been made. The central customs administration forwards the mutual assistance messages to a limited number of local offices selected on the basis of empirical judgement. Both in Belgium and in Germany the Court noted a number of cases where, following mutual assistance messages, irregularities had been detected, already in 1999 and 2000, but the amounts due had still not been recovered.

**1.43.** *The Commission is examining the effectiveness of the systems used by each Member State to deal with mutual assistance messages as part of 2001's annual inspection programme.*

**1.44.** *The Commission has also informed the UK authorities of shortcomings in their procedures for dealing with mutual assistance messages. Further verifications of procedures in the United Kingdom, Belgium and Germany will be made in 2001. The points made by the Court will be followed up in the context of this inspection.*

(24) Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters (OJ L 82, 22.3.1997, p. 1).

(25) OLAF: European Anti-fraude Office.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*Limitations to the effectiveness of anti-dumping measures*

## Long and complex proceedings

1.45. The following proceedings could weaken the effectiveness of anti-dumping measures:

- (a) the Commission acts normally on a written complaint which must already provide substantiated evidence on the dumping and injury. The preparation of such documentation includes the obligation for the industry to prepare exhaustive and time-consuming files and statistics;
- (b) even if the written complaint leads to an investigation by the Commission, a decision on the imposition of provisional anti-dumping duties is often taken only towards the end of the maximum delay of nine months from the start of the investigation and the issuing of a decision on definitive anti-dumping measures usually takes up the maximum allowed period of 15 months;
- (c) for each modification or review of an existing measure the same long procedure applies: a written complaint is required, including full documented evidence.

1.46. An example of the economic disadvantages of the long duration of the proceedings is represented by the fertilisers' sector. As fertilisers are mainly bought and used during the sowing period, if the dumping starts near the beginning of this period, before the first possible anti-dumping measure (provisional duties) is taken the Community producers of fertilisers affected will have lost a full marketing season.

**1.45.**

- (a) According to the applicable legislation, complaints have to be documented. The quasi-judicial nature of anti-dumping investigations means that decisions and findings must be based on facts, the Commission cannot initiate investigations or impose measures on the basis of unsubstantiated allegations.
- (b) and (c) The services of the Commission always work within the deadlines set in the relevant international agreements and Community legislation. Anti-dumping measures must be based on a thorough and complete investigation, which takes time. If measures were imposed after a quick and superficial investigation the instrument would lose all credibility and remain exposed to undesirable challenges in the courts. In any case, provisional duties can be imposed if warranted, and they usually are in cases in which definitive duties are finally imposed. It should also be noted that, in the case of reviews, measures are usually already in place.

*In short, due process, including the rights of the defence, takes time and resources but is a necessary requirement.*

**1.46.** The Commission would stress that the applicable legal requirements have to be respected. Measures can only be imposed after a thorough investigation. In addition, if measures were taken hastily before the Community industry's allegations are verified, exporters might unjustifiably lose an entire marketing season if the allegations turned out to be unfounded.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## Weaknesses of undertakings

1.47. The confidentiality of undertakings causes problems to the customs authorities especially when imports take place via third countries as was the case for Council Regulation (EC) No 2320/97 of 17 November 1997 imposing definitive anti-dumping duties for seamless steel pipes (26) (27).

1.48. Although the Regulation requests production certificates issued by the exporting producers, it does not provide for a cross check between the certificates presented for customs clearance and the lists of the issued certificates that have to be sent to the Commission to allow it to monitor the exporters' compliance with the undertakings.

## Insufficient market protection

1.49. The Court's audit revealed that goods subject to anti-dumping duties if imported from certain countries can be imported in large quantities from other countries at prices lower than the prices of the imports to which anti-dumping duties apply (for instance unwrought magnesium, refractory chamottes, glyphosate). In the case of refractory chamottes, in 1999 the

1.47. The Commission stresses that the details of price undertakings are commercial information of an extremely sensitive and confidential nature (see also comments to point 1.25. above). This does not prevent customs from checking the authenticity of either the production certificates referred to by the Court or of any other formal requirements, which are not covered by confidentiality. The Commission actually helped Member States' customs to ascertain the authenticity of such certificates whenever doubts arose. Finally, the respect of the minimum prices is monitored by the Commission services.

1.48. For reasons concerning the protection of commercial interests, only the Commission knows details of undertakings, as the Court also stated under point 1.25 of its Report.

TARIC includes data concerning the obligation to present a certificate (mentioned in the respective anti-dumping legislation) as a condition to apply a differentiated anti-dumping duty rate or exemption of the duty, for the company in question.

Data supplied by Member States for the 14/6 database permits to distinguish imports subject to duties from those subject to undertakings by individual exporters. Together with the undertaking reports made by the same exporters, a double-checking system is in place which allows the identification of potential problems.

1.49. The fact that a product subject to measures may be imported from other countries at prices which are lower than those of the imports to which duties apply is irrelevant. A low price does not necessarily mean that the product is being dumped. The purpose of anti-dumping measures is not to protect the Community market from low-priced imports in general, but to remedy dumping causing injury to the Community industry.

(26) OJ L 322, 25.11.1997, p. 1.

(27) According to Article 2 of Council Regulation (EC) No 2320/97, the products must be produced and sold for export to the Community by the companies listed, upon presentation to the competent Member State's customs services of a valid, original production certificate issued by one of the companies listed in the Regulation. Undertakings were accepted for 11 producers from Hungary, Poland, Czech Republic, Romania and the Slovak Republic.

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quantity imported from countries not affected by anti-dumping duties was nearly three times larger than the quantities subject to anti-dumping duties, and the prices of the former were up to 50 % lower than those of the latter (28). It is questionable if, in cases like this, the anti-dumping measure applied assures an effective protection of the Community market.

## Conclusions and recommendations

1.50. Globally, the Court's audit did not reveal any major bias in the implementation of the anti-dumping regulations. However, the control of the existing system has shown a number of weaknesses both at Commission level and at Member States level. The evasion of anti-dumping duties does not only result in a loss of own resources but also reduces the effectiveness of the anti-dumping policy.

**1.50.** The Commission's replies have drawn upon the results of its own inspections during 2000, looking at the effectiveness and reliability of procedures for calculating and collecting anti-dumping duties in Member States. As well as the individual reports made to each Member State, which incorporated 35 observations, the Commission also produced a thematic report drawing together the various trends seen. The Commission's inspections of anti-dumping duties were made using a systems-based approach concentrating on key areas including, of course, an assessment of compliance.

1.51. In this context the Commission should:

- (a) ensure the reliability of the database 14/6 and cross-check its content with the financial information forwarded by the Member States on own resources corresponding to anti-dumping duties (paragraphs 1.27 to 1.30);
- (b) ensure the effectiveness of customs control by avoiding ambiguous or imprecise formulation of the regulations on customs and anti-dumping duties (paragraphs 1.40 and 1.41);
- (c) give appropriate guidance to national customs on matters of construction and enforcement of anti-dumping legislation (paragraphs 1.36 and 1.40);
- (d) collect and analyse all available information (such as database 14/6, declarations on own resources, Ownres, mutual assistance, Eurostat, etc.) highlighting anomalous trade patterns or practices and take it into account when devising and implementing its anti-dumping policy.

**1.51.**

- (a) *The Commission considers that implementing this recommendation is unlikely to provide any substantial improvement, given the different objectives and timing phases of the two systems.*
- (b) *The Commission makes continuous efforts to obtain clear legal provisions and does not consider that the present formulation of the anti-dumping regulations is ambiguous.*  
*The Community Customs Code and its related implementation provisions have been and continue to be the subject of regular updating and simplification.*
- (c) *Implementation of Community legislation is, of course, primarily the responsibility of Member States, but insofar as clarification can be given the Commission will naturally assist Member States.*
- (d) *The Commission ensures proper use of the information channels at its disposal but it considers that one of the principles of its anti-dumping action, i.e. that it is driven by industry complaints, should be maintained. Action on its own initiative has to respect the legal framework and will have to remain ancillary.*

(28) According to statistical data from Eurostat.

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1.52. The national customs authorities should:

- (a) set up and effectively use adequate technical tools for selection and control of customs declarations related to anti-dumping duties (paragraphs 1.31 to 1.34);
- (b) proceed to the swift collection of retroactive anti-dumping duties still due and avoid missing such collection in the future (paragraph 1.42);
- (c) follow-up adequately mutual assistance messages (paragraph 1.44).

### **Protection of the Community's financial interests**

#### Introduction

1.53. With regard to own resources, in principle fraud and other irregularities, unlike expenditure, are not recorded in the budget at all and therefore cannot be pinpointed when its implementation is checked. Against this background, the Court wanted to put the results of its DAS-related work into perspective, hence its presentation of a summary of the situation regarding the protection of the Community's financial interests in the field of own resources.

1.54. For the purpose of financing the budget, reduced receipts under the headings of traditional own resources or the VAT-based resource are offset by increased recourse to the GNP-based resource. The main consequence of that, therefore, is that the distribution of the financial burden divided between the Member States and various categories of taxpayers is different. Any malfunctioning of the traditional own resources and common VAT systems is ultimately likely to have an impact on the principles of the single market.

#### The legislation

1.55. Article 280(1) of the Treaty establishing the European Community and two Council Regulations<sup>(29)</sup> provide the framework for measures taken by the

**1.55.** At present thirteen Member States have ratified the Convention; the Commission continues to encourage the others to do so.

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<sup>(29)</sup> Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities' financial interests (OJ L 312, 23.12.1995, p. 1) and Council Regulation (EC, Euratom) No 2185/96 of 11 November 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities' financial interests against fraud and other irregularities (OJ L 292, 15.11.1996, p. 2).

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Community and the Member States to protect the Community's financial interests at the level of both revenue and expenditure. Furthermore, a convention on the protection of these interests by means of the harmonisation of national criminal codes was signed on 26 July 1995 by the representatives of the Member States' governments. However, this convention and its successive protocols had still not entered into force <sup>(30)</sup> on 7 September 2001, as it had not been ratified by all the Member States.

1.56. With more specific regard to Community own resources, Regulation (EC, Euratom) No 1150/2000 <sup>(31)</sup> contains several provisions requiring the Member States to provide regular information on fraud and irregularities they have detected and on the controls they have introduced to prevent and monitor them.

1.57. A Commission decision <sup>(32)</sup> defined the form of the various notifications required of the Member States by the Regulation. The Commission also set up in 1997 a computerised system (Ownres) for recording and forwarding data on cases of fraud and irregularities amounting to more than 10 000 euro.

## Results presented by the Commission

1.58. Since the Court's last Annual Report was adopted, the Commission has published a great deal of information on the establishment and collection of traditional own resources and, in particular, fraud and irregularities detected (**Table 1.2**).

1.59. It should be noted that the total value of the fraud and irregularities cases notified by the Member States doubled between 1999 and 2000, despite a fall in the number of such cases.

On 23 May 2001, in view of the incomplete ratification of these instruments (see below), the Commission proposed a directive based on Article 280(4) taking up the majority of the provisions and protocols of the convention. This directive is currently being discussed within the Council. The Commission has urged the Member States to pursue the ratification process in order to enable the provisions not included in the directive also to enter into force. The Council has also on several occasions urged Member States to ratify the convention.

**1.57.** Amendments to the Commission Decision of 20 March 1997 have been proposed in order to overcome the shortcomings found in practice.

<sup>(30)</sup> Convention on the Protection of the European Communities' Financial Interests (OJ C 316, 27.1.1995).

<sup>(31)</sup> Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources (OJ L 130, 31.5.2000, p. 1).

<sup>(32)</sup> Commission Decision 97/245/EC, Euratom of 20 March 1997 laying down the arrangements for the transmission of information to the Commission by the Member States under the Communities' own resources system (OJ L 97, 12.4.1997, p. 12).

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1.60. At the end of 2000, on a cumulative basis, Ownres contained 11 407 cases. These cases totalled 1 482,8 million euro, 362,6 million euro of which has been recovered.

The scope of the information presented

1.61. The Commission stresses that, as far as fraud and other irregularities are concerned, the figures provided by the Member States since Decision 97/245/EC, Euratom was adopted, have not been homogeneous and that explanations will have to be sought of them concerning the anomalies detected<sup>(33)</sup>. These difficulties are especially acute when it comes to distinguishing between fraud and other irregularities. The Commission also believes that the different control methods applied by the various national administrations preclude valid comparison of the figures submitted by the Member States<sup>(34)</sup>.

**1.61.** *The Commission has approached the national administrations to stress the need to receive homogenous information. It has also made improvements to the presentation of this information and decided that, as of the financial year 2000, the reports required under Article 280 of the Treaty and Article 17(3) of Regulation (EC, Euratom) No 1150/2000 would be merged.*

**Table 1.2 — Traditional own resources — Fraud and irregularities involving over 10 000 euro notified by the Member States**

(Mio EUR)

	Number of cases	Amounts	Percentage of the budget	Budget
1996	2 149	284,4	2,09	13 583,6
1997	2 628	294,0	2,07	14 172,3
1998	2 126	249,2	1,77	14 110,7
1999	2 752	266,2	1,92	13 857,6
2000	2 403	534, 5	3,50	15 267,2

Source: European Commission.

<sup>(33)</sup> Paragraph 2.2.1. of the 'Summary report of the comments made by the Member States on the activity and the results of their controls as well as the questions of principle as regards traditional own resources — Financial year 1999 — (Article 17(3) of Council Regulation (EC, Euratom) No 1150/2000)' (Document COM(2000) 718)). Germany, for example, seems to have provided a figure that is highly disproportionate to the volume of goods it traded; the Netherlands is supposed to have forwarded a partial set of figures, due to informatics difficulties etc. Problems regarding the homogeneity of data forwarded by the Member States persisted in 2000 (see paragraph 11 of the 2000 Annual Report on the protection of the Communities' financial interests and the fight against fraud — (Document COM(2001) 255)).

<sup>(34)</sup> Paragraph 2.1.2. of the abovementioned Summary Report.

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1.62. Under the terms of Decision 97/245/EC, Euratom, no questions are put to the Member States concerning the methods and criteria used to check declarations prior to clearance through customs (percentage of declarations checked on the basis of documents and physical examinations of goods, risk profiles applied to select declarations that are to be checked, etc.). The same applies to the payment of levies provided for by the common organisation of the market in sugar. Information concerning the various national administrations' powers as regards amounts still to be collected was presented for the first time in 2001<sup>(35)</sup>, while recovery measures by the Member States are frequently characterised by slow administrative and legal procedures and differing interpretations of Community law by the national authorities<sup>(36)</sup>.

1.63. As the Commission has found, the information available does not yet enable the Member States' efficiency in detecting fraud and other irregularities, or their ability to recover outstanding amounts promptly, to be assessed<sup>(37)</sup>.

Commission audits connected with protecting the Communities' financial interests

1.64. Every year the Commission carries out audits in the Member States that are based on detailed risk analysis that takes account of, *inter alia*, information contained in the Ownres system. The Commission also checks that national provisions concerning the collection and the making available of own resources comply with Community law, examines and enters in the accounts the monthly statements forwarded by Member States and closely follows up any observations that the Court of Auditors has notified to Member States or published in its reports.

1.65. Amongst other things, OLAF investigates matters relating to traditional own resources. OLAF reported that it had opened 120 files in connection with suspected fraud in 2000. The total amount recoverable is 608,7 million euro<sup>(38)</sup>.

<sup>(35)</sup> Paragraph 8 of the 2000 Annual Report (abovementioned document COM(2001) 255).

<sup>(36)</sup> Paragraph 7.1 of the Commission's 1999 Annual Report on protecting the Communities' financial interests and the fight against fraud (document COM(2000) 718).

<sup>(37)</sup> Title II of the 2000 Annual Report (abovementioned document COM(2001) 255).

<sup>(38)</sup> Paragraph 12.3 of the 2000 Annual Report (abovementioned document COM(2001) 255).

**1.62.** *As part of their supervision, in line with the resources available, the Commission services check that the controls carried out by the customs authorities meet the requirements of Community regulations. The Commission also uses its available resources to avoid differing interpretations of Community legislation.*

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## Conclusions and recommendations

1.66. Given that it has been over five years since the Convention on the Protection of the European Communities' Financial Interests was signed, the entry into force of this Convention and of its Protocols ought to be considered a priority. This cannot take place, however, unless the Member States that have not yet ratified it do so as soon as possible.

1.67. Information on the Member States' efforts to protect the Community's financial interests in the field of traditional own resources is not yet sufficiently consistent and complete. For this reason it cannot be used to assess the various Member States' ability to detect and efficiency in detecting fraud and other irregularities as well as recovering the sums involved.

1.68. This is why the Court recommends that the Commission should:

- (a) continue and intensify its dialogue with Member States so as to identify better the sort of information that is useful and arrive at an unequivocal interpretation of this information;
- (b) continue its efforts with a view to making an evaluation and comparing the efficiency of the administrative and judicial procedures and structures set up by the Member States to protect the Community's financial interests. The likelihood of recovering a substantial proportion of the debts entered in the B accounts could then be assessed more accurately (see paragraph 9.6).

## VAT/GNP own resources

1.69. In the case of the VAT and GNP own resources the scope of the audit is limited because the EU's receipts reflect macroeconomic statistics whose underlying data cannot be tested directly. In contrast, the EU's expenditure and revenue from traditional own resources are the direct product of the aggregation of numerous individual transactions where the legality and regularity can be directly tested.

## Analysis of the system

1.70. The VAT/GNP audit takes as its starting point the receipt by the Commission from the Member States of the macroeconomic aggregates (either as forecasts or as real figures) and seeks to assess the Commission's system for handling the data until it is ultimately reflected in the final accounts.

**1.67.** *The Commission is currently in the process of updating Decision 97/245/EC, Euratom in order to improve its practical effectiveness.*

**1.68.**

**(a) and (b)** *The Commission shares the Court's concerns.*

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1.71. The quality of the macroeconomic data provided by Member States clearly affects the ultimate value of individual Member States' contributions. However, the current absence of an accepted means of measuring the quality prevents the Court from assessing the financial impact of any failings. The Court looks at the difficult question of quality separately in its special reports, such as the recent Special Report 17/2000<sup>(39)</sup> and its follow-up (see paragraphs 1.107 to 1.121).

**1.71.** The Commission has worked with the GNP Committee since 1988 to ensure the quality (i.e. the consistency with ESA concepts, the comparability, the reliability and the exhaustiveness) of the GNP data used for budgetary purposes. The Commission believes that, in conjunction with the activities of the GNP Committee, the regular checks conducted by its departments of Member States' compliance with accounting rules and the improvement of statistical sources are sufficient to ensure an appropriate level of quality of own resource GNP. Quality assurance procedures are being put in place by Eurostat and Member States' statistical offices in a number of areas of basic statistics. However, to put a numerical value on the quality of GNP is, as the Court acknowledges, very difficult and the Commission and the GNP Committee have already expressed reservations with respect to this approach (see Commission's reply to the Special Report 17/2000 of the Court, page 20, paragraphs 63 to 79). However the Commission has tried several approaches and continues to explore others to address this very difficult question.

## Audit findings

1.72. The audit identified some problems in communications between Commission departments. The unit which informs Member States about adjustments to their VAT and GNP own resource payments at the end of the year got a disjointed and at times misleading flow of data from units responsible for verification. Moreover there was confusion as to which unit was responsible for checking that Member States made available the correct amounts of own resources.

**1.72.** Member States' budget contributions are determined on the basis of the best available information. Whenever the unit responsible for controlling Member States' bases for own resources acquires more precise data about those bases, it forwards the data to the unit that manages receipts as soon as the usual checks have been accomplished, unless there appears to be a risk of confusion. The communication of certain new VAT data as late as November 2000 did not give rise to any difficulties. There was one error concerning a Member State's GNP base because the late lifting of a reservation was not taken into account when the balance was notified to the national authorities. This error has been corrected and particular attention will be paid to such operations in future. The Commission's services have also taken steps to clarify and strengthen the procedure for reconciling payments to the own resource account with recovery orders.

1.73. Furthermore, the audit found that the Commission failed to reconcile properly the different sets of data (local system, accounting system and the data warehouse) on which the published statutory revenue account is based (see paragraph 9.46).

**1.73.** Based on recent technical improvements, a new approach for regular reconciliation is under analysis and a first limited test has been carried out for the 2000 annual closure on consumption and commitment appropriations. This approach relies on reconciliation between DWB and DWC data in order to cover the full chain of the different sets of data.

<sup>(39)</sup> OJ C 336, 27.11.2000.

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## Conclusions and recommendations

1.74. Taking into account the limitation to the scope of the audit, the Court obtained a reasonable assurance that the VAT and GNP resources were correctly assessed and collected. However, the procedures to ensure the integrity of the computing data during the accounting process do not comply with current best practices. Therefore, the Commission should continue to improve the procedures to regularly reconcile the different sets of data.

## Protection of the Community's financial interests

## The importance of VAT

1.75. More than one third of the EU budget is funded from the VAT-based resource. The Member States' contributions<sup>(40)</sup> are fixed by applying a call-up rate to the taxable transactions stipulated in the sixth VAT Directive<sup>(41)</sup>. Any loss due to fraud or shortcomings in the national systems may affect the VAT resource base.

1.76. Even though some Member States' bases have been capped at 50 % of their GNP, on account of the applicable rules, the other Member States'<sup>(42)</sup> contributions accounted for approximately 65,5 % of the financing of the VAT resource in 2000.

## Estimates of VAT losses

1.77. Various disparate and non-comparable data exist for evaluating VAT losses, specifically with regard to fraud<sup>(43)</sup>. The general conclusion is that 'the VAT system as a whole is considerably affected by fraud'<sup>(44)</sup>. A recent Commission document on changes in VAT revenue in the Member States states that fraud leads to a considerable loss of revenue in absolute terms<sup>(45)</sup>. The impact

**1.74.** *The Commission's services accept their responsibility to continue to improve procedures and to comply with current best practices.*

<sup>(40)</sup> Council Decision 94/728/EC, Euratom of 31 October 1994 (OJ L 293, 12.11.1994, p. 9).

<sup>(41)</sup> Council Directive 77/388/EEC of 17 May 1977 (OJ L 145, 13.6.1977, p. 1).

<sup>(42)</sup> Belgium, Denmark, Germany, France, Italy, Austria, Finland and Sweden.

<sup>(43)</sup> See, for example, the Commission communication, 'A strategy to improve the operation of the VAT system within the context of the internal market' COM(2000) 348 final of 7 June 2000; SCAF document No 26 of 30 June 1997; SCAF document No 37 of 2 February 1998.

<sup>(44)</sup> SCAF document No 60 of 17 November 1998.

<sup>(45)</sup> Working document 'Trend in Member States' VAT receipts' of 15 January 2001, p. 16.

**1.77.** *The document quoted (SCAF No 60) concluded that several types of fraud have been detected in the present VAT system, affecting pure domestic trade as well as intra-community and international trade. Moreover an increasing problem of fraud affecting intra-community trade and international trade has been identified. The Commission has analysed Member States VAT receipts and has concluded that,*

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on the Community budget represents a mere fraction of this loss. The effect is limited by, firstly, the capping of part of the VAT bases and, secondly, by the application of the call-up rate (0,8644 % in 2000).

*although detected fraud in intra-Community trade accounts for a considerable loss of receipts in absolute terms, it does not appear to have a tangible impact on VAT receipts.*

## Regulatory framework

1.78. In principle, the Member States alone are responsible for managing VAT. However, they must inform the Commission of the procedures they apply for registering taxable persons and for determining and collecting VAT, and of the operation and results of their inspection systems. The Commission is required to examine, with each Member State, whether these procedures may be improved in any way. It is also required to report on the matter every three years<sup>(46)</sup>. The Council considered that these provisions would enable measures to combat fraud<sup>(47)</sup> to be strengthened.

1.79. The national administrative authorities cooperate with one another and with the Commission so as to ensure that this VAT legislation<sup>(48)</sup> is complied with. To this end, the Commission must centralise the Member States' experience, in particular as regards new means of tax evasion or fraud, so as to improve the mechanism. The Member States must also provide the Commission with any information concerning intra-Community transactions which may be of interest at the Community level, as well as the texts of any national law provisions they adopt in the field of administrative cooperation. The Commission provides the competent authority in each Member State with any available information as quickly as possible. Lastly, every two years the Commission publishes a report on the conditions governing the application of these provisions.

<sup>(46)</sup> Article 12 of Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989, p. 9).

<sup>(47)</sup> Declaration recorded in the Minutes when Article 12 of Regulation (EEC, Euratom) No 1553/89 was adopted.

<sup>(48)</sup> Articles 11, 12 and 14 of Council Regulation (EEC) No 2189/92 of 27 January 1992 (OJ L 24, 1.2.1992, p. 1).

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Limited follow-up on national control systems

1.80. The workings and performance of national VAT control systems need to be monitored by the Commission. However, the information concerning collection in the Member States and on the importance of certain aspects of VAT fraud is scattered amongst various Commission departments and not consolidated. For example, the Commission's work does not bring out differences between Member States as regards their recovery effort and the extent of the fraud.

1.81. The Commission's actions are geared to the obligation to publish a report every three years <sup>(49)</sup>. The various reports contain a summary of the information provided by the Member States in response to a questionnaire. However, the Commission does not conduct independent analyses of this information. The reports do not allow the effectiveness of the various national inspection systems to be compared or their development to be assessed. The fact is that they are characterised by structural inconsistency and by generic observations and recommendations, which are sometimes identical from one report to another. By way of example, although the introduction of a system of risk analysis is one Commission recommendation which has been made in various reports since 1992, this matter has not been specifically evaluated for each Member State.

1.82. The Court has already commented on certain problems posed by these reports. For example, the Commission undertook to analyse and evaluate each Member State's inspection system <sup>(50)</sup>. However, this analysis is not reflected in the most recent report <sup>(51)</sup>.

**1.80.** Under Article 12 of Regulation (EEC, Euratom) No 1553/89 on own resources accruing from VAT, Member States must inform the Commission of the 'modalities and results of their VAT control systems'. The Commission stresses the fact that control procedures change only slowly over time. Information about these procedures is therefore provided on an intermittent basis and the Commission has neither the requirement nor the resources to monitor them continuously. The fact that information about VAT fraud and systems of control and recovery are shared among different Commission departments is justified by the responsibilities and consequent needs of these departments. The Commission believes that its services coordinate their activities well enough to avoid the risks implicit in the Court's remarks and provide each other with the information that they need to perform their respective tasks.

**1.81.** The Commission does not believe that the object of its reports on VAT own resources is to compare the effectiveness of the various national VAT control systems and assess their evolution. These analyses are best conducted in the directorate-general charged with developing and implementing the European Union's fiscal policy, which is in any case closely involved in the preparation, execution and follow-up of own resource control missions. The focus of successive reports has varied as the Commission has identified matters that merited particular attention at the time in question. For example, there were obvious reasons why the report published in 2000 should concentrate on the transitional intra-Community VAT system in operation since 1993. Moreover, the Commission has for some time been actively promoting the introduction and refinement of risk analysis mechanisms in the national VAT administrations. A further seminar in the series devoted to the development of this technique, at which all Member States, the candidate countries and the Commission will be represented, will be held in the framework of the Fiscalis programme in September 2001.

**1.82.** The Commission would recall that on 28 January 2000 it submitted to the Council and the European Parliament a report constituting a comprehensive examination of each Member State's VAT control system (COM(2000) 28 final) and that it has therefore fulfilled its undertaking. This report made recommendations to improve VAT control and administrative cooperation. These recommendations were based on a review in depth of each Member State's control system, encompassing 63 specific questions covering areas such as control powers, control programmes, selection methods, penalties, number of control visits, control officials, multilateral controls, etc.

<sup>(49)</sup> See paragraph 1.78.

<sup>(50)</sup> Paragraphs 3.22 to 3.26 of Special Report No 9/98, together with the Commission's reply (OJ C 356, 20.11.1998).

<sup>(51)</sup> COM(2000) 28 final of 28 January 2000.

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Moreover, these recommendations have been taken up by the Council's *ad hoc* Working Party on Tax Fraud. The Ecofin Council on 5 June 2000 took note of the conclusions of the *ad hoc* Working Party and called on the Commission to submit, as soon as possible, appropriate proposals for increasing administrative cooperation between Member States to combat tax evasion.

1.83. As regards the monitoring of the development of VAT revenue, the Court's 1998 Annual Report (52) noted the incomplete and uncoordinated nature of the Commission's work. In February 2001, the Commission submitted a report on the development of VAT revenue for the first time. It mentions that some Member States, especially Germany and Italy, experience problems in collecting VAT, but provides no further explanation (53). Additional analyses would be useful.

Failings in the administrative cooperation between Member States

1.84. In order to improve administrative cooperation with regard to VAT, several instruments have been employed at Community level:

- (a) the Standing Committee on Administrative Cooperation (SCAC) (54) and its anti-fraud sub-committee (SCAF), made up of representatives of the Member States and chaired by the Commission;
- (b) the Fiscalis programme, which aims to improve the internal market's system of indirect taxation (40 million euro over five years) (55);
- (c) exchanges of information under Regulation (EEC) No 218/92 and Directive 77/799/EEC (56);

(52) Paragraphs 1.19 to 1.26 (OJ C 349, 3.12.1999).

(53) See aforementioned 'Trend' document (p. 16).

(54) Established under Article 10 of Regulation (EEC) No 218/92.

(55) Decision No 888/98/EC of the European Parliament and of the Council of 30 March 1998 (OJ L 126, 28.4.1998, p. 1).

(56) Envisaged in Article 4 of Regulation (EEC) No 218/92.

1.83. The Commission's working document on the evolution of VAT receipts, which has been forwarded to the Court, concluded that there is no evidence to suggest that fraud in intra-Community trade has a tangible impact on VAT receipts. However, anomalies have been found for a few Member States. This could indicate that they have problems in collecting VAT. However, an analysis of trends in VAT receipts is bound to be based on approximate estimates and therefore caution must be exercised in the interpretation of the figures. The Commission will further examine these anomalies in the framework of the VAT own resource controls.

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(d) the Advisory Committee for the Coordination of Fraud Prevention (Cocolaf) (57);

(e) other general measures to fight fraud within the single market (5,65 million euro in 2000).

1.85. With regard to fraud, the Commission relies on the information Member States are prepared to submit within the Committees. However, the operations of the SCAC and SCAF Committees are affected by legal and administrative problems. Nevertheless, Article 10 of Regulation (EEC) No 218/92 invests the Commission with responsibility for proposing the necessary measures, even in the event that the Committees do not manage to adopt an official position. The situation is also characterised by other problems, such as the limited powers of the national representatives and the doubts expressed by SCAF as to its ability to recommend 'anything at all' (58). These difficulties slow down the decision-making process and explain the often repetitive nature of items on the agenda.

1.86. The Fiscalis programme includes staff exchanges and training. As the performance criteria were not clearly defined, it is difficult to evaluate its contribution to improving administrative cooperation.

1.87. In order to compensate for the abolition of customs checks and ensure that tax revenue was not lost when the 'transitional' VAT system came into effect in 1993, a computerised system for automatically exchanging information on the value of intra-Community deliveries of goods (VIES) was set up between the national authorities. In spite of improvements made since the system was introduced, the problems affecting VIES to which the Court has already drawn attention (59) have not yet been resolved, i.e. the slowness of the system,

**1.85.** Unlike traditional own resources, there is no legal obligation for Member States to inform the Commission about fraud in the VAT area (number of cases detected, amounts involved, etc.).

*The Commission agrees that decision-making procedures are slow in SCAC. This is largely due to the fact that most of the decisions relating to administrative cooperation and the fight against fraud must be taken by consensus in non-legally-binding decisions. The Commission stresses that one of the objectives of the new proposal for a regulation of the European Parliament and the Council on administrative cooperation in the field of VAT (COM(2001) 294 final of 18 June 2001) is to transform the SCAC into a regulatory committee that will be able to take decisions on all matters by qualified majority vote.*

**1.86.** The Fiscalis programme has a range of instruments to achieve its objectives: seminars, exchanges of officials, multi-lateral controls, training activities and IT systems. All activities must have objectives set before approval is given and outcomes can be measured individually against those objectives. In addition, as required by the Fiscalis Decision itself, a mid-term evaluation of the programme has been carried out, taking full account of reports on the impact of the programme by Member States.

**1.87.** The Commission points out, in its First Article 14 report, that the VIES functions technically well. The availability of the information depends on the time limits for input imposed on traders. These time limits are regulated in the sixth VAT Directive and are therefore not a shortcoming of the system itself. A shortening of the time limits imposed on traders is considered disproportionate since it would increase significantly the administrative burden on business, while it would not substantially decrease the possibilities of fraud.

(57) Commission Decision 94/149/EC of 23 February 1994 (OJ L 61, 4.3.1994, p. 27).

(58) See SCAF No 220 of 28 September 1999, paragraph 8, on the subcommittee's doubts concerning making recommendations to SCAC.

(59) Special Report No 9/98, paragraphs 3.10 and 3.11 and 3.18 to 3.21.

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the inability to stop large-scale fraud in time and the failure to include certain activities (such as services, the purchase of new means of transport by persons not identified for VAT purposes and distance sales).

As concerns the possibilities of using VIES information to detect some specific types of fraud in time, the Commission believes that additional means of control are needed in order to stop such types of fraud and that risk analysis both at the stage of registration and at repayment as well as more rapid and direct administrative cooperation are essential tools which could be used. The new proposal for a regulation of the European parliament and of the Council on administrative cooperation in the field of value added tax (COM(2001) 294 final) will offer new possibilities for quick exchange of information.

The Commission intends to intensify the exchange of information between Member States to overcome the present shortcomings of the system. The new proposal on administrative cooperation in the field of VAT envisages (outside the VIES system) also in this area increased possibilities of exchanging information.

## Insufficiencies in the legal armoury

1.88. At national level, the exchange of relevant information within the Community for anti-fraud purposes is often hampered by the Member States' legislation on the protection of personal data. However, Community legislation<sup>(60)</sup> authorises the Member States to limit the rights of individuals, in particular in cases of criminal proceedings and the protection of the financial interest of the Member State or of the European Union in the area of taxation<sup>(61)</sup>. Furthermore, with regard to fighting fraud, other shortcomings were identified by the Council's ad hoc group set up in 1999<sup>(62)</sup>.

**1.88.** The Commission services are aware of the problems raised by the Court relating to the exchange and the processing of personal data. They take the view that Member States should make use of Article 13 of Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data, which provides for measures to safeguard the financial interests of the Member States. This problem, as well as the all other legal obstacles identified by the Council's ad hoc group on tax fraud, are dealt with in the new proposal for a regulation on administrative cooperation in the field of VAT.

1.89. At Community level, the Convention on the Protection of the European Communities' Financial Interests, interpreted in the light of the report explaining this convention, does not include VAT as it is not an own resource collected directly on behalf of the Communities. The same is true of Regulation (EC, Euratom) No 2988/95<sup>(63)</sup>, concerning the same area. Any

<sup>(60)</sup> Directive 95/46/EC of 24 October 1995 (OJ L 281, 23.11.1995, p. 31).

<sup>(61)</sup> Article 13(1)(d) and (e) of the aforementioned Directive.

<sup>(62)</sup> For example, obstacles to officials from other Member States' tax authorities being present.

<sup>(63)</sup> OJ L 312, 23.12.1995, p. 1.

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measure to make the fight against fraud more effective, including the adoption of a common definition, is likely to be financially beneficial for the Community budget.

1.90. When OLAF was set up in 1999, the Commission was aware of the lack of an adequate legal basis and of certain Member States' reluctance to recognise the legitimacy of any UCLAF operational measure to combat VAT fraud<sup>(64)</sup> at Community level. However, a more specific and adequate legal basis was not proposed at the time. Recently, the Commission stated that 'another element likely to increase the risk of fraud is the absence of a clear legal basis for international coordination of VAT investigations by OLAF/Commission'<sup>(65)</sup>.

## Conclusions and recommendations

1.91. The Member States have sole responsibility for managing VAT, but the Commission is responsible for facilitating and coordinating the measures undertaken in the Member States. The Court considers that the Commission does not make enough use of the information at its disposal and of the room for manoeuvre it enjoys to improve administrative cooperation and systematically monitor the operations and performance of the national systems.

1.92. In view of the above, the Court wishes to make the following recommendations:

(a) the Commission should adopt an integrated approach to monitoring national VAT systems which also deals with recovery and fraud problems;

**1.90.** *In order to improve Community-wide cooperation and information exchange in fields susceptible to cross-border fraud, the Commission included in its work programme 2001 the task of framing a proposal for a directive of the European Parliament and of the Council establishing a system for cooperation between the Member States' authorities and the Commission with a view to protecting the financial interests of the Communities against illegal activities, including VAT-related activities and money laundering.*

**1.91.** *Member States bear primary responsibility for VAT control. However, the present Community legal framework for administrative cooperation in the field of VAT does not offer the Commission a coordination function. Regulation (EEC) No 218/92 (VIES) and Directive 77/799/EEC provide a framework for the system of exchange of information among Member States, but not for exchange of information between the Member States and the Commission. The role of the Commission is limited to evaluating the functioning of the arrangements and to offering Member States the facility to pool experiences. Moreover, Article 12 of Regulation (EEC, Euratom) No 1553/89 does not confer on the Commission a task of facilitating or coordinating VAT control. The Commission has neither the requirement nor the resources to undertake more in this area.*

**1.92.**

**(a)** *The Commission notes this recommendation;*

<sup>(64)</sup> See the Commission's reply to Special Report No 9/98, paragraph 3.39.

<sup>(65)</sup> See the Commission's reply to the Court's 1999 Annual Report, paragraph 1.59 (OJ C 342, 1.12.2000).

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- (b) the Commission's reports must focus more on its monitoring of the performance and development of national control systems;
- (c) the institutional mechanisms introduced by way of administrative cooperation should be reviewed. Their aims must be clarified and their procedures improved. The Commission should demonstrate the utility of its programmes within the national authorities. It should also highlight the effects of its actions on exchanges of information between Member States;
- (d) the draft new legal base consolidating the current instruments for administrative cooperation and mutual assistance should enable the difficulties described to be overcome and clarify the respective responsibilities of the Member States and the Commission. Legal problems, such as the protection of personal data, affecting the exchange of information between Member States and between Member States and the Commission must be resolved.

*Overall conclusion*

1.93. The checks and systems analysis carried out for traditional own resources gave satisfactory overall results concerning the reliability of the accounts and the legality and regularity of the underlying transactions entered in the accounts of the Member States. The errors found during examinations of transactions and systems did not materially affect the accuracy of the revenue in the revenue and expenditure account, and the Court therefore concludes that the amounts shown are correctly stated and refer to legally and regularly collected duties. Nevertheless, particular problems concerning the maintenance of B accounts remain to be resolved (paragraphs 1.17 to 1.19).

- (b) *The Commission takes an increasing interest in this question. For example, the references in the Court's annual report for 1999 to studies carried out in two Member States on the use of statistical methods to detect sectors at risk is the subject of continuing discussions between the Commission and the Member States;*
- (c) *The new Commission's proposal for a regulation of the European Parliament and of the Council on administrative cooperation in the field of value added tax revises the functioning of the current arrangements. As regards the Fiscais programme, the Commission fully agrees with the Court on the importance of being able to assess the impact of the programme tools. That is why the Commission has just carried out an evaluation exercise which concludes that the programme was a good instrument to achieve a better cooperation between tax administrations;*
- (d) *To strengthen administrative cooperation in the field of VAT, the Commission adopted, on 18 June 2001, a proposal for a regulation of the European Parliament and of the Council on administrative cooperation in the field of value added tax. This proposal establishes a single legal framework which sets out clear and binding rules governing cooperation between Member States. The framework provides for more direct contacts between services with a view to making cooperation more efficient and faster. It will also facilitate more intensive and swifter exchanges of information between tax administrations for the purpose of combating fraud more effectively.*

**1.93.** *The Commission is concerned about the structural deficiencies in the separate accounts system and is continuing to explore those avenues that might improve the overall performance.*

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1.94. Regarding VAT and GNP, the Court obtained a reasonable assurance that the resources were correctly assessed and collected. However controls over data integrity in the Commission's computer accounting system still need to be improved. The Court underlines that like all taxation schemes, customs duties and VAT are exposed to evasion (paragraphs 1.53 to 1.68 and 1.75 to 1.92).

## FOLLOW-UP TO PREVIOUS OBSERVATIONS

*Traditional own resources*

1.95. Most of the observations, for which the follow-up is detailed below, were covered in the Council's recommendations on the Discharge and in the European Parliament's resolutions (66).

**Annual Report concerning the financial year 1998**

1.96. In its Annual Report concerning the financial year 1998, the Court noted that the separate accounts kept by the Member States contained significant errors. As it stated in its reply, the Commission concentrated its checks on the Member States' separate accounts. In addition, it initiated two cases of infringement proceedings against Germany, one of which it had announced in its reply to the Court's observations. Measures potentially leading to similar proceedings were also undertaken in the course of 2000 so as to ensure that Austria, Belgium and Denmark modified accounting practices regarded as not complying with Community legislation.

**Securities and guarantees provided for in the Community Customs Code to protect the collection of traditional own resources (Special Report No 8/99)**

Postponement of payment of duties, temporary importation of goods and incomplete declarations

1.97. The Court noted a number of anomalies in respect of specific legislative situations. The anomalies

(66) In particular, the European Parliament's Resolution of 16 January 2001 concerning the Court of Auditors' Special Report No 8/99.

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essentially concerned inadequate monitoring of adherence to the applicable provisions when goods were released for free circulation under a simplified declaration procedure, insufficient monitoring of guarantees provided when goods were imported temporarily and the failure to observe deadlines for rectifying incomplete declarations.

1.98. The Commission, in particular by means of its own checks, took account of the Court's observations so as to ensure that the Member States corrected the anomalies observed. It reminded the Member States, in the context of the Advisory Committee on Own Resources, of the requirements of the Community Customs Code with respect to guarantees where payments are postponed.

## Transit

1.99. The Court noted several anomalies in the implementation of the rules governing the monitoring of overall guarantees, the granting of exemptions from guarantees and requests for securities under the transit system. The Commission asked the Member States for the information and clarification required to determine the potential financial consequences of the anomalies observed. It also asked them, in a communication to the Advisory Committee on Own Resources, to ensure that Community rules on the establishment, evaluation and annual appraisal of the value of the overall guarantee in the context of Community transit were correctly implemented.

1.100. In its reply to the Court's observations, the Commission stated that it had been unable to secure agreement from the Member States to adjust the provisions concerning the overall guarantee. According to the Member States, the new computerised transit system (NCTS) could be expected to provide a satisfactory response to guarantee problems. The fact is that a particular module of the NCTS would make it possible to monitor the use of each type of guarantee. The legal provisions governing the introduction and use of such a system should be adopted in April 2001. The Commission plans to implement the new system in full towards June 2003.

**1.100.** *Four Member States and three partner states signatory to the Common Transit Convention, which are currently already implementing the new computerised transit system (NCTS), are preparing to incorporate new functions into the system as of 1 December 2001.*

*Three other Member States and three partner states are preparing to join the system in the first half of 2002 at the operational level which the first group will have reached by that time.*

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TIR (transport international routier)

1.101. The Court noted that in Germany duties on imports which took place using TIR carnets and which were theoretically guaranteed were entered in a separate account. Consequently, these sums should have been made available to the Community budget. Thus, in November 2000 the Commission sent the German authorities a reasoned opinion pointing out the irregular nature of this course of action. However, in January 2001 the Member State rejected the Commission's arguments.

**1.101.** *The Commission is continuing to pursue this infringement.*

1.102. Furthermore, the Commission undertook measures to improve the implementation of the TIR agreement which led to the agreement being amended. These amendments concern the guarantee system and were adopted by the TIR Convention Management Committee at its session of 19 October 2000. The amendments will be sent for approval to signatories by the Secretary-General of the United Nations and should come into effect no more than 15 months later.

#### Appeals

1.103. The Court highlighted cases where the Customs Code provisions requiring the provision of a guarantee were implemented incorrectly, in particular when an administrative appeal is lodged against the customs authority's decision. The Commission sought information from the Member States as to the nature of the various situations in question. At the end of 2000, it submitted to the Advisory Committee on Own Resources an initial summary report and continued to examine the information it had obtained.

#### Making established entitlements covered by a guarantee available to the Commission

1.104. The special report noted that the approach to entering customs debts covered by a guarantee in the A or B accounts differed from one Member State to another. Similar problems were noted in the 1998 Annual Report and are subject to appropriate monitoring (see paragraph 1.96).

#### Conclusions and recommendations

1.105. The Commission has endeavoured to continue its examination of the cases brought up by the Court and to ensure that Member States rectify the anomalies

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observed. Even if most of the Court's observations concern the Member States' administrative activities, the Commission remains responsible for implementing Community legislation in a homogeneous and consistent manner. In this respect, the infringement proceedings which it has initiated are a move in the right direction. As regards transit, it will be possible to assess the results of computerisation only once implementation has commenced.

1.106. The Court urges the Commission to continue to press the Member States to support a project portrayed as essential for remedying the most substantial problems in the transit scheme.

*The Commission's management of the quality of GNP statistics*

**The need for transparent control of GNP statistics**

1.107. Gross national product (GNP) is the key statistic in the Community VAT/GNP resources system. In this context, the Court highlighted in its previous reports the need for systematic and transparent verification of the production of GNP statistics, (67) allowing for a reliable and auditable framework (68).

1.108. In its recommendation on the Discharge to be given to the Commission for the financial year 1999, the Council endorsed the Court's recommendations that the Commission take measures to better explain the way it verifies GNP statistics and to improve the transparency of this process.

1.109. The latest audit consisted of a review of the existing quality control systems and standards, an

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(67) Special Report No 17/2000 on the Commission's control of the reliability and comparability of the Member States' GNP data, paragraph 82.

(68) Special Report No 6/98 concerning the Court's assessment of the system of resources based on VAT and GNP, paragraph 5.11.

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assessment of the management control of two GNP reservations for four Member States (Belgium, Spain, the Netherlands and Sweden) (69), and a review of the way users of GNP statistics are informed about their quality.

**A sound framework for the management of GNP statistics**

1.110. A mandatory framework defines the basis for both bilateral and multilateral verification and assessment of GNP statistics:

- (a) Council Regulation (EC, Euratom) No 1150/2000 defines the bilateral verification between the Commission and each Member State;
- (b) Council Directive 89/130/EEC, Euratom provides the framework for the multilateral verification based upon a committee comprising of representatives of the Member States and chaired by a representative of the Commission (the GNP Committee).

1.111. In addition, the Commission, in conjunction with the GNP Committee, provides a sound basis for the management of GNP quality, by way of Commission decisions or by proposing guidelines and recommendations (for example: Commission Decision 94/168/EC, Euratom on GNP exhaustiveness and Recommendations of the GNP Committee on the borderline between intermediate consumption and final uses).

1.112. Voluntary initiatives are also relevant. The 'Qualistat' initiative has been introduced by the Commission in order to improve the quality of statistics, in line with internationally accepted standards (e.g. ISO norms) and existing best practices employed by some Member States. Output and process quality control form part of the initiative, both of which can be used to ensure a greater degree of quality and understanding of the production of GNP statistics.

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(69) A reservation is placed by the Commission when, after examining the inventories of the sources and methods used by the Member States for producing their GNP, it detects a significant discrepancy between the Community norms and the national practices.

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**Flexibility of the management framework**

1.113. The GNP Committee is adaptable, and has been able to plan its activities for the coming years taking into account major changes, for example:

- (a) the need for a new directive following the ratification of the new own resources Decision (e.g. in order to implement the change from gross national product to gross national income);
- (b) the increasing demand for quality issues in the Commission and subsequent involvement in voluntary initiatives.

**Inadequate application of the management framework**

1.114. With regard to quality assessment and reporting practices, the framework is not systematically used. The audit showed that documentation of the treatment of some GNP reservations was not always clearly and precisely linked to underlying evidence. In some cases, there was only a general reference to documents and missions. References to paragraphs within these documents and mission reports would provide a much better tool for purposes of reviewing and auditing. Furthermore, this would facilitate transfer of knowledge in case of staff changes.

1.115. Because of these shortcomings, the Commission's judgement cannot be easily assessed. The lack of transparency can lead to less efficient verification, and differences in the treatment between Member States. The Court's opinion on the GNP fourth resource management is stated in Chapter 9 of this report concerning the Statement of Assurance (see paragraph 9.56).

**Communication to users is occasionally incomplete**

1.116. According to international standards (e.g. ISO 8402), quality is defined by reference to the performance of a product or service in satisfying the needs of the user. The Court has examined whether these needs are explicitly formulated by the users (<sup>70</sup>), and satisfied by the Commission's statistical services.

**1.114.** *The Commission is currently improving the presentation of the documentation in its control files and one feature will be a better cross-referencing between documents.*

**1.115.** *The Commission is naturally eager to remedy any apparent lack of transparency and believes that its services have made substantial progress in this respect, both in the course of their own work and in response to previous remarks by the Court.*

<sup>(70)</sup> The GNP Committee, Commission services in charge of the revenue management, and the Discharge Authority.

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1.117. The Commission provides the GNP Committee with documentation, on which it bases its opinion on the GNP statistics. This opinion is largely founded upon two documents which present respectively the data and explanatory information collected every year by the Commission from each Member State (the 'GNP questionnaires'), and also on the reports and analyses provided by the Commission itself throughout the year.

1.118. However, the contents of the replies to the latest GNP questionnaires have been shown to vary markedly among Member States and there is no clear indication of any references to previous responses to the questionnaire. Moreover, the reports and analyses, upon which the opinion of the GNP Committee is based, are not evident.

1.119. Occasionally, the information sent to users is incomplete. For instance, in 2000, the Commission revenue management service misinterpreted information from the statistical service concerning the GNP resource, largely due to insufficient explanation of the figures (the 'meta data'). Consequently Belgium was requested to contribute a wrong amount.

**1.118.** *The Commission is aware of the Court's desire that the opinion of the GNP Committee should refer more explicitly to the many individual reports on which the overall opinion is based. The Commission will examine the feasibility of this proposal in conjunction with the GNP Committee.*

**1.119.** *The Commission accepts that an isolated particular error was made in interpreting the GNP data for Belgium, leading to a request for overpayment. This error has since been corrected. The responsible services will in future submit GNP data to a check specifically intended to ensure that this kind of situation cannot arise again and that the calculation of the adjustments to the balances fully coincides with the figures officially transmitted by Eurostat. The growing importance of the GNP own resource obliges the Commission to keep under review the procedures for receiving and verifying the Member States' statistical data on which the resource is based.*

### Conclusions and recommendations

1.120. A sound and adaptable framework for the management of the GNP quality control is already in place at Community level. However, in practice, the Commission does not systematically employ this framework, which can lead to a lack of transparency in the process of quality control and can weaken its assessment of the GNP statistics. Moreover, the communication to users regarding the quality of GNP statistics is occasionally incomplete.

1.121. For these reasons, the Court recommends that:

(a) the Commission should systematically apply the existing norms or guidelines for verification and reporting purposes;

**1.120.** *The Commission considers it does systematically apply all the 'management framework'. Answers to the Court's specific comments are given in paragraphs 1.114, 1.115, 1.118 and 1.119. The Commission is putting in place procedures to ensure greater transparency of its GNP verification process for users.*

### 1.121.

**(a)** *The norms and guidelines for GNP verification and reporting purposes have been developed by the Commission in conjunction with the national accounts experts of the Member States in the GNP Committee. They have been, and will be, consistently applied;*

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(b) the Commission should systematically accompany figures or technical opinions with relevant supplementary information to users;

(c) the preparation of the new directive, implementing the change from gross national product to gross national income, should be the occasion to require Member States to report periodically on the quality of their statistics.

(b) *The Commission (Eurostat) always endeavours to accompany figures or technical opinions with supplementary information relevant to users. It should be remembered however that the needs of users vary: administrators in the Commission's Budget services, statisticians in the GNP Committee, auditors in the Court and so on;*

(c) *Under current discussions on a future GNP Directive, the Commission is examining with the GNP Committee the feasibility and possible content of a periodic report on quality by the Member States.*

## CHAPTER 2

**The common agricultural policy**

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## INTRODUCTION

2.1. This chapter concerns the expenditure of the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF-Guarantee), and the expenditure charged to chapter B2-5 1 ('Controls and other operations in the agricultural sector') (1).

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

2.3. This chapter consists of five parts:

- (a) the implementation of the budget for the financial year 2000;
- (b) the specific appraisal of agriculture in the context of the Statement of Assurance for the financial year 2000;
- (c) the clearance of the accounts;
- (d) the follow-up of previous observations;
- (e) principal observations in special reports.

2.4. In addition to the observations contained in this chapter, the common agricultural policy has been the subject of special reports and opinions. A list of these is published in the Annex II.

## BUDGETARY MANAGEMENT

*The initial budget became the final budget*

2.5. For the financial year 2000 the initial appropriations under subsection B1 of the budget for the

(1) The figures given under the heading 'Implementation of the budget for the financial year 2000' (paragraphs 2.5-2.28) only concern subsection B1 of the budget. With regard to Chapter B2-5 1, the initial budget in respect of commitment appropriations amounted to 51,5 million euro. These appropriations were not amended in the course of the year and commitments for the financial year came to 49 million euro (95,1 %).

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EAGGF-Guarantee amounted to 41 469 million euro <sup>(2)</sup> (including the monetary reserve <sup>(3)</sup> of 500 million euro) (see **Table 2.1**), i.e. 49 % of the total operating appropriations for payment from the budget. This 41 469 million euro was equivalent to 99,4 % of the ceiling provided in the financial perspective (41 738 million euro) and 89,1 % of the amount in the agricultural guideline (46 549 million euro).

**Table 2.1 — EAGGF-Guarantee 2000**

(Mio EUR)

Financial perspective heading: 1. Subsection B1: EAGGF-Guarantee <sup>(1)</sup>							
	Total heading	Of which:					
		B1-1	B1-2	B1-3	B1-4	B1-5	B1-6
		Vegetable products	Animal products	Related expenditure	Rural development	Accompanying measures	Monetary reserve
<b>Financial perspective ceiling</b>	41 738						
<b>Budget changes</b>							
Initial appropriations <sup>(2)</sup>	41 494	25 867	9 521	1 501	4 084	21	500
Final appropriations available	41 469	25 909	9 328	1 238	4 184	0	810
<b>Implementation of the budget</b>							
Appropriations used <sup>(3)</sup>	40 437	25 813	9 276	1 172	4 176	0	0
% of final available appropriations	98	100	99	95	100	0	0
Appropriations carried over to 2001	0	0	0	0	0	0	0
% of final available appropriations	0	0	0	0	0	0	0
Appropriations lapsing	1 062	98	52	94	8	0	810
% of final available appropriations	2	0	1	8	0	0	100

<sup>(1)</sup> Non-differentiated appropriations.<sup>(2)</sup> Including the provisional appropriations (B0-4 0) and the monetary reserve of 500 Mio EUR.<sup>(3)</sup> Commitments.

Source: 2000 revenue and expenditure account.

<sup>(2)</sup> — Excluding provisional appropriations of 24,9 million euro.

— Final adoption of the general budget of the European Union for the financial year 2000 (OJ L 40, 14.2.2000).

<sup>(3)</sup> The monetary reserve is intended to cover (in respect of amounts above 200 million euro) adverse changes in the dollar/euro parity used for budget estimates. Conversely, any savings above 200 million euro due to a favourable change in this parity are to be transferred to the monetary reserve.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.6. The initial appropriations (4) were not amended by any supplementary and amending budgets during the financial year. The final appropriations therefore amounted to 41 469 million euro.

*Expenditure amounted to 98,7 % of appropriations*

2.7. Expenditure amounted to 40 437 million euro, i.e. 98,7 % of the total appropriations available, excluding the monetary reserve (see **Table 2.1**) and 87 % of the agricultural guideline. Plant products accounted for 63,8 % of expenditure, animal products 22,9 %, ancillary expenditure 3,0 %, and rural development 10,3 %. Broken down by type, expenditure was divided between direct aid (70 %), refunds (13,9 %), structural measures (10,5 %) and intervention measures (3,2 %). Structural measures, which were essentially linked to rural development, showed an upward trend, while direct aid and intervention measures fell slightly.

*Provisional appropriations were cancelled*

2.8. The provisional appropriations (24,9 million euro) initially earmarked for 'other measures in the veterinary, animal welfare and public health field' (4 million euro) and for 'support for the management of resources in support of the common fisheries policy' (20,9 million euro) were not used and were therefore cancelled at the end of the financial year.

*310 million euro irregularly transferred to the monetary reserve*

2.9. In view of the change in the dollar/euro parity (5), surpluses amounting to 510 million euro were entered under various items. As stipulated in the Regulation on budgetary discipline (6), savings in excess of 200 million euro, i.e. 310 million euro, were transferred to the monetary reserve.

(4) SAB no 1 only amended the allocation of appropriations between B1-4 0 8 and items B1-4 0 8 0 and B1-4 0 8 1. This SAB, approved on 2 August 2000, was not published in the OJ until 17 April 2001.

(5) The budget was drawn up on the basis of a parity of 1 euro = 1,12 US dollars, whereas the average quotation over the reference period (1.8.1999-31.7.2000) was 1 euro = 0,99 US dollar.

(6) Council Regulation (EC) No 2040/2000/EC of 26 September 2000 on budgetary discipline, Article 11 (OJ L 244, 29.9.2000, p. 27).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.10. However, the time limit stipulated in the Regulation for the proposal for a transfer was not respected. The Commission forwarded this proposal to the Council on 10 January 2001, whereas, according to the Regulation, it should have been forwarded at the end of the month of October 2000 at the latest. It is clear that, under the current regulations and with the procedure followed by the Commission, it will never be possible for this time limit to be observed.

**2.10.** Although there would be sufficient overall appropriations to cover the transfer of EUR 310 million to the monetary reserve, the precise location of these availabilities could only be determined after Member States had transmitted detailed information on execution by budget line, information which did not exist at the time when the report was established. Once the availability of the necessary funds had been identified within the individual budget lines of the EAGGF Guarantee Section, the Commission presented the transfer proposal to the budgetary authority. This was the procedure followed by the Commission which, in its view, even if it led to a delay in the presentation of the transfer proposal, was consistent with the principles of sound budgetary management and avoided unnecessary recourse to other procedures such as a supplementary and amending budget.

2.11. In addition, when making the transfer to the monetary reserve the Commission withdrew most of the 310 million euro from Chapter B1-3 7, 'Clearance of previous years' accounts and reduction/suspension of advances', and not from the items where the savings had been made (see **Table 2.2**). The Commission therefore waited for the last statements from the Member States in order to determine under which items appropriations were still available. This procedure, which has already been the subject of a Court observation (7), does not allow to present to the budgetary authority all the transfers between chapters that ought to have been submitted to it.

**2.11.** The Regulation on budgetary discipline does not require transfers to the monetary reserve to be effected solely and entirely from those lines where expenditure is influenced by changes in the euro/dollar parity. In this respect, the second sentence of Article 11(1) of that Regulation states 'where the dollar strengthens against the euro compared with the rate used in the budget, savings in the Guarantee Section of up to EUR 500 million in 2000 and 2001 and EUR 250 million in 2002 shall be transferred to the monetary reserve'. Only in the case of the additional budgetary costs engendered by a fall in the dollar against the euro is it specified that transfers shall be made to those particular headings of the EAGGF Guarantee Section affected by the fall in the dollar (third sentence of Article 11(1)).

**Table 2.2 — Transfer to the monetary reserve**

Budget chapter	Origin of savings	Withdrawals actually made
B1-1 0 Arable crops	371	0
B1-1 1 Sugar	48	48
B1-1 3 Cotton	44	0
B1-1 8 Other vegetable sectors (rice)	6	0
B1-3 0 Products outside Annex I	35	0
B1-3 2 Islands and peripheral regions	7	0
B1-3 7 Clearance of former years	0	262
<b>Total</b>	<b>510</b>	<b>310</b>

Source: Transfer of appropriations No 79/2000.

(7) See Annual Report 1998, paragraph 2.28.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

The Commission has pointed out in previous reports and transfer proposals concerning the impact of movements in the dollar exchange rate (for example, in the Report and Transfer Proposal for 1998 — SEC(1998)1893 final of 13.11.1998) that the savings for each sector need not necessarily result in identical end-of-year availabilities. Factors other than the dollar exchange rate have a very significant effect on final appropriation requirements for the various chapters for any year, for example, the volume of exports, the level of world prices in dollars or fluctuations in payments. Indeed the Commission drew attention to such factors in its reply to point 2.28 of the Court's Annual Report for 1998 (OJ C 349, 3.12.1999, p. 53).

*Significant amounts of revenue entered in the expenditure budget*

2.12. According to the principle of universality <sup>(8)</sup>, revenue may not be assigned to particular items of expenditure and no offsetting adjustments may be made between revenue and expenditure. Nevertheless, negative amounts totalling 3 798,3 million euro (more than 9 % of expenditure) (as against 3 057,7 in 1999 and 2 498 in 1998) <sup>(9)</sup>, are included in EAGGF-Guarantee expenditure <sup>(10)</sup>. The Court considers, as mentioned in its Opinion No 1/2001 <sup>(11)</sup> — given on a proposal for a regulation amending the Financial Regulation — that this negative expenditure should be entered in the general statement of revenue.

2.13. The overall total for items showing negative balances was 1 899,4 million euro, whereas the budget provided for revenue of only 1 220 million (+ 55 %). Of this 1 899,4 million euro, the balance from previous financial years accounted for 568 million (29,9 %), reductions in advance payments for 510 million (26,9 %) and the additional levies due on account of milk quota overruns for 161 million (8,5 %) <sup>(12)</sup>.

**2.12.** The Commission considers that negative expenditure should not be entered in the statement of general receipts. Instead it considers that these amounts, which are repayments of amounts which have already been financed by the EAGGF, should be treated as earmarked revenue to be used by the EAGGF, as proposed in the recast of the Financial Regulation.

**2.13.** The difference of EUR 680 million between the budgeted negative expenditure (EUR 1 220 million) and the actual negative expenditure (EUR 1 899,4 million) is accounted for principally by higher than expected receipts from sales of goods stored in public intervention (+EUR 383 million) and higher than anticipated reductions in the advances (+EUR 410 million).

Receipts from such budget items are, by their nature, very difficult to foresee, depending in the case of sales from public storage on very fragile market conditions and prices influenced by unforeseeable crises such as BSE and foot-and-mouth disease. Particularly in the cases of reductions of the advances, the amounts result from the non-respecting of the legislation by Member States (non-respect of payment deadlines, absence of controls) or faults on the part of the operators (fraud, irregularities, milk levy); these are amounts recovered on expenditure declared by the Member States and included in the Community's budget.

<sup>(8)</sup> See Articles 4 and 27 of the Financial Regulation.

<sup>(9)</sup> See Annual Report 1999, paragraph 2.10 and Annual Report 1998, paragraph 2.11.

<sup>(10)</sup> 27 budget items (almost 14 % of items) include negative expenditure.

<sup>(11)</sup> Opinion No 1/2001 (OJ C 55, 21.2.2001).

<sup>(12)</sup> This amount of 161 million euro does not include the additional levy for the financial year 2000 for Italy (245,9 million euro), which was subject to a reduction in the advance payment (see paragraphs 2.17 and 2.19).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.14. Revenue also came from profits made on the sale of stocks of agricultural products, mainly because of pessimistic depreciation (corresponding to the difference between the buying price and the estimated price on disposal). This revenue amounted to 588 million euro (13).

2.15. Finally, 72 million euro of the 1 899,4 million euro concerned 21 budget items against which the total revenue estimates entered amounted to only 50 million euro.

2.16. For the Commission, the effect of this general underestimation of revenue is an increase in the appropriations available and therefore a greater flexibility in the management of the budget.

**2.14.** As indicated in point 2.13, the receipts from sales of intervention products are influenced by many factors of which depreciation is but one. In accordance with Regulation (EEC) No 1883/78, stocks are depreciated at the end of the financial year to their foreseeable sale prices in order not to transfer potential losses to succeeding financial years. Higher than budgeted 'profits' on subsequent sales can be the result of lower than expected purchases into intervention, higher prices for sales or higher than expected volume sales, which are all direct results of market changes.

**2.15.** The 21 items referred to concern recoveries due to frauds and irregularities which are again by their nature very difficult to estimate. It would be imprudent to overestimate such receipts without a minimum of documentary evidence.

**2.16.** The Commission's approach is to take a prudent and rigorous approach to estimating all budgetary requirements. The underestimates referred to by the Court arose principally in items dealing with sales from public storage, which are strongly influenced by changes in market conditions not easily foreseeable at the time of establishment of the budget, and reductions in the advances, which are by their nature impossible to forecast.

### *Substantial reductions in advance payments once again*

2.17. One of the main features of the financial year 2000 (as for the 1999 financial year) is the scale of the reductions in advance payments imposed on various Member States, due, on the one hand, to weaknesses in the application of the integrated system and in the implementation of controls (Greece, 75,2 million euro) and, on the other, to the absence of the additional levy payments on milk quota overruns (Greece, 7,5 million euro; Spain, 6,2 million euro; Italy, 380,6 million euro; Portugal, 20,6 million euro).

(13)

Financial year 2000

(Mio EUR)

	Outturn	Available appropriations
Skimmed-milk powder	- 291	- 63
Beef and veal	- 95	- 130
Butter and cream	- 47	- 12
Olive oil	- 16	- 18
Rice	- 9	- 6
Cereals	- 130	25
	- 588	- 204

## THE COURT'S OBSERVATIONS

2.18. In the case of Italy, the 380,6 million euro concern the marketing year 1999/2000 (245,9 million) and the marketing year 1998/1999 (134,7 million). The reduction in the advance payment for the marketing year 1999/2000 is due to the forwarding of erroneous data. This situation forced the Commission to include this amount under the reduction of advance payments item instead of under the additional levies item, which constitutes a breach of the principle of specification of appropriations and leads to a lack of transparency in the accounts. The reduction of 134,7 million euro in the advance payment (due to a delay in forwarding the data for the financial year 1999) was entered in the accounts for the financial year 2000 and this constitutes a breach of the annuality rule (14).

## COMMISSION'S REPLIES

**2.18.** *The reduction of EUR 245,9 million for Italy in respect of the marketing year 1999/2000 marketing year resulted from the fact that Italy, in contravention of the legislation which provides for payment of the amount due by 1 September of the year in question, did not collect or pay over to the EAGGF the full amount of the supplementary milk levy due in respect of that marketing year.*

*In cases where the legislation has not been respected, the Commission proceeds with the recovery of amounts due by way of reductions of the advances for which a specific budget item has been provided (B1-3 7 0 1). As highlighted by the Court, the Commission has no alternative in such a situation.*

*A revised questionnaire submitted by the Member State after the end of the financial year 1999 gave rise to an additional reduction of EUR 134,7 million in respect of the 1998/1999 marketing year. The late transmission of the information made it impossible to collect this amount in the financial year 1999. However to prevent a repetition of this problem based on the data transmitted for the financial year 1999/2000, the Commission based its reduction of EUR 245,9 million referred to above on an extrapolation of previous years' data rather than simply relying on the initial questionnaire provided by the Member State.*

2.19. The scale of these reductions in advance payments (509 million euro compared with 464 million in 1999) demonstrates the continuing existence of shortcomings in the systems of the Member States concerned.

*Management of the budget marred by too many transfers of appropriations*

2.20. The Court reviewed (15) the financial information relating to the management of the budget for the financial year, presented by the Commission in Volume I of the revenue and expenditure account for the financial year 2000.

**2.19.** *The main reductions within EUR 509 million concern non-payment of the milk levy (EUR 414,8 million) involving only four Member States.*

(14) See Annual Report 1999, paragraph 2.15.

(15) The Court has reviewed the information presented by the Commission in Volume I of the revenue and expenditure account. The purpose of that Volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available, as well as between the appropriations finally available and those utilised. This review did not seek to provide assurance as to the reliability of its contents. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.21. Volume I does not give a true and fair view of the execution of the budget for the financial year. For example:

- (a) there are no explanations of the reasons for transfers;
- (b) there is no mention of the supplementary and amending budget;
- (c) there are virtually no explanations for the differences between the budget outturn and the final budget;
- (d) the presentation of figures is inconsistent (figures in millions sometimes rounded, sometimes retained in full; difference between outturn and budget sometimes mentioned, sometimes passed over without comment) and sometimes wrong (<sup>16</sup>);
- (e) lastly, only the rural development chapter is presented in accordance with the Commission accounting officer's instructions.

2.22. Neither does Volume II give a very accurate view of the budgetary implementation. For example, expenditure that had been correctly charged to headings B1-4 0 8 0 (Main agriculture-related measures) and B1-4 0 8 1 (Other measures) were grouped together under article B1-4 0 8 (Promoting the adaptation and the development of rural areas), obscuring the separation of these expenditure items that had been adopted by SAB No 1.

2.23. During the financial year, 175 out of 218 budget items were affected by transfers of appropriations. In all, these movements — i.e. the total amount of the transfers — came to 8 189 million euro (19,7 % of the final appropriations), which represents a considerable increase in comparison with previous financial years

**2.23.** *It would be normal to expect a high level of transfers in a year which was particularly tight for budget execution with 98,7 % of the available appropriations utilised. This is highlighted by the fact that the transfers necessary, including those for rural development, after receipt of the final monthly declaration amounted to EUR 4 437,06 million. In addition,*

<sup>(16)</sup> In the clearance of accounts chapter expenditure is mentioned, but it is, in fact, revenue, and in the 'Intervention in the form of beef storage' article, there is mention of a reduction of expenditure, whereas it is, in fact, revenue; the amount for the initial budget in the 'Other measures' chapter is wrong; the expenditure total in the 'Food aid' chapter is wrong; some of the totals in the table of changes in appropriations and expenditure in 2000 are wrong.

## THE COURT'S OBSERVATIONS

(10,2 % in 1999 and 5,2 % in 1998) (17). The Commission partly justifies the scale of these transfers with the erroneous initial allocation of appropriations within the rural development chapter.

2.24. However, the number of transfers is influenced by the variable quality of the Member States' estimates and monitoring of expenditure. Some transfers were made in order to cope with additional expenditure entailed by delays in payments, or in the implementation of the programmes. For example, item B1-1 2 2 0 ('Consumption aid and schemes related to the consumption of olive oil') was the subject of five increases in appropriations totalling 19,6 million euro for expenditure during the 1997/1998 marketing year and item B1-1 0 6 2 ('Five-year set-aside') was the subject of six increases totalling 10,6 million euro for expenditure relating to the period 1988 to 1992. The Commission must demand more reliable payment estimates by the Member States, so that it does not continually have to adjust the appropriations.

2.25. Transfers made purely for reasons of convenience, such as those already mentioned in the Court's Annual Report concerning 1999 (18), increased in volume in 2000. For example, in the case of 32 budget items (involving a total of 226,8 million euro (19), compared with 41,6 million euro in 1999 (18)), the withdrawals carried out had to be offset by means of subsequent replenishments or vice versa.

## COMMISSION'S REPLIES

as mentioned by the Court, 2000 was the first year for the declaration of expenditure under rural development programmes and transfers within this chapter alone on 18 budget items accounted for EUR 3 878 million.

**2.24.** As indicated in the 1999 Annual Report, the Commission has already taken steps by providing in Regulation (EC) No 1750/1999 for corrections where actual expenditure differs significantly from forecasts.

The budget items B1-1 0 6 2 and B1-1 2 2 0 concern two measures which had terminated prior to the financial year 2000 and for which the 2000 budget did not therefore provide any appropriations. In fact Member States executed payments more slowly than anticipated and a series of transfers was necessary in order to book the declared expenditure to the budget. As old measures were involved, it was considered prudent only to request transfers to deal with expenditure effectively realised instead of basing the requests on Member States' forecasts.

**2.25.** In effect, in order to be able to book expenditure to the budget on a monthly basis, rather than leaving it suspended, it is sometimes necessary to carry out transfers of appropriations, and afterwards to re-establish the original situation. Such movements can be necessary due to the nature of the line, as for example in the case of budget lines dealing with 'Other costs of public storage' where losses may occur during a certain period which later, due to market movements, are transformed into profits (see point 2.26) or because of accounting adjustments carried out by Member States. For example, in the case of budget item B1-1 0 5 1, which was reinforced during the year, excess appropriations existed at the end of the financial year because one Member State moved EUR 19,4 million of expenditure from this item to other items in the final monthly declaration of expenditure.

(17) See Annual Report 1999, paragraph 2.6, and Annual Report 1998, paragraph 2.4.

(18) See Annual Report 1999, paragraph 2.21.

(19) The following items were affected by withdrawals or increases that were subsequently offset by movements in the contrary direction: B1-1 0 0 0, 1 0 0 1, 1 0 1 3, 1 0 1 4, 1 0 4 0, 1 0 4 1, 1 0 4 3, 1 0 5 0, 1 0 5 1, 1 0 5 2, 1 0 5 4, 1 0 5 5, 1 0 6 0, 1 2 3 0, 1 5 0 2, 1 5 1 5, 1 6 1 1, 1 6 2 2, 1 6 2 3, 1 7 1 0, 1 7 5 0, 1 8 0 0, 1 8 5 1, 1 8 5 4, 2 0 2 4, 2 0 3 4, 2 1 2 5, 2 1 2 9, 3 0 1 2, 3 0 1 3, 3 0 1 9, 3 9 9 0.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.26. Other movements of appropriations also reveal shortcomings in the monitoring of appropriations. In the case of 'other public storage costs for cereals', the initial budget of 25 million euro was first increased by 13 million euro, then subjected to six withdrawals for a total of 166,1 million euro, ending with a (negative) balance of final appropriations of - 128,1 million euro. The Commission should endeavour to tighten up on the management of transfers.

**2.26.** It is very difficult to forecast the outcome of budget lines which cover the 'profits or losses' on the sale of intervention goods such as the one cited by the Court, dependent as they are on fragile market conditions and price movements. For the budget line in question, effective expenditure at 31 January 2000 stood at EUR 41 million, necessitating a reinforcement of EUR 16 million compared to the original budget in order to book the expenditure to the budget. However, taking into account a profit forecast by the Member States of EUR 3,5 million, the reinforcement requested was limited to EUR 13 million.

Subsequent improvements in market conditions/sales resulted in higher than expected receipts (see comments under point 2.14).

*AGREX computer system will be modified*

2.27. In its Annual Reports concerning the financial years 1997, 1998 and 1999 (20), the Court criticised the lack of progress in replacing the computer system used for the management of agricultural expenditure (AGREX). In 2000 the Commission began the introduction of a new system which is due to become operational in 2002.

*Conclusion*

2.28. Expenditure under subsection B1 amounted to 40 437 million euro, i.e. 98,7 % of final appropriations (see paragraph 2.7). The budget management for 2000 was once again characterised by a high number of transfers (8 189 million euro, i.e. more than 19 % of initial appropriations) (see paragraph 2.23) and by the inclusion of significant sums of revenue or negative expenditure (3 798 million euro, or more than 9 % of expenditure) (see paragraph 2.12). Transfers and the amount of negative expenditure both increased considerably compared with 1999 (they doubled and quadrupled, respectively). The large volume of these transfers certainly made for a high rate of utilisation of most of the budget headings, but it also reflects the variations in the quality of the estimates both of revenue (see paragraphs 2.12 to 2.16) and of expenditure (see paragraphs 2.23 to 2.26). The Commission should therefore

**2.28.** The increase in the level of transfers was due to a number of factors, including the presence of rural development expenditure for the first time (see point 2.23) and changing markets for products in public storage (see point 2.25) and it was necessary to ensure a very high level of budgetary execution (98,7 %). High receipts from the clearance of accounts procedure, reductions of the advances and sales from public stocks contributed to the increase in negative expenditure.

Particularly good market conditions for cereals, skimmed milk powder and butter were also responsible for a certain variation in the estimates of receipts and expenditure for these products.

The Commission is conscious of the need to improve the quality of forecasts and has already provided for corrections in the

(20) Annual Report 1997, paragraphs 2.24-2.25, Annual Report 1998, paragraphs 2.33-2.34, and Annual Report 1999, paragraph 2.23.

## THE COURT'S OBSERVATIONS

make an effort to improve the quality of these estimates (in cooperation with the Member States) and to review certain budgetary management procedures (see paragraphs 2.23 to 2.26). Finally, concerning negative expenditure (see paragraphs 2.12 to 2.16) the practice must be reviewed (in particular in the context of the current revision of the Financial Regulation), as recommended by the Court in its Opinion No 1/2001.

## COMMISSION'S REPLIES

*area of rural development where actual expenditure diverges significantly from the forecasts of Member States.*

*In the matter of negative expenditure the Commission reaffirms its proposal in the recast Financial Regulation that such amounts should in future be treated as earmarked revenue (see point 2.12).*

## SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

### *Examination of a representative sample of transactions*

2.29. The payments relating to the 2000 appropriations of subsection B1 of the budget (40 437 million euro, see **Table 2.1**) were subjected, for the Statement of Assurance, to a sample survey covering both the reliability of the accounts and the legality and the regularity of the underlying transactions. Each transaction selected was examined <sup>(21)</sup> on the premises of the paying agency, the competent local authority and the final beneficiary.

2.30. The Court's comments on the reliability of the accounts have been grouped together in Chapter 9 (see paragraphs 9.8 and 9.24). The comments on the legality and the regularity of the underlying transactions are set out and described below.

### **Substantive errors**

2.31. The Court examined the whole range of agricultural expenditure (66 % of which is under the integrated administration and control system (IACS)). The audit covered all aspects of the operations from the Commission's payments through the paying agencies in the Member States up to the final beneficiaries (in most cases farmers). Substantive errors are errors which affect the value of the selected transaction. The audits did not provide evidence of improvement in the situation previously remarked on.

**2.31.** *The Commission does not agree with the Court's view that certain types of error are substantive where it considers that the Community rules have been followed. The Commission does not consider that any of these cases was irregular in any way.*

*In several other cases, the Commission will request clarifications from the Member States to establish more precisely the irregular nature of the operations in question.*

<sup>(21)</sup> With a view to verifying the reality of the transaction, its conformity with the eligibility criteria and other regulatory requirements, as well as the accuracy of the amount of the aid and its entry in the accounts.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*In the case of another group of types of errors which the Court considers substantive, the amounts involved are often minor, even though the Court regards some of these operations as totally incorrect. For obvious reasons of cost-effectiveness, no action is taken on these small amounts. The Commission is aware that certain errors and financial corrections are made during the clearance of accounts procedure.*

*The Commission does not therefore totally agree with the Court about these errors.*

*However, the Commission would stress that it takes due note of all the Court's comments and where necessary will make the corrections required during the clearance of accounts procedure, as and when it obtains the relevant information from the Member States concerned.*

**Errors at final beneficiary level**

2.32. In the case of the errors linked to the common market organisations (90 % of the expenditure), most of these errors were at the level of the final beneficiary and concerned for the most part overstatements either of area (often minor overstatements) as regards plant products (about one error in two), or of the number of head of stock for the animal premiums (about one error in five).

2.33. Area overstatements concern numerous Member States (Denmark, Germany, Spain, France, Italy, Sweden, United Kingdom). In contrast, overstatements of animals primarily affect two Member States (Italy and United Kingdom).

2.34. Other errors come from incorrect application of the regulations, such as when the final use of a subsidised product is not respected (pastry-cooks' butter, Spain), or when dispatches to secondary warehouses are regarded as external deliveries (aid for dried fodder, France).

2.35. As regards rural development (10 % of the expenditure), most of the errors are at the final beneficiary level. All these errors concern agri-environmental measures and derive either from an area over-declaration or from non-observance of the provisions of the regulations.

**2.32.** *The Commission agrees with the Court that the amounts in question are minor, even where the Court has attributed a high percentage of errors to these operations.*

**2.33.** *In absolute terms, these over-declarations of areas and animals often concern small amounts.*

**2.34.** *An investigation will be made into the case of pastry-cooks' butter in Spain to determine whether it is systematic in nature; if appropriate, it will be dealt with under the clearance of accounts procedure.*

*In the case of aid for dried fodder (France), the Commission does not accept the Court's legal interpretation of the rules and does not accept that errors occurred.*

**2.35.** *A certain number of cases concerning rural development are still under consideration awaiting a response from the Member States.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Systematic management errors**

2.36. Some of the errors found prove on examination to be systematic. They affect the whole range of transactions of a particular type managed by an intermediate body. The principal type of systematic error observed concerns unwarranted deductions from aid payments.

2.37. Greece again deducted <sup>(22)</sup> a contribution of 3 % for the ELGA (compulsory agricultural insurance fund) from all aid granted for citrus fruits, cotton <sup>(23)</sup>, olive oil and tobacco. Altogether, this contribution represented almost 64 million euro. For olive oil there is also a second deduction — equivalent to 1 % of the aid paid — for the national confederation of producers (i.e. approximately 8 million euro).

2.38. In Italy three national confederations <sup>(24)</sup> deduct a contribution from payments to their members, on behalf of the local organisations of producers. For one of the three confederations alone these contributions accounted for almost 4 million euro.

2.39. Finally, in Sweden, as in the previous year <sup>(25)</sup>, the cost of land surveys carried out had to be paid by the farmers before any aid application was submitted. This practice, which is the equivalent of a deduction from the amount of aid, enabled the Member State to recover approximately 3,6 million euro. It should be noted, however, that this practice was terminated with effect from the marketing year 2000.

2.40. In addition to these national levies, there were other levies that were charged on a local scale by producer associations and cooperatives. For example:

- arable crops (2 %, Greece),
- olive oil (1 % + a standard charge, Greece),
- fruit and vegetables (1 %, Greece) and flat-rate retention per hectare (Spain),
- tobacco (3,5 % Germany, 2,63 % Greece).

**2.36.** The Commission is already aware of the errors concerning unwarranted deductions which stem from the practices of the Member States and has notified them to the Member States under the clearance of accounts procedures.

**2.37.** The Commission is aware of the situation in Greece and is taking action.

**2.38.** The Commission is aware of the situation in Italy and is taking action.

**2.39.** As regards Sweden, the rules have always forbidden deductions to meet the cost of land surveys of cropland. The Swedish authorities have abandoned this practice. The Commission will make an appropriate financial correction.

**2.40.** As regards Greece, a correction has been made since 1994 through the clearance of accounts. The Commission does not consider that the rules forbid such deductions in the case of fruits and vegetables. Action will be taken on the cases of Germany and Spain.

<sup>(22)</sup> Annual Report 1999, paragraph 2.29.

<sup>(23)</sup> In the case of aid for cotton, the contribution is deducted by the mills and then paid to ELGA.

<sup>(24)</sup> CNO, Unasco and Unaprol.

<sup>(25)</sup> Annual Report 1999, paragraph 2.30.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.41. These practices are compatible neither with the Community regulations, which stipulate that aid — apart from deductions for which there is express provision — must be paid to the recipient in full, nor with the more general principle of equal treatment of all farmers in the Union.

#### Other management errors

2.42. The other substantive errors at the level of local management, i.e. the administration of aid for a given region, account for approximately one substantive error in every ten. For example, compensatory aid was granted on a volume of products higher than the volume permitted by the regulation (citrus fruit withdrawal, Greece).

2.43. The substantive errors at the level of central management, i.e. the administration of aid for the whole of a Member State's territory, account for approximately one substantive error in every four. For example, the Spanish authorities omitted to deduct from the advances paid a sum that they should have deducted, the deduction being deferred to the payment of the balance and therefore to another financial year (production aid for table olives) (26). Similarly, France has not yet applied to a forwarding agent the regulatory penalties for a delay in delivery (food aid for Russia in November 1999).

2.44. Lastly, other errors come from calculation errors (use of an erroneous exchange rate as regards animal premiums, United Kingdom) or from mistakes of interpretation of the regulations (non-application of the reductions relating to quantities not marketed as regards aid for bananas, France) (27).

#### Formal errors

2.45. Formal errors do not affect the amount of the transactions examined. They concern the non-observance of a regulatory provision, but the non-

2.41. Apart from the comments by the Commission on these points, constant vigilance is maintained on non-compliance with the rules.

2.42. As regards the withdrawal of citrus fruit in Greece, the Commission does not consider that the rules forbid this practice.

2.43. In the case of Spain, the deduction was applied to the balance.

In the case of France, the Commission will take appropriate action.

2.44. The incorrect exchange rate in the United Kingdom will be considered in the light of the response from the Member State. In this case, as in that concerning non-application of the reductions relating to quantities not marketed as regards aid for bananas in France, action will be taken through the clearance of accounts.

2.45. Where a formal error affects a provision concerning checks, the Commission applies the guidelines on flat-rate corrections in the clearance of accounts.

(26) The national implementing circular has since been amended and provides for deduction from the advance.

(27) The aid must be given for fruit actually marketed.

## THE COURT'S OBSERVATIONS

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observance does not have any direct consequence as regards the value of the transaction. However, such an infringement of the regulations, in particular when it concerns a provision concerning controls, can have significant consequences, since it may even make it impossible to check the legality and the regularity of certain transactions.

**2.46.** The frequency of the errors discovered by the Court (disregarding multiple errors affecting the same transaction) is still high and most of them are at the level of the central or local management in the Member States.

## Checks carried out by the Commission

**2.47.** With regard to the management of payments by the Commission, the Court's analysis of the monthly payment orders showed that, for eight months out of twelve (corresponding to a total of 33 286 million euro, i.e. 82,4 % of payments), the payment orders had been initialled after the regulatory deadlines. The extreme example is that of a commitment of December 1999 (6 924 million euro) that was recorded on 30 May 2000, whereas the deadline was fixed by the regulations at 20 March. A similar observation was made for 1998 and 1999 (28).

## Checks carried out by the Member States

**2.48.** In 1999 and 2000 the Court examined the extent to which IACS was implemented in 1998 at the Commission and in six Member States (Germany, Spain, France, Ireland, Portugal and United Kingdom). The examination concerned, in particular, area aid schemes and beef and veal premiums. The Court's observations were set out in a special report (29). Although the final deadline for full implementation of IACS was 1 January 1997, persistent weaknesses were found in the Member States visited during the Court's audit. These mainly concerned insufficient cross-checks of surface areas and animals, some incomplete and out-of-date databases and poor quality field inspections. Moreover, practices in the Member States differed, although the Commission issued a number of interpretations and recommendations of the complicated regulations. The Commission needed to continue its efforts to improve the quality of the information it requested and received from the Member States and to evaluate and use that information to improve its management of their implementation of IACS.

**2.47.** While recognising that progress remains to be made, the Commission notes that the situation with regard to the time allowed for payment orders to be initialled has improved. Since August 2000, only two delays have been encountered, of one and five days respectively.

**2.48.** See the Commission's response to point 2.66.

(28) Annual Report 1999, paragraph 2.33.

Annual Report 1998, paragraph 2.49.

(29) Special Report No 4/2001 (OJ C 214, 31.7.2001).

## THE COURT'S OBSERVATIONS

2.49. The substantive, systematic and formal errors mentioned in this chapter demonstrate the persistence of these weaknesses in the systems in many Member States. The Court's audit thus highlighted a number of shortcomings:

(a) as regards the data needed for carrying out administrative checks:

- (i) IACS computer files for animal premiums (France and United Kingdom), cereals and cotton (Greece) and olive oil register (olive oil, Italy) had not been updated;
- (ii) olive oil register incomplete (olive oil, Greece);
- (iii) land register lacked reliability (aid for processing citrus fruit and citrus fruit withdrawal, Greece);
- (iv) shortcomings and inconsistencies in documents held either by producer organisations (citrus fruit withdrawal, Greece, and dried fodder, France) or by producers (Germany, France, Ireland, Netherlands and United Kingdom);

(b) as regards the actual conduct of the administrative checks:

- (i) absence of systematic verification of eligibility by local management organisations (arable crops, United Kingdom), or producer organisations (olive oil, Spain; aid for citrus fruit processing, Greece);
- (ii) inadequacy of certain cross-checks (between stocks as shown in accounts and actual stock: starch, France) between the application, land registry data and databases (cotton and citrus fruit processing, Greece, and tobacco premium, Germany);

## COMMISSION'S REPLIES

**2.49.** The Commission acknowledges certain systemic weaknesses in some Member States but cannot agree with the Court about their persistence. It is aware of these weaknesses, or they are subject to flat-rate one-off financial corrections or urgent recommendations are made to introduce the improvements desired.

(a) as regards the data needed for carrying out administrative checks:

- (i) in the absence of reliable alternative checks, flat-rate corrections are made;
- (ii) Greek olive oil register: corrections have already been made through the clearance of accounts;
- (iii) lack of a reliable land register: corrections have already been made;
- (iv) shortcomings and inconsistencies in documents: corrections will be made in proven cases;

(b) as regards the conduct of the administrative checks:

- (i) the absence of systematic verification is penalised through the clearance of accounts;
- (ii) the inadequacy of certain cross-checks is verified and conclusions drawn through the clearance of accounts.

## THE COURT'S OBSERVATIONS

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(c) as regards the execution of on-the-spot checks:

- (i) non-respect of the minimum level of checks for cotton (Greece), olive oil (Portugal), animal premiums and fruit and vegetable withdrawal (France) and public storage (free distribution, France) and citrus fruit processing (Italy);
- (ii) non-compliance with annual rotation of applications to be checked (olive oil, Spain) <sup>(30)</sup>;
- (iii) non-compliance as regards the random nature of the checks (animal premium, United Kingdom);
- (iv) non-compliance as regards completeness of measures for olive oil (Portugal) or non-compliance as regards tests on butter (France).

(c) *as regards the execution of on-the-spot checks, this is the main cause of corrections through the clearance of accounts.*

## Conclusion

2.50. The audits did not provide evidence of improvement in the situation remarked on previously. This concerns the substantive errors (representing amounts wrongly paid) (see paragraphs 2.31 to 2.44) and the IACS measures in particular. In addition, formal errors remain frequent (see paragraphs 2.45 to 2.49) and significant.

2.51. All these errors highlight certain inadequacies in some of the essential aspects of IACS (see paragraphs 2.48 and 2.49). That ought to encourage the Commission and the Member States to review and improve the way in which IACS operates.

2.52. Finally, the Commission should consider the question of unwarranted deductions at national level from the aid paid to producers (see paragraphs 2.36 to 2.41) and should endeavour to find a final solution to this problem, in the light of Council Regulation (EC) No 1259/1999 <sup>(31)</sup> in particular.

2.50. *As it stated in point 2.31, the Commission does not agree with the Court that a large number of substantive errors have been detected. In fact it does not believe that the number of errors has grown considerably.*

2.51. *The Commission has noted the Court's invitation to review and improve the operation of the IACS and will continue its efforts in this direction.*

2.52. *Regulation (EC) No 1259/1999 deals with much of the question concerning unwarranted deductions from the aid paid to producers since it requires payments to be made to the beneficiaries in full. The other sectors are covered by their market regulations. In the cotton and fruits and vegetables (withdrawals) sectors, the Commission considers that the rules do not forbid such deductions in 2000.*

<sup>(30)</sup> At least two thirds of the checks must relate to applications that were not checked in the previous two years.

<sup>(31)</sup> Article 2 states that payments are to be made to beneficiaries in full (OJ L 160, 26.6.1999, p. 113).

## THE COURT'S OBSERVATIONS

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## CLEARANCE OF ACCOUNTS

*Introduction*

2.53. The Commission must take a financial clearance decision no later than 30 April each year. The financial decision shall cover the integrality, exactitude and veracity of the accounts submitted for the preceding EAGGF year. The Commission may also decide to exclude expenditure from Community financing because it does not comply with Community rules. Such conformity (also known as compliance) decisions are not subject to any deadline and cover a number of years but the corrections can only be applied retrospectively for a maximum of two years preceding written notification to the Member State concerned.

2.54. In the course of 2000, the Commission took two conformity decisions (fourth and fifth) to exclude expenditure from Community financing in respect of the period 1996 to 1998<sup>(32)</sup>. The financial decision referring to 2000 was taken in May 2001<sup>(33)</sup>. These decisions have been audited by the Court.

*Conformity decisions***Corrections**

2.55. The Commission has recourse to flat-rate corrections only in cases where the actual financial impact of systems weaknesses (one-off corrections) cannot be established. The rate applied depends on the severity of the failure of controls (see **Table 2.3**) although there is an element of judgement involved. In practice, one-off corrections are relatively low in value, for example, less than 5 % of the total corrections under the fourth conformity decision. One-off corrections are typically made for accounting-related 'errors' — payments after the

2.55. As mentioned by the Court, there is often an element of judgement involved when establishing financial flat-rate corrections. The table established by the Court (see Table 2.3) is therefore in itself not enough to judge the level of the proposed financial corrections. The guidelines for the calculation of financial corrections are laid down in working document VI/5330/97, which needs to be taken into consideration in its entirety. Likewise under the heading 'Further consideration of the real financial losses' (page 13 of the guidelines), it is explained that the correction resulting from

<sup>(32)</sup> Commission Decision 2000/216/EC of 1 March 2000 (OJ L 67, 15.3.2000, p. 37) and Commission Decision 2000/449/EC of 5 July 2000 (OJ L 180, 19.7.2000, p. 49).

<sup>(33)</sup> Commission Decision 2001/474/EC of 8 May 2001 (OJ L 167, 22.6.2001, p. 27).

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deadlines specified in the regulations, advance payments not followed by settlements, overclaims, failure to respect ceilings, etc. Flat-rate corrections apply to more general systems weaknesses that cannot be precisely quantified and are thus more controversial and are often contested during conciliation. In several cases the Court does not agree with the level of flat-rate correction applied. The following paragraphs explain why.

*the application of the criteria as summarised by the Court in table 2.3 should, like other criteria, be examined in the light of other information. It also expressly mentions the opportunity of the Member State, through additional verifications or additional information, to demonstrate that the deficiency was not as serious as it appeared. Hence, those elements need to be taken into account by the Court when assessing the financial corrections made by the Commission.*

2.56. **Table 2.4** shows the distribution of expenditure excluded from Community financing per financial year. In 2000, a total amount of 579,7 million euro (229,2 + 350,5 million euro, fourth and fifth conformity decisions respectively) was excluded, mainly for the financial years 1996 to 1998. The corrections principally cover arable crops, animal premiums and the quality of physical checks of products qualifying for export refunds.

2.57. It is still too early to compare the financial years 1996 to 1998 with the period preceding the reform of the clearance of accounts procedure, as the Commission has taken further decisions in 2001 affecting the financial years concerned.

### Weaknesses in the procedure

#### Delays in notification of findings

2.58. The Court has previously noted delays in the Commission's issue of mission reports and notification

**Table 2.3 — Corrections: use of flat rates<sup>(1)</sup>**

Criteria for a financial correction	Significant weaknesses in the application of EC regulations which imply a real risk of financial loss for the EAGGF.
Use of 2 % flat rate	Key controls are satisfactory but secondary controls are partly or totally ineffective.
Use of 5 % flat rate	Not all the key controls are executed in the number, frequency and with the rigour required by the regulations. Therefore, the risk of loss for the Fund is significant.
Use of 10 % flat rate	One or more key controls do not operate and it is thus not possible to determine the eligibility of a claim and its regularity. Therefore, the risk of loss for the Fund is high.
Use of 25 % flat rate	There is no system of controls for a measure, in a Member State or one of its regions, and there are signs of frequent irregularities and frauds. There is a risk of high losses to the Fund.
Use of higher flat rates	If the weaknesses are such that most of the payments are irregular.

<sup>(1)</sup> Commission document VI/5330/97.

Table 2.4 — Clearance of accounts corrections (1996-2000)

(Mio EUR)

Amounts	1996	1997	1998	1999	2000	
Financial decisions						
Expenses declared (including B1-3 7 0)	39 062,5	40 884,3	38 857,4	40 726,2	40 410,6	
Expenses initially disjoined <sup>(1)</sup>	25 986,7	107,8	2 453,5	—	7 489,7	
<b>Expenses cleared</b>	<b>39 062,5</b>	<b>40 884,3</b>	<b>38 857,4</b>	<b>40 726,2</b>	<b>32 920,9</b>	
Corrections in the first financial decision	1,1	- 1,0	0,9	1,6	3,2	
Corrections in the second financial decision	9,9	- 0,1	2,6	—		
<b>Total amount of corrections in the financial decisions</b>	<b>11,0</b>	<b>- 1,1</b>	<b>3,5</b>	<b>1,6</b>	<b>3,2</b>	
<b>Conformity decisions</b>						<b>Total</b>
<i>Taken in 1999</i>						
First conformity decision, 1999/186/CE	82,5	7,1	0,0	0,0	0,0	<b>89,6</b>
Second conformity decision, 1999/351/CE	12,7	17,4	2,6	0,0	0,0	<b>32,7</b>
Third conformity decision, 1999/603/CE	68,8	33,1	0,0	0,0	0,0	<b>101,9</b>
<i>Taken in 2000</i>						
Fourth conformity decision, 2000/216/CE <sup>(2)</sup>	81,2	83,9	64,1	0,0	0,0	<b>229,2</b>
Fifth conformity decision, 2000/449/CE <sup>(3)</sup>	143,1	105,6	80,4	0,7	20,7	<b>350,5</b>
<b>Total amount of corrections in the conformity decisions</b>	<b>388,3</b>	<b>247,1</b>	<b>147,1</b>	<b>0,7</b>	<b>20,7</b>	
<b>Total amount of corrections <sup>(4)</sup></b>	<b>399,3</b>	<b>246,0</b>	<b>150,6</b>	<b>2,3</b>	<b>23,9</b>	
Corrections for late payments	25,2	27,2	15,6	0,0	0,0	
Milk super levies	0,0	0,0	0,0	0,0	0,0	
<b>Total amount of corrections net of late payments and milk super levies</b>	<b>374,1</b>	<b>218,8</b>	<b>135,0</b>	<b>2,3</b>	<b>23,9</b>	
<b>Percentage of corrections in the expenses cleared</b>	<b>1,0 %</b>	<b>0,5 %</b>	<b>0,3 %</b>	<b>0,0 %</b>	<b>0,1 %</b>	

<sup>(1)</sup> From 1996 to 1998, they correspond to the expenses of paying agencies whose accounts could not be cleared in the first instance after the conclusion of the certification report or due to the insufficient work of the certification body.

These expenses were later cleared, during a second financial decision, after more work was done on paying agencies' accounts.

In 2000, they correspond to the expenses of paying agencies which did not provide Table of X in due time.

<sup>(2)</sup> Corrections made for export refunds have been split between EAGGF years 1996 to 1998 by dividing them by 3 as there was no detail in the Commission's summary report.

<sup>(3)</sup> The correction of 20,7 Mio EUR for 2000 is related to a case of fraud in export refunds in France for EAGGF years 1988 to 1990.

<sup>(4)</sup> From 1996 on, this total is still provisional, there are still conformity decisions to be taken.

NB: — The amounts in italic are still provisional.

— Exchange rates: those used by the Commission in its summary reports.

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letters (34). A similar situation has also been found in respect of this year's conformity decisions, for example concerning meat in Germany and France. In the light of the '24-month rule' (35), it is important that the notification of findings is sent to the Member States in a timely manner.

## Member State failure to provide data

2.59. Once again (36) Spain has not supplied the Commission with financial and statistical information (IACS inspections). The results of the IACS on-the-spot inspections, coupled with independent confirmation by the certifying body that the inspections have been correctly executed, constitute an essential element in providing assurance that IACS is being properly implemented. Failure to supply this information is thus a very serious matter, and undermines confidence in the operation of the system. The Commission should therefore consider making it obligatory that the requested statistical information be provided to and be systematically verified by the certifying body (37).

**2.59.** The Commission must emphasise that it also regrets that Spain has often failed in its obligation to transmit reliable and timely data to the Commission, which was a major factor in making transmission of claim, inspection and penalty data in respect of IACS a regulatory requirement as from 2000 onwards. It is also stressed that such failings are assessed in the clearance of accounts procedure.

As regards the suggestion that certifying bodies should verify statistical information, this has previously been the case in several Member States. Certifying bodies do report interesting aspects concerning inspection targets, for example, and these are indeed followed up in the clearance of accounts procedure.

*The Commission will examine appropriate action.*

## Individual corrections

## Export refunds

2.60. In 1996 and 1997 the Commission conducted an enquiry into the quality of physical checks on exports attracting refunds. These physical checks, which should be carried out without prior warning (38), constitute key

(34) See paragraphs 2.45 in the Annual Report concerning the financial year 1999 (OJ C 342, 1.12.2000) and 2.77 in Annual Report 1998 (OJ C 349, 3.12.1999).

(35) The Commission may only exclude expenditure which has been effected within 24 months prior to the Commission's communication of its findings. Article 5(2)(c) of Council Regulation (EEC) No 729/70 (OJ L 94, 28.4.1970, p. 13), as amended by Regulation (EC) No 1287/95 (OJ L 125, 8.6.1995, p. 1).

(36) See comments in the Annual Report concerning the financial year 1999, paragraph 2.47 (OJ C 342, 1.12.2000).

(37) See Special Report No 22/2000, paragraph 49 (OJ C 69, 2.3.2001).

(38) Article 3(1) of Council Regulation (EEC) No 386/90 (OJ L 42, 16.2.1990, p. 6).

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controls and when a key control is applied but 'not in number, frequency or depth required by the Regulation' (see **Table 2.3**), a 5 % correction should be applied.

2.61. The Commission found that Denmark (<sup>(39)</sup>) had procedures which effectively meant that the exporter knew in advance of lodging the export declaration if a physical control was to take place (or not) and which therefore thwarted the operation of a key control. In the Court's view, the application of the Commission's criteria could have implied a 10 % flat-rate correction (the key control was completely ineffective, see **Table 2.3**), an additional 29 million euro. In addition, the application of sanctions, in the event of an exporter requesting a refund in excess of that applicable, has been compromised (<sup>(40)</sup>).

**2.61.** *In its audit in Denmark the Commission found that the physical controls had been carried out. Even though weaknesses were established, the Commission does not think those controls can be considered thwarted as the Court states. The weaknesses discovered did indeed limit the effectiveness of the controls, but this is not to be compared with a situation where no key control was carried out at all. In order to justify a 10 % flat-rate correction — following the guidelines on financial corrections (document VI 5330/97) — one or more key controls must not be operating at all which was not the case in Denmark. Therefore the Commission is of the opinion that the application of the 5 % flat rate correction was justified and is in accordance with the abovementioned guidelines, which state that 'when all key controls are applied, but not in the number, frequency, or depth required by the regulations, then a correction of 5 % is justified...' (see also general comment under point 2.55).*

## Overshoot of base areas

2.62. Under the 1992 reform, each Member State had to draw up a regionalisation plan, including yields per region (taking account of factors such as soil fertility and irrigation) and determine 'base areas' (land used for the cultivation of cereals, oilseeds and protein plants during the period 1989 to 1991). If these base areas are overshot, the aid paid to the farmers must be reduced accordingly.

2.63. The Commission's market services carry out annual controls to check whether the base area has been exceeded. In Spain, France and the United Kingdom, the Commission found that the overshoot had not resulted in a reduction of the amounts paid to farmers and applied corrections of 7,7 million euro for the 1996 harvest year, which was equivalent to the amount overpaid. However, this meant there were delays of several years (1996 to 2000) before the Member States concerned were penalised. As soon as an overshoot has

**2.63.** *Member States are responsible for establishing if the base area has been exceeded or not. The Commission's market departments carry out checks to see whether the areas communicated by the Member States are plausible. In cases where the area communicated is considered not to be plausible, an investigation in greater depth is instigated under the normal clearance-of-accounts procedure and gives rise to financial consequences by excluding expenditure from Community financing. Infringements of Regulation (EEC) No 1765/92 are not treated differently under the clearance of accounts procedure compared to other infringements of Regulation (EEC) No 3887/92, as the rate of correction is always based on an assessment of the actual loss to the Community budget. The Commission will consider whether it is legally possible to introduce certain forms of penalties in these circumstances.*

(<sup>39</sup>) In Denmark, customs physical checks were carried out on the basis of a pre-announcement sent to customs before loading. If customs establish that the information on the pre-announcement is wrong, the trader can complete and present a correct export declaration afterwards. The export declaration is the legal document establishing the claim for export refunds.

(<sup>40</sup>) Article 11 of Commission Regulation (EEC) No 3665/87 (OJ L 351, 14.12.1987) (applicable up to 30 June 1999) as amended by Regulation (EC) No 495/97 (OJ L 77, 19.3.1997, p. 12).

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been established (<sup>41</sup>) (and where aid has not been reduced) the Commission should consider introducing some form of penalty for such cases (<sup>42</sup>).

2.64. The Commission also used the wrong rate of aid to calculate the correction for Spain, which was consequently 2,4 million euro too low, which represents about 1 % of the total correction of 206 million euro.

## Integrated administration and control system area aid

2.65. The integrated administration and control system (IACS) (<sup>43</sup>) was to be fully operational as of 1 January 1997. The Council stipulated that if any part of IACS was operational before the dates laid down, Member States should use it for their management and checking activities (<sup>44</sup>).

2.66. The Court concluded in its Annual Report for 1999 (<sup>45</sup>), contrary to the position of the Commission, that it considers the cross-checks and the on-the-spot checks, provided for in the regulation, to be key controls and that these two controls are complementary. Hence, if a Member State fails to carry out any of these checks, the Court considers that a 5 % flat-rate correction should be applied. The Court does not understand the Commission's attitude, which seems to treat the cross-checks required to prevent double payments as an ancillary control.

**2.66.** *The Commission has already expressed disagreement with the Court's view in its reply to the Annual Report concerning the financial year 1999.*

*Key controls are those physical and administrative checks required to verify the existence of the subject of the claim. The key controls in the arable crops sector are on-the-spot controls and cross-checks to independent land registers.*

*Ancillary controls are those administrative operations required to correctly process claims. A control to identify duplicate claims for the same subject would therefore not be a key control, but an ancillary control in the arable crops sector, as it does not verify the existence of the subject of the claim.*

(<sup>41</sup>) With effect from the marketing year 2000/2001, this information shall be forwarded to the Commission at the latest by 31 October in the marketing year concerned (Article 26 (1) of Commission Regulation (EC) No 2316/1999) (OJ L 280, 30.10.1999, p. 43).

(<sup>42</sup>) The Court has also established that a similar framework to that applicable for base areas does not exist for bovine animals. See paragraphs 54(b) and 67 in Special Report 4/2001(OJ C 214, 31.7.2001).

(<sup>43</sup>) Introduced by Council Regulation (EEC) No 3508/92 (OJ L 355, 5.12.1992, p. 1) and implemented by Commission Regulation (EEC) No 3887/92 (OJ L 391, 31.12.1992, p. 36).

(<sup>44</sup>) Article 13(2) of Council Regulation (EEC) No 3508/92 (OJ L 335, 5.12.1992, p. 1).

(<sup>45</sup>) See the Annual Report concerning the financial year 1999, paragraphs 2.50-2.51 (OJ C 342, 1.12.2000).

## THE COURT'S OBSERVATIONS

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Integrated administration and control system — Animal premiums

2.67. As from 1 January 1997, when IACS was to be fully implemented, Member States were supposed to have completed their identification and registration of all animals in accordance with Council Directive 92/102/EEC (<sup>46</sup>). A complete identification and registration system (I & R) is the cornerstone of the control of animal premiums, enabling Member States to carry out administrative controls (cross-checks) as well as effective on-the-spot checks (<sup>47</sup>).

2.68. The corrections in relation to animal premiums were mainly based on complete or partial failures in establishing effective I & R systems.

2.69. In Portugal, a herd register (a key control) for sheep and goats had not been established, which meant an increased inherent risk to the EAGGF and the quality of on-the-spot checks was found not to be satisfactory. While the Commission had applied a 5 % correction in respect of 1995, it only imposed a 2 % correction on 1996 and 1997 expenditure.

2.70. The Commission (Directorate-General for Agriculture (DG AGRI)) had found that the quality of on-the-spot controls had only improved slowly between 1994 and 1999. In the Court's view, the progress was not sufficient to justify the reduction from 5 % to 2 % from 1996 onwards according to the Commission's criteria (see **Table 2.3**). A 5 % flat rate (an additional 3.6 million euro) should also have been applied for financial years 1996 and 1997.

**2.69 and 2.70.** Portugal: Ewe premium

*The Commission does not share the Court's opinion because:*

- the overall on-farm inspection level rose from 10,6 % for 1995 to 13,7 % for 1996 — an increase of 29 %, and the proportion of animals subject to on-farm inspection was 30 % for 1996, which was the result of a much improved risk analysis procedure introduced after earlier Commission criticisms,
- in 1995 Portugal had used, for the first time, a private company to conduct its on-farm inspection programme, which led to particularly deficient controls, whereas for subsequent years evidence suggests that control performance did improve,
- the clearance of accounts audit missions conducted in 1994 and 1995 led to a series of criticisms that, by allowing time for INGA to fully reorganise its control regime, reaped benefits in 1996. Indeed, this was the case with, for example, the much improved risk analysis applied to select producers for inspection in 1996, leading to the high proportion of inspected animals mentioned above.

*Therefore, the Commission is satisfied that a lower flat-rate correction for claim years subsequent to 1995 was indeed justified.*

(<sup>46</sup>) OJ L 355, 5.12.1992, p. 32.

(<sup>47</sup>) See the Annual Report concerning the financial year 1996, paragraphs 4.45-4.55 (OJ C 348, 18.11.1997).

## THE COURT'S OBSERVATIONS

2.71. In respect of suckler cow premiums, there was no reason for considering the risk to the EAGGF lower for the marketing year 1996 than for the marketing year 1997. For both marketing years the I & R system was not operational and the error rate found by the Portuguese authorities was 18,3 % for 1996 and 19,7 % for 1997. Both rates indicate that key controls (howsoever defined) failed and that a 5 % correction was justified. The application of the Commission's criteria (see **Table 2.3**) would have warranted a 5 % flat-rate correction (an additional 1,7 million euro) for 1996 (a level which corresponds to the correction for 1997) rather than the 2 % applied.

## COMMISSION'S REPLIES

**2.71. Portugal: Suckler cow premium**

*The Commission considers that the situation regarding non-compliance with governing rules in 1997 was clearly less satisfactory than for 1996.*

*It should first be pointed out that a flat-rate correction of 5 % was indeed applied in respect of certain high risk categories (combat animals, suckler cow premium expenditure for claim year 1996). Additionally, it must be mentioned that a flat-rate correction of 5 % was applied for both years in respect of special beef premium, emphasising the in-depth assessment by the Commission services of the overall position concerning the bovine premium sector.*

*In the context of the clearance of accounts guidelines for assessing flat-rate corrections, 'when the regulations explicitly require a particular check, the Member State has no choice other than to apply this check...'. Since the integrated administration and control system had to be completed only by 1 January 1997, it is from that date onwards that Portugal's implementation was deemed more seriously deficient.*

*In these circumstances, the Commission is satisfied that a lower flat-rate correction for claim year 1996 was justified.*

## Accompanying measures

2.72. Cross-checks to avoid double claims are also a key control for accompanying measures. In Spain and Italy, the Commission had found that aid claims under accompanying measures had not been cross-checked with the IACS database. In the Court's view, the application of the Commission's criteria (see **Table 2.3**) would have warranted a 5 % flat-rate correction for Spain (an additional 5,7 million euro) and for Italy (an additional 12 million euro), rather than the 2 % applied.

**2.72. Regulations (EEC) No 2078/92 and (EC) No 746/96 made no provision for the greater integration of accompanying measures into the IACS, particularly as regards area declarations. Since use of the IACS database is frequently ill-suited to agri-environmental measures, the results of cross-checks on areas could sometimes give no definite response as regards the areas declared. Accordingly, cross-checks were regarded as compulsory checks (in accordance with Article 19(3) of Regulation (EC) No 746/96) although secondary from the point of view of risk since they had to be supplemented by other types of checks. The context changed from 2000 because Regulation (EC) No 1750/1999 provided for the greater integration of rural development measures into the IACS and the IACS itself had changed. To take account of those changes, Annex 8 to document AGRI/17933/2000 states that cross-checks in all appropriate cases against IACS data on all parcels receiving support in order to avoid any unjustified payment are key checks. This provision applies from 1 January 2001.**

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It should also be noted that the obligation to carry out cross-checks applied from 1 January 1997. The correction proposed concerns 1997 and 1998, a period which should be regarded as transitional when the Commission wished to show a degree of understanding by applying a correction rate of 2 %. This position was justified by the fact that the introduction of cross-checks required a considerable effort, particularly since, for example in Italy, the two measures were not managed by the same paying agency.

## Fruit and vegetables

*Inadequacy of the documents justifying the Commission's position*

2.73. Following a DG AUDIT visit to France in September 1997, it became apparent that one undertaking was receiving processing aid for peaches and pears in syrup which it was incorporating into fruit salads and compotes. However, aid can only be granted on peaches and pears in syrup when these are end products<sup>(48)</sup>. Documents on the Commission file indicate that the Commission suspected fraud but the case was not referred to OLAF. The decision not to treat this irregularity as a fraud case has not been documented. The corrections implemented amounted to 2,3 million euro for 1996, 2,6 million euro for 1997 and 1,8 million euro for 1998.

## Flax

*Lack of precision in the regulations*

2.74. In the United Kingdom, two audit visits by the Commission revealed that aid had been granted for growing a variety of flax which is not normally eligible for aid<sup>(49)</sup>. The British authorities had treated it as an experimental variety, which is allowed by the regulation<sup>(50)</sup>. From 1994/1995 onwards, it was grown over vast areas: 1 903 ha in 1994/1995, 5 407 ha in 1995/1996 and 7 990 ha in 1996/1997, but no proof

<sup>(48)</sup> Regulation (EEC) No 1558/91 (OJ L 144, 8.6.1991, p. 31).

<sup>(49)</sup> The Klasse variety does not feature in Annex A to Regulation (EEC) No 1164/89 (OJ L 121, 29.4.1989, p. 4).

<sup>(50)</sup> Article 2 of Regulation (EEC) No 1164/89.

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was ever given to the Commission of tests which should have been performed about the production of fibres.

2.75. The Commission considered that the areas grown for experimental purposes were exaggerated and should not be more than 100 hectares. Therefore it applied corrections of 1,45 million euro for the financial year 1995, 5,9 million euro for 1996 and 8,1 million euro for 1997. The case was brought before the Court of Justice and the resulting judgment, in November 2000, annulled the corrections. The grounds were that the Commission had no legal basis to limit the size of an experimental area, neither in the regulations nor in a directive; there was no evidence to show that the sowing was not in proportion to the review envisaged (<sup>51</sup>) and that the absence of tests was not relevant because the condition of eligibility for aid was the sowing of the area, not the processing of the crop harvested (<sup>52</sup>).

2.76. Aid for areas sown with varieties under review was only abolished with effect from the 1998/1999 marketing year. Had the regulations been more precise, most of the aid need not have been paid or the Commission could have made corrections. The EAGGF could have saved around 15,5 million euro over the financial years 1995 to 1997 (see also paragraphs 2.77 to 2.84).

**2.76.** *The United Kingdom authorities did not inform the Commission in good time about the extent of the experimental areas sown with this variety. Only after the inspection visit of the Commission's clearance of accounts staff did the size of the areas sown become evident. Thus financial corrections for the total area exceeding the experiment were applied. Furthermore the Commission proposed a change of the legislation which was decided by the Council with effect from the 1998/1999 marketing year.*

## Failure to act on the Court's observations

## Flax aid

2.77. In its Annual Report concerning the financial year 1992 (<sup>53</sup>), the Court had recommended to the Commission that any further encouragement of fibre flax production should be avoided since, even at that time, there was a production surplus for which no buyer could be found. In 1993, the regulations concerning the cultivation of fibre flax and hemp were amended. The aid for the production of seeds was added to the aid per hectare. This new rate effectively doubled the rate of aid per hectare and was far more attractive than the aid for other arable crops.

**2.77 to 2.84.** *The Commission first became aware of problems when its staff noticed the increase in the cultivated flax areas in Spain from 1994. Consequently DG AGRI Clearance of Accounts undertook a mission in July 1995 which detected anomalies in the flax sector in Spain which could be summarised under the term 'premium hunting'.*

(<sup>51</sup>) Case C-148/99, judgment of 9 November 2000.

(<sup>52</sup>) Articles 3 to 8 of Regulation (EEC) No 1164/89.

(<sup>53</sup>) OJ C 309, 16.11.1993.

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2.78. In its Annual Report concerning the financial year 1995 (54), the Court observed a rapid growth in the surface area devoted to fibre flax production and in the related expenditure between 1994 and 1995, and noted the emergence of two new large-scale producer countries, Spain and the United Kingdom. It noted that the quantities produced far exceeded market requirements and recommended that the Commission should take an active interest in this market in order to remedy this market surplus. Between the 1992/1993 and the 1999/2000 marketing years, the total area sown with fibre flax in Spain rose from 0 to 126 000 hectares. In Spain, control of the common market organisation for flax is exerted by the regional governments.

2.79. The risk of a production for the sake of aid was clearly highlighted as early as the Commission's clearance of accounts unit's audit visit to Spain of July 1995 (55). The audits conducted in June 1997 (56) by the market division of the Commission responsible for flax, followed by that of July 1998 (57), in conjunction with OLAF, confirmed this impression (58). A flat-rate correction for weakness of management of the measure was applied to Spain for the financial years 1994 and 1995 (59). This correction was not applied in subsequent financial years because the Commission considered, on the basis of the joint audit conducted with OLAF in 1998, that the Spanish authorities had improved the situation regarding compliance with the statutory requirements.

2.80. The regulations did not require flax straw to be processed, nor did they stipulate a minimum flax straw yield per hectare, a minimum fibre yield per tonne of flax straw processed, or a minimum quality standard

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This was confirmed by further reports in June. In July 1998 UCLAF participated in a mission in Spain, mainly on hemp, but some verifications were also carried out for flax which showed the presence of anomalies in the flax sector. As a consequence of the problems of the sector the Commission took the following legislative measures.

- In February 1996, the Commission made a proposal for a reform of the aid system, which basically consisted in fixing a maximum guaranteed area and different levels of aid for pulled and cut flax. The Council did not adopt that proposal.
- In these circumstances, the Commission made a new proposal in December 1996 for processing of the straw to become compulsory. This proposal was adopted by the Council and entered into force in 1997/1998.
- As the areas declared continued to increase, the Commission added a minimum yield requirement as from 1998/1999.
- In November 1998, the legislation was amended so as flax and hemp had to be declared under the IACS and controls and penalties became tighter.
- In November 1999, the Commission made a new proposal for a reform in this sector, which was eventually adopted by the Council in July 2000 and will enter into force in July 2001.

(54) OJ C 340, 12.11.1996.

(55) Control Report (17-21 July 1995) 31.1.1996.

(56) Report on the flax production and processing industry in Spain (11 and 12 June 1997), 97/2358a.

(57) Audit report (27-31 July 1997), 26.11.1998.

(58) It was even established that, between 1994 and 1996, it was not possible to process any of the flax straw produced, since Spain did not possess the requisite processing capacities. The flax straw appears to have subsequently been processed into fibre, but this was not marketed because there were no sales outlets for it. Moreover, the yields recorded were substantially less than those of the traditional producer countries and the quality of fibre obtained was very mediocre.

(59) 10 % of the expenditure declared by Spain under budget item 1400 for the financial years 1994 (PTA 2,3 million) and 1995 (PTA 40,4 million).

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for flax straw. As early as 1996, the Commission decided to propose amendments to the regulations in force at that time. It attempted to put in place a maximum guaranteed area system, which would have meant that surface areas could be limited, but this proposal was not adopted by the Council. As from the 1997/1998 marketing year, the granting of aid became conditional on the purchaser or the producer providing an undertaking to process, and all processors had to be approved. By late 1998, it was clear to DG AGRI that the common organisation of the markets (COM) in flax and hemp required a complete overhaul in order to counter the abuses detected in the field, particularly in Spain but also, to a lesser degree, in other Member States. However, the only immediate measure taken was to set, with effect from the 1998/1999 marketing year, a minimum flax straw yield per hectare which varied according to the harvesting method used. None of these provisions had any effect either: surface areas continued to increase, and flax straw was processed but was not marketed.

2.81. In 1999 some stocks of flax straw and fibre were destroyed by unexplained fires, and the same thing happened again in 2000. These events were symptomatic of serious irregularities in Spain. In July 1999, at the request of OLAF (European Anti-fraud Office), the Spanish public prosecutor responsible for the prevention of fraud opened a criminal investigation into the matter.

2.82. The clearance of accounts unit of the Commission did not conduct another audit in Spain but, on the basis of meetings and information obtained from the Spanish authorities, it suggested that, pursuant to Article 4(3) of Council Regulation (EC) No 2988/95 on the protection of the European Communities' financial interests, a flat-rate correction of 10 % of the expenditure declared by Spain in the financial years 1996 to 1998 (7,2 million euro) be applied for premium hunting. The letter of notification of the correction, submitted in March 2000 to the Commission's legal service, has not yet been sent. In April 2001, the legal service stated that it could not give its approval to the correction because all the conditions stipulated in the regulation had been fulfilled, which was true, and the correction could not be made on the basis of criteria that had been 'added as afterthoughts' to the regulations. Moreover, by virtue of the 24-month time limit, a correction could only relate to expenditure disbursed from July 1997 onwards, because the letter of notification of findings was sent to the Spanish authorities in July 1999.

2.83. In July 2000, the clearance of accounts unit conducted an audit concerning the management of the measure in Spain, and in particular controls on

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*The problems of the flax sector in Spain became notorious after several fires of stocks of non-processed and processed flax had occurred (in April and May 1999) at the premises of processing companies leading to suspicion of fraud. In consequence the control bodies of the Spanish autonomous regions made a comparison between the total declared production of flax for the producers delivering to these processors and the technical capacity of the processors which revealed many inconsistencies. For the financial years 1996 to 1998 the clearance of accounts procedure is still ongoing. For 1999 the financial correction will take into account the findings of an investigation which OLAF launched in 2000. Therefore, in October 1999 the Spanish authorities (FEWA — as coordinating body of the paying agency of the autonomous regions) asked for further time (until 30 April 2000) to pay the aid as they had to do further checks on several 'cases of presumed irregularities'. The Commission granted the extension.*

*DG AGRI undertook an audit mission in June 2000 together with DG AUDIT (FEWA and Castile-Leon) in order to verify expenditure in the marketing year 1998/1999. At the same time OLAF performed several audit missions in Spain dealing with the presumed fraud cases. In December 2000 the Spanish 'Fiscalia Anticorrupcion' informed OLAF of the conclusions of the inquiry. OLAF finalised its report in March 2001. The clearance of accounts procedure is currently ongoing on the basis of these findings. The Commission would like to recall that the 24-month limitation for financial corrections does not apply to the financial consequences of irregularities and negligence attributable to administrative authorities or other bodies of the Member States (Article 8(2) of Regulation (EC) No 1258/1999). Therefore the Commission considers the conclusions of the Court as regards the loss to the EAGGF premature.*

*The Commission decided on a 10 % correction for weaknesses in the control system for 1994 and 1995. For the financial years 1996 to 1998 the clearance of accounts procedure is still ongoing. For 1999 the findings of the OLAF investigation will be the basis for a financial correction. Therefore the Commission considers that the weaknesses discovered in Spain are and were addressed adequately by the Commission. As explained above (points 2.84 to 2.91) the Commission made efforts to propose changes to the regulation as early as February 1996, but these were rejected by the Council.*

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processors. During this audit, it became apparent that the Spanish authorities had not communicated in good time<sup>(60)</sup>, the significant irregularities that had come to light at the time of the controls. This observation might have been made a lot earlier and could have served as a firm legal basis for corrections for the financial years 1996 to 1998. Moreover, by virtue of the 24-month time limit, a correction for this omission could only relate to expenditure disbursed from March 1999 onwards (the letter of notification of findings having been sent to the Spanish authorities in March 2001).

2.84. As a result of the combined effects of particularly weak regulations, indifference to the Court's recommendations, insufficient follow-up by the Commission, premium hunting related to flax aid was the order of the day in Spain between 1994 and 2000 and there are indications that serious irregularities could have become widespread. Had the regulatory provisions been adequate, much of the aid to Spain (around 180 million euro) need not have been paid for the EAGGF years 1994 to 2000 (see also paragraph 2.76).

*Financial decision for 2000***Late submission of documents and payment data**

2.85. The certifying body reports and accounts for four paying agencies — Région Wallonne (Belgium), FEGA (Fondo Español de Garantía), Navarra and La Rioja (Spain) — were submitted after the deadline of 10 February 2001. One paying agency (FEWA) was not able to produce the accounts on time due to a failure of the FAUDIT-ED (Public Storage data system) hardware supplied by the Commission. The other delays were due to a failure to dedicate adequate resources to the certification. Nevertheless, these documents were available in time for the Commission to take its decision.

2.86. However, by the time of the consultation with Member States, 19 paying agencies had failed to provide the Commission with the individual payment data required under Community legislation<sup>(61)</sup>.

<sup>(60)</sup> Article 6(2) of Regulation (EEC) No 1164/89.

<sup>(61)</sup> Commission Regulation (EC) No 2390/1999 (OJ L 295, 16.11.1999, p. 1).

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Consequently, the Commission proposed to disjoin<sup>(62)</sup> the accounts of these paying agencies from the decision. In the event two paying agencies provided the data immediately. The decision was taken on 8 May and all the expenditure in respect of 17 paying agencies (7 490 million euro) was disjoined.

2.87. The fact that paying agencies failed to provide certain payment data does not call into question whether the accounts are 'true, complete and accurate'<sup>(63)</sup>. The Court considers that these are not grounds for disjoining expenditure. The Commission should find alternative means to oblige Member States to submit the required data on time and should avoid delays in taking the financial decision.

**2.87.** Member States are required by the regulations to supply individual payment data to the Commission. Two Member States did not send the required information. This affects the effectiveness of the overall clearance process as certain checks cannot be carried out, or cannot be carried out fully, in those Member States. It is manifestly unfair on those Member States that have sent the necessary data. The Commission therefore felt that it was wrong to accept the accounts of paying agencies that had failed to provide individual payment data.

Nevertheless, the Commission notes the Court's comments and will consider carefully the action it should take in the future in similar cases.

#### Qualification of accounts and corrections made

2.88. Certifying bodies are required to obtain an overall confidence level of 95 %. Most did so from substantive testing alone, but some reduced the level of assurance required from substantive testing to 70 % and obtained the balance of assurance from other sources<sup>(64)</sup>. Statistical sampling (MUS — monetary unit sampling) was used for the vast majority of account testing<sup>(65)</sup>. The overall conclusion is that the level of error detected by the certifying bodies in the paying agencies' accounts<sup>(66)</sup> in 2000 did not exceed 1 % (412 million euro) of the total declared. Six paying

<sup>(62)</sup> A disjunction is a formal decision. It has no financial implication. The disjoined expenses will be cleared later, after additional work or information is provided to the Commission.

<sup>(63)</sup> Article 3(1) of Commission Regulation (EC) No 1663/95 (OJ L 158, 8.7.1995, p. 6).

<sup>(64)</sup> See Special Report No 22/2000, paragraph 39 (OJ C 69, 2.3.2001).

<sup>(65)</sup> See Special Report No 22/2000, paragraphs 33 to 35.

<sup>(66)</sup> See Special Report No 22/2000, paragraph 24.

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agencies — Région Wallonne (Belgium), Baden-Württemberg (Germany), Navarra (Spain), SDE (Service déconcentré de l'Etat, France) and Ofival (Office Interprofessionnel des Viandes, France) and Ifadap (Instituto de Financiamento e Apoio ao Desenvolvimento da Agricultura e Pescas, Portugal)— had material levels of error.

2.89. In total the accounts of 23 paying agencies were qualified by the certifying bodies (see **Table 2.5**). Many of these qualifications were of a minor technical nature, but amounts of 89 million euro were identified for 10 paying agencies. If the paying agency takes appropriate action to remedy the weaknesses found and to recover overpayments, the Commission does not impose corrections.

2.90. The total value of corrections made based on the certification of the accounts is 3,2 million euro. With regard to corrections based on the results of statistically determined samples, the Commission's policy is to correct for the most likely error (MLE). The correction should be based on the MLE extrapolated from the overpayments only, and it should be made clear to the certifying bodies that underpayments should be excluded<sup>(67)</sup>. The corrections based on the MLE have not been included in the financial decision and will be made during the conformity process (some 35 million euro). They should have been made in the financial decision.

#### Accreditation concerns

2.91. The accounts of the SDE (France) have been qualified for the third successive year. Notwithstanding past criticisms, the French authorities gave temporary responsibility<sup>(68)</sup> for the rural development measures to the SDE. Expenditure under the rural development measures was 187 million euro, of which 8,9 million euro has been qualified. The certifying body qualified a total of 43 million euro (4,69 % of the expenditure declared)

**2.90.** *The Commission notes the Court's comments that corrections based on extrapolation of errors should have been made in the accounting clearance. It will carefully consider whether the current regulatory framework permits this to be done in the future.*

<sup>(67)</sup> Commission Guideline No 8 refers only to overstatements when calculating the MLE.

<sup>(68)</sup> From 2001 CNASEA will be responsible for rural development measures.

Table 2.5 — Paying agencies by expenditure declared in 2000

No	Member States	Paying agency	Amounts declared in Mio EUR (1)	% of total	Qualified accounts (2)
1	I	AGEA	5 077,38	12,32	
2	F	ONIC	4 302,99	10,44	x
3	EL	Gedidagep (3)	2 611,06	6,34	x
4	UK	MAFF	2 281,53	5,54	
5	IRL	DAF	1 628,21	3,95	
6	E	Andalucía (3)	1 598,26	3,88	
7	DK	EU-Direktoratet	1 336,59	3,24	
8	F	ONIOL	1 094,91	2,66	
9	F	SDE	919,59	2,23	x
10	A	AMA	904,33	2,19	
			<b>21 754,85</b>	<b>52,80</b>	
11	D	Bayern Landwirtschaft	836,13	2,03	
12	D	Hamburg-Jonas	801,22	1,94	
13	F	Onilait	797,00	1,93	
14	E	Castilla y León (3)	757,05	1,84	
15	S	SJV	751,42	1,82	
16	SU	MMM	727,56	1,77	
17	UK	IBEA	707,01	1,72	
18	F	Ofival	700,57	1,70	x
19	E	Castilla La-Mancha (3)	664,13	1,61	
20	B	BIRB	663,38	1,61	
21	E	FEGA	601,97	1,46	
22	D	Niedersachsen	596,57	1,45	x
23	F	FIRS	564,18	1,37	
24	D	BLE	550,20	1,34	
25	P	INGA	538,03	1,31	x
26	UK	SERAD	535,70	1,30	
27	NL	PZ	522,48	1,27	
28	E	Extremadura (3)	504,80	1,23	
29	NL	HPA	445,78	1,08	x
30	E	Aragón (3)	381,41	0,93	
31	D	Baden-Württemberg	375,76	0,91	x
32	D	Mecklenburg-Vorpommern	356,48	0,87	
33	D	Brandenburg	341,70	0,83	
34	D	Sachsen-Anhalt	339,04	0,82	
35	I	DCCC	319,82	0,78	
36	D	Sachsen	289,41	0,70	x
37	UK	WOAD	282,66	0,69	
38	B	Ministerie van Landbouw (DG3)	277,02	0,67	
39	F	CNASEA	275,46	0,67	
40	NL	LASER	266,18	0,65	
41	D	Nordrhein-Westfalen LWK Munst	250,68	0,61	
42	D	Schleswig-Holstein	248,50	0,60	x
43	E	Cataluna (3)	248,19	0,60	x
44	D	Thüringen	242,17	0,59	x
45	F	Oniflhor	230,75	0,56	x
46	UK	DARD	226,18	0,55	
47	D	Hessen	184,19	0,45	x
48	F	Onivins	174,56	0,42	x
49	D	Rheinland-Pfalz	150,21	0,36	x
50	E	Canarias (3)	142,45	0,35	
51	P	IFADAP	135,49	0,33	
52	F	Odeadom	135,16	0,33	
53	I	ENR	127,86	0,31	
54	E	Valencia (3)	125,23	0,30	
55	E	Navarra (3)	114,05	0,28	x
56	D	Nordrhein-Westfalen LWK Bonn	92,81	0,23	
57	E	Galicia (3)	87,41	0,21	
58	NL	PVE	82,24	0,20	
59	E	Murcia (3)	81,49	0,20	
60	A	ZA Salzburg	70,84	0,17	x
61	IRL	DMNR	53,08	0,13	x
62	NL	DLG	50,96	0,12	
63	E	Madrid (3)	45,64	0,11	
64	A	BMLFUW Pras B10	42,15	0,10	
65	NL	PT	41,67	0,10	
66	E	Asturias (3)	41,17	0,10	
67	E	Pais Vasco (3)	38,87	0,09	
68	E	La Rioja (3)	29,13	0,07	
69	F	SAV	27,87	0,07	
70	L	Ministère de l'agriculture	20,64	0,05	
71	E	Baleares	18,55	0,05	
72	E	Cantabria (3)	18,50	0,04	
73	D	Bayern, St MLU	16,80	0,04	
74	D	Saarland	15,20	0,04	x
75	UK	FC	13,52	0,03	
76	B	Vlaamse Gemeenschap	9,27	0,02	
77	D	Hamburg	9,17	0,02	
78	F	Ofimer	8,32	0,02	
79	D	Nordrhein-Westfalen LfBj	7,93	0,02	
80	B	Organisme payeur de la Région wallone	5,57	0,01	x
81	D	Nordrhein-Westfalen LfA	2,88	0,01	x
82	UK	CCW	2,63	0,01	
83	D	Berlin	1,88	0,00	
84	A	BMLF Abt VI. B.8 (Wein)	1,37	0,00	
85	D	Bremen	1,24	0,00	
86	E	FROM	0,36	0,00	
		<b>Total</b>	<b>41 199,78</b>	<b>100,00</b>	<b>23</b>

(1) It should be noted that some of the Member States do not automatically deduct any negative amounts under the budget item B1-3 7 0 0 (clearance of accounts) from the amounts they declare. However, the amounts shown in this table are the amounts actually declared by the Member States.

(2) Account qualified because of financial errors, scope restrictions or other reserves.

(3) Disjoined from the financial decision of 8 May 2001.

NB: Exchange rates for Member States outside euro zone:

Denmark: 7,4619, Greece: 340,75, Sweden: 9,0455, United Kingdom: 0,6156.

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and concluded that the SDE fails to meet key accreditation criteria, is not viable and is unauditible. Both the Court and the Commission<sup>(69)</sup> are of the opinion that the French authorities should withdraw the accreditation from SDE. Failure to do so should result in the reduction of advances.

2.92. For the Région Wallonne, simplified accreditation procedures have been applied since 1996. Given the increase in expenditure managed by this paying agency the Commission has demanded an accreditation review.

2.93. In general, the situation with regard to debtors remains unsatisfactory with particular concerns in respect of Valencia (Spain), DCCC (Direzione Compartmentale delle Contabilità Centralizzate) and AGEA (Agenzia per le Erogazioni in Agricoltura — Italy) and Welsh Office (United Kingdom). The total value of reported debt is 2 014 million euro. OLAF's progress in recovering debts has been limited. The total debt outstanding according to OLAF data is 2 210 million euro. It is not possible to reconcile this amount with the total reported by the paying agencies because the latter is not confined to communications under Regulation (EEC) No 595/91 and there are timing differences. OLAF has undertaken an exercise to clear all debt registered prior to 1995. The amount concerned is 944 million euro. With a view to making corrections in the conformity decisions, OLAF must notify (under Article 8 of Regulation (EC) No 1663/95) the Member States concerned of the amounts it intends to charge them and what can be written-off against the EAGGF. As at June 2001, OLAF had notified 10 Member States of its intention to propose a clearance of accounts decision charging 5,5 million euro to them and writing-off 63 million euro. Italy, which has the largest share of reported debt (68 %) was informed that 67 million euro might be written off while an amount of up to 331 million euro might have to be charged to the national budget. The first conformity decision to include corrections for debts charged to Member States is unlikely to be taken before the end of 2001.

**2.92.** *A full accreditation review of the paying agency for the Walloon Region has now been carried out. The certifying body considers, in its conclusions, that the structure of the paying agency has been improved and is in compliance with the EU legislation*

**2.93.** *The clearance of accounts unit has taken several initiatives to examine the management of debts held by the paying agencies and is carrying out a further enquiry in 2001. It is accepted that the situation with regards to debtors remains unsatisfactory at many agencies, but many improvements have been made. Better management of debts is a major priority for the clearance of accounts unit.*

<sup>(69)</sup> See Annual Report 1999, paragraph 2.66 (OJ C 342, 1.12.2000) and Special Report 22/2000, paragraph 18 (OJ C 69, 2.3.2001).

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2.94. The certifying bodies for the majority of the German paying agencies were not 'operationally independent of the paying and coordinating agencies' (63). Following a request from the Commission this problem has been addressed by the German authorities and all the certifying bodies should be independent by the time they carry out the 2001 certification.

2.95. The Annex to Commission Regulation (EC) No 1663/95 states that 'no payments shall be made in cash' (70). In Greece, most farmers are effectively paid in cash. Although they receive a cheque, if there is no bank in or near the village where they live, they endorse the cheque in favour of the cooperative whose representative cashes it at a bank. He distributes the cash to the farmers who are supposed to sign the payments listing to indicate that they have been paid. Amounts of less than DRA 100 000 are paid directly in cash. The audit trail disappears the moment the cheques have been cashed.

2.96. The Greek authorities recognise the weaknesses associated with this system and have undertaken to introduce payment by bank transfer but little action has been taken. The Commission has informed the Greek authorities of the need to introduce direct payments for all schemes for the next marketing year and has threatened to impose financial penalties if they fail to do so. The steps taken by the Commission are essential to provide an adequate audit trail.

### Conclusion

2.97. Despite the introduction of the reformed clearance of accounts procedure in 1996, the Commission continued to find some significant weaknesses in the underlying systems during the course of its conformity audits covering expenditure in the EAGGF years 1996, 1997 and 1998 (see also paragraphs 2.17 to 2.19 concerning reductions in advances). In the Court's opinion, in some instances, the Commission should have applied higher flat-rate corrections in the conformity decisions which as a result should have been higher (see paragraphs 2.61, 2.64 to 2.70 and 2.72). The financial decision should have been taken on time, the fact that

*2.97. As the Court stated in Special Report No 22/2000 and in point 2.194, the reform has increased transparency in the Member States and has been a considerable achievement. The Commission is convinced that the reform of the clearance procedure, together with other developments such as the IACS have considerably reduced the risk to Community budget. It believes it has applied flat-rate corrections in accordance with the fourth subparagraph of Article 7(4) of Regulation (EC) No 1258/1999 and document VI/5330/97. As explained in point 2.55, when making financial corrections, the Commission takes into account all the elements of the guidelines and does not base itself only on a summary of criteria.*

(70) The text in the French version of the regulation is incorrect: 'no payment shall be made immediately'.

## THE COURT'S OBSERVATIONS

paying agencies failed to provide details of individual payments is not sufficient grounds for disjoining expenditure. Moreover, despite repeated observations by the Court, weaknesses in legislation governing flax were not remedied until major irregularities had been discovered. Had the regulatory provision been adequate, much of the aid to Spain and the United Kingdom, around 195,5 million euro, need not have been paid for the EAGGF years 1994 to 2000 (see paragraphs 2.76 and 2.84).

## COMMISSION'S REPLIES

*The disjunction of expenditure by certain paying agencies complies with Article 4(6) of Regulation (EC) No 1258/1999, Article 2(1) of Regulation (EC) No 1663/95 and Regulation (EC) No 2390/1999.*

*As for flax in Spain, the Commission decided on a 10 % correction for weaknesses in the control system for 1994 and 1995. For the financial years 1996 to 1998 the clearance of accounts procedure is still ongoing. For 1999 the findings of the OLAF investigation will be the basis for a financial correction. Therefore the Commission considers that the weaknesses discovered in Spain are and were addressed adequately by the Commission. As explained above (points 2.84 to 2.91) the Commission made efforts to propose changes to the regulation as early as February 1996, but these were rejected by the Council.*

## FOLLOW-UP OF PREVIOUS OBSERVATIONS

*Physical checks of agricultural products receiving export refunds*

2.98. In its Special Report No 20/98 (71) the Court made recommendations aimed at improving the framework for the control of export refund transactions. The main recommendations related to:

- the more effective use of risk analysis for the selection of export consignments for physical checks,
- the recording, evaluation and reporting of the results of such checks,
- the introduction of a strategic planning approach tailored to the type of product exported,
- the need to test products systematically for sound and fair marketable quality,
- the desirability of making risk analysis obligatory and extending this to cover all measures and regimes affecting the EU budget, thus enabling Member States to allocate their resources more effectively.

(71) Special Report No 20/98 (OJ C 375, 3.12.1998) (hereinafter called 'SR No 20/98').

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.99. The report also called upon the Commission to speed up the follow-up of deficiencies it had detected in the Member States' systems.

2.100. The following paragraphs detail the consideration by the European Council and Parliament of those recommendations and the Commission's actions in response.

#### **The Council of the European Union's recommendations**

2.101. The Council of the European Union, in its Agri-fin Group report of 5 February 1999 on the Court's Special Report No 20/98, accepted the Court's main observations and recommended that the Commission adopt the following measures:

- (a) the Commission should bring together the relevant data about practices in the Member States with the objective of improving the quality of controls throughout the Community by sharing experience;
- (b) the improvement of controls should be pursued as appropriate through analyses presented in the Trade Mechanisms Committee, which should also reflect the practices of the Directorate-General concerned and of OLAF;
- (c) the intensity of physical controls over export refund transactions should be determined on the basis of a prudent risk analysis, with lighter controls applied to standard and less risky products.

#### **The European Parliament's proposals**

2.102. In its report of 4 March 1999 on the granting of discharge for the financial year 1997, the European Parliament agreed with the Court's main observations and invited the Commission:

- (a) to improve coordination between physical checks and a posteriori controls<sup>(72)</sup> in the context of an appropriate legal framework, as suggested by the

#### **2.102.**

- (a) *The following indents should be added:*

- *by requiring Member States to submit annual evaluations of the execution and effectiveness of physical checks (SR No 20/98, paragraph 4.4, sixth indent),*

<sup>(72)</sup> Council Regulation (EEC) No 4045/89 (OJ L 388, 30.12.1989, p. 18).

## THE COURT'S OBSERVATIONS

Court. For the sake of efficiency, such coordination should prevail over considerations relating to subsidiarity;

(b) to pay greater attention to the effectiveness of the procedures for the selection of consignments for physical checks;

(c) to make it obligatory for the Member States to use risk analysis and to submit annual evaluations of the implementation and effectiveness of the checks;

(d) to impose systematic testing of the marketable quality of all samples submitted for laboratory analysis.

## COMMISSION'S REPLIES

— *by permitting, for those Member States having opted for risk analysis, a reduction in the level of laboratory testing where positive assurance is available from repeated satisfactory results (SR No 20/98, paragraph 4.4, ninth indent)*.

**The Commission's follow-up of the Court's observations**

2.103. The Commission has responded positively to some of the Court's observations and recommendations:

- by applying financial corrections<sup>(73)</sup> totalling 188 million euro on various Member States which had not complied with stipulations concerning physical checks<sup>(74)</sup> (**Table 2.6**) (SR No 20/98, paragraph 2.6),
- by informing Member States about the use of risk analysis via the Trade Mechanisms Committee (SR No 20/98, paragraph 4.4, third indent),

<sup>(73)</sup> Commission Decision 2000/216/EC of 1 March 2000 excluding from Community financing certain expenditure incurred by Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF) (OJ L 67, 15.3.2000, p. 37) and Commission Decision 2000/449/EC of 5 July 2000 excluding from Community financing certain expenditure incurred by Member States under the Guarantee Section of the European Agricultural Guidance and Guarantee Fund (EAGGF) (OJ L 180, 19.7.2000, p. 49).

<sup>(74)</sup> Council Regulation (EEC) No 386/90 of 12 February 1990 on the monitoring carried out at the time of export of agricultural products receiving refunds or other amounts (OJ L 42, 16.2.1990, p. 6).

**Table 2.6 — Total corrections made following Commission Decisions No 2000/216/EC and No 2000/449/EC**

Financial year	Member State	Sector	Budgetary item	Reasons	Financial consequences (EUR) <sup>(1)</sup>
1996-1998	Belgium	Export refunds	2100	Non-compliance with the minimum check rate in the beef/veal sector	186 173
1996-1998	Denmark	Export refunds	Various	Shortcomings in the quality of the checks made by customs	29 077 014
1996-1998	Germany	Export refunds	Various	Non-compliance with the minimum check rate, shortcomings in the qualitative checks	21 872 394
1996-1998	Greece	Export refunds	Various	Shortcomings in the quality of the checks made by customs	1 031 894
1996-1998	France	Export refunds	Various	Shortcomings in the quality of the checks made by customs	99 083 770
1996-1998	Italy	Export refunds	Various	Non-compliance with the check rates, shortcomings in the quality of the checks made by customs	31 847 349
1996-1998	Luxembourg	Export refunds	Various	Shortcomings in the quantitative checks (weighing)	5 466
1996-1998	United Kingdom	Export refunds	Various	Shortcomings in the quality of the checks in the cereals sector	5 171 461
<b>Total</b>					<b>188 275 521</b>

<sup>(1)</sup> Correction equivalent to 5 % of the total expenditure on financing export refunds for agricultural products for all countries except Luxembourg, for which there was a correction equivalent to 2 % of the total expenditure on financing export refunds for agricultural products.

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- by asking Member States to apply a uniform classification of the risks attached to different goods (SR No 20/98, paragraph 4.4, fourth indent),
- by encouraging the Member States to incorporate into their national risk analysis system a monitoring and feedback system to ensure that targeted checks are carried out or satisfactory explanations for not doing so are recorded (SR No 20/98, paragraph 4.4, fifth indent),
- by permitting, for those Member States having opted for risk analysis, a reduction in the intensity of checks over standard goods<sup>(75)</sup> and at customs offices concerned only with few operators and a limited range of goods<sup>(76)</sup> (SR No 20/98, paragraph 3.7),
- by obliging Member States to make annual evaluations of their execution of physical inspections (SR No 20/98, paragraph 4.4, sixth indent).

2.104. However, there has been a lack of action on other points raised by the Court in that the Commission:

- has not proposed a requirement for the routine testing<sup>(77)</sup> by customs laboratories of sound and fair marketable quality of exports of agricultural products at the time of export (SR No 20/98, paragraph 4.4, eighth indent),

**2.104.**

Article 5(5) of Regulation (EC) No 2221/95 was introduced by Regulation (EC) No 2655/1999. However, routine testing of all aspects of soundness of all samples taken under Regulation (EEC) No 386/90 by laboratories designated for customs checks would be impossible in some cases (e.g. hormones in meat and glycol in wine).

<sup>(75)</sup> Commission Regulation (EC) No 2221/95 of 20 September 1995 laying down detailed rules for the application of Council Regulation (EEC) No 386/90 as regards physical checks carried out at the time of export of agricultural products qualifying for refunds (OJ L 224, 21.9.1995, p. 13).

<sup>(76)</sup> Commission Regulation (EC) No 2655/1999 of 16 December 1999 amending Regulation (EC) No 2221/95 laying down detailed rules for the application of Council Regulation (EEC) No 386/90 as regards physical checks carried out at the time of export of agricultural products qualifying for refunds and amending Regulation (EC) No 3122/94 laying down criteria for risk analysis as regards agricultural products receiving refunds (OJ L 325, 17.12.1999, p. 12).

<sup>(77)</sup> This would apply to all samples taken under Article 3(3) of Council Regulation (EEC) No 386/90.

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- has not considered creating a legal framework providing for the best combination of physical and a posteriori controls (SR No 20/98, paragraph 4.1),
- has not evaluated the effectiveness of arrangements for selecting goods for physical inspection (SR No 20/98, paragraph 4.3),
- has not made proposals to render compulsory the use of risk analysis, given that Greece and Italy were not in a position to implement risk analysis owing to lack of computerisation (SR No 20/98, paragraph 4.4, first indent),
- has not sought to oblige Member States to notify physical inspection strategies annually, including rates of inspection differentiated by assessed risk (SR No 20/98, paragraph 4.4, second indent),
- has not obliged Member States to compile specific databases of export refund irregularities (SR No 20/98, paragraph 4.4, seventh indent).

## COMMISSION'S REPLIES

*Member States have been invited to describe in the annual report the measures which have been taken in order to improve coordination with Regulation (EEC) No 4045/89. The Commission will examine with Member States how to better combine the control efforts at the moment of export and a posteriori.*

*Within the framework of the clearance of EAGGF accounts, audit visits were carried out in different Member States in 1999 and 2000 in order to evaluate specific customs procedures. During these audits some attention was given in some Member States to the topic of the selection of controls for physical inspection. In the future this aspect will be taken more into account in the annual reports.*

*Because of the criticisms of some Member States (e.g. Greece, which is not in a position to apply a system of risk analysis because of the lack of a computer system) risk analysis was at least not made compulsory. However, in order to push Member States to introduce such a system, the simplifications of Article 5a of Regulation (EC) 2221/95 (e.g. reduction of the control rate for NA-I products) applies only in those Member States which use a system of risk analysis.*

*Following the remarks of several Member States, some flexibility is required where physical checks are concerned. It is sometimes necessary to amend strategic programmes in the course of the year in order to adapt new circumstances.*

*Regulation (EEC) No 595/91 requires the Member States to communicate to the Commission a list of irregularities which have been the subject of primary or judicial findings of fact. OLAF is currently making available an application which will allow Member to establish and communicate the cases of irregularity in electronic format. The output will enable Member States also to create their own database with all the information about these cases, including the information as proposed by the Court of Auditors.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.105. The Commission has partially followed the Court's recommendations. With regard to improving checks, its approach has largely been to make this an option rather than an obligation, by inviting Member States to use risk analysis.

2.106. In order to improve the effectiveness of customs checks, the above recommendation, to make the application of risk analysis obligatory, still needs to be extended to all the areas of checks with a financial impact on the EU budget (78).

**2.106.** *The Commission agrees with the Court of Auditors that risk analysis needs to be extended to all areas of checks with a financial impact on the EU budget. Following the Customs 2000 seminar held with the Member States to examine risk analysis, the Commission has been working with them on a risk analysis implementation plan covering the risk management process. This plan is now being implemented. Expected results include:*

- *harmonised model for risk management process,*
- *inventory of risk parameters for economic operators,*
- *risk information exchange form to enable the Member States to exchange information rapidly.*

*Given the Commission's opinion on the risks inherent in introducing risk analysis via legislation across a wide range of controls, it has concentrated on this question via the above-mentioned implementation plan.*

## *Common organisation of the market in sheepmeat and goatmeat*

### **Introduction**

2.107. The common organisation of the market (CMO) in sheepmeat and goatmeat was introduced in 1980. The payment of an annual premium to producers is its main measure. There have been no major changes to the regime since the introduction of individual limits on premium rights in the 1993 marketing year.

(78) Forward (point 5) of Special Report No 13/98 concerning the use of risk analysis techniques in customs control and the clearance of goods and Special Report No 20/98 on the audit of physical checks of agricultural products receiving export refunds (OJ C 375, 3.12.1998).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

2.108. Annual budgetary expenditure has fluctuated considerably (2 210 million euro in 1993, 1 425 million euro in 1997, 1 894 million euro in 1999). The main factor which determined expenditure was the level of market prices, while the number of animals on which premiums were paid, in the 1993 to 1999 period, has been stable at about 72,5 million.

2.109. For the period 1993 to 1998, sheepmeat and goatmeat gross indigenous production and consumption were almost stable at an average of 1,14 and 1,36 million tonnes respectively. The Community has, therefore, a self-sufficiency rate of about 84 %, and the supply deficit is met by imports from third countries. The Commission does not have a stated position on the desirable level of EU production, but limits on the individual premium rights effectively act as a constraint on indigenous production.

2.110. On 16 May 2001 the Commission announced what it termed 'a simpler and more market oriented sheepmeat regime' and made a proposal for a new Council Regulation (79).

**2.109.** *The overall stability of the sheepmeat market and the balance that exists between domestic supplies and imports on the one hand and consumption on the other demonstrates that production in the Community is at an appropriate level.*

**2.110.** *Prior to drawing up its reform proposal the Commission undertook an evaluation of the regime. The Commission presented its proposal on the basis of this study and its own reflections on the operation of the ewe premium scheme in particular.*

#### The Court's audit

2.111. The management aspects of the sheepmeat and goatmeat CMO were reviewed at the Commission and in six main producer Member States (80) which together account for over 90 % of relevant expenditure. The objective of the Court's audit was to examine the current operation of the premium scheme and to verify the extent to which the issues previously identified continue to persist. The Court also examined the extent to which the latest proposal addressed the problems identified during the audit.

2.112. The results of the Court's last audit work on this market, covering the period up to the 1992/1993 marketing years, were published in Special Report No 3/95 (81). The Court, in this report, was particularly critical of the lack of clear objectives for the CMO, the mechanism used to determine the amount of the premium and the system used for collecting prices.

(79) COM(2001) 247 final.

(80) Greece, Spain, France, Ireland, Italy and the United Kingdom.

(81) OJ C 285, 28.10.1995.

## THE COURT'S OBSERVATIONS

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**Performance is not measured**

2.113. The overall goals of the CMO set out in Article 39 of the Treaty include, in particular, market stability and a fair standard of living for the agricultural community concerned<sup>(82)</sup>. In this context, Council Regulation (EC) No 2467/98<sup>(83)</sup> provides compensation for 'loss of income'. Although the Commission has services and statistical sources which measure income and farm activity, it has not transformed the abovementioned goals into specific objectives for the sector nor has it defined any indicators against which the achievement of objectives and performance could be measured.

**Defective system for setting prices and premium**

2.114. For the ewe premium scheme a basic price and a weighted average market price for the Community are determined. A premium is granted when the average market price is below the basic price and it is calculated as the difference between these two figures. It aims to compensate producers for a notional loss of income.

2.115. Since 1989 until the provisions were changed by Council Regulation (EC) No 1669/2000<sup>(84)</sup>, the basic price was required to be fixed annually by the Council on a proposal from the Commission taking account of factors such as the situation in the market, production and consumption prospects, production costs, the situation in the other livestock sectors and past experience. No evidence was provided by the Commission of the extent to which these factors were considered, if at all. In fact, the basic price of 504,07 euro per 100 kg of carcass weight has not changed for the last six years and is maintained for 2001 and the following years despite the numerous changes in the factors which should influence this price. The Commission was unable to provide any information as to how the basic price was calculated.

**2.113.** *The lamb price is a market indicator and the 'income loss' is an attempt to create a very simple derived indicator that gives information about the level to which the income falls. There are some income indicators in the statistical systems but they are very difficult to use since their estimates are not available at the end of the marketing year when farmers need the premium payment.*

**2.115.** *The Commission regularly prepares reports on the situation and development of agricultural activities in the Community, which normally includes the income of sheep farmers. This is done using income indicators coming from both FADN (Farm Accountancy Data Network) and Eurostat. Those reports are taken into account when examining any amendments to agricultural policy.*

*The function of the basic price in so far as setting the premium is concerned is to provide a basis for calculating a level which can ensure a reasonable income for producers. Furthermore, when fixing the basic price, account is taken of budgetary constraints, which in recent years have restricted any possible increase in expenditure.*

<sup>(82)</sup> Third recital of Council Regulation (EC) No 2467/98 of 3 November 1998.

<sup>(83)</sup> OJ L 312, 20.11.1998, p. 1.

<sup>(84)</sup> OJ L 193, 29.7.2000, p. 8.

## THE COURT'S OBSERVATIONS

2.116. In the Member States audited, the systems for collecting, recording and transmitting market prices to the Commission were examined. These prices are the basis for determining the Community average market price and consequently the level of Community support. A number of weaknesses and inconsistencies were found which call into question the reliability of the system and the accuracy of the data used:

- (a) the weighting coefficients given to the various representative markets and the categories of lamb used for price reporting, both of which are fixed by Regulation, do not reflect the actual situation and prevailing selling patterns <sup>(85)</sup> in the Member States; Community expenditure would be reduced if market prices were collected for representative weight categories and if coefficients reflecting throughput were applied <sup>(86)</sup>;
- (b) in the Member States visited, there was little evidence in support of the criteria used in selecting the representative markets and the weighting coefficients; furthermore, the absence of adequate documentary evidence of how prices were calculated was found to be an inherent weakness in the system; national authorities do not check or review regularly the source and accuracy of data supplied to them;
- (c) in Greece, Spain and Italy, the weight categories of lamb used for price reporting (provided for in the Regulation) are not representative of the market and

## COMMISSION'S REPLIES

**2.116.** The Commission has evaluated the problem of price reporting and has come to similar conclusions to the Court. In order to obtain a truly representative price the relative importance of the throughput on the various markets over time should be weighted. Whilst it may be more accurate, a system of this sort could only be made to work if up to date detailed information on slaughterings were available. Such an approach would render the regime far more bureaucratic than it is at present, thereby increasing administrative costs.

*The point made under (c) with regard to weight categories highlights one of the difficulties of obtaining comparable price information. For this reason the notion of standard quality was established.*

<sup>(85)</sup> Lamb is sold in different ways, for example, in live markets, directly to abattoirs, to dealers at the farm gate and to cooperative organisations. Not all of these practices are recognised in the Regulation. Furthermore, the coefficients applied to the markets which are stipulated in the Regulation do not always reflect throughput. For instance, in the United Kingdom the Regulation applies a weighting coefficient of 97 % to live markets and 3 % to the abattoirs. During the audit it was stated that 50 % of lamb is sold in the live markets and 50 % is sold directly to the abattoirs.

<sup>(86)</sup> On the basis of a sample of weeks randomly selected and by applying adjusted coefficients to reflect the actual situation in only three Member States (United Kingdom, Ireland and France), it is estimated that the ewe/goat premium paid for the 1999 marketing year would be lower by at least 52 million euro, i.e. about 3,4 % of the amount paid.

## THE COURT'S OBSERVATIONS

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national production; in these countries the preferred smaller lamb and goat carcasses, which attract higher prices, are excluded from the reporting process<sup>(87)</sup>; this is borne out by Eurostat price figures which show that these are up to 60 % higher than the prices recorded under the CMO<sup>(88)</sup>;

- (d) with the exception of prices recorded in the live markets, all other sources of market prices generally do not refer to the prices obtained by the producers but instead to those obtained by traders and wholesalers; reported prices should reflect those received by the producers;
- (e) there are differences in the administrative practices in the Member States and even within Member States<sup>(89)</sup>, which affect the comparability of the prices reported.

#### **Late and incomplete premium statistics**

2.117. In Commission Regulation (EEC) No 2700/93<sup>(90)</sup>, Article 2 requires Member States to send to the Commission, by a certain date, statistical information relating to premium applications. In the period 1997 to 1999 only Germany, Ireland and the United Kingdom submitted the information by the

**2.117.** *The problem of obtaining statistics in a timely fashion from Member States is not unique to the sheep and goat sector. The situation is not helped in this sector by the fact that the obligations to provide information are not set down clearly. The reform of the regime will provide the opportunity to improve texts and make the requirements much clearer.*

<sup>(87)</sup> According to Eurostat statistics on lambs slaughtered in 1999, the average weight in kilos per carcass was 9,73 in Greece, 11,07 in Spain and 6,62 in Italy. Commission Regulation (EEC) No 1481/86 requires that market prices for these three countries are reported for lambs weighing between 12 and 16 kilos carcass weight.

<sup>(88)</sup> New Cronos data for fattening lambs between 2 and 12 months, which is the category comparable with that covered by the CMO, converted from live weight to carcass weight.

<sup>(89)</sup> For example the prices recorded in the marché de Rungis (France) refer to wholesale prices, while in the market of Athens the recorded wholesale prices are reduced by 10 % to eliminate the margin enjoyed by the wholesalers and the prices reported by the market in Rome do not refer to transactions within the market but to prices collected by phone from slaughterhouses. In Spain for certain regions the prices reported are indicative prices for the forthcoming week and not actual prices. In some Member States information about prices is collected by phone or set by a committee while in other Member States the prices are based on detailed documentary evidence obtained from live markets and slaughterhouses.

<sup>(90)</sup> OJ L 245, 1.10.1993, p. 99.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

specified date. At the time of the audit, delays by the other Member States ranged from three to eighteen months. Furthermore, the Commission did not have at its disposal complete information about the number of applications for the ewe premium submitted in the last three years. Information necessary for the management and the control of the scheme is clearly not available on a timely basis.

#### Unclear individual rights and unused quotas

2.118. The situation concerning the total of the individual rights is unclear and it was not possible to obtain confirmation by comparing the total number of rights held in each Member State with those detailed in internal Commission documents. While global national ceilings for premium rights are set for Austria, Finland and Sweden respectively, no officially fixed ceilings exist for the other Member States. The Commission's latest figures indicate that in the United Kingdom the premium was paid on a number of animals in excess of the total of the individual rights in 1994 and 1996 (<sup>91</sup>).

2.119. From 1993 to 1999 the average use of the quota at Community level has been about 91,7 %. The administrative complexity of the system and the national procedures laid down are such that, regardless of demand, 100 % of quota will never be used.

#### Doubtful basis for additional ewe and goat premium in less-favoured areas (LFA); absence of regular review of areas classified

2.120. Sheep and goat farming is found predominantly in LFAs (about 80 % of the animals) where few alternatives exist. In addition to the ewe premium, specific aid is available for producers farming in these areas. The aid is a flat-rate premium per ewe/goat which has remained

**2.118.** *The ceilings per Member State are the sum of rights allocated to individual farmers calculated on the basis of claims for the premium submitted during a reference year. To clarify the situation, it is proposed under the reform of the regime to publish the national ceilings in an annex to the basic regulation.*

**2.119.** *Firstly a small percentage of quota can be kept in the national reserve. In addition some producers may not use their full entitlement. The reasons for this can be structural or economic and not only due to the complexity of administrative procedures. For example in 1999 quota usage ranged from 59 % in Finland and 70 % in Germany to 98 % and 99 % in Spain and the United Kingdom respectively.*

**2.120.** *The flat-rate supplement for producers in less-favoured areas, or rural world premium, was introduced initially as a means of protecting such producers from fluctuations in the premium following the introduction of stabilisers. It was acknowledged that these producers enjoyed less*

(<sup>91</sup>) The Commission's clearance of accounts services are investigating this matter.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

unchanged since 1995 (<sup>92</sup>). During the audit, no evidence was provided justifying the level of this premium. Furthermore, the Commission does not have any data on the differing costs of production and income between producers farming in less-favoured areas and those farming in other areas.

2.121. The lists of less-favoured areas in each Member State, first established in 1975, have been modified several times. In all cases the modification has increased the amount of land designated as less-favoured. The total area classified as less-favoured, expressed as a percentage of the total utilised agricultural area (UAA), was 33,9 % in 1975, 49,2 % in 1988 and 55,2 % in 1998. There is no evidence that the Member States or the Commission conduct any programmed or regular review of the status of the areas classified as less-favoured.

flexibility in responding to changing market conditions and that the loss of income resulting from the stabiliser effect would be likely to have unfavourable consequences. The evaluation study found that producers in less-favoured areas had generally fared better, when compared to the average, than other producers. It can be concluded therefore that it has been a successful instrument.

**2.121.** As regards the classification procedure, it must be pointed out that in conformity with community legislation on less-favoured areas (Regulation (EC) No 1257/1999, which replaced Regulation (EC) No 950/97), the Commission is responsible only for checking that amendments to the list of less-favoured areas proposed by Member States respect the Community classification criteria. This Regulation does not provide for a regular review of the status of already classified areas and does not allow the Commission to propose a modification of the approved list or to refuse a modification of the list if the classification criteria are respected.

As for the increase of the percentage of LFA of the total utilised agricultural area the increase between 1975 and 1988 is largely due to the accession of Greece, Spain and Portugal and the increase between 1988 and 1998 is caused by the enlargement with Austria, Finland and Sweden all six countries having a very high proportion of LFAs.

Mindful of the fact that the less-favoured areas may increase in scope and lead to increases in the numbers of farmers eligible to receive the supplement, the Commission in its proposal to reform the regime proposed that additional criteria be taken into account by Member States when they determine the areas where the supplement may be paid. In any event such areas may not be outside less-favoured areas.

## Related Community measures

2.122. There are interactions between sheep and goat farming and Community measures such as rural development and environmental protection measures, especially for farming in the less-favoured areas. The eligibility conditions for these measures and the level of the Community support have an impact on sheep farming

**2.122.** The Commission is aware of the interactions between sheep and goat farming and the Rural Development measures part-financed by the EU. While the impact of some of these measures (e.g. investment aid, setting up aid) on the economic situation of sheep and goat farmers should not be underestimated, the Commission wishes to underline that:

(<sup>92</sup>) 6,641 euro per ewe to producers of heavy lambs and 5,977 euro per ewe/goat to producers of light lambs/goats.

## THE COURT'S OBSERVATIONS

and on farmers' income. The Court found that the national and Commission services had not calculated the impact the various schemes may have on budget, production and farmer income.

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- (1) *agri-environmental measures compensate farmers only for the costs incurred or the income foregone, linked to the fulfilment of commitments going beyond good farming practices and*
- (2) *compensatory allowances for less-favoured areas aim at compensating the severity of any permanent natural handicap affecting farming activities.*

**2.123.** The Court's Special Report No 14/2000 (<sup>93</sup>) on 'Greening the CAP' reported on overgrazing issues in the sheep and goat sector in certain regions of Greece, Ireland and the United Kingdom (paragraphs 23 and 24). Article 9 of Council Regulation (EC) No 2467/98 provides that Member States may apply appropriate environmental protection measures on the basis of the specific situation of the land used for the production of sheep and goats. Greece (for the region of Attica) and the United Kingdom took some measures under this provision, while Ireland, in order to address the problem of overgrazing on commonage land, introduced an interim national framework plan in 1998 (<sup>94</sup>) pending the preparation of commonage framework plans within the rural environmental protection scheme (REPS).

**2.123.** In drawing up its proposal for reforming the regime, much consideration was given to the environmental effects of sheep and goat farming. In the framework of the rules on cross-compliance with environmental protection requirements established in Regulation (EC) No 1259/1999, Member States are obliged to analyse the impact of agricultural sectors on the environment. They must draw up annual progress reports on the implementation of the measures and penalties, including an assessment of their effects.

*In the proposal to reform the regime the Commission has proposed that it draw up a report taking into account in particular reports presented by Member States, which should provide a good basis for monitoring cross-compliance with environmental requirements.*

**The recent Commission proposal does not fully address the shortcomings identified by the Court**

**2.124.** The Commission's proposal focuses mainly on the setting of the premium. When it announced its new proposal, it admitted that the method for calculating the premium was flawed due, principally, to the complicated nature of the system and the lack of uniformity in the Member States' approach.

**2.125.** The Commission proposed a flat-rate premium of 21 euro per animal. This is based on the average of the premiums from 1998 to 2000. While this flat-rate premium will remove the ambiguities and uncertainties of the old system, it does not reflect the situation in the market.

**2.125.** In fixing the level of the flat-rate premium the average of 1998, 1999 and 2000 was taken as a starting point. This figure (EUR 20,6) and the Rural World supplement of EUR 6,641 were rounded up to EUR 21 and EUR 7 respectively. When making the proposal the Commission respected the principle of budgetary neutrality and the need to remain within the framework of the financial perspective for agricultural expenditure agreed during the Agenda 2000 reforms.

(<sup>93</sup>) OJ C 353, 8.12.2000.

(<sup>94</sup>) With regard to certain commonages the interim national framework plan provides for an immediate 30 % reduction in sheep numbers and for the years 1999 and 2000 the freezing of quota rights at 70 % of the 1998 entitlement.

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2.126. Another element of the Commission proposal is the introduction of specific national quotas. This responds to the Court's criticism of the existing situation (see paragraph 2.118) and is to be welcomed.

2.127. Weaknesses identified by the Court but not covered by the new proposal are the absence of specific and quantified objectives (see paragraph 2.113) and the failure of Member States to communicate essential statistics concerning premium applications (see paragraph 2.117).

### Conclusion

2.128. In so far as the current regime is concerned, the Court's audit shows that many of the shortcomings revealed in Special Report No 3/95 still persist. The recommendations made then were not followed, as is evidenced by the absence of clearly defined objectives and periodic appraisal of their attainment (see paragraph 2.113), the deficiencies in setting the basic price, the market price and subsequently the level of the premium (see paragraphs 2.114 to 2.116), the failure of the Member States to communicate premium statistics (see paragraph 2.117), and the lack of regular review of the status of the less-favoured areas (see paragraph 2.121).

**2.128.** As recommended by the Court in its Special Report No 3/95, the Commission carried out a study of the regime, which was completed in 2000. On the basis of the evaluation study and its own reflections on the operation of the ewe premium scheme in particular, the Commission decided to present its proposal to reform the regime with the aim of correcting the current deficiencies in the light of recent experience and the perspectives for the sheepmeat market.

The Commission can agree with many of the observations made by the Court, which also concur with some of the findings contained in the report of this evaluation, in particular with regard to price reporting and the methodology used for the calculation of the premium. A number of shortcomings identified in the Special Report No 3/95 have been addressed. For example, it is proposed that the fattening regime be abolished.

In conformity with Community legislation on less-favoured areas the Commission competence consists in checking that the modifications of the list of less favoured areas proposed by Member States respect the community classification criteria.

### Recommendations

2.129. Over and above its new proposal, the Commission should:

- (a) determine specific and quantified objectives against which the performance of the scheme can be measured,
- (b) re-examine the basis of the flat-rate premium it proposes to introduce,
- (c) ensure that Member States fulfil their obligation to supply statistics by the specified date,

**2.129.** In its conclusions, the evaluation study identified a number of options, which included maintaining the status quo, improving the present system or modifying the regime. Given the findings of the evaluation study, it was not considered acceptable to maintain the status quo. The administrative burden which would be imposed by trying to improve the present regime was also considered to be unacceptable. The results that could be obtained would be uncertain. The improvement of the present system would involve obtaining a quality of data and information, which is just not available, at least in the short term.

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- (d) review the continuing status of areas designated as less-favoured and
- (e) review the interaction between the different Community measures affecting the sheepmeat and goat-meat sector, with a view to making proposals for improving their impact.

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*The draft proposal before the budgetary authorities recognises that certain aspects of the regime have worked well, such as individual limits, for example, in maintaining balance and stability in the sector. It also acknowledges that, whilst it may be cumbersome, the present mechanism has resulted in an appropriate level of premium.*

*The main modification to the regime concerns the replacement of the deficiency payment by a flat-rate payment. This will be stable and predictable and, being a known fixed amount, will allow forward planning and simplify farm management. It will enable producers to respond more readily to market signals. By carrying out this modification it will also be possible to simplify the administration of the premium regime and avoid the need for burdensome price reporting procedures and complex calculations. As the proposal removes the link between the premium and prices and production it is more adapted to the objectives of the World Trade Organisation (WTO). The change to a fixed premium will also result in a greater degree of budgetary certainty, as the fluctuations in the level of the premium seen in the past would disappear.*

*The Commission's management of the common organisation of the market in fruit and vegetables*

### Introduction

2.130. In its 1994 Annual Report (95), the Court commented on the increasing imbalance in the fruit and vegetable markets for certain products and weaknesses in control which resulted in high withdrawal costs to the budget. In 1996 the Commission introduced a reform of the Common Market Organisation (CMO) which came into force on 1 January 1997 (96).

2.131. In its 1998 Annual Report (97), the Court assessed the extent to which the reform's new measures addressed its criticism. The actual implementation of the reform was not part of the audit at this time. Modifications of the CMO were introduced in December 2000 (98) and entered into force for the 2001/2002 marketing year.

(95) Annual Report of the Court of Auditors of the European Communities concerning the financial year 1994, Chapter 2 (OJ C 303, 14.11.1995).

(96) Council Regulation (EC) No 2200/96 of 28 October 1996 on the common organisation of the market in fruit and vegetables; Council Regulation (EC) No 2201/96 of 28 October 1996 on the common organisation of the markets in processed fruit and vegetable products; Council Regulation (EC) No 2202/96 of 28 October 1996 introducing a Community aid scheme for producers of certain citrus fruits (OJ L 297, 21.11.1996).

(97) Annual Report of the Court of Auditors of the European Communities concerning the financial year 1998, Chapter 2 (OJ C 349, 3.12.1999).

(98) Council Regulation (EC) No 2699/2000 of 4 December 2000 (OJ L 311, 12.12.2000, p. 9).

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2.132. This report examines the extent to which the implementation of the measures under the 1996 Reform have addressed previous problems. It also examines the extent to which the latest modifications are intended to address remaining shortcomings.

**2.132.** The Commission would remind the Court that while it was preparing its report under Regulation (EC) No 2200/96, it presented proposals to the Council in July 2000, to tackle 'four important issues (...) which need addressing urgently'. These issues were listed as the rigidity of the arrangement for processed tomatoes; the level of the guarantee quantities (quotas or thresholds) for processed tomatoes, pears and citrus fruit; simplification of the operational fund system and improvement in the management of export refunds.

2.133. The audit concentrated on the key elements of the reform intended to reduce structural imbalances, to increase the role and membership of producer organisations (POs), their funding and their operational programmes. It also examined the management of withdrawals from the market and the processing of certain fruit (peaches, pears and citrus fruits). The fieldwork was carried out in the five main producer Member States namely, Greece, Spain, France, Italy and the Netherlands, where EAGGF expenditure on operational funds, operational programmes, withdrawals or processing is most significant.

**Production is concentrated in the South and remains fragmented**

2.134. Current annual EU fresh fruit and vegetable production is about 30 and 55 million tonnes respectively. EU production is concentrated mainly in the southern Member States, Italy being the biggest producer with 25 million tonnes, followed by Spain (21 million tonnes). In terms of production value, these two Member States account for 50 % of total EU marketed production (see **Table 2.7**). Since 1980, EU production of fruit has increased in volume by 12 % and that of vegetables by 20 %. Consumption of fresh fruit and vegetables has remained stable at some 29 and 41 million tonnes respectively but is increasing for processed fruit, notably fruit-juice.

2.135. Production of fresh produce is characterised by wide variations in volume reflecting climatic conditions. While, on the demand side a small number of large retailers have dominated the market, supply has remained dispersed and fragmented.

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**Regulatory framework and budgetary significance**

2.136. The sector is governed by two CMOs, one for fresh and one for processed products. They utilise the following main measures:

- (a) incentives for producers to join POs in order to enhance production and channel sales through them;
- (b) financing of withdrawals of surplus production to stabilise prices;
- (c) for a limited range of fresh fruit and vegetables intended for processing, production aid paid to producers; before the 2000 modifications, production aid for peaches and pears was paid to processors on condition that they paid contracted producers a specified minimum price.

**Table 2.7 — Value of marketed production of fresh fruit and vegetables of Member States; value of marketed production via producer organisations**

(Mio EUR)

Member states	Total marketed production		Marketed production of all producer organisations	
	Average 1999/2000 value	%	Value	% of total value of marketed production
	(1)	(2)	(3)	(4 = 3:1)
B	1 038,43	3	738,14	71
DK	167,50	1	48,54	29
D	1 735,84	6	593,97	34
EL	2 159,38	7	325,00	15
E	6 768,57	22	3 391,51	50
F	4 889,19	16	2 709,93	55
IRL	186,51	1	17,62	9
I	8 700,00	28	2 347,84	27
L	5,00	0	0,00	0
NL	2 279,00	7	1 618,61	71
A	344,11	1	59,88	17
P	782,49	3	61,13	8
FIN	174,61	1	22,51	13
S	166,22	1	67,02	40
UK	1 740,96	6	457,91	26
<b>Total EU</b>	<b>31 137,81</b>	<b>100</b>	<b>12 459,61</b>	<b>40</b>

Source: Report from the Commission to the Council on the state of implementation of Regulation (EC) No 2200/96 (COM(2001)36 final).

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2.137. Since 1996, annual Community expenditure on fruit and vegetables (excluding bananas) (99) has been about 1 300 million euro, some 3 % of total EAGGF Guarantee expenditure (see **Table 2.8**). The value of production represents some 15 % of total EU agricultural production. Overall, the trend of expenditure for withdrawals has been downward and has fluctuated between some 100 and 300 million euro. It amounted to 169 million euro in 2000. Expenditure for

**Table 2.8 — Total expenditure from 1994 to 2000 for the CMO for fruit and vegetables**

(Mio EUR)

Budget line	Title	1994	1995	1996	1997	1998	1999	2000
<b>Fruit and vegetables - Fresh</b>								
1-1500	Export refund	187	203	73	67	41	23	33
1-1501	Withdrawals	390	360	164	294	138	91	169
1-1502	Operational fund of POs	2	0	0	6	239	256	270
1-1504	Hazelnut	0	0	0	0	4	5	10
1-1505	Grubbing up	0	127	108	0	67	20	0
1-1506	Promotion measures	9	6	7	0	0	0	0
1-1507	Nuts	89	75	80	77	110	94	107
1-1508	Bananas	138	116	203	206	208	178	235
1-1509	Other Interventions	9	11	21	19	34	15	9
<b>1-150</b>	<b>Total fresh</b>	<b>824</b>	<b>898</b>	<b>656</b>	<b>669</b>	<b>841</b>	<b>682</b>	<b>833</b>
<b>Fruit and vegetables - Processed</b>								
1-1510	Export refund	30	36	25	17	18	17	13
1-1511	Production aid — Tomatoes	362	377	357	372	328	322	279
1-1512	Production aid — Fruit-based products	97	111	138	144	87	94	84
1-1513	Production aid — Dried grapes	109	122	130	121	115	128	122
1-1514	Production aid — Tinned pineapple	4	5	17	4	6	8	5
1-1515/1503	Compensation — Citrus fruits	130	282	235	244	113	203	215
1-1516	Production aid — Raspberries	1	1	1	1	0	1	1
1-1517	Specific measures (Asparagus)	0	0	0	0	3	2	1
1-1519	Other Interventions	0	0	0	0	0	0	0
<b>1-151</b>	<b>Total processed</b>	<b>733</b>	<b>934</b>	<b>903</b>	<b>903</b>	<b>670</b>	<b>775</b>	<b>720</b>
1-159	Other (=recoveries)	0		0	- 3	0	0	- 2
	<b>Total fresh and processed</b>	<b>1 557</b>	<b>1 832</b>	<b>1 559</b>	<b>1 569</b>	<b>1 511</b>	<b>1 457</b>	<b>1 551</b>

Source: Sincom.

(99) The CMO for bananas is the subject of a separate audit.

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operational funds managed by producer organisations, created by the 1996 reform, rose from 239 million euro in 1998 to 270 million euro in 2000.

**The main problems reported previously by the Court and the 1996 Reform**

2.138. The 1996 Reform addressed certain of the problems identified by the Court in 1994 with regard to:

- (a) the absence or inadequacy of PO funds,
- (b) the limited membership of POs,
- (c) the unacceptably high level of withdrawals for certain products and weak procedures for withdrawing,
- (d) the ineffectiveness of the fixing of prices and aid levels for processed products,
- (e) the limited role of the threshold mechanism <sup>(100)</sup> as a means of reducing surplus production,
- (f) weak controls and inadequate monitoring.

The changes introduced are described in paragraphs 2.139 to 2.142.

Enhancing the role of producer organisations (POs)

2.139. The 1996 reform sought to reduce withdrawals by channelling a bigger part of production to the market. For this purpose, it enhanced the role of POs and gave incentives to farmers to join them. It introduced operational funds for recognised POs, co-financed by the Community and the producers themselves. They

**2.139.** *The Commission would point out that the two possible uses of operational funds, i.e. to finance either operational programmes or withdrawals, are complementary measures, each with a role to play in market management, in the one case affecting its short-term operation and in the other its structural aspects.*

<sup>(100)</sup> Withdrawal compensations and production aid are reduced in the following year if the quantities withdrawn or the quantities processed exceed the established limits (intervention thresholds and processing thresholds). The threshold mechanism was ineffective because it did not have an immediate effect on production.

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were to be used mainly for implementation of operational programmes, approved by Member States, for adapting production to demand and improving quality and marketing. They could also be used to supplement Community payments for withdrawals and to pay compensation for the withdrawal of other products which were not eligible for Community aid.

## Reducing the levels of aid

2.140. The 1996 reform limited the quantities eligible for withdrawals, reduced the level of aid and simplified the scheme. The CMO also required produce to be destroyed only as a last resort giving preference to free distribution, disposal for animal feed, processing and non-food use. Intervention thresholds were maintained as a complementary measure for a transitional period (up to 2002).

2.141. In order to encourage POs to present their products for processing rather than for withdrawals, production aid for citrus fruits became payable directly to them as opposed to the aid for processed peaches and pears which continued to be paid to processors. For citrus fruits, the reductions in aid<sup>(101)</sup> due to overshoots of the processing threshold, applied to POs and for processed peaches and pears, to processors.

## Improving controls and achieving better monitoring

2.142. The changes adopted in order to improve controls and achieve better monitoring were to include new and stricter criteria for the recognition of producer organisations. Formal approval of operational programmes at Member State level was introduced as well as monitoring of their implementation. New rules for withdrawals were put in place. A special corps of inspectors, comprising national and Commission staff, was to be introduced in order to supervise the uniform application of controls in Member States. Finally, the reform required the Commission to report to the Council on the implementation of the 1996 reform by 31 December 2000.

<sup>(101)</sup> Proportional reductions in the following years aid level follow overshoots of the threshold.

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**The implementation of the 1996 Reform was only partially successful**

Performance of producer organisations has been variable

*Problems with the funding of producer organisations*

2.143. Community co-financing of POs' operational funds was subject to a double limit: the Community contribution to an individual PO could not exceed 4,5 % of the value of its marketed production (VMP) but the total amount given to all POs could not exceed 2,5 % of the total value of production marketed through all EU producer organisations. Thus the amounts available each year could only be notified to them after the implementation of the programme for the financial year concerned. The 4,5 % was therefore not guaranteed for the individual POs and this created uncertainty with regard to the amount of support they would get.

2.144. The value of production marketed through POs varies greatly from one PO to another (see **Table 2.7**): the average VMP by PO ranges from 1,46 million euro in Portugal to 145 million euro in the Netherlands (see **Table 2.9**). Moreover, some 10 % of the POs received 50 % of total EU aid with an average of nearly 2 million euro per organisation. In contrast 47 % of POs received less than 100 000 euro <sup>(102)</sup>.

**2.144.** The Commission did suggest in its communication to the Council and Parliament of July 1994 on the development and future of Community policy in the fruit and vegetables sector <sup>(1)</sup>, that aid for producer organisations should be based on a degressive sliding scale related to the size of the PO concerned. This idea of paying particular attention to the difficulties of small producer organisations came in for so much criticism that the Commission dropped it from its proposals in October 1995. It should also be noted that there is no simple direct correlation between a producer organisation's turnover and how many members it has or its members' individual turnover. In other words, a 'big' producer organisation may be made up of a very large number of small individual producers.

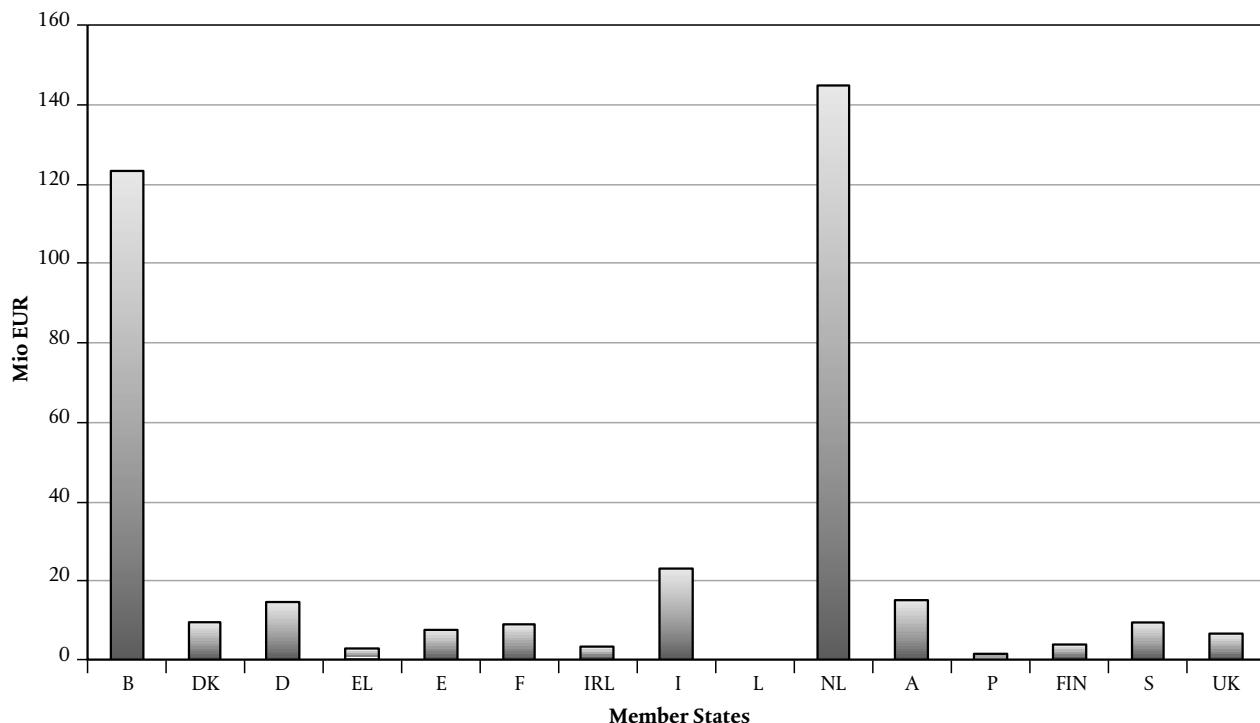
2.145. As a result, resources did not reach Member States in proportion to the level and value of their total production. This is due to the fact that both the number of POs and the level of participation of farmers varies between Member States, leading to big differences in the proportion of total production being marketed through POs. For example, the Netherlands, which accounts for about 7 % by value of total EU production, received 15 % of the operational funds. Conversely Italy and Greece which account for 28 % and 7 % of production by value received 21 % and less than 1 % of the funds respectively (see **Table 2.10**). At regional level within

**2.145.** One of the main principles underlying the reform was to concentrate the bulk of Community financial assistance for the fruit and vegetable sector on producer organisations. It seems more appropriate therefore when judging the breakdown of Community aid by Member State to compare this aid and the value of production marketed by producer organisations in each Member State. The figures (average for the period 1997 to 2000) are as follows:

<sup>(102)</sup> Report from the Commission to the Council on the state of implementation of Regulation (EC) No 2200/96 on the common organisation of the market in fruit and vegetables (COM(2001) 36 final), paragraph 2.5, page 24.

<sup>(1)</sup> COM(94) 360 final of 27 July 1994.

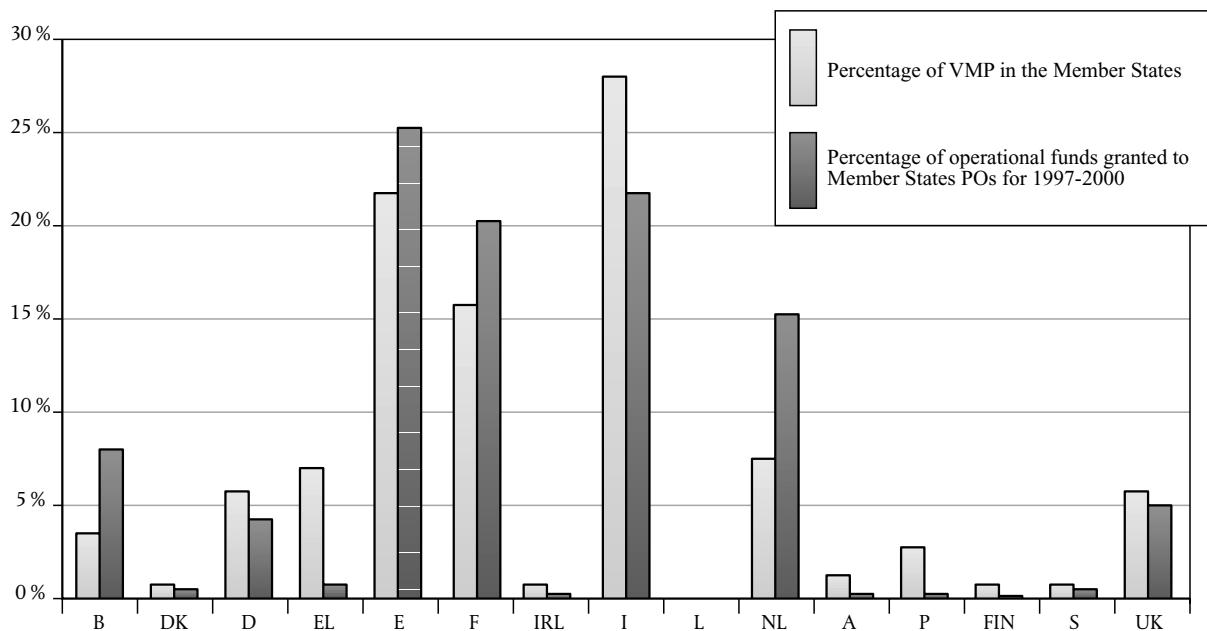
**Table 2.9 — Average value of marketed production of fresh fruit and vegetables by producer organisation with an operational programme**



N. B.: This chart shows that the average value of production marketed by producer organisation in Belgium and the Netherlands was at least between 6 and 7 times greater than in other Member States.

Source: Report from the Commission to the Council on the state of implementation of Regulation (EC) No 2200/96 (COM (2001)36 final).

**Table 2.10 — Fresh fruit and vegetables: proportion of the value of marketed production of the Member States compared to proportion of operational funds granted to their producer organisations for the period 1997 to 2000**



N. B.: This chart shows that there is little correlation between the value of the marketed production of the Member States and the funding granted to their producer organisations.

Source: Report from the Commission to the Council on the state of implementation of Regulation (EC) No 2200/96 (COM (2001) 36 final) and financial reports 1997 to 2000.

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Member States, the distribution of resources was also disproportionate. For example, in Italy, 90 % of the resources went to the POs in the North although production is concentrated in the Centre and the South.

## COMMISSION'S REPLIES

Member State	Member States producer organisations' share in total Community production by POs (%)	Member States share in Community aid to operational funds (%)
Belgium	6	7
Denmark	0,5	0,4
Germany	5	4
Greece	2	0,9
Spain	25	26
France	22	22
Ireland	0,2	0,2
Italy	20	21
Netherlands	14	14
Austria	0,4	0,3
Portugal	1	0,2
Finland	0,2	0,0
Sweden	0,5	0,4
United Kingdom	4	4

These figures show that a real difficulty arises only for Portugal and Greece. In these two Member States, as the Commission noted in its report of December 2000, the producer organisations are in a weaker position in terms of marketed production, and the percentage of POs applying for operational funds is also lower than in the rest of the Community. However, this is true only for that part of production that is marketed as fresh produce. In the case of processing and export aid, the Mediterranean countries receive more Community support than the other Member States.

In its communication of July 1994, the Commission advised against the general introduction of area payments for fruit and vegetables whereby financial aid would be directly linked to each individual producer's production. In deciding on and approving the reform in October 1996, the Council and Parliament followed the Commission's lead on this point.

*The complexity of the regulations has resulted in measures within the operational programmes which are inappropriate and inconsistent*

2.146. The implementing procedures gave Member States responsibility for approving the operational programmes put forward by the POs. However, the procedures were complex and cumbersome. In some cases, they left Member States and POs significant room for manoeuvre and were susceptible to misinterpretation as evidenced by the 130 plus explanatory notes which the

**2.146 to 2.149.** The Commission reiterates that, in the interests of subsidiarity and to avoid a technocratic approach divorced from reality and enable the producer organisations to make the best use of Community money to address the specific local difficulties each one of them encountered, it was decided to implement the rules for the application of operational programmes in stages. The first stage consisted of Regulation

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Commission issued in response to the numerous queries from Member States (103).

2.147. The Commission did not specify sufficiently the criteria for operational programmes. Two years after their introduction, the Commission had produced only a 'non-exhaustive' list of ineligible measures (104). Some derogations relating to the ineligibility of general production costs, overhead expenditure, individual actions to the direct benefit of a limited number of members, were also permitted. This has resulted in variations in implementation between Member States and even regions within them, and the approval of programmes that were unclear.

2.148. Because the Commission did not specify how it wanted PO expenditure to be classified, various practices were adopted in the Member States/Regions. Dissimilar measures were put under the same heading, thus making it difficult to extract reliable data for evaluation.

2.149. Owing to the imprecise nature of certain derogations accorded by the Commission in Regulation (EC) No 1647/98, certain inconsistencies were noted in the Member States. POs visited in Spain, France and Italy devoted a significant share of their programmes to refunding overhead expenditure and general costs at the expense of measures that would more directly improve their competitiveness and performance. In particular, there were examples of high expenditure on personnel in Emilia-Romagna, representing in some cases more than 50 % of the total programme expenditure. For the four POs visited in Andalusia, general overheads and personnel expenditure represented some 70 % of the programmes. High reimbursements by POs to individual members were noted in France. Furthermore, although there was a clear need for increased investment in computer technology in the French POs, expenditure was very low in this area.

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(EC) No 411/97, which merely contained a general framework. This was followed by interpretative notes dealing with specific points, then by Regulation (EC) No 1647/98, which established a 'non-exhaustive list of ineligible operations and expenditure' and lastly by Regulation (EC) No 609/2001, which specifies what operations and expenditure are eligible and which ones are not.

*The Court says the Commission failed to classify the various categories of expenditure by producer organisations precisely enough or to pay sufficient attention to the 'clear need for increased investment in computer technology in the French POs'. The Commission would point out that, with regard to operational programmes, it wanted to avoid taking over the producer organisations' role without any guarantee that such a move would be effective.*

*The Commission welcomes the Court's criticism that there is a contradiction between withdrawals and the construction of new greenhouses or new plantations. Perhaps not enough attention has been devoted to this point and it should now be reviewed.*

(103) Following requests by Member States concerning certain provisions of the regulations, interpretative notes are sent by the Commission to the latter. These interpretative notes are normally adopted by the Commission and distributed to all Member States in the management Committee's meetings. Interpretative notes have no binding effects.

(104) Commission Regulation (EC) No 1647/98 (OJ L 210, 28.7.1998, p. 59).

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2.150. Some measures in operational programmes were incompatible with the market situation. For example, in Spain, some POs financed new orange plantations and construction of greenhouses for tomatoes although they had previously withdrawn 30 % and 40 % respectively of their production of oranges and tomatoes.

*Many producers are still not persuaded of the benefits of producer organisations*

2.151. The reform anticipated that membership would increase through the new funding provided to POs. However, in Greece and in Southern Italy, producers continued to prefer to sell their production individually rather than joining producer organisations. Moreover, the limited use of operational programmes in these regions by producer organisations illustrated that they were content to claim compensation aid for withdrawals or processing, without making serious attempts to adapt their production to the market.

2.152. Individual producers who did not join an organisation and were not obliged to follow their rules, were still permitted to claim withdrawal and processing aid though at a slightly reduced rate of 90 %. Moreover, they were still able to sell their production on local markets, sometimes at more favourable rates than those offered by the local PO.

*The proportion of production marketed through producer organisations is still too low to achieve the potential benefits*

2.153. At European level, the value of the production marketed through POs (organised VMP) between 1997 and 1999 rose by only 5 % to 40 % of total production, well below the target level of 60 % initially foreseen by the Commission. In individual Member States the level of the organised VMP varied from some 70 % for the Netherlands, where producers are well organised, to as low as 8 % for Portugal, where this is not the case (see **Table 2.7**). At Regional level, the variations were similar. For example, in Italy, the organised VMP ranged from some 62 % for the North to 31 % in the South and as little as 7 % in the Centre.

**2.151.** The Commission regrets that some producer organisations have not been very effective. It stresses that the prime objective of the common market organisation sets for producer organisations is to bring production into line with market demand, in terms of both quantity and quality. It emphasises that responsibility for the recognition of producer organisations and for the withdrawal of recognition lies with the Member States. The Commission will step up its controls to improve the situation described by the Court.

**2.152.** Withdrawals are not designed to boost the incomes of 'good' producer members of a producer organisation but as a macro-economic measure to even out short-term fluctuations in total production and help keep it in line with demand. Excluding individual producers altogether would make them overstock the market with manifestly surplus products. This would adversely affect the market price to the detriment of all concerned and, in particular, members of producer organisations, whose efforts would thus be penalised. The same applies to processing aid.

**2.153.** The figure of 60 % of Community production of fruit and vegetables marketed by producer organisations was only an estimate on which calculations were based for the financial statement accompanying the reform proposals in 1995, and it is referred to as a forecast in the proposal transmitted to the Council in July 2000.

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The management of withdrawals continues to be weak and reductions in aid for overproduction are ineffective

2.154. The 1996 reform has been successful in reducing expenditure on withdrawals. In 2000, it was 10 % (169 million euro) of the CMO expenditure, compared to 25 % (390 million euro) in 1994. At Member State level, withdrawal expenditure remained high in those countries where producers were not yet affiliated to producer organisations. For example in 2000, withdrawal aid in Greece and Italy was some 52 million euro compared with only 1,7 million euro in the Netherlands. The same products were involved as in 1994 namely: apples, peaches, nectarines, oranges and cauliflower which, together, consumed more than 75 % of withdrawal aid in 2000. This indicates that there has been insufficient adaptation of these markets. During the 1999/2000 marketing year, withdrawals of peaches, nectarines and cauliflower exceeded their intervention thresholds. Structural surpluses continue to persist at European level, especially for nectarines and peaches.

2.155. The reductions in aid, calculated by the Commission (<sup>105</sup>) for exceeding withdrawal thresholds, were too low to act as a deterrent. For example, in the case of cauliflower, a 6,3 % overshoot of the intervention threshold in 1997/1998 was followed by a reduction in aid of only 0,34 %. This did not prevent a substantial increase in the production the following year and subsequent overshoots of the thresholds of respectively 7,8 % and of 51 % for 1998/1999 and 1999/2000. The corresponding reductions in aid were only 0,4 % and 2,36 % respectively. The same was observed in the case of nectarines where a 150 % overshoot in 1999/2000 generated a penalty of only 15 %. While this approach

**2.154.** *The Commission takes the view that it may well be too soon to draw conclusions about the impact of the 1996 reform on withdrawals after only three marketing years. For these three marketing years withdrawals were limited to 60 %, 50 % and 40 % respectively of the quantities marketed, whereas the final limit, applicable from 2002/2003 (percentages of the quantities actually marketed) will be 5 % for citrus fruit, 8,5 % for apples and pears and 10 % for the other products concerned. The adaptation of products such as peaches and nectarines in particular needs to be judged over the long term because these are perennial crops.*

**2.155.** *The Commission would stress that the two ways in which the 1996 reform aims to reduce withdrawals are by limiting the percentages eligible for withdrawal and by progressively reducing the amount of the Community compensation for withdrawal. The only reason why the intervention thresholds were maintained during the transitional period while the limit on quantities eligible for withdrawal remained high (60 %, 50 %, 40 %) was to prevent the reform from giving producers easier access to withdrawals in the first years of application than was the case before the reform. The Commission therefore logically continued to apply the intervention thresholds in the same way as the Council had done in the past.*

<sup>(105)</sup> The Commission calculates the reductions in aid by dividing the quantities of withdrawals above the intervention threshold by total production. The result is then applied to the following year's aid as a reduction. For example, for the 1998/1999 marketing year, the threshold for withdrawals of cauliflower had been fixed at 111 300 tonnes. Withdrawals reached 120 064 tonnes which represented an overshoot of 8 764 tonnes, i.e 7,8 % of the threshold. The aid should then be reduced by 7,8 %. However, the reduction in aid calculated by the Commission was much lower since it divided the overshoot (8 764 tonnes) by total production (2 226 908 tonnes), which represented a reduction in aid of only 0,4 %. Thus the following year aid was only reduced by this percentage.

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is not irregular, it is highly inefficient for the purpose of market management. This system of reducing aid was in contrast to that applied by the Commission to processing aid where the reductions were equal to the production above the threshold. Had such a system applied to cauliflower for the 1997/1998, 1998/1999 and 1999/2000 marketing years, aid would have been reduced by 6,3 %, 7,8 % and 51 % respectively and the EU budget would have benefited by some 1,8 million euro.

**2.156.** Inconsistencies were found in the data for withdrawals provided by the Commission. The Commission published (<sup>106</sup>) figures for withdrawals of cauliflower of 118 908 tonnes, 120 064 tonnes and 170 502 tonnes for 1997/1998, 1998/1999 and 1999/2000 respectively. These figures had been supplied by the Member States and were used without verification by the Commission to calculate the overshoot above the threshold and the corresponding reductions to be applied to the following marketing year's withdrawal aid. However, in the event, the aid paid by the Commission for these marketing years was 16 million euro, 10,3 million euro and 15,4 million euro, based on actual withdrawals of 172 181 tonnes, 116 696 tonnes and 184 042 tonnes, without the correct reductions in aid having been applied. Indeed, if the processed aid method of reduction had been applied, the aid for cauliflower for 1998/1999 would have been reduced to 63,27 euro/tonne instead of 88,49 euro/tonne, with a supplementary saving of some 2,9 million euro. For 1999/2000, an additional saving of 3,5 million euro would have been made, following the same method. Inconsistencies also exist in the figures for peach and nectarine withdrawals for the 1999/2000 marketing year.

**2.156.** *A cut in Community withdrawal compensation based on the threshold being exceeded can be applied only before the marketing year has started. Failure to observe this rule would entitle producers to consider that they had not been notified in good time of measures affecting their investments, giving the Court of Justice grounds for reproaching the Commission.*

*Overrun of the threshold must be determined on the basis of a period equivalent to the marketing year (in accordance with Article 27(1) of Regulation (EC) No 2200/96) but not the exact period of the marketing year. For instance, overrun of the threshold for cauliflowers is determined for the period 1 March to 28 February, whereas the marketing year for cauliflowers runs from 1 May to 30 April. The 118 909 tonnes mentioned in the Official Journal quoted by the Court was the figure for withdrawals reported to the Commission in April 1998 by the Member States for the period for 1 March 1997 to 28 February 1998. The 172 181 tonnes mentioned by the Court was the figure for a different period: from 1 May 1997 to 30 April 1998.*

*Even if a period equivalent to a marketing year is taken, it may happen, when the Commission checks whether or not the intervention thresholds have been exceeded, that the Member States, given the deadlines, transmit data on withdrawals of one or the other product that have later to be corrected. As stated above, for the sake of legitimate producer confidence, the Commission cannot change the Community withdrawal compensation once the marketing year has started, even if it receives updated information. It has, however, initiated a clearance of accounts procedure against one Member State which reported figures that were too low.*

(<sup>106</sup>) OJ L 151, 21.5.1998, p. 24; OJ L 124, 18.5.1999, p. 3;  
OJ L 108, 5.5.2000, p. 8.

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2.157. Data provided by the Commission showed that in the implementation period 1997 to 2000, some 24 million euro (3,6 %) was spent from the operational funds of the POs to supplement Community payments and compensate for withdrawals of products not covered by Community compensation. Information provided to the Court by Member States showed, in some cases, different amounts to those recorded by the Commission (<sup>107</sup>). This suggested inconsistencies in classification and amounts of withdrawal expenditure which may result in infringements of Regulation (EC) No 2200/96 concerning quantities eligible for withdrawal compensation.

2.158. Measures introduced by the Commission for increasing free distribution of withdrawals were not effective enough. Consequently, the bulk of withdrawals in the intervening period continued to be destroyed. An evaluation by external consultants (<sup>108</sup>) employed by the Commission, showed that free distribution amounted to only two per cent, of apples and oranges withdrawn.

There were inconsistencies in the management of aid for processed peaches and pears

2.159. Before the modifications which were introduced in 2000, the regulation left the Commission room for manoeuvre on fixing the minimum price processors have to pay producers. However for processing aid, which is paid to processors out of Community resources, the regulation prescribed that it be based on the difference between the minimum price and the world price, without exceeding this difference (<sup>109</sup>). Any variation in the minimum price or the world price therefore had an effect on the level of aid.

2.160. The criteria used by the Commission for fixing the minimum price were not coherent and there was no assessment of its impact on producers income. For example, in 1997/1998, the Commission reduced the minimum price of peaches by 2 %, just in order to follow a similar evolution of the minimum price for

2.157. *The Commission notes the Court's comments. It will check with the Member States whether the figures transmitted were correct.*

2.158. *The Commission would emphasise that it has always endeavoured, and will continue to do so, to ensure as far as possible that products withdrawn from the market are not destroyed. Free distribution of these products is and will remain a priority, despite the inherent difficulties, primarily the fact that fruit and vegetables are highly perishable. The quantities withdrawn and distributed free of charge totalled 76 000 tonnes for the marketing year 1997/1998, 27 000 tonnes for 1998/1999 and 45 000 tonnes for 1999/2000.*

<sup>(107)</sup> COM (2001) 36 final, p. 25.

<sup>(108)</sup> Evaluation of the European Community's food programmes, Final Report — December 1998, page 36.

<sup>(109)</sup> The actual amount is calculated by applying to the difference a yield coefficient in terms of raw material and processed products. For 1998/1999, the yield coefficient between raw material and processed peaches was fixed at 0,847.

2.160. *The processed peach industry faced an exceptional situation in 1997 and 1998, with very low production levels in Greece and, consequently, marked price increases at both world and Community level. This unprecedented situation justified the increase in the minimum price. The price rise in the Community was a reality for processors, and the Commission*

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tomatoes. Then, for 1998/1999, the Commission decided to raise the minimum price for peaches by 15 % from 267,55 euro/tonne to 307,68 euro/tonne, to reflect in part the increase in the world price of peaches which had risen to 236 euro/tonne. This decision implied a production aid of 60,65 euro/tonne instead of 26,7 euro/tonne which would have been obtained by maintaining the minimum price at its previous level. The decision to increase the minimum price was contrary to the general CAP trend of reduced direct aid and prices and has prevented savings of some 14 million-euro.

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*had to take it into account. Failure to do so would indeed have given grounds for reproaching the Commission.*

*For the 1998/99 marketing year the aid was cut by 25 % (from 81,28 euro/tonne in 1997/98 to 60,65 euro/tonne in 1998/99). This cut in aid was also justified in the context of the marketing year in question, when the economic situation improved for Community processors. The Commission could have set the aid at the level advocated by the Court (26,7 euro/tonne), but the cut in aid would have been far too severe: 67 %. When setting the aid and price levels, the Commission must take into account the economic situation prevailing in a given marketing year. Its decisions must not, however, further accentuate fluctuations and destabilise a whole sector of economic activity by making changes that are too sudden.*

*The prices and aid set for the 1998/99 marketing year were fully justified and did not lead to an excessive increase in the minimum price or in expenditure.*

2.161. Processing thresholds are fixed in order to limit Community expenditure. The threshold of 582 000 tonnes set for peaches in 1990 reflected average production of the three previous years. This was well above the EU consumption level of some 300 000 tonnes. After 1997, the Commission did not propose to adjust the threshold downwards, even though production fell in Italy. Therefore the threshold allowed production of processed peaches to increase without penalties in the other Member States (110).

2.162. For processed pears, the threshold of 102 000 tonnes fixed in 1989, also reflected the average production of the three previous years. However it was well below the EU consumption level of some 125 000 tonnes. Since then, the threshold has not been adjusted upwards to reflect increased production which lasted until 1998/1999. The threshold has been systematically exceeded for the last three marketing years (1997/1998 to 1999/2000) by 25 %, 34 % and 40 % respectively.

**2.161 and 2.162.** *The Commission takes the view that the purpose of the Community support for the processing of certain fruit and vegetables introduced in 1969 is to ensure that traditional production of the raw material in question has an outlet, not to make the Community self-sufficient.*

(110) Exports have increased whereas imports remained stable. Production is concentrated in Greece with about 65 % of total production.

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2.163. The penalties resulting from the overshoots of the pear thresholds were applied by the Commission to all EU processors, irrespective of the Member States responsible for the overproduction. The Commission calculated the reduction in aid, equal to the percentage of the overshoot which resulted in significant reductions in processing aid. This was reduced from 180,87 euro/tonne in 1996 to 118,86 euro/tonne for 1999. Thus EU pear processors, who still had to pay a high level of minimum price for their raw material (356 euro/tonne), were placed at a disadvantage compared with their non-EU competitors. Despite the aid received, they still had to pay, net, some 237 euro/tonne for the raw material whereas their competitors paid only 160 euro/tonne. The low level of the processing threshold and the high penalties applied might explain the fall in the production of processed pears which occurred in 1999/2000 (¹¹¹).

Payment of direct aid to certain producers has not achieved the intended impact

2.164. From 1996, aid became payable directly to producers of citrus for processing (¹¹²). Consequently production aid to processors as well as the minimum price for producers were abolished. In Italy and Greece where producers are not well organised, processors paid very low prices to farmers. For example, in Greece, some processors paid producers as little as one drachma per kilo of oranges (0,0030 euro/kilo), well under the production cost. Even with the aid, producers received in

**2.163.** All the Commission did was to apply the Community rules that had been in force for over thirty years, which stated that the consequences of a Community threshold being exceeded must be applied uniformly to the whole Community sector concerned. There were no calls for changes to this policy during the discussions preceding the 1996 reform. It was only more recently that wishes were expressed for a change to this practice, leading to the Commission's proposals of July 2000 and to Regulation (EC) No 2699/2000. The cut in aid for pears between 1996 and 1999 was mainly (two thirds) due to the improvement in the economic situation (higher world prices for the raw material).

The decline in pear processing in 1999/2000 followed several years of substantial increases. The fall was thus relative and could be regarded as a return to normal. There is no evidence that the decline can be attributed to the cut in aid. The explanation is more likely to be found in competition from the fresh produce market. Prices on the fresh market are often more attractive to pear growers, who thus shun the processing industry. The difficulty of managing this scheme therefore lies entirely in the twin needs of ensuring sufficient producer incomes, and thus a sufficiently high minimum price, and maintaining processor competitiveness, and thus keeping the industry's costs within reasonable bounds, all strictly in line with WTO rules. This explains why the Commission cut the minimum price, which, as the Court rightly points out, had remained relatively high, for the 1999/2000 marketing year.

**2.164.** Citrus growers obtain their incomes not only from selling their produce for processing but also from sales on the fresh produce market. It is thus the total income per hectare or per kilogram, not just the income from processing that must be compared with the cost of production. Only 20 % to 30 % of citrus production in the Community goes for processing on average, i.e. the bulk of growers' incomes and thus their means of covering their production costs, is derived from the fresh produce market.

That said, the situation described by the Court does reflect the situation that exists when producers are not well organised or when producer organisations lack dynamism. Growers are then in a less strong economic position with regard to the processing industry and some may be tempted to 'dump' their produce for processing merely in order to obtain Community aid. Such a situation is certainly not healthy from the economic point of view. Here again tighter checks on producer organisations may help to improve the situation. In

(¹¹¹) Production of processed pears has decreased from 140 689 tonnes in 1996/1997 to 92 438 tonnes in 1999/2000 with a slight decrease in imports and relatively stable exports. Production is concentrated in Spain and Italy.

(¹¹²) In the citrus scheme, more than half of the expenditure is being devoted to orange processing (130 million euro). Expenditure was highest in Italy (70,3 million euro) followed by Greece (31,3 million euro) and Spain (27,9 million euro).

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this case a maximum of 0,076 euro/kg, whereas their production cost was estimated at 0,25 euro/kg.

2.165. Processing thresholds for oranges, fixed well under the level of EU consumption, have been exceeded every year since the reform. The reductions in aid, applied to the producers, were of 42 %, 32 % and 30 % for each marketing year following the reform. They were applied to all orange producers, irrespective of the Member States or producer organisation responsible for the over production. The Greek authorities maintain that producers' income dropped by 50 %.

2.166. Following a record production of processed oranges in 1997/1998 the orange processing aid was reduced. The aid granted to producers, added to their selling price of the processed oranges, became lower than the Community compensation for withdrawal. Therefore producers were encouraged to deliver their production for withdrawals rather than for processing.

The gap between producers' incomes has in some cases widened

2.167. Analysis of the Commission's data on the Farm Accountancy Data Network showed considerable variations in the farmers' annual incomes, expressed as farm

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Spain, on the other hand, the 1996 reform led to incomes from deliveries to processors that were often higher than the minimum price in force before the reform.

**2.165.** With regard to the level of the citrus processing threshold and the penalties for exceeding it, see points 2.168 to 2.170.

The 1996 reform was designed to encourage the processing of citrus fruit into products that would be more competitive on the market. This change in production did come about in Spain, but was less marked in Italy and scarcely perceptible in Greece. The main reason for this was that a large proportion of the varieties available in Italy and Greece were not suitable for both the fresh market and processing. This situation was further aggravated by weak producer organisations and, in particular, their marketing structure. The result was that the producer price fell in Greece but rose in Spain.

**2.166.** The 1997/98 marketing year was the first one after the changes were made to the aid scheme for the processing of citrus fruit. It had been decided as part of the reform, at the Council's request, that the penalty for overrunning the processing threshold would be applied during the marketing year of the overrun. The final aid for 1997/1998 could not therefore be calculated until after that marketing year. There can therefore have been only a weak correlation between this aid and withdrawals in the marketing year. It is also pointed out that more than 1,9 million tonnes of oranges were processed during the 1997/1998 marketing year, an all-time record (the average in recent years had been around 1,5 million tonnes). Withdrawals for that marketing year, 188 000 tonnes, represented only 4,82 % of production.

Drawing comparisons between the selling price of citrus fruit for processing and the Community withdrawal compensation is thus a delicate matter requiring great caution to be exercised.

**2.167.** The Commission would point out that the common organisation of the market in fruit and vegetables is based on the premise that, faced with increasingly concentrated demand,

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net value added/annual work unit (113), between Member States. They increased more in those countries that already had a high organised VMP before the reform. For example incomes in the Netherlands evolved more favourably than in Greece and Italy, and, to a lesser extent, than in Spain, even though the latter two are the biggest producers. Between 1992 and 1998, vegetable growers' incomes in these Member States actually decreased, thus widening the gap between them and the better organised Member States. For example income for vegetable growers in the Netherlands increased by some 49 % from 1992 to 1998, to a level of 29 000 euro. Also, the income of Dutch fruit growers increased by 138 % during the same period to a level of 10 432 euro. In contrast Greek fruit and vegetable growers have seen their revenue drop respectively by 32 % and 27 % to 2 892 euro and 3 957 euro for 1997.

The effectiveness of control systems in several Member States remains weak

2.168. At the time of the audit (1998-1999), despite Parliament's request (114) that resources dedicated to inspections be increased, the Commission had allocated only two staff to the newly created special corps of inspectors. With so few resources, this corps was not fully operational and could only function in a limited way.

2.169. The control procedures established in certain Member States lacked effectiveness. For example, the distribution of control tasks between various bodies in France and Italy, resulted in inefficient and uncoordinated checks. In Italy, the control authorities delegated key control elements of payments to processors and producers to their professional associations. This did

channelling supply through producer organisations is more than ever an economic necessity to strengthen the market position of producers and boost their incomes. Of course, this does not mean that we should not look into the reasons why producer organisations are not developing in some regions of the Community. This issue will undoubtedly play a prominent part in the Commission's work in the months to come. And the answer is certainly neither obvious nor simple.

(113) The indicator chosen was the farm net value added/annual work unit. This corresponds to the payment for fixed factors of production (work, land, capital), which allows holdings to be compared irrespective of the family, non-family factors of production employed. The division by annual work unit takes into account the differences in labour force to be remunerated by the holding. All data have been deflated to their first year of availability (1992, except Austria, Finland, Sweden: 1995).

(114) European Parliament Decision 96/377/ECSC, EC, Euratom of 17 April 1996 giving discharge to the Commission in respect of the implementation of the general budget of the European Union for the 1994 financial year (OJ L 148, 21.6.1996, p. 45, point 22).

2.168. The Council was also responding to the request from Parliament when, on a proposal from the Commission, by Regulation (EC) No 2200/96, it established a corps of inspectors. The number of inspectors assigned to the corps was increased in 2000 to three (the requirement had been assessed at five in 1996, subject to the allocation of resources by the budget authority). The Commission considers that the special corps was operational, given that several investigations were conducted in the Member States. These also involved, as provided for in the Council Regulation, work by national experts.

2.169 to 2.174. The Commission confirms that there were some weaknesses in the organisation of controls in the Member States. The findings of the Commission's audits were similar to those of the Court. These shortcomings are being tackled in connection with the clearance of accounts, and financial corrections will be made, where appropriate, for the Member State concerned.

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not achieve the degree of independence usually required for the operation of internal controls.

2.170. The reinforced role given to POs is a key element of the reform. Recognition of POs which qualifies them for financial support, requires regulatory visits on the spot. Also operational programme measures must comply with the reform. Member States are required by regulation to make annual visits to at least 10 % of the POs and to ensure coverage of 30 % of Community assistance.

2.171. Recognition was granted to producer organisations in France and Italy without the required checks being carried out. Operational programmes were also agreed without prior visits in France, Italy and the Netherlands. Final payments for 1997 (Spain and France) and part of 1998 (France) were made without the benefit of the required annual inspections, although some of these were made at the end of the programmes. Moreover, in a French PO, final payment was made without the necessary adjustments resulting from a previous inspection.

2.172. Generally, expenditure was difficult to monitor because of the classification of non homogenous expenditure under varying headings. Several non eligible items of expenditure had to be disallowed following the Court's audits in Spain, France and Italy. In particular, the audit revealed errors in the VMP declared by POs, which led to errors in EU funding of some POs in Spain and Italy.

2.173. The required 100 % inspection of destruction was not carried out in Spain, France and Italy. Moreover, some cases of destruction which did not comply with environmental criteria were detected in Spain and France. Because of the ineffectiveness of the checks on withdrawals in Greece, Spain and France, the quality and quantities of products eligible for withdrawal payments is uncertain.

2.174. Community aid is payable for the quantities of peaches and pears presented for processing. Every year, Member States are required to check on the spot, 25 %

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of all quantities processed and to analyse samples of finished products in order to test their quality. At the same time, payment of the minimum price to POs should be verified. The checks of processed fruit were weak as regards:

- (a) sampling of processors (Spain);
- (b) sampling of finished products or raw material (Greece, France);
- (c) quality and quantity of raw material or quality of finished products and stock taking (Greece, France, Spain, Italy);
- (d) payment of the minimum price to the producers (Greece, Spain, Italy);
- (e) areas under cultivation by citrus producers (Greece, Spain and Italy).

2.175. Aid for environmental measures under the CMO, paid through POs to producers, has to be cross-checked with agri-environmental aid paid out directly to individual producers under Regulation No 2078/92. Effective cross-checks were not being carried out in Spain, France and Italy, exposing the Community to duplication of payments. The same risk of double financing applies for grubbing-up aid paid to individual farmers and grubbing-up aid paid from POs to its members.

Monitoring by the Commission is impaired by the lack of reliable data and the inadequacy of its analysis

2.176. The Commission lacked much of the basic information for monitoring the market effectively. For example, it did not possess complete data on the number of POs and their members, the withdrawals financed by operational funds or even the EU production of fruit and vegetables for all products. Numerous inconsistencies in the figures for withdrawals, provided by the Member States and not corrected by the Commission were noted (see paragraphs 2.156 to 2.157). Likewise, figures were inaccurate for production. For example, figures concerning total production of nectarines and cauliflower were consistently undervalued in the Commission's preliminary draft general budgets for the years

**2.175.** *The development of IACS, as concerns its use for checking aid claims other than those managed under IACS, as well as the introduction of a cross-check obligation, has permitted a number of improvements since the Court started its audit of the CMO.*

**2.176.** *The availability of statistics depends first and foremost on the ability of the Member States to obtain the information, process it and transmit it to the Commission. Given the large number of individual products in the fruit and vegetable sector (nearly 100) and the relative importance of the sector, the statistics are bound to be selective.*

Annex II to Regulation (EC) No 609/2001 lists the requirements to be met by the reports which Member States have to send the Commission each year on producer organisations and operational programmes, inspections carried out and their results. The Member States were even notified of the form

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1994 to 1998, by quantities varying from 8 000 tonnes to 190 000 tonnes.

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*these reports should take. The Commission hopes in this way to improve its statistics on producer organisations and operational programmes in the near future.*

*As far as information on production and withdrawals is concerned, the Commission relies on data from the Member States. It points out that it has initiated a clearance of accounts procedure against one Member State which under-reported withdrawals.*

**2.177.** On the 24 January 2001 the Commission produced a report for the Council on the implementation of the regime (115). However it did not analyse how the funds had been spent or their impact on the market's objectives, in particular those relating to the balance of the market and farmers' income.

**2.178.** The Commission was neither proactive in preventing failings in the implementation of operational programmes in the Member States nor did it take immediate corrective action when informed of these failings. While regulations were modified, this was too late to influence the content of the programmes.

**2.177.** As indicated in the foreword, the aim of the Commission's report of 24 January 2001 was 'to describe the current situation' to provide 'background for policy proposals that might be made at a later stage' in a debate on the market organisation.

**2.178.** The Commission takes the view that a distinction needs to be made between misinterpretations of the rules in force and Member States' decisions under the powers assigned to them by those rules to examine the operational programmes submitted by producer organisations. In the first case the Commission initiates the appropriate infringement or clearance of accounts procedures. In the second case the Commission amends the rules where it sees fit. But such amendments must be in accordance with the acquired rights of the producer organisations and the principle of legitimate confidence. They are not therefore as a rule retroactive.

Of course, the amendments the Commission constantly makes to the rules for the application of the CMO generally originate from and always take account of the results of inspection visits to Member States. This is particularly true of Regulation (EC) No 609/2001, which concerns operational funds and programmes, and Regulation (EC) No 1148/2001, which relates to checks on compliance with marketing standards. Preparations are also under way for a revision of Regulation (EC) No 412/97 on the recognition and operation of producer organisations.

**The 2000 modifications do not fully address the shortcomings identified by the Court**

**2.179.** The Commission proposed further modifications of the reform to the Council in 2000 which have been accepted for implementation from 2001. It addresses some of the preceding issues as follows:

(115) Report from the Commission to the Council on the state of implementation of Regulation (EC) No 2200/96 on the common organisation of the market in fruit and vegetables (COM(2001) 36 final of 24 January 2001).

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- (a) simplification of the Community co-financing system of operational funds and adoption of a uniform rate of co-financing should reduce financial uncertainty and enable POs to give higher priority to long-term collective strategies rather than measures that yield short term gains (see paragraph 2.144);
- (b) replacing the yearly fixed minimum price to producers with a fixed direct aid and abolishing processing aid for peaches and pears should ensure that errors and/or lack of transparency in the annual fixing of minimum price and aid are avoided (see paragraphs 2.159 and 2.160);
- (c) increasing the processing thresholds for pears and citrus should allow greater processing in these areas (see paragraphs 2.161 to 2.163 and 2.165 and 2.166);
- (d) reducing the quantity of citrus fruits eligible for withdrawal aid should limit the use of withdrawals by POs (see paragraph 2.166);
- (e) setting thresholds at national rather than at Community level should sensitise Member States to overproduction (see paragraphs 2.163 and 2.165).

2.180. The 2000 modifications do not, however, address the following matters:

- (a) despite the importance of the POs to the success of the regime, no additional measures have been introduced to attract greater membership; aids to individual producers remain (see paragraph 2.152); Community financing is still linked to the VMP of the POs which favours the better organised producers to the detriment of new POs (see paragraph 2.144);

**2.180.**

- (a) *The common organisation of the market in fruit and vegetables is based on the principle of freedom of choice for producers as to whether or not to join a producer organisation, and it makes them responsible for their choice. If the majority of producers in some regions prefer not to join an effective PO, they must also take the consequences of their decision. A comparison of the income of those belonging to POs and that of non-members will show which choice was better. In any case, the Commission is convinced that a decision to join a producer organisation must be motivated by economic considerations, not simply a desire to gain access to Community subsidies.*

*The Commission is also convinced that Community aid schemes should be geared not to attracting new members*

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*to producer organisations but to sustaining the efforts of those who submit to the rules and disciplines to the benefit of the sector as a whole.*

*It is pointed out that Article 14 of Regulation (EC) No 2200/96 provides for special start-up aid for producer organisations.*

- (b) Community funding is still not geared to actual production in Member States/Regions (see paragraphs 2.145);
- (c) although overall withdrawals have reduced significantly, they remain high in those Member States with a low degree of organisation; overproduction still persists for some products (see paragraph 2.154);
- (d) justification for the new aid rates to producers in terms of producers' income and market balance has not been presented by the Commission.

**(b)** As indicated above, the Commission considers that the suggestion that Community financial support should be geared to the scale of production in each Member State or region is not economically justified. It has no plans to do so.

**(c)** The Commission sees the Court's comment that withdrawals 'remain high in those Member States with a low degree of organisation' as encouragement to pursue the policy followed for forty years in the fruit and vegetable sector, which gives high priority to producer organisations.

**(d)** The Commission takes the view that the whole range of market organisation mechanisms is designed to ensure that the objectives set for the common agricultural policy in Article 33 of the EC Treaty are fully achieved. The purpose of the changes to the common market organisation proposed in July 2000 and approved by the Council in December 2000 was to make the rules applicable to tomato processing less rigid; adjust certain processing thresholds to take account of the strong growth in demand, simplify the way in which operational funds function and improve the management of refunds. These changes are bound to improve the overall operation of the market organisation and thus prove beneficial for producer incomes and market equilibrium.

### Conclusion

2.181. The changes made to the CMO in 1996 and 2000 have provided some response to issues raised previously by the Court and those resulting from its more recent examination. However important problems remain.

2.182. The CMO is not achieving equitable results across Member States: market balance and substantially improved revenues have been generated principally in those Member States/Regions which were well organised before the reform; in the other Member States/Regions however, some of which are the main producers, progress has been slow and in some cases

**2.182.** The Commission is fully aware of the differences between Member States as regards the situation of their fruit and vegetable growers. It is convinced that a structural improvement in the situation and incomes of these producers will come first and foremost from better gearing of their production, in terms of both quality and quantity, to effective market demand. This is true both for fresh products and for those

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has been reversed as far as income is concerned. For these Member States, enhancing the role of producer organisations has not been a success (see paragraphs 2.151 to 2.154 and 2.167). If, as the Commission believes, prospects for significant improvement in their level of organisation are low, other means of achieving the CMO's objectives should be considered.

intended for industrial processing. The Commission remains convinced that channelling supply through producer organisations, which enables it to be controlled, and a policy of contracts with processors are powerful instruments for improvement. It does not dispute that the general instruments of market organisation such as standards, operational funds, withdrawals, import measures and export refunds sometimes need to be supplemented by 'special measures' to help in certain particular situations. This is why special support arrangements have in the past been introduced for nuts and soft fruit. The Commission constantly considers possible improvements or adjustments to the market organisation.

## Recommendations

2.183. Before presenting any further proposal for reform to the Council, the Commission should improve the data it maintains on the market so as to prevent the type of inconsistencies noted during the audit (see paragraphs 2.156, 2.157 and 2.176). A more comprehensive evaluation of the impact of Regulation (EC) No 2200/96 needs to be carried out by the Commission than that done recently (see paragraph 2.177). The Court recommends that the Commission carry out objective economic analyses and market reviews, by product, Member State/Region and by type of grower. This should examine aid levels, thresholds and ceilings in terms of their expected and actual impact. The results should be compared with alternative aid scenarios, in particular those which have been adopted with greater success elsewhere.

2.184. If, on the other hand the role to be played by POs is to be maintained, further incentives to encourage membership should be explored. The uneven distribution of the Community funding should be addressed by the Commission. This means that the capacity of the weak POs has to be strengthened. The Commission could consider making membership of recognised POs a condition for receiving aid, as is the case in other markets (e.g. bananas). This could improve the effectiveness of POs and discourage excessive production. The method of reducing aid following overshoots of the withdrawal threshold should be revised so as to become more dissuasive (see paragraph 2.155).

2.185. As far as management and control of the CMO is concerned, the Commission should monitor the implementation of operational programmes more carefully and, where necessary, intervene in order to ensure that the measures introduced by POs are directed to

**2.183 to 2.185.** Even if it cannot accept them all, as indicated above, the Commission welcomes the Court's recommendations. It shares the Court's concern about statistics and will not fail to inform the Member States accordingly. Member States are often reluctant to respond to the Commission's requests, but the Commission is obliged to rely on them in such matters. It acknowledges that 'objective economic analyses and market reviews' are essential and will undertake them as far as the human resources at its disposal permit. It would point out lastly that the main objective of Regulation (EC) No 609/2001, even before the Court made its request, was to define more clearly the categories of measures and expenditure that may be included in an operational programme and those that are to be excluded.

The Commission accepts that improving the situation in the fruit and vegetable sector is tied up with increasing the concentration of supply through producer organisations. The Commission would point out that since the 1996 reform and the changes introduced in 2000, virtually all the Community financial support for this sector is provided via producer organisations. It takes the view, finally, that checks on existing organisations must be stepped up to ensure that those that are not economically and commercially effective and have no ambition beyond benefiting from Community aid do not slow the sector down and deter producers from joining forces.

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achieving improvements in competitiveness and performance (see paragraph 2.151) and respond more directly to the actual needs of the market (see paragraph 2.152). It should ensure that the special corps of inspectors has sufficient resources to fulfil its control responsibilities and intervenes where necessary to ensure that Member States' control procedures are reliable (see paragraphs 2.168 to 2.175). Finally, it is essential that the Commission amend and simplify Regulation (EC) No 1647/98 in order to clarify the concept of eligible items to be financed by producer organisations in order to avoid misinterpretation of the Regulation leading to inefficient use of the funds (see paragraphs 2.147, 2.149 and 2.150) and specify how expenditure should be classified so that reliable data can be extracted for evaluation (see paragraph 2.148).

## PRINCIPAL OBSERVATIONS IN SPECIAL REPORTS

2.186. The following paragraphs contain a summary of principal observations of special reports on EAGGF-Guarantee subjects adopted by the Court since the 1999 annual report and which have not been taken into account during the discharge procedure on the 1999 accounts.

### *Reform of the clearance of accounts*

2.187. In addition to paragraphs 2.53 to 2.97 which refer to the clearance of accounts for a specific year, Special Report No 22/2000 (<sup>116</sup>) examined the reform of the clearance of accounts procedure introduced in 1996. It concluded that the reform had resulted in improved accountability at Member State level and should be regarded as a considerable achievement, even though it had not accelerated the overall time needed for clearing expenditure in both financial and conformity terms for a given EAGGF year.

**2.186.** *The Commission has acted on the Court's comments.*

**2.187.** *Concerning the overall timescale for the conformity procedure, the Commission accepts that the last corrections for 1996 will not be made any quicker than under the old procedure. However, the new procedure has resulted in considerable amounts of corrections being imposed at a much earlier stage than in the past (see paragraphs 54 and 55).*

*1996 was the first year of the reformed procedures for the clearance of accounts. The Commission expects the final corrections for later years to be introduced considerably earlier than would have been the case under the old system. The full effects of the reform have not yet been seen. In this context, the Commission considers that the conciliation procedure has contributed to this global improvement.*

*The Commission welcomes the Court of Auditor's conclusion that the reform of the clearance of accounts process has resulted in improved accountability and is a considerable achievement.*

<sup>(116)</sup> Special Report No 22/2000 on the evaluation of the reformed clearance of accounts procedure (OJ C 69, 2.3.2001).

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2.188. There were still, however, an excessive number of paying agencies, too many of which failed to meet all of the required accreditation criteria. The Commission had, as a result, resorted to clearance of accounts corrections for two Member States.

2.189. Although technical weaknesses needed rectification, the Certifying Bodies had generally succeeded in producing reports and certificates within deadlines. For almost one third of total expenditure declared by paying agencies for 1998, certificates were issued with reservations (which did not necessarily mean that the expenditure was irregular).

2.190. Recourse to the Conciliation Body had led to an overall reduction of about 10 % in financial corrections imposed on Member States, but the Commission needed to address the delays in the procedure and failure, in many cases, to conciliate the views of the Commission and Member States.

#### *Integrated administration and control system (IACS)*

2.191. Special Report No 4/2001 (<sup>117</sup>) concluded that IACS provided a sound basis for controlling arable crops and animal premium expenditure (some six million aid applications each year). The Court's main recommendations to the Commission concerned the development of an efficient management information system and the simplification and harmonisation of the regulatory framework (see also paragraph 2.48).

#### *Milk quotas*

2.192. Special Report No 6/2001 (<sup>118</sup>) considered the effectiveness of the quota regime in controlling EU milk production and achieving market equilibrium. Production was restricted to the target level and the previously increasing trend of budgetary cost of the CMO was reversed. Nevertheless, the overall level of quota set did not bring milk production into line with unsubsidised internal consumption and export. Moreover, despite the subsidised surplus, costing almost 3 billion euro a year to finance, decisions reforming the CMO for milk and milk products provided for a 2,5 % increase in the

**2.188.** The legislative authority decided that the number of paying agencies should be decided by the Member States. While the Commission would welcome a reduction in the number of paying agencies its influence is limited. The Commission has however encouraged the Member States to reduce this number and some have done so. The number of paying agencies was reduced to 86 in September 2000.

**2.189.** The Commission believes that it is far too simplistic to take the amount of expenditure declared by certifying bodies with qualified accounts and use this as a performance measure. It is important to examine each qualification individually before making judgements on this point.

**2.190.** Procedural delays in conciliation are not a matter for the Commission and conciliation of its views with those of the Member States is not always the correct solution for the parties concerned.

**2.191.** The Commission is currently engaged in consolidation of all the rules on this subject.

**2.192.** The current level of quotas is the result of political decisions and its cost to the budget, as the Court states, about EUR 3 billion per year, not only ensures market balance but is in line with all the objectives of the common agricultural policy such as producers' incomes and rural development, plus other economic aspects such as employment in processing plants.

The quotas scheme has been a vital tool for restraining expenditure in the milk sector and in that sense the cost to the taxpayer has fallen considerably since its introduction in 1984.

(<sup>117</sup>) OJ C 214, 31.7.2001.

(<sup>118</sup>) OJ C 305, 30.10.2001.

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national reference quantities between April 2000 and April 2005.

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The Commission believes that, in the present circumstances, fixing quotas at a level which secures a balance between production on the one hand and consumption and non-subsidised exports on the other would require a fall in production of about 20 %. It considers that this would require the scrapping of production capacity and hence of processing capacity.

The decisions taken by the Council as part of Agenda 2000 were the result of intense political negotiations and the increase in quotas was the price paid for the extension of the scheme beyond 31 March 2000, the date when it would have finished under the 1992 rules. In any case, the fall in institutional prices planned from 2005 made this increase possible. The specific increases should not contribute to greater imbalances since, in large part they correspond to quantities already produced.

**2.193.** Some 17 years after its introduction in 1984, the quota regime was still not fully implemented. Italy continued not to enforce the levy on individual producers, while improvements made in Spain and Greece left outstanding levy debt problems. Although the Commission recovered levy debt from the Member States where milk producers did not pay the levy, its dissuasive effect on producers was lost and the national subsidy effect distorted competition.

**2.194.** In the short term, the Commission should examine the possibility of allowing transfer of quota between producers operating in different Member States. In the medium term, the Commission should make proposals aiming at bringing overall milk production into line with unsubsidised internal consumption and potential unsubsidised exports, while ending the quota regime.

**2.193.** With regard to the incomplete implementation of the regime, the Commission, in addition to imposing financial corrections, opened infringement proceedings against Italy (reasoned opinion 97/2228) and Spain (reasoned opinion 97/2227) for incorrect application of the milk quota regime and failure to collect the levy. In the case of these two Member States these problems are partly due to the fact that the producers and purchasers have challenged the levy before the national courts and that those legal proceedings are very lengthy.

**2.194.** The Commission considers that contemplating the transfer of quotas between the Member States would call into question the basis for the rules on quotas as set out in Council Regulation (EEC) No 3950/92 because the system was designed on the basis of a national quota. It also believes that such a major change in the administrative system for quota management would not seem appropriate in view of the Court's desire to abandon the system.

As noted in the reply to point 2.198, quotas were fixed having regard to factors other than the budget. The Commission considers that bringing milk production into line with unsubsidised consumption and exports, as request by the Court, would entail a reduction of about 20 % in the present quota level. Furthermore a reduction of production on such a scale could entail compensation for producers and so does not appear consistent with the phasing out of the quota scheme advocated by the Court.

As regards the future, the Council has agreed to undertake a mid-term review in 2003 on the basis of a Commission report with a view to allowing the current supplementary levy scheme to expire after 2006. The Commission will consider various options when preparing its report.

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*Special report on BSE (bovine spongiform encephalopathy)*

2.195. The main recommendations concerning the control of BSE in the Court's Special Report No. 19/98 (119) were that the Commission should develop a strategy to manage the crisis, and that proper animal identification and registration systems should be enforced. The Court's follow up (Special Report No. 14/2001 (120) on the Report focused on the action taken by the Commission to identify and eradicate BSE.

2.196. The follow up found that the Commission's strategy for dealing with BSE is basically sound, but its effectiveness is severely limited by the following factors:

- (a) the institutional procedures for passing legislation have restricted and delayed the implementation of key BSE control measures, such as the EU-wide ban on removal and use of specified risk materials (SRMs);
- (b) implementation of BSE related legislation by Member States has been inadequate in several key areas; the ban on feeding mammalian meat and bone meal to ruminants has not been properly implemented by most Member States, and the true incidence of BSE has been under-detected by several Member States in the past. Consumers and animals are therefore exposed to different risks in different Member States, through a combination of poor implementation of BSE control measures, and a lack (until recently) of an EU definition of SRMs;
- (c) the measures currently available to the Commission to enforce the implementation of BSE legislation by Member States are insufficient;
- (d) animal identification and registration systems are still not fully operational in all the Member States, despite the 1 January 2000 deadline.

**2.195.** *The Commission considers the report in general a fair objective analysis of the BSE measures introduced and implemented since 1998. In general the Commission endorses the report's conclusions and recommendations.*

**2.196.** *The reflections of the Court on re-orienting subsidies and encouraging extensification constitute the major part of the decision proposed by the Commission and adopted by the Agricultural Council of 20 June 2001. The decisions taken (covering 2001 to 2003) include, for both premium schemes, a progressive reduction of the stocking density from 2 LU/ha to 1,8 LU/ha, for the special beef premium a substantial reduction of the national ceilings and, with regard to the suckler cow scheme, the introduction of a compulsory minimum number of heifers to be kept under this scheme and a suspension of reallocating premium rights from the national reserves.*

(119) Concerning Community financing of certain measures taken as a result of the BSE crisis (OJ C 383, 9.12.1998).

(120) OJ C 324, 20.11.2001.

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2.197. The follow-up draws attention to other issues such as modern livestock production and marketing, especially feeding and rearing methods, the problems of production linked CAP support schemes for cattle and whether the Commission needs specific additional powers to enforce action on Member States.

*Refunds for the use of potato and cereal starch and potato starch aid*

2.198. Special Report No 8/2001 (<sup>121</sup>) examined the operation of the production refunds system, as modified in 1992, and the payment of direct aids to growers of potatoes for starch production and to potato starch producers. The aim of these subsidies, which cost the Community budget about 900 million euro in 2000, is to maintain the competitiveness of Community producers and users of cereal starch and potato starch.

2.199. The three Member States (Germany, France and the Netherlands) which together receive about 70 % of expenditure were visited and the Court made observations on the quality of controls, the method of calculating the production refund, the monitoring of modified starch and the management of the quota system for production of starch potatoes.

2.200. The Commission had never assessed whether the basic objectives of the system were being achieved: key issues were the competitiveness of the cereal and potato-starch user-industries, income of farmers receiving direct aid and compensation for the specific structural disadvantage of potato starch producers.

**2.198. — 2.200.** From the comments of the Court, the Commission concludes that this scheme does not cause major difficulties in its implementation. The Court revealed certain deficiencies but those do not, apart from the problem in one Member State, seem to be serious. Every system is perfectible and the Commission will of course draw the attention of the Member States to the conclusion of the Court in this report.

**2.199.** With regard to the monitoring of modified starch, the Commission, which is aware of the possibility of abuse and irregularities, has regularly checked the application of special measures for this product and discussed them with the Member States and those working in the sector. Some statutory provisions have been adjusted, including the introduction of declarations committing manufacturers to guarantee correct utilisation of the product, which the Member States are required to respect and check. It is also ready, if necessary, to look at the conditions in force and, if necessary, Regulation (EEC) No 1722/93.

**2.200.** The Commission monitors the situation in the sector regularly and consults the relevant departments of the Member States and those working in the sector. As part of its systematic evaluation of sectoral agricultural policies, DG AGRI included in its programme for 2000 the commissioning of a study on the 'evaluation of Community policy on starch and starch products'. The main points to be considered were:

- the effectiveness and efficiency of the measures applied in the starch and starch products sector including production and export refunds, and specific measures in the potato starch sector including the premium for potato-starch producers and production quotas;
- a number of points regarding agricultural incomes and the development of the regions concerned.

<sup>(121)</sup> OJ C 294, 19.10.2001.

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*The results of the study should be available at the end of 2001. A number of points being prepared could prove useful in preparing the report required by Regulation (EC) No 1868/94 which the Commission will present to the Council by 31 October 2001. The report will cover the allocation of the potato starch quota in the Community and any proposals required.*

**Export refunds — Destination and placing on the market (Special Report No 7/2001) (122)**

2.201. The export refund system, costing the EU taxpayer some 5 billion euro each year, provided for refund rates for certain products to be differentiated by destination, as long as satisfactory evidence (proof of arrival) was presented that the goods had been placed on the market at the declared destination.

2.202. In 1992 the Commission provided a catalogue of model proofs to assist Member States in checking proofs of arrival, but this was not subsequently updated. Large disparities were found between Member States as regards these checks.

2.203. Although the Commission had not undertaken a general audit of the proof of arrival system, it had identified major weaknesses in Member State checks at the time of export, resulting in financial corrections amounting to 188 million euro.

2.204. Some Member States had not carried out required audits of approved supervisory companies. Where such audits occurred, serious shortcomings and irregularities were detected, although these were not always satisfactorily followed-up.

**2.202.** *The system selected to prove importation from a non-member country is based mainly on documentation issued by the public authorities, such as customs import documents. In 1992, a catalogue of forms and customs stamps valid in 59 non-member countries was made available to the Member States. The Commission supports the idea of considering whether a catalogue could be prepared, at least for certain countries, and kept permanently up to date.*

**2.203.** *Although the Commission has not undertaken a general audit of the proof of arrival system, it has undertaken a specific audit of proofs of arrival issued by supervisory companies in Germany, which de facto was the only Member State accepting such certificates on a large scale. This resulted in a financial correction of some EUR 20 million.*

**2.204.** *Approval of and checks on the operations of surveillance companies are a matter for the Member States. However, if a Member State decides to withdraw the approval it had granted to a surveillance company, the Commission notifies the other Member States, explaining the reasons which led the Member State to withdraw its approval, if it knows them.*

*Furthermore, when the Commission was informed that a Member State has withdrawn approval of a surveillance company which was part of a group, it asked the other Member States which had subsidiaries of that group approved on its territory to check whether the same shortcomings existed there.*

*The approval conditions for surveillance companies will be evaluated during the ongoing audit (started in May 2001) on differentiated refunds carried out under the clearance of accounts.*

(122) OJ C 314, 8.11.2001.

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2.205. Although a key role in monitoring arrival of the exported goods was assigned to Member States' embassies in third countries, Member States did not issue guidelines on checks to be carried out before issuing certificates of unloading. Physical checks at the time of unloading were rarely performed.

2.206. OLAF and DG AGRI had detected or caused to be detected a number of serious irregularities and suspected frauds in some of the most important export destinations. Supervisory companies were implicated in some cases. The Court's audit uncovered further suspected irregularities and instances where the justification for payment of refunds to certain destinations is questionable. The suspected irregular payments referred to in this report amount to some 100 million euro.

2.207. The system of proofs of arrival includes a compliance cost burden on administrations and trade alike, and provides minimal assurance. The Court recommended that proofs of arrival should only be required in cases of doubt, or for high risk destinations but that *a posteriori* checks by Member States on placing on the market should be intensified and should include consultation of shipping and container movement databases and records held by hauliers for all transactions selected for audit. If the requirement for the systematic presentation of proofs of arrival were maintained, the Court recommended that the existing system for validating proofs of arrival and for authorising supervisory companies and Member States' embassies to issue such proofs should be considerably strengthened.

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**2.205.** *Unloading certificates issued by the embassies are just one of the proofs allowed by the rules for obtaining payment of the refund. Article 16 of Regulation (EC) No 800/1999 contains an exhaustive list of the various proofs which may be used.*

**2.206.** *According to the information received from the Court, the amount relates basically to suspected irregularities established in one Member State in the period 1994-1996 (EUR 60 million) and to irregular exports to Iraq after the introduction of the embargo in 1991 (about EUR 40 million). The cases are pursued by the Commission, and they are followed up in accordance with the rules. In the other cases appropriate action will be taken by the Commission.*

**2.207.** *Relaxing the conditions for presenting proofs of arrival in the way recommended by the Court is not workable, because, requiring proof of arrival only in cases of doubt, or for high risk destinations, would create a potential risk of losing control of exports to countries for which an export refund is not fixed. Furthermore, it would entail increasing risks of fraud and irregularities. It would also expose the Community to fundamental criticism in the way the EU monitors and controls its subsidised trade with third countries, particularly taking into consideration the international undertakings to refrain from granting an export refund for specific markets.*

*The Commission will discuss with the services responsible for *a posteriori* checks how to include consultation of shipping and container movement databases in the audit programmes.*

*The Commission will also consider a system which would make the surveillance companies assume their responsibilities more fully. In this regard, it will discuss with the Member States the possibility of making approval of such companies subject to provision of a guarantee*

**2.206 to 2.211.** *The special report on export refunds does not use the words 'serious abuse'; it refers to 'suspected irregularities and instances where the justification for payment of refunds is questionable'.*

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*Common elements among findings and conclusions in the above reports*

2.208. Four of the six special reports mentioned above include significant positive findings. The reformed clearance of accounts system and the IACS had both contributed to improved management of large amounts of EU funds, while the milk quota regime had restricted production to the target level. The Commission strategy for dealing with BSE was basically sound. The fifth report, on potato starch, is less positive, while the sixth confirmed that differentiated export refunds were open to serious abuse.

2.209. Certain major objectives had not been achieved. The reform had not decreased the overall time needed to complete both financial and conformity clearance of expenditure for a given year. The milk quota system had not brought production into line with unsubsidised demand. Action to deal with BSE was limited by institutional procedures for passing legislation and inadequate Member State implementation in several key areas. For potato starch aids and for differentiated export refunds, the achievement of basic objectives had not been evaluated by the Commission.

2.210. Persistent weaknesses in Member States' checking of Community operations were noted in the IACS and for export refunds. The milk quota system was still not fully implemented 17 years after its introduction.

2.211. Simplification and harmonisation could, in general, facilitate better management, reduce administrative cost and ease the burden on beneficiaries of aid.

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As for the special report on 'potato starch', it can be concluded from the comments of the Court that this scheme does not cause major difficulties in its implementation. The Court revealed certain deficiencies but those do not, apart from the problem in one Member State, seem to be of serious nature.

Special report 'Clearance of accounts'

Concerning the overall timescale for the conformity procedure, the Commission accepts that the last corrections for the 1996 year will not be made any quicker than under the old procedure. However, the new procedure has resulted in considerable amounts of corrections being imposed at a much earlier stage than in the past.

1996 was the first year of the reformed procedures for the clearance of accounts. The Commission expects the final corrections for later years to be introduced considerably earlier than would have been the case under the old system. The full effects of the reform have not yet been seen. In this context, the Commission considers that the conciliation procedure has contributed to this global improvement.

Special report 'Milk Quotas'

The Commission believes that, in the present circumstances, fixing quotas at a level which secures a balance between production on the one hand and consumption and non-subsidised exports on the other would require a fall in production of about 20 %. It considers that this would require the scrapping of production capacity and hence of processing capacity.

Special report 'BSE'

The Commission welcomes the positive assessment on the strategy it developed to deal with the BSE crisis.

Special report 'Starch'

The Commission has undertaken an in-depth study, whose results will be available at the end of 2001.

The Court describes in general terms the main control deficiencies established in some Member States. The Commission agrees that, even for those Member States where IACS has been implemented, weaknesses still exist and are treated accordingly in the context of the clearance of accounts procedure.

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*In respect of export refunds it must be added that Member States were corrected for the persistent weaknesses in checking Community operations. Commission ad hoc Decisions 4, 5 and 6 refer to financial corrections of about EUR 230 million.*

*With regard to the incomplete implementation of the milk quota regime, the Commission, in addition to imposing financial corrections, opened infringement proceedings against Italy (reasoned opinion 97/2228) and Spain (reasoned opinion 97/2227) for incorrect application of the milk quota regime and failure to collect the levy. In the case of these two Member States these problems are partly due to the fact that the producers and purchasers have challenged the levy before the national courts and that those legal proceedings are very lengthy.*

*The Commission will continue its efforts to simplify and harmonise the relevant regulatory framework.*



## CHAPTER 3

### Structural measures

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## INTRODUCTION

3.1. This chapter deals with heading 2 of the financial perspective concerning structural measures. It examines the implementation of the four Structural Funds (SFs): the European Regional Development Fund (ERDF), the European Social Fund (ESF), the European Agricultural Guidance and Guarantee Fund, 'Guidance' Section, (EAGGF-Guidance), the Financial Instrument for Fisheries Guidance (FIFG) and the Cohesion Fund.

## BUDGETARY MANAGEMENT

*Introduction*

3.2. The year 2000 was the first financial year of the new financial perspective and of the Structural Funds' programming period 2000 to 2006. Important features of the financial year were the new budgetary nomenclature, considerable underutilisation of commitment and payment appropriations due, in particular, to the slower than anticipated implementation of this new period, and large-scale recourse to carry-overs of appropriations.

3.3. A new budgetary nomenclature was adopted in the budget for the year 2000. Title B2-1, Structural Funds, was no longer subdivided by Fund but into chapters, and, in particular, according to the priority objectives of the Structural Funds. This new organisation has the advantage of improving identification of the appropriations for the new programming period and it is consistent with the cofinancing by objective of multi-Fund programmes. However, with regard to the preceding periods, one result of the new nomenclature, for example, is that the entire payment appropriations for the completion of previous Objective 1 programmes under the four Structural Funds (12 000 million euro) are grouped under one article (B2-1 0 4). As the Court has already pointed out in its Opinions No 2/2001 and No 4/97<sup>(1)</sup>, for budget headings covering such amounts

*3.2. The year 2000 was mainly devoted to programming as was the case in the first years of previous Structural Funds' programming exercises. The uptake of funding consequently failed to reach the rate expected. This situation was envisaged in the Inter-institutional Agreement of 6 May 1999 on budget discipline. The Commission considers that given the scale and complexity of the programming work required, the delays were lengthy but reasonable.*

*3.3. As a result of changes in the budget breakdown from 2000, there is now a heading for each Structural Funds' chapter entitled 'Completion of earlier programmes' showing all the payment appropriations for the relevant Funds. Under the Commission's computerised accounting system for the general budget (Sincom), there is a subdivision for this heading identifying the payments made by each Fund.*

*The structure of the budget serves, primarily, to determine the specific allocations of appropriations according to their purpose. The larger the number of budget items, the more complicated the management of appropriations becomes and the larger the number of appropriation transfers needed to ensure their optimal implementation. It can be concluded that the amount of funding allocated to budget headings is not a fundamental criterion in determining the structure of the budget but rather the adoption of uniform decisions on expenditure.*

(<sup>1</sup>) Opinion No 2/2001 on a proposal for a Council Regulation on the Financial Regulation applicable to the general budget of the European Communities (submitted pursuant to Article 279 of the EC Treaty), point 6 (OJ C 162, 5.6.2001, p. 1). Opinion No 4/97 on the proposal for a Council Regulation (Euratom, ECSC, EC) amending the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities, point 15 and Annexes 1.20 and 1.21 (OJ C 57, 23.2.1998, p. 1).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

the budgetary principle of specification is divested of meaning at the very moment the budget is drawn up. The result is the coexistence of budget headings to which huge amounts in appropriations have been allocated and of others covering only a few thousand euro.

3.4. Structural measures accounted for 25,3 % of the commitments and 33,1 % of the payments against the total appropriations available in 2000 (for more details, see **Tables 3.2 and 3.3**). Commitments under the new programming period 2000 to 2006 for the SFs amounted to 15 446,2 million euro; payments totalled 5 906,7 million euro. Transactions in respect of previous periods amount to 2 397 million euro in commitments made, mainly against appropriations carried over from the previous financial year; the figure for payments is 19 998,9 million euro. As regards the Cohesion Fund, transactions totalled 2 246,4 million euro in commitments and 1 685,2 million euro in payments.

3.5. Budget estimates turned out, once again, to be very far removed from actual implementation and the budgetary information exchange network between the Commission and the finance ministers in the Member States proved to be ineffectual. With regard to the payment appropriations, the fact that 7 % of Fund interventions were paid in instalments, instead of the 3,5 % anticipated when the budget was drawn up, and that requests for payment for the previous periods amounting to 6 500 million euro, which were awaiting appraisal and payment at the end of 1999, were settled late, meant that it was possible to avoid under-implementation on an even greater scale (?).

**3.5.** *The Commission is aware of the relatively wide discrepancy as compared with the budget estimates for 2000, especially in the case of the payment appropriations.*

*In the case of commitment appropriations, the estimates for 2000 depended on the uncertainty regarding the adoption of programmes before the end of the financial year and to a lesser extent on the share-out between the different Funds of the assistance granted to programmes.*

*The late adoption of the assistance packages prevented funds being disbursed in compliance with the financial perspectives at the end of the financial year and during the first quarter of 2001.*

*As regards the payment appropriations, delays in the adoption of new programmes resulted in the under-utilisation of the appropriations for payment of the initial advance. In view of the situation regarding the availability of appropriations, the Commission decided to pay the entire amount of the advance in accordance with the regulation.*

*Where programmes are under way, payments are made on the basis of applications submitted by the Member States at irregular intervals. The system based on the budget information exchange network referred to by the Court can be questioned only in relation to the forecasts for these latter operations.*

*However, the Commission considers that the new arrangements for preparing forecasts based on Article 32(7) of Council Regulation (EC) No 1260/1999 will mean that forecasts will gradually be improved, as and when the*

(?) See the Annual Report for 1999, paragraphs 3.13 and 3.14 (OJ C 342, 1.12.2000).

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authorities responsible for the 2000 to 2006 programmes are established and get organised.

Regarding the EUR 6 500 million, a significant proportion of these payments were made only when the conditions for payment were met (i.e. when the decision to amend the programme was adopted and the request for payment was received), which only occurred in 2000.

3.6. 160 million euro of the Communities' legal obligations for the programming period 1994 to 1999 had no budget cover<sup>(3)</sup>. As no commitment appropriations were entered in the budget for the year 2000 for completion of the measures for the period 1994 to 1999, this shortfall had to be covered, in the end, by a matching reduction in those allocations to the new programming period which had originally been earmarked, in accordance with the provisions of the regulation, for innovative measures and technical assistance<sup>(4)</sup>. This was done by a transfer made by the budgetary authority.

**3.6.** In 2000 the Commission satisfied the financial commitment obligations for certain programmes for the 1994 to 1999 period which had met the requirements for commitment in full but were not covered in 1999 as there were insufficient appropriations in the 1999 budget.

In order to finance these obligations a transfer of EUR 160 million had to be made from the allocation in the 2000 budget for measures for the period 2000 to 2006 whose implementation was delayed.

In accordance with the Inter-institutional Agreement of 6 May 1999, the Commission began by making the adjustments that were possible to the budget as adopted and then submitted a proposal for the revision of the financial perspectives to the budgetary authority, which adopted the proposal.

### *Implementation of the appropriations*

3.7. **Table 3.1** traces the implementation of the appropriations for the structural measures in accordance with the presentation of heading 2 of the financial perspective. The available commitment appropriations, taking reconstituted appropriations and appropriations carried over from 1999 into account, totalled 32 252 million euro for the Structural Funds and 2 662 million euro for the Cohesion Fund. In total, the respective utilisation rates were 55,3 % and 84,4 %. The available

**3.7.** While implementation of the budget in 2000 was indeed as described by the Court, if account were taken of the disbursement of commitment appropriations carried over to 2001, the rates of implementation of Structural Funds and Cohesion Fund appropriations entered in the 2000 budget would be 80,8 % and 100 % respectively.

<sup>(3)</sup> See paragraph 3.6 of the Annual Report concerning the financial year 1999 and the 1999 Statement of Assurance (OJ C 342, 1.12.2000).

<sup>(4)</sup> Council Regulation (EC) No 1260/1999 of 21 June 1999, laying down general provisions on the Structural Funds (general regulation) breaks down the allocation of resources to the Structural Funds as follows: 69,7 % for Objective 1 (135 900 million euro), 11,5 % for Objective 2 (22 500 million euro), 12,3 % for Objective 3 (24 050 million euro), 5,35 % for the Community Initiatives and 0,65 % for innovative schemes and technical assistance.

## THE COURT'S OBSERVATIONS

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payment appropriations were 32 621 million euro for the Structural Funds and 2 959 million euro for the Cohesion Fund and the utilisation rates were 79,4 % and 57,0 % respectively.

**3.8.** *Tables 3.2 and 3.3* show in detail the implementation of the appropriations in Subsection B2 of the budget (Structural operations, financial mechanism, other agricultural and regional operations, transport and fisheries) covered by heading 2 of the financial perspective (5). The utilisation rate for the majority of headings for the new period, 2000 to 2006, was very poor (see paragraph 3.17). In particular, the utilisation rates of commitment appropriations for Objective 1 and Objective 2 for the new period alone are 56,8 % and 4,5 %, and the utilisation rates for payment appropriations are 53,7 % and 7,2 %. All payments made in 2000 correspond to the initial instalment, as no intermediate payment has yet been made. When the budget was drawn up, intermediate payments had been estimated at 1 300 million euro. For the new Community Initiatives (Leader, Interreg, EQUAL and URBAN) budget implementation was 0 % both for commitments and appropriations, as no measure had been approved.

**3.9.** The Commission decided to carry over to the financial year 2001, in respect of heading 2, commitment appropriations amounting to 8 639 million euro (including 1 034 million euro for approved measures, see paragraph 9.16) and 1 470 million euro in payment appropriations (including 1 027 million euro for measures for which commitments had already been made, see paragraph 9.17). This decision has had the effect of extending the financial year, *de facto*, by three months and robs the principle of annuality of all meaning. The Court recommended abolishing carry-overs of appropriations in its Opinion No 2/2001 (6). Moreover, the Commission should have provided better evidence to back up the explanations it gave (7) to justify these carry-overs. The poor rate of implementation in 2000 will have consequences for the management of the budget during the remainder of the programming period 2000 to 2006. The forecasts for the development of

**3.8.** *If account were taken of the disbursement of commitment appropriations carried over to 2001, the rates of implementation of appropriations entered in the 2000 budget for Objectives 1 and 2 would be 82,7 % and 76,5 % respectively.*

**3.9.** *The Commission takes the view that it adopted the decision on carry-overs in compliance with the Financial Regulation and that the explanations for the decision are fully in line with the conditions laid down in the Regulation. The re-entry in the budget of EUR 6 152 million in commitment appropriations was proposed by the Commission and adopted by the budgetary authority in accordance with point 17 of the Inter-institutional Agreement of 6 May 1999. This Agreement envisaged delays in programming in the 2000 to 2006 period, and hence the annulment of part of the appropriations and the possibility of re-entering them subsequently for the period 2002 to 2006.*

*The impact of re-entry in the budget is limited to a maximum increase in the annual allocation of 5,5 % in the programming for the period 2002 to 2006. The Commission considers that the likelihood of budget operations being concentrated*

(5) Titles B2-5 to B2-9 of Subsection B2 of the budget do not concern structural measures. The new budget nomenclature has not yet resolved this inconsistency.

(6) Opinion No 2/2001, paragraph 7 (OJ C 162, 5.6.2001, p. 1).

(7) Commission Decision: Carry-over of appropriations from 2000 to 2001 (differentiated appropriations) (SEC (2001) 449 final, 14 February 2001).

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commitments and payments for the period have now been distorted, with effect from the first year, and an amendment of the financial perspective should have been proposed by the Commission<sup>(8)</sup> in application of the Interinstitutional Agreement<sup>(9)</sup>. The transfer of the unused allocation of commitment appropriations (6 152 million euro) to the financial years 2002 to 2006 will lead, as in the previous period, to an even greater concentration of budgetary operations in the final years of the programming period.

## COMMISSION'S REPLIES

*in the final years of the programming period is small, especially as only the appropriations for 2000 may be re-entered.*

*With regard to the payment appropriations, the carry-over is justified for payment of the 7 % advance for programmes approved in 2000 where this payment could not be made before the end of 2000.*

**Table 3.1 — Development and implementation of the 2000 budget**

(Mio EUR)

Financial perspective heading: 2. Structural measures						
	Total heading		Of which			
	Commitment appropriations	Payment appropriations	Structural Funds	Commitment appropriations	Payment appropriations	Cohesion Fund
<b>Financial perspective ceiling</b>	32 678,00		30 019,00		2 659,00	
<b>Budget development</b>						
Initial appropriations <sup>(1)</sup>	32 678,00	31 801,57	30 019,00	29 001,57	2 659,00	2 800,00
Final available appropriations <sup>(2)</sup>	34 913,97	35 579,78	32 252,27	32 621,09	2 661,70	2 958,69
<b>Budget implementation</b>						
Appropriations used	20 089,53	27 590,79	17 843,17	25 905,57	2 246,36	1 685,22
% of final available appropriations	57,54	77,55	55,32	79,41	84,40	56,96
Appropriations carried over to 2001	8 638,85	1 470,00	8 225,30	1 170,00	413,55	300,00
% of final available appropriations	24,74	4,13	25,50	3,59	15,54	10,14
Cancelled appropriations	6 185,59	6 518,99	6 183,80	5 545,52	1,79	973,47
% of final available appropriations	17,72	18,32	19,17	17,00	0,07	32,90

<sup>(1)</sup> Budget finally approved by the European Parliament on 16 December 1999 (OJ L 40, 14.2.2000).

<sup>(2)</sup> Budget appropriations amended after taking into account the supplementary and amending budgets and transfers, including appropriations carried over from 1999, the appropriations from revenue relating to contributions from third parties and other revenue corresponding to a specific use as well as appropriations made available again.

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

Source: Revenue and expenditure account 2000.

<sup>(8)</sup> COM(2001)149 final, 13 March 2001. Proposal for a decision of the European Parliament and of the Council on the adjustment of the financial perspective to take account of implementation.

<sup>(9)</sup> Interinstitutional Agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure (OJ C 172, 18.6.1999, p. 1).

Table 3.2 — Budgetary implementation for measures and Structural Funds during the 2000 financial year

(Mio EUR)

	Budget reference	Appropriations				Total appropriations available (c) + (d) + (e)	Implementation of appropriations available	Rate of implementation of appropriations available (%)	Appropriations carried over to financial year 2001	Appropriations cancelled at year-end	
		Initial budget	Final budget after SAB and transfers	Carry-overs from previous financial years	Appropriations made available again					Amount (f) - (g) - (i)	% (j)/(c)
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h) = (g)/(f)	(i)	(j)
C	Objective 1	B2-1 0	20 781,00	20 787,31	862,31	17,72	21 667,33	12 703,91	58,63	5 374,80	3 588,63
	Objective 2	B2-1 1	3 668,00	3 742,21	472,87	7,97	4 223,04	709,89	16,81	2 648,75	864,40
	Objective 3	B2-1 2	3 505,00	3 505,78	55,91	0,00	3 561,69	3 373,37	94,71	187,76	0,57
	Other structural measures (outside O1)	B2-1 3	161,00	171,46	18,80	0,13	190,39	171,89	90,28	14,00	4,50
	Community initiatives (1)	B2-1 4	1 743,00	1 755,58	786,40	4,22	2 546,20	851,02	33,42	1 695,18	96,56
	Innovative measures and technical assistance	B2-1 6	161,00	56,67	6,96	0,00	63,62	33,10	52,02	30,52	53,87
	Subtotal 'Structural Funds'	B2-1	30 019,00	30 019,00	2 203,23	30,04	32 252,27	17 843,17	55,32	6 183,80	20,60
	Cohesion Fund	B2-3	2 659,00	2 659,00	0,00	2,70	2 661,70	2 246,36	84,40	413,55	0,07
P	EEA Financial Mechanism	B2-4	p.m.								
	Total		<b>32 678,00</b>	<b>32 678,00</b>	<b>2 203,23</b>	<b>32,74</b>	<b>34 913,97</b>	<b>20 089,53</b>	<b>57,54</b>	<b>8 638,85</b>	<b>6 185,59</b>
	Objective 1	B2-1 0	17 378,42	17 728,42	2 357,25	17,72	20 103,39	15 485,17	77,03	1 020,00	3 598,22
	Objective 2	B2-1 1	4 209,18	4 359,18	496,30	7,97	4 863,45	3 859,54	79,36	150,00	853,91
	Objective 3	B2-1 2	2 894,81	3 343,83	0,00	0,00	3 343,83	3 094,14	92,53		249,69
	Other structural measures (outside O1)	B2-1 3	1 056,70	1 056,70	0,00	0,00	1 056,70	980,59	92,80		76,11
	Community initiatives (1)	B2-1 4	3 091,68	2 289,66	733,52	3,14	3 026,32	2 301,39	76,05		724,93
	Innovative measures and technical assistance	B2-1 6	370,77	223,77	3,62	0,00	227,39	184,74	81,24		42,65
	Subtotal 'Structural Funds'	B2-1	29 001,57	29 001,57	3 590,69	28,82	32 621,07	25 905,57	79,41	1 170,00	5 545,52
	Cohesion Fund	B2-3	2 800,00	2 800,00	157,79	0,99	2 958,69	1 685,22	56,96	300,00	973,47
	EEA Financial Mechanism	B2-4	p.m.								
	Total		<b>31 801,57</b>	<b>31 801,57</b>	<b>3 748,38</b>	<b>29,82</b>	<b>35 579,78</b>	<b>27 590,79</b>	<b>77,55</b>	<b>1 470,00</b>	<b>6 518,99</b>
											<b>20,50</b>

(1) Including the appropriations entered in Chapter B-0 4 0 'Provisional appropriations' (Equal CI: Cas – 544,812; PAs – 140,901).

NB: C = Commitments; P = Payments.

Source: Sincom and revenue and expenditure account.

**Table 3.3 — Implementation of appropriations, broken down by Structural Funds**

(Mio EUR)

Budget item	Description	Commitments			Payments		
		Appropria-tions available	Implemen-tation	%	Appropria-tions available	Implemen-tation	%
B2-1 0 0	Objective 1 — EAGGF-Guidance	2 618,47	1 239,28	47,33	1 010,01	587,57	58,17
B2-1 0 1	Objective 1 — FIFG	403,22	324,49	80,47	157,77	157,77	100,00
B2-1 0 2	Objective 1 — ERDF	12 761,18	8 175,55	64,07	5 330,12	2 714,52	50,93
B2-1 0 3	Objective 1 — ESF	4 978,13	2 058,26	41,35	1 605,21	894,95	55,75
B2-1 0 4	Objective 1 — Completion of earlier programmes	906,33	906,33	100,00	12 000,28	11 130,37	92,75
<b>Total 'Objective 1'</b>		<b>21 667,33</b>	<b>12 703,91</b>	<b>58,63</b>	<b>20 103,39</b>	<b>15 485,18</b>	<b>77,03</b>
B2-1 1 0	Objective 2 — ERDF	3 016,08	143,60	4,76	495,49	36,85	7,44
B2-1 1 1	Objective 2 — ESF	663,92	23,25	3,50	175,81	11,55	6,57
B2-1 1 2	Objective 2 — Completion of earlier programmes	543,04	543,04	100,00	4 192,16	3 811,14	90,91
<b>Total 'Objective 2'</b>		<b>4 223,04</b>	<b>709,89</b>	<b>16,81</b>	<b>4 863,45</b>	<b>3 859,54</b>	<b>79,36</b>
B2-1 2 0	Objective 3 — ESF	3 505,00	3 316,67	94,63	1 474,20	1 433,53	97,24
B2-1 2 1	Objective 3 — Completion of earlier programmes	56,70	56,70	100,00	1 869,63	1 660,61	88,82
<b>Total 'Objective 3'</b>		<b>3 561,70</b>	<b>3 373,37</b>	<b>94,71</b>	<b>3 343,83</b>	<b>3 094,14</b>	<b>92,53</b>
B2-1 3 0	FIFG (outside Objective 1)	161,00	142,50	88,51	59,89	59,89	100,00
B2-1 3 1	Completion of earlier programmes — FIFG	0,00	0,00	0,00	146,23	117,61	80,43
B2-1 3 2	Completion of earlier programmes — EAGGF-Guidance	29,39	29,39	100,00	850,59	803,09	94,42
<b>Total 'other structural measures (outside Objective 1)'</b>		<b>190,39</b>	<b>171,89</b>	<b>90,28</b>	<b>1 056,70</b>	<b>980,59</b>	<b>92,80</b>
B2-1 4 0	Leader	291,70	0,00	0,00	0,00	0,00	0,00
B2-1 4 1	Interreg	818,00	0,00	0,00	139,00	0,00	0,00
B2-1 4 2	EQUAL	467,90	0,22	0,05	90,00	0,00	0,00
B2-1 4 3	URBAN	117,40	0,00	0,00	0,00	0,00	0,00
B2-1 4 4	Completion of earlier programmes	851,20	850,80	99,95	2 797,32	2 301,39	82,27
<b>Total 'Community Initiatives'</b>		<b>2 546,20</b>	<b>851,02</b>	<b>33,42</b>	<b>3 026,32</b>	<b>2 301,39</b>	<b>76,05</b>
B2-1 6 0	Technical assistance and innovative measures — EAGGF-Guidance	1,18	0,00	0,00	4,78	0,00	0,00
B2-1 6 1	Technical assistance and innovative measures — FIFG	1,10	0,79	71,82	1,03	0,42	40,78
B2-1 6 2	Technical assistance and innovative measures — ERDF	35,56	12,15	34,17	16,76	3,76	22,43
B2-1 6 3	Technical assistance and innovative measures — ESF	14,84	9,41	63,37	16,72	5,86	35,05
B2-1 6 4	Completion of earlier programmes	10,94	10,74	98,17	188,11	174,70	92,87
<b>Total 'Technical assistance and innovative measures'</b>		<b>63,63</b>	<b>33,10</b>	<b>52,02</b>	<b>227,39</b>	<b>184,74</b>	<b>81,24</b>
<b>Total 'Structural Funds'</b>		<b>32 252,27</b>	<b>17 843,17</b>	<b>55,32</b>	<b>32 621,09</b>	<b>25 905,57</b>	<b>79,41</b>

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*Indicative distribution of the appropriations available for the 2000 to 2006 period*

3.10. Fixing the allocation of appropriations for the Structural Funds for the 2000 to 2006 period and their indicative distribution between the three Objectives, the Community Initiatives and the Member States represented a technical and political operation on a considerable scale and resulted in a global methodological framework defined in the conclusions of the Berlin European Council, in the new general regulation (Article 7) and in the minutes of the Council meeting of 21 June 1999 (10).

3.11. It was possible to carry out an initial distribution of the appropriations between the Member States for the three priority Objectives on the basis of the application of objective criteria (11). Subsequently, allocations based on the 'special situations' of the Member States were added to them by political decisions taken during the Berlin European Council (2 800 million for Objective 1; 160 million for Objective 2 and 650 million for Objective 3).

3.12. With regard to the indicative distribution by Member State of the appropriations for the Community Initiatives, clearer procedures than those applied for the preceding periods were drawn up by the Commission. For URBAN, only objective criteria were used. For Interreg, EQUAL and Leader, 40 % of the appropriations were distributed on the basis of the relative share of each Member State in the corresponding Community Initiatives for the period 1994 to 1999, 40 % on the basis of objective criteria specific to each Community

**3.12.** *The indicative distribution of funding from the Structural Funds for the current programming period, including the Community Initiatives, was made on the basis of objective criteria, other than for some adjustments involving small amounts. This represents a major step forward, as the old rules applying in earlier periods did not allow it. Furthermore, while it is true that the methodology adopted for the distribution of overall funding for the Initiatives has not been made public at this stage, it has however been explained in detail to each Member State.*

(10) Document 9431/99 ADD 1 PC/CONS 40 of 2 July 1999. Addendum to the draft minutes of the Council's 2192nd meeting (General Affairs) which took place in Luxembourg on 21 June 1999.

(11) For Objective 1, these are regional prosperity (difference between per capita GDP in the eligible regions and the Community average), national prosperity (per capita GDP) and the level of unemployment; for Objective 2, it is the population and, for Objective 3, long-term unemployment, youth unemployment, the rate of employment, disparities between men and women, the level of qualifications and poverty. Commission Decisions Nos 1999/500/EC, 1999/501/EC, 1999/504/EC and 1999/505/EC of 1 July 1999, fixing an indicative allocation by Member State of Structural Funds commitment appropriations under the FIFG (outside Objective 1) and Objectives 1, 2 and 3 respectively for the period 2000 to 2006 (OJ L 194, 27.7.1999, pp. 47, 49, 60 and 63).

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Initiative and 20 % taking into account the Berlin European Council's decisions (covering 900 million euro), the commitments given by the Member States and their special situations. Nevertheless, neither the methodology applied nor the reasons for the amendments made on the basis of non-objective criteria, other than those decided in Berlin in respect of special situations in Member States, have been made public.

*Review of the Commission's comments on financial management (12)*

3.13. With regard to structural measures, the information provided by the Commission in Volume I of the revenue and expenditure account for the financial year 2000 is more comprehensive than in previous years. However, the Commission does not provide a satisfactory explanation there of why the programmes which, according to the Commission, were ready at the end of 2000 were not adopted, when it is delays in the adoption of programmes that are responsible for entitlements being under-used and for the large amount of carry-overs of appropriations. Except in the case of the FIFG, the Commission does not indicate that automatic commitments and advance payments were not made in 2000 once the programmes had been adopted.

3.14. The Commission provides tables which show quite substantial transfers, but it provides no explanation of the non-utilisation of the majority of the appropriations allocated to certain budget headings. By way of example, the allocation for the 'Objective 1 ERDF' heading was increased by 1 750 million euro in terms of payment appropriations. In the end, these transfers proved useless, as the appropriations were not used. Moreover, these ultimately unnecessary transfers between headings relating to different programming periods reduce the significance of the declared rates at which available appropriations were implemented.

**3.14.** *It is true that substantial transfers were made in 2000, some of which ultimately proved unnecessary given the overall level of under-utilisation in that year.*

*In the case of old programmes, the under-utilisation of payments for certain headings in 1999 created an imbalance in the budget for 2000. Some chapters (for example, the old programmes for Objectives 2 and 5(b)) had insufficient payment appropriations in 2000 and consequently had to be boosted.*

*In the case of the new programmes, as indicated in point 3.5, the requirements for payment appropriations depended on the programmes being adopted in sufficient time and this remained unknown up to the end of the financial year. At the end of the year, in circumstances which suggested significant under-utilisation for several budget headings, the Commission re-allocated the available funds to headings which might need them if the programmes were adopted in sufficient time for the advances to be made.*

(12) The Court has reviewed the information presented by the Commission in Volume I of the revenue and expenditure account. The purpose of this volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available as well as between the appropriations finally available and those utilised. This review did not seek to provide assurance as to the reliability of its contents. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

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3.15. Approximately 59 % of payment appropriations carried over from the financial year 1999 (3 748 million euro) were used, a figure which led to the cancellation of appropriations corresponding to the Structural Funds and to the Cohesion Fund totalling 1 380 and 158 million euro respectively. The Commission does not comment on this abnormal situation, which is the consequence of the inappropriate use of carry-overs of appropriations (see paragraph 3.9). Lastly, the explanations given for each Structural Fund vary considerably. For example, with regard to Objective 1 no specific mention is made of the ERDF and two-and-a-half pages of comments on the implementation of the EAGGF-Guidance are followed by two paragraphs on the implementation of the ESF.

### *Implementation of the programmes*

3.16. The management of the Structural Funds in 2000 concentrated on measures concerning four programming periods, i.e. the new period 2000 to 2006, the preceding period, 1994 to 1999, the period 1989 to 1993 and the period before the reform in 1988.

### **The 2000 to 2006 period: implementation slower than anticipated**

3.17. The adoption of the new forms of assistance proved much slower than anticipated. The five-month deadline laid down in the regulation was exceeded in the case of virtually all applications for assistance. The new rules, which were designed to accelerate and simplify the programming procedures<sup>(13)</sup>, did not produce the expected results. On 31 December 2000 the Commission adopted for Objective 1 (development and structural adjustment of regions whose development is lagging behind), the seven CSFs (Community support frameworks) and 18 of the 19 SPDs (single programming documents) planned, but only 49 of the 101 OPs (operational programmes) submitted by the Member States. For Objective 2 (economic and social reconstruction of areas experiencing structural difficulties), only eight of the 96 OPs/SPDs submitted were approved. This situation is attributable, in part, to delays in the adoption of the lists of areas eligible under Objective 2, in particular for Italy, whose list was not adopted until July 2000. Within the framework of Objective 3 (adaptation and modernisation of educational, training and employment policies and systems), which is financed

**3.15.** The Commission indeed made a large carry-over of payment appropriations from 1999 to 2000. The reason for this was the existence of requests for payments submitted to the Commission late in the year but not paid, which could not in any way be regarded as late payments. This build-up of payment requests suggested significant pressure on payment appropriations in 2000 which was only partly borne out, and this explains the partial under-utilisation of the appropriations carried over.

**3.17.** As indicated above in points 3.4 and 3.8, the under-utilisation of the budget in 2000 was the result of delays in adopting programmes.

These were due, partly, to the Commission's late adoption of certain decisions, even though these were justified by the need to comply with the rules (adoption of eligible areas, add-onality) or on grounds of sound financial management (guidelines, negotiation of CSFs, SPDs, programmes).

Secondly, as the Court states, there was a failure in many cases to meet the deadlines set in Article 15 of Regulation (EC) No 1260/1999. It should be borne in mind nevertheless that the programming exercise for 2000 to 2006 was superimposed on the final adjustment of the programming for the period 1994 to 1999 and that these two exercises, by their nature political, were conducted within very complex decision-making frameworks.

<sup>(13)</sup> Recital No 34 of Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds (OJ L 161, 26.6.1999, p. 1).

## THE COURT'S OBSERVATIONS

solely by the European Social Fund, the majority of forms of assistance planned (all except four) were approved. No Community initiative (CI) programme was adopted.

## COMMISSION'S REPLIES

The comment by the Court on the slower-than-anticipated start to this new programming period is accurate, particularly in relation to Objectives 1 and 2. This delay was justified, however, by the need to ensure better integration of the Structural Funds (a point criticised by the Court in relation to the 1994 to 1999 period) and the reflection in Structural Funds programming, particularly for the ESF, of the European employment strategy. In some cases, the operational programmes and/or SPDs presented by the Member States were entirely recast following the first phase of the negotiations. This was the case particularly for Spain, which presented regional single-fund programmes for Objective 1 which were 'converted' into multi-fund programmes with a broader range of objectives.

In other cases, especially that of Greece, the delay was due to the Commission's requirement that satisfactory management structures be put in place before the assistance measures were adopted.

The task of defining (in partnership) both quantified targets and monitoring, outcome and impact indicators with the quality required for the necessary evaluations that comply with the rules in some cases also took considerable time, which was difficult to reconcile with the five-month deadline.

**3.18.** In the case of several programmes adopted in 2000, commitments and the corresponding payment instalments, although automatic, were not made by the Commission in 2000 but in 2001 after the relevant appropriations had been carried over (see paragraph 3.9). In view of the new provisions in the regulation concerning total or partial decommitment of unused appropriations<sup>(14)</sup> by the end of the second year following the year of commitment, the consequences for programmes for which the relevant commitment was formalised at the end of the year 2000 in comparison with programmes for which the commitment was finalised at the beginning of 2001 are considerable: in the first case, automatic decommitments would commence in 2002 while in the second case they would be carried out in 2003.

**3.18.** The Commission is aware of this situation and is examining the consequences for the  $n + 2$  rule in cases where, for a given programme, the 2000 tranche was committed for one Fund in 2000 out of appropriations for that financial year and for another Fund in 2001 out of appropriations carried over.

However, the Commission considers that in practice the problem will be limited given that:

- for most programmes, payments made since 1 January 2000 are eligible,
- in the case of the tranche for 2000, almost half has been used up by the advances, and consequently the other half only should be used within the deadline set by the  $n + 2$  rule, i.e. the end of 2002 for the commitment for 2000 and the end of 2003 for the commitment for 2001,
- in the case of the tranche for 2001, the deadline in all cases is the end of 2003.

This problem is confined to multi-Fund programmes which have been partly committed in 2000 and for which difficulties would arise in using up half the commitment made in 2000 before the end of 2002, when all the commitments for 2000 and 2001 should have been used up before the end of 2003.

<sup>(14)</sup> Article 31(2) of Regulation (EC) No 1260/1999.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.19. The financing plans for new measures reproduce the annual distribution set out in the Community financial perspective (15). These plans are not accompanied by real forecasts of the measures' progress. This imposes limits on the effectiveness of the programming, monitoring and evaluation instruments which are applied to the interventions.

**3.19.** Under Articles 18 and 19 of Council Regulation (EC) No 1260/1999 assistance packages are the subject of a financing plan specifying for each year and each priority the different sources of financing.

*The Commission emphasises the tightening of budgetary discipline arising from the provisions adopted regarding programming (financial perspectives) and commitment, which involve a close link between the financing plans for assistance measures and the financial perspectives.*

*Regarding the implementation of programmes, the n+2 rule imposes a framework on the national authorities establishing close links between their implementation plans and the financing plans for programmes, while giving them considerable flexibility in planning and implementing measures.*

### The 1994 to 1999 period

3.20. With regard to finalising commitments for the 1994 to 1999 period, amendments had to be carried out during the financial year 2000 to correct inconsistencies discovered at the end of 1999 between the legal commitments and the budget commitments, although some had still not been dealt with at the end of 2000. In 1999, in particular at the end of the year, the monitoring committees for many forms of assistance used their powers to decide on amendments to the financing plans (16). These amendments must be confirmed by the Commission in the form of a formal decision within 20 working days, but this deadline was never adhered to. At the end of 2000, numerous amendments had still not been confirmed, which causes uncertainty in the management of the measures because two financial plans now coexist, the one actually in force and the one adopted by the monitoring committee. Moreover, there is still no global information on the state of progress of the measures for the period 1994 to 1999. As for Objective 2 in the period 1994 to 1996, only 12 of the 72 ERDF interventions have been closed (two in 1999 and 10 in 2000). For the 73 ESF interventions, all the requests for payment of the balance, except one, have been submitted to the Commission, which, however, did not carry out the relevant decommitments, for a total of 74,4 million euro, in 2000.

**3.20.** Concerning amendments to programmes, the Commission adopted the majority of final decisions concerning assistance packages for 1994 to 1999 in 2000. This is logical since the Member States had until 31 December 1999 to make their final amendments to programmes, in order to align the assistance measures on the final implementation forecasts.

*It should be borne in mind that amendments made by the Member States must be forwarded to the Commission, which adopts them in the form of amendments to the decisions granting aid. In many cases, requests from Member States were forwarded to the Commission several months late and, in some cases, with errors that had to be corrected. The Commission regrets the excessive delay in the updating of the final decisions amending programmes.*

*By contrast, under the new regulation this procedure is simplified as the Member States themselves will adopt amendments of this type within priorities by adjusting programme complements for assistance packages, which will be sent to the Commission for information. Provided the adjustments do not affect the total financing for each Fund and priority, no amendment to the decision will be needed.*

*Regarding the Objective 2 programmes in the 1994 to 1996 sub-period, more have been terminated and the number of assistance operations completed up to the end of June 2001 is 24 out of 72.*

(15) Articles 31(1), 28(2) and 17(2)(c) of the general Regulation.

(16) Procedures for amending the forms of assistance, annexed to the SPDs and OPs for the 1994 to 1999 period.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

Concerning the ESF, the Commission accepts the Court's comment. However, it should be noted that in June 2001 the amount mentioned by the Court had been reduced by over EUR 12 million: all the decommitments for Germany totalling EUR 6 894 717 had been made and the amount still not closed for Italy had been reduced by EUR 5 307 620.

*The other cases remaining open are being studied very closely in order that they can be finalised rapidly during the 2001 budget year.*

#### The periods prior to 1994: closure of the measures

3.21. On 31 December 2000, the amounts outstanding for the periods prior to 1994 came to 934 million euro, 100 million euro and 42 million euro respectively for the ERDF, the ESF and the EAGGF-Guidance, compared to 1 481 million euro, 170 million euro and 80 million euro as at 31 December 1999. In several cases, amendments to the financing plans for the measures, which should have been closed several years before, were approved by a Commission decision in 2000.

3.22. In 2000, progress in the closure of interventions was still slow even if an improvement was noted in the case of certain Member States (in particular Italy and the United Kingdom). The Court can only reiterate the observations made in its previous Annual Reports and in its Special Report No 14/98<sup>(17)</sup> which reported the shortcomings, at the level of the Member States and the Commission, which were at the root of the delays in the closure of the measures. Above all, the inability of the Commission to give due consideration to the findings of the audits carried out by the various Commission departments and by the Court remains one of the main causes for delays in closure.

**3.21.** *The figures given by the Court bear out the progress made by the Commission in winding up assistance operations for the period before 1994. This has been carried out in compliance with the rules applying in each specific case, the most litigious situations being, of course, those presenting the greatest difficulty.*

*At the end of June 2001, the number of ERDF assistance operations still to be wound up was 94 with total outstanding commitments of EUR 632 million.*

**3.22.** *The Commission is doing everything it can to wind up all the assistance operations for the period before 1994. As and when the circumstances of programmes allow, it closes them. This position is mentioned in the work programmes adopted by the Commission.*

*Having said that, the winding up of assistance operations is a matter not solely for the Commission. It involves third parties and must, in addition, be carried out in compliance with the rules and requirements of sound financial management. Regulation (EC) No 1260/1999 states that, even upon automatic decommitment under Article 52, final payment (closure) must be made giving rise 'to the repayment of amounts unduly paid'. It should be noted also that Article 52(5) of Regulation (EC) No 1260/1999 extended the deadline for submitting applications for final payment to 31 March 2001. Lastly, the account taken of the results of checks carried out by the various Commission departments and the Court prolongs the discussions with Member States.*

<sup>(17)</sup> Special Report No 14/98 (OJ C 368, 27.11.1998).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.23. In its Special Report No 14/98, the Court had recommended the use of provisional closures where one or more measures were still to be examined<sup>(18)</sup>, in order to avoid entire programmes remaining in abeyance when problems identified during audit only concerned a very limited number of projects, or even only one. Whatever the case, the Commission should decommit automatically, no later than 30 September 2001, the amounts committed for operations or programmes approved before 1 January 1994 in respect of which no application for final payment has been received<sup>(19)</sup>.

**3.23.** The Commission considers that provisional closures, by suspending payment for one or more projects in an assistance operation, are not always practicable since:

- (1) *the amounts of the operations in question are frequently not properly determined if the scale of the problem is not itself properly determined first;*
- (2) *the national authorities are often reluctant to cooperate in determining the amount to be suspended.*

*The procedure for suspending payments is lengthy as it involves entering into discussions with the beneficiary Member State as provided for in Article 24 of Regulation (EEC) No 4253/88.*

*The Commission is endeavouring firstly to complete examinations now in hand and to make the necessary corrections rather than embark upon provisional closures whose legal basis is unclear.*

## SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

### *Introduction*

3.24. The financial data relating to commitments and payments made in 2000 concerning the 2000 to 2006 and previous programming periods for structural measures are presented in paragraph 3.4 of this report.

3.25. The Court based its work towards issuing the Statement of Assurance on an examination of the accounts and on an analysis of certain control systems introduced by the Commission in the area of structural measures. For the financial year 2000, the Court evaluated the implementation of Regulation (EC) No 2064/97 on the financial control of SF measures by the Member States, the implementation of new provisions for the programming period 2000 to 2006, the procedures for the closure of measures and the checks carried out by the Commission in respect of SF measures.

<sup>(18)</sup> Paragraphs 4.3 (c) and 3.17 of Special Report No 14/98 on the closure of the forms of ERDF assistance (OJ C 368, 27.11.1998, p. 1).

<sup>(19)</sup> Article 52(5) of Regulation (EC) No 1260/1999.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.26. In addition, the Court directly examined certain commitment and payment transactions listed in the accounts. Payments corresponding to the closing balances for measures also gave rise to thorough checks in respect of all expenditure declared for a sub-programme throughout the period of assistance (two ERDF payments and a Cohesion Fund project). As closure in respect of the ESF occurs in annual instalments, thorough checks were made in this area regarding the 1998 instalment of an operational programme.

3.27. Observations on the reliability of the Community accounts and general observations on the legality and regularity are set out in Chapter 9 of this year's Annual Report (see paragraphs 9.13 to 9.15 and 9.56 to 9.60). Observations on the legality and the regularity of transactions concerning structural measures and on the systems examined are set out below.

*Analysis of the underlying transactions***Commitments**

3.28. Legal commitments corresponding to the 2000 instalment for programmes in the new period which had been covered by Commission decisions prior to 31 December 2000 were not subject to budgetary commitments in 2000 (see paragraph 9.16 of this report).

3.29. In more general terms, the Court wishes to point out that the payment of commitments in instalments for multiannual transactions, as envisaged by SF legislation, is nevertheless incompatible with the definition of differentiated appropriations given in Article 1(4) of the Financial Regulation. In Opinion No 2/2001 on the recasting of the Financial Regulation, the Court pointed out that the incorporation of this exception into the Financial Regulation itself was not likely to eliminate this incompatibility.

3.30. The Court's examination of the commitments entered in the accounts did not give cause for any further remark concerning their legality and their regularity. Nevertheless, the Court did find some occasional anomalies which would indicate that there are a number of weaknesses in the internal control procedures. For example, there is an ERDF budget commitment which was validated before the decision to approve the

**3.28.** *The Commission is aware of this problem which is the outcome of differences in approach to the programme adoption procedure (see reply to point 9.15).*

**3.29.** *The Commission has noted the Court's objections concerning the payment of commitments in annual instalments. In its reply to the Court's Report for 1999 (see points 3.21 and 3.22) the Commission outlined the benefits that commitments of this kind could have in certain cases. In any event, since the Regulation was adopted on that basis, the commitments will be paid in annual instalments during the period 2000 to 2006.*

**3.30.** *The Commission considers that the errors identified by the Court are formal errors of minor character which are insufficient to justify the conclusion of weaknesses in the internal control procedure. All three cases cited are 'one-off' errors which had no financial impact.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

measure was taken by the Commission, a Cohesion Fund project which was the subject of two separate approval decisions, an ERDF commitment for which the final deadline does not take into account the two-year limit imposed by the regulation.

**Payments**

3.31. For the programming period 2000 to 2006 of the Structural Funds, the payments made in 2000 entail the transfer of an initial advance of 7 % of the total cost of a measure. This transfer takes place when the first instalment is committed. Subsequent payments will entail the reimbursement of expenditure incurred on the basis of declarations certified by the Member States. No payment of this kind was made in this first year of the programming period.

3.32. Transfers of instalment payments for measures decided upon in 2000 did not take place, however, during the financial year (see paragraph 9.17 of this report).

3.33. In the case of previous programming periods, payments take the form of advances, intermediate balances or a final balance. They are contingent upon a declaration of expenditure certified by the Member State, provided that the declared volume reaches a pre-defined threshold specified in the measure's financing plan. Requests for payment of the balance must be accompanied by a report on the implementation of the instalment concerned.

3.34. Since 2000, Cohesion Fund payments have consisted of a 20 % advance followed by refunds of expenditure, the disbursement of which depends on the project's status and are based on declarations by the national authorities describing progress made in relation to physical and financial indicators which are specified in the Commission's decision to grant approval. Payment of the balance of 20 % (or 10 % in duly substantiated cases) of the Community contribution requires the Member State to submit a report confirming that the project has been completed in line with its objectives.

3.35. Whether in the case of the Structural Funds or of the Cohesion Fund, the size of Community payments is not necessarily equivalent or proportional to the volume of expenditure declared by the Member States. As the Court has stated in all of its reports in support of

**3.32.** *The reason for the absence of transfers of advances in 2000 for programmes approved in that financial year is, firstly, the fact that the budget commitment for certain programmes was not made in 2000 and, secondly, that the commitment for a few programmes was made at the end of the year (see reply to point 9.21).*

**3.35.** *Any impact on the Community budget of the premature payment of advances would be very limited and transitory, since the issue is not the amount paid but the timing, and because rectification of any anomalies in the declaration could take place at or before closure. With regard to final*

## THE COURT'S OBSERVATIONS

previous Statements of Assurance, the majority of the errors detected in declarations of expenditure do not in themselves necessarily affect the amounts disbursed by the Commission. In view of possible over-declarations, the level of eligible expenditure after detected errors have been deducted, could still justify payment of the advance or the transfer of the balance concerned. However, the frequency of the anomalies observed in declarations of expenditure shows that the potential impact on the Community budget of the early transfer of advances or of the payment of excessive balances (see paragraph 3.39) is real.

3.36. Legality and regularity errors which directly affect the amounts of the underlying transactions (substantive errors) occur mostly in the Member States, at the level of the final beneficiaries, which also include public authorities that manage programmes or measures where projects are self-managed. The level of errors observed in declarations which give rise to intermediate payments did not vary significantly when compared with previous financial years. The most frequent errors are the same as those observed previously in various Member States, namely:

- (a) expenditure or measures which are ineligible according to the general regulations or specific provisions;
- (b) expenditure which is declared eligible but which exceeds the amount actually incurred;
- (c) expenditure which is not justified by any adequate supporting information or documentation;
- (d) the inclusion of costs unrelated to the projects approved;
- (e) the failure to take account, when calculating the rate of Community financing, of estimated revenue generated by the project;
- (f) over-estimation of the final request for payment.

## COMMISSION'S REPLIES

payments of programmes from the 1994 to 99 period (apart from Objective 2 programmes for 1994 to 96) will be subject to all the provisions laid down in Regulation (EC), No 2064/97, and in particular the requirement in Article 8 concerning a closure statement by an independent body, which will provide increased assurance that non-eligible expenditure has been excluded from the final expenditure declaration.

**3.36 and 3.38.** The Commission has not been able to complete its in-depth examination of all the cases in the limited time available, and for some cases replies from Member States have not yet been provided. The analysis carried out shows that the majority of errors concern the inclusion by the final beneficiary in expenditure declarations of ineligible or unjustified elements. The other principal category concerns the incorrect application of Community rules by the managing authority. However, in a number of cases, the Commission does not share the Court's interpretation. The Commission will in any event conclude its investigation of the cases identified by the Court and ensure that the necessary financial corrections are made.

In the context of the disbursement of billions of euros of public expenditure to support many thousands of individual projects of wide diversity, it is inevitable that there will be certain cases of expenditure items being inadequately justified by the beneficiaries, of errors in expenditure declared and of non-compliance with eligibility rules or other implementation requirements. It is inherent in the system of implementation of the Structural Funds that a number of final beneficiaries, for some items of expenditure, will fail to meet the detailed technical requirements and the high standards laid down. The concern of the Commission is to ensure that where expenditure has been incurred in clear breach of the applicable rules, it is not co-financed by the Structural Funds. For that reason, for the programming period 2000 to 2006, the procedure of certification of expenditure by the Member States has been strengthened and made more precise in Regulation (EC) No 438/2001, so that ineligible expenditure is excluded from the declaration made to the Commission. Other requirements relating to financial management and control have also been reinforced by that Regulation, and the obligations regarding financial corrections where irregularities are detected are set out in Regulation (EC) No 448/2001.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.37. Furthermore, the question of the VAT paid by the central authorities, which is regarded as a real cost but the eligibility of which is not established (see paragraph 3.46 of the Annual Report concerning the financial year 1999), has not met with an answer, notwithstanding that in its reply the Commission undertook to clarify the matter (see the Commission's reply to paragraph 3.46).

**3.37.** With regard to the question of eligibility of VAT incurred by public administrations, the Commission indicated in its reply to point 3.46 of the annual report for 1999 that, whilst admitting the Court's restrictive interpretation was possible, it followed a different interpretation for the reasons set out in that point. The Commission maintains its interpretation of datasheet No 15, whose provisions have now been incorporated into rule 7 of Regulation (EC) No 1685/2000. Nevertheless, in order to ensure that the application of the new rule is clearly understood by those concerned, an explanation of this point will be provided in the information document on the eligibility rules to be produced.

3.38. Other types of error are also of the same kind and frequency as those observed previously, namely:

- (a) the Commission's failure to observe regulatory deadlines, in particular the two-month deadline for making a payment after an eligible request has been received;
- (b) the inadequacy of the checks carried out by the national authorities in respect of the eligibility of expenditure declared;
- (c) the failure to keep supporting documentation in respect of declared expenditure or the inability to reconstitute the audit trail;
- (d) the failure to observe procedural arrangements for public-works contracts;
- (e) the unreliability of the financial breakdown for national programmes at the regional level;
- (f) the lump-sum declaration of expenditure without presentation of the appropriate supporting documentation.

3.39. The detailed checks carried out by the Court in respect of measures closed in 2000 showed that significant errors continue to be made in declarations leading to payment of a final balance:

- (a) in the case of one Objective 1 ERDF sectoral OP for the period 1989 to 1993 (Italy — 'Industry and services'), the checks in respect of a sub-programme found that only 39,9 % of declared expenditure was eligible; this error does not affect the Community payments only because of a very significant over-declaration of 239 %;

**3.39.**

- (a) *The expenditure found to be ineligible by the Court arises from a number of separate findings for different projects.*  
*Information which has been provided by the national authorities will be examined in detail. However, it is noted that there is in any event no financial impact for the Community budget.*

## THE COURT'S OBSERVATIONS

- (b) in the case of one Objective 2 ERDF regional SPD for the period 1994 to 1996 (Italy — Piedmont), the share of expenditure which was not eligible for the sub-programme examined represented 31,1 % of the expenditure declared, with the result that Community funds financed surplus payments of 9,8 million euro, i.e. 33,3 % of the ERDF contribution to this sub-programme;
- (c) in the case of one Cohesion Fund project (Greece — distribution and purification of water in Chalcis), a combination of ineligible expenditure at the rate of 7,2 % of the amount declared and of a rate of finance which did not make adequate allowance for the revenue generated by the project led to an excess payment of 0,8 million euro, i.e. 19,6 % of the Cohesion Fund contribution to this project;
- (d) concerning the ESF, an intensified audit of the 1998 closure for one region (North Rhine-Westphalia) of an Operational Programme (CI Employment 1994 to 1999, Germany) has identified a proportion of ineligible expenditure of 15,7 % for this region, representing 2,7 % of the 1998 ESF contribution for the whole national programme. This error was due to the declaration of advance payments instead of actual expenditure, overstatement of expenditure by the use of flat rates and the lack of documentation concerning parts of the public co-financing.

## COMMISSION'S REPLIES

- (b) The Court's findings concerned three separate measures in one of the sub-programmes of the SPD. The two main issues, which concern a major part of the expenditure found by the Court to be ineligible, are whether the legal and financial commitment at national level was effected before the deadline for certain projects, and the lack of proof that the benefits of the programme were limited to enterprises in the Objective 2 area. Further information is required before the Commission can complete its enquiries on these points. Nevertheless it is accepted that an amount of ineligible expenditure was included in the final declaration, and necessary recovery action will be carried out.
- (c) The rate of co-financed grant took account of the Commission concern for the equality of treatment between Member States with differing policies for charging for water supplies. These differing policies are addressed in a directive due to come into effect in 2004. With regard to the ineligible expenditure the Commission will take action to recover any undue payment when all the information is available and its enquiries have been completed.
- (d) DG EMPLOI accepts the principle of the error uncovered by the Court. Contact has been made with the competent authorities to rectify the situation described by the Court.

**Outstanding commitments**

3.40. Commitments for structural measures are intended to remain open, at least in part, for several years, and until final closure in the case of commitments concerning the last instalment for a measure. Nevertheless, justification for keeping commitments open applies only to amounts which may give rise to payments. The Court therefore verified the validity of old commitments still outstanding at the end of 2000.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.41. A number of commitments concerned files which had already been closed and where the unused balance had not been cancelled immediately. The Commission should ensure that a final payment or recovery cannot be authorised before a cancellation is made.

3.42. Cases where a commitment seems technically justified very often concern old measures which could not be closed due to very slow and inefficient procedures. However, in certain cases it is clear that the full commitment is no longer necessary, in particular where the payment request submitted does not match the amount available. In such cases, the Commission should make the corresponding cancellation without delay.

3.43. Overall, the Court noted that in 10 % of the cases examined at least part of the commitment should not have given rise to any payment. In order to ensure that unjustified commitments do not remain in the accounts, the Commission should take greater care to adjust commitments to actual requirements.

*Analysis of the control systems*

**Implementation of Regulation (EC) No 2064/97**

3.44. In 2000 the Court audited the implementation by the Commission and Member States of Regulation (EC) No 2064/97<sup>(20)</sup>. This regulation sets out a system of checks by Member States on expenditure incurred on projects co-financed by the European Union (Article 3)<sup>(21)</sup> and requires that a closure statement be provided by an independent body no later than at the time of the request for final payment and the final declaration of expenditure for each form of assistance (operational programme, single programming document, Community initiative) (Article 8).

<sup>(20)</sup> OJ L 290, 23.10.1997, p. 1.

<sup>(21)</sup> Article 3 requires that Member States verify the effectiveness of the management and control systems in place and the expenditure declarations made at the various levels. The checks, which must be carried out before the closure of each form of assistance, must cover at least 5 % of the total eligible expenditure.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.45. The findings of this audit were published in Special Report No 10/2001 (OJ C 314, 8.11.2001), together with findings from the audit of the implementation of Regulation (EC) No 1681/94<sup>(22)</sup> (see paragraphs 3.130 to 3.131). The audit work took place in the Commission and in Germany, Spain, France, Italy and the United Kingdom. A preliminary visit was carried out in Portugal.

3.46. In addition, in the course of examining the legality and regularity of a sample of underlying transactions as part of the Statement of Assurance 2000 audit, the Court also examined the progress made in complying with Regulation (EC) No 2064/97 for the forms of assistance in that sample. This allowed the Court to obtain more up-to-date information and to cover an additional four Member States (Greece, Ireland, Sweden and the Netherlands), as well as more regions in the six Member States visited initially. Thus progress in implementing the regulation was assessed for a wider selection of forms of assistance and in ten Member States. The findings from this further testing confirm those in Special Report No 10/2001.

#### Problems of implementation

3.47. The Special Report found that, although Regulation (EC) No 2064/97 represents an important initiative by the Commission to improve financial control of Structural Funds expenditure by Member States and that the checks made and the resultant closure statements should help to avoid the European Union co-financing ineligible expenditure, Member States were not applying the regulation correctly (Special Report, paragraphs 42 to 84). The report stated that, despite the useful guidance given in two appendices in the Structural Funds Audit Manual, the Commission had not given sufficient clear and timely guidance and that it carried out little assessment of Member States' implementation of the regulation by the end of 2000.

**3.47.** The issues raised by the Court regarding the implementation of Regulation (EC) No 2064/97 are all set out in its Special Report to which the Commission has given detailed replies. The essential elements of those replies are therefore repeated here. Since the entry into force of Regulation (EC) No 2064/97, the Commission has made great efforts to give detailed guidance to Member States on the implementation of its provisions, notably through the Structural Funds audit manual, first presented in June 1998 and through the systematic treatment of questions relating to the regulation in the framework of the bilateral coordination meetings with Member States, in the annual meeting of EU Financial Controllers in 1998, 1999 and 2000 and on other occasions.

As regards assessment of the application of the regulation, since 1999, a number of audit missions have been carried out by Structural Funds' services covering compliance with certain aspects of the regulation. In preparation for the closure of programmes from the 1994 to 99 period, a full enquiry was launched at the beginning of 2001 into the implementation of the regulation by all Member States. Where problems are identified in the course of this enquiry, the national authorities are informed so that they are able to take remedial action.

<sup>(22)</sup> OJ L 178, 12.7.1994, p. 43.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

3.48. The Special Report (paragraph 33) further stated that there have been delays in the execution of the 5 % checks by Member States which must be completed by June 2002 (final date for closure). The additional testing in the context of the Statement of Assurance found that in Italy and Greece checks in some OPs audited by the Court had still not started by the spring of 2001. This was also the case for one OP in Germany. It is a matter of concern that Member States may not be able to carry out checks of sufficient quality in the time remaining.

3.49. The Commission had given conflicting explanations of the provision which allows a proportional reduction in the 5 % minimum percentage to be checked for forms of systems approved before the entry into force of this regulation and confusion was noted in Member States as to its implementation (Special Report, paragraphs 75 to 79). The further testing in the context of the Statement of Assurance revealed confusion over the application of the proportional reduction in the sample size in Greece, and in Italy, Ireland and Sweden the Member States authorities interpreted the reduction to mean that checking of expenditure incurred prior to 1998 was not required.

3.50. A common weakness reported upon in the Special Report was the inclusion of expenditure which had not been incurred at the time of the check, particularly where projects were checked at an intermediate stage. In such cases the Member States' authorities counted the entire authorised eligible expenditure as checked (paragraphs 70 to 72). The additional testing carried out by the Court showed further examples of this in France and Sweden.

3.51. The Special Report (paragraph 69) found weaknesses in the content of the reports resulting from the checks. In many cases few details were provided of what work had actually been carried out and what had been tested. Quantified results were rarely given. Checks should be fully documented and there should be a written report of the work undertaken (see Special Report, paragraphs 40 to 41). The further testing showed that documentation of the checks carried out was poor in OPs examined in Ireland, France, Spain and Greece, with little evidence of the work done.

**3.48.** The Commission shares the Court's concern about the delays in some Member States in carrying out the checks clearly required under Regulation (EC) No 2064/97. Member States must ensure that the control provisions of the regulation are complied with before closure and, if necessary, must apply for an extension of time for this purpose. As a result of its own audit work, the Commission has specifically drawn the attention of Member States to the consequences of failing to comply fully with the control requirements of the regulation.

**3.49.** The regulation allows the proportional reduction to be applied in different ways and does not specify whether it should be pro rata expenditure or pro rata temporis. Whilst the Commission has indicated how the provision may be interpreted it cannot impose one uniform basis for applying the reduction. The Regulation does not permit pre-1998 expenditure to be excluded from all checks. This is now the common position of the Commission. Based on the findings of the Commission's audit work in 2001, only in one Member State, Ireland, is it still maintained that checking of expenditure incurred prior to 1998 is not required.

**3.50 to 3.52.** The Commission has not yet visited all the Member States mentioned by the Court for all Funds in the course of the audit work on the application of the regulation which it is currently carrying out. However, from the audits that have been completed, examples of many of the weaknesses identified by the Court have been found, and appropriate recommendations have been made.

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3.52. The Special Report (paragraph 66) states that many checks were limited to the operation of systems rather than substantive checking of individual projects' expenditure declarations. The further testing carried out showed that in OPs audited in Germany and Ireland those performing the checks carried out few or no visits to the final beneficiary. In the Netherlands, for the ERDF all projects are audited on the spot at an intermediate stage. At the closure stage, reliance is placed by the checker on the work of the project's own external auditors, who do not necessarily check compliance with ERDF rules.

## Conceptual problems with the Regulation

3.53. The Special Report highlighted some conceptual problems in the regulation. The method by which the checks should be applied was not clearly defined at the time the regulation was issued, although advice was subsequently given on selection of the sample in Appendices 2 and 5 of the Commission's Structural Funds audit manual. The fact that the regulation requires the sample of expenditure declarations to be checked to be representative and risk-based has led to questionable practices in the Member States. One approach could be to combine the two methods in a logical framework in which a risk analysis is undertaken, identifying items for exhaustive checking, in order to detect and correct errors, complemented by the checking of a representative sample from the remaining population which would show whether or not this is indeed low risk and unaffected by a material incidence of error (Special Report, paragraphs 19 to 21).

3.54. The report also highlighted Member States' concern that by carrying out thorough checks and systems audits and reporting a high frequency of irregularities, they might be penalised by a reduction in European Union co-financing. This could discourage Member States from issuing critical statements. Nevertheless, if the 5 % sample leads to a high frequency of irregularities, it would indicate that a significant level of irregularities still remained in the 95 % not tested. If the irregularities identified during checks are systemic, Article 7 of the regulation requires Member States to correct those cases which have not been individually identified by these checks. It is essential that the use to which the Commission will put the closure statements should be addressed now and Member States informed, particularly in respect of the irregularities found which are non-systemic. It is not clear to the Court what legal

**3.53.** The Commission is currently reviewing the Structural Funds audit manual and will take account of the findings of its own audit work in relation to Regulation (EC) No 2064/97, as well as the observation of the Court, and will discuss the detailed methodology with Member States.

**3.54.** The body designated under Article 8 of Regulation (EC) No 2064/97 is required to indicate in the closure statement any irregularities that have not been satisfactorily dealt with and the amount of Community aid affected. The Commission will therefore have a basis for excluding such amounts from co-financing. If the irregularity is systemic, Member States should have extended checks to cover all operations likely to be affected.

The body providing the closure statement has to give its opinion, on the basis of all the checks carried out and the corrective action taken under Article 7, as to the validity of the request for final payment and the legality and regularity of the underlying operations. It is expressly provided in Article 8(2) of the regulation and in the indicative model for the closure statement that if the frequency of errors found is high, the

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basis would be available to the Commission to make financial corrections (Special Report, paragraphs 81 to 84).

body designated pursuant to Article 8 will indicate that it is not in a position to give an unqualified opinion even if such errors have been satisfactorily dealt with.

In such a case, the Commission service will discuss with the national authorities the action to be taken. The second subparagraph of Article 8(2) provides that the Commission may require further checks to be carried out and the Commission is responsible for making financial corrections.

The Commission considers that Article 24 of Regulation (EEC) No 4253/88 provides a legal basis for extrapolated or flat-rate financial corrections as indicated in the internal guidelines on financial corrections of 15 October 1997.

3.55. The regulation does not set out in detail how Member States should carry out the checks. However, in the Court's view, internationally accepted auditing standards should be applied. These require *inter alia* that those undertaking the checks should be independent of those implementing the project. The Court's audit showed that this principle is not always respected by the Member States (Special Report, paragraphs 37 to 41 and 61 to 62).

3.55. The Commission agrees regarding the importance of ensuring the independence of those carrying out checks. Nevertheless, account has to be taken of the administrative structures of the Member States, the resources available having regard to the size of the programme, and the risks involved, when applying this standard and assessing whether the degree of independence is sufficient. It is clearly not acceptable that a check be carried out by the person responsible for implementing the project.

3.56. The Special Report concluded that unless prompt action is taken to ensure correct application of the regulation by Member States, there will not be sufficient, reliable information to form the basis upon which to close the forms of assistance. Accordingly the Special Report recommended that the Commission should carry out a detailed review of Member States' implementation of the regulation and provide additional guidance and that the Commission should urgently and systematically issue advice to Member States on the adequacy of the checks undertaken and the reports made.

**Implementation of the new provisions in respect of the programming period 2000 to 2006**

3.57. The Structural Funds Regulations for the period 2000 to 2006, which were adopted by the Council of the European Union on 21 June 1999, are characterised in particular by greater decentralisation and a determination to manage the Community budget with greater rigour.

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3.58. The preparation of structural measures for this new period occurs in two distinct phases: firstly, the contents of the CSFs, SPDs or OPs and their financing plan must be approved by the Commission and, secondly, the additional programming, which concerns the project-selection process, is sent to the Commission for information. The Member States could thus expect to receive an advance of 7 % (or a fraction) of the total Structural Funds contribution within five months of sending their proposal for a structural programme to the Commission, pursuant to Article 28(1), of the Structural Funds Regulation. Due to the late adoption of the programmes, only a few of the Member States received this payment within the stipulated time once they had sent their first proposal (see paragraph 3.17).

3.59. As regards Community payments, the 'n + 2' rule contained in Article 31(2), second subparagraph, of Council Regulation (EC) No 1260/1999 of 21 June 1999 stipulates that the Commission shall automatically decommit any part of a commitment which has not been settled by a payment on account, or for which it has not received an acceptable payment application by the end of the second year following the year of commitment; the contribution from the Funds to that assistance is also reduced by that amount.

3.60. The application of this automatic decommitment rule is unclear as regards the link with the date of the commitment, in particular in cases where a decision to make a contribution from the Funds under Article 28 of the aforementioned regulation is taken at the end of a year, whereas the corresponding budgetary commitment is made only at the beginning of the following year. The link with the budgetary commitment, as laid down in Article 31 of the Structural Funds Regulation, may lead to unequal treatment due to a change of financial year attributable to the Commission. The fact is that programmes where adoption and the budgetary commitment of the first instalment took place in the same financial year are penalised when compared with programmes where the Commission made the budgetary commitment in the year after the programmes were adopted (see paragraphs 3.18 and 3.28).

3.61. In so far as those concerned do not always know why the 'n + 2' rule has been applied, for the sake of administrative simplicity and legal certainty the Commission should ensure that the Member States and other interested parties are officially informed of the commitment date chosen by the Commission and of the date

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**3.58.** In its reply to point 3.17 the Commission set out the main reasons for the failure to observe the five-month deadline, including the overlap with the final adjustments to the programmes for the preceding period, the extended negotiations with the Member States and the requirement that adequate management structures be put in place.

**3.60 to 3.61.** The effect indicated is a consequence of the provisions of Article 31(2) of the Council Regulation, but, as indicated in the reply to point 3.18, the Commission considers that in practice this problem will be of limited scope. The Commission provided Member States with information on commitments made for ERDF in 2000 at the meeting of the Committee on the Development and Conversion of Regions on 21 February 2001.

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on which the resulting automatic decommitment is to be checked.

**Procedures for the closure of measures**

3.62. The Structural Fund Regulations contain few specific rules for closing measures. The only applicable provision in the coordinating regulation sets a deadline of six months after the physical completion of the measure for submitting the payment request and the related implementation reports. Regulation (EC) No 2064/97 also requires a declaration of validity for measures in the period 1994 to 1999, a requirement which does not apply to the 1989 to 1993 period and from which 1994 to 1996 measures under Objective 2 are exempt de facto. Regulation (EC) No 1260/1999 governing the programming period 2000 to 2006 states that the Commission will decommit, by 30 September 2001 at the latest, sums corresponding to measures decided upon prior to 1994 in respect of which a final request for payment has not been made by 31 March 2001, and will decommit by 30 September 2003 at the latest sums relating to measures in the 1994 to 1999 period in respect of which a final request for payment has not been made by 31 March 2003, except for transactions or programmes which have been suspended on legal grounds.

3.63. Owing to the lack of binding provisions in the regulations, the Commission departments responsible for managing the various Funds have had to develop their own closure arrangements. These arrangements occasionally converge, as in the case of the authorisation, at budgetary and physical implementation level, of off-setting between measures within a given sub-programme. On the other hand, practice differs as regards the payment of instalments, with only the ESF closing the various annual instalments, whilst the other Funds settle subsequent commitments when total declared expenditure reaches the required level.

3.64. In September 1999, the Commission also adopted the decision 'Guidelines for the financial closure of operational measures (1994 to 1999) of the Structural Funds' (23), a document which codifies various obligations stemming from the regulations in force and sets limits on the flexibility of financial

**3.63.** Any divergence in practice between the Funds for the 1994 to 1999 period was limited since all final closures were subject to the same financial implementing provisions. For the 2000 to 2006 period, detailed internal financial rules have been drawn up which will be applied for all the Funds.

(23) Document SEC(1999) 1316 final of 9 September 1999.

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implementation. The innovations include closure in the absence of a request for a final balance and/or a final implementation report, the restriction of Community financing to amounts actually allocated to final beneficiaries and details of possibilities for partial closure in the event that aid is suspended or a financial adjustment is made.

3.65. These guidelines could make it possible, to some extent, to compensate for the fact that failure to submit final documents does not entail debarment. As regards closure where final documents are lacking, the Commission is considering issuing formal notification six months after the deadline for payments has expired, a step which would enable it to close a measure on the basis of the most recent available data. However, there is a danger that the present deadline for automatic decommitments would mitigate the effects of the formal notification procedure.

3.66. However, this group of provisions and guidelines does not constitute a clearly defined and rigorously applicable closure procedure which would guarantee the legality and regularity of the transactions underlying contributions from the Community budget for all completed programming periods. The detailed checks carried out by the Court revealed the persistence of a high level of errors in the measures closed in 2000 (see paragraph 3.39) following the pattern of the findings for the previous years (see paragraphs 3.49 to 3.51 of the Annual Report concerning the financial year 1999 and paragraphs 3.29 to 3.30 of the Annual Report concerning the financial year 1998).

3.67. For example, the limitation of aid for amounts actually allocated to beneficiaries is a requirement which stems directly from existing legislative principles. The need for a reminder may be ascribed to the Commission's practice of applying the planned intervention rate to eligible expenditure even when the actual rate was lower, as the Court pointed out in its 1998 Annual Report (24). It should be pointed out that the Commission ought to apply this rule equally to measures for the period 1989 to 1993 which are still to be closed and re-examine closed measures in respect of which an excess payment may have been made (see also paragraph 3.114 of this report).

**3.65.** *The Commission considers that the procedure referred to by the Court will be useful in accelerating the closure of programmes in certain cases.*

**3.66.** *The purpose of the guidelines is to formalise the treatment of certain aspects of closure where procedures may have been divergent. They do not seek to set out the checks which should be made by the responsible services to ensure, for example, that all audit findings have been properly dealt with or that the final reports are complete and satisfactory. These procedures form part of the internal financial circuits laid down by each Directorate-General. Furthermore, the basis for the assurance as to the legality and regularity of the operations co-financed will be the closure statement which has to be submitted under Article 8 of Regulation (EC) No 2064/97 and which will be the subject of checks by the Commission. The requirement of closure statements should give greater assurance that ineligible expenditure of the type identified by the Court in its controls of closed programmes is excluded prior to submission of final declarations to the Commission.*

**3.67.** *The guidelines adopted by the Commission in 1999 on the winding-up of programmes for 1994 to 1999, which are now applied for the final payment for those programmes, are in line with the Court's requirements.*

(24) Annual Report concerning the financial year 1998, paragraph 3.30.

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3.68. The procedure for partially closing measures where projects have been suspended for legal reasons was not consistently applied, as shown by various cases within the ambit of the EAGGF-Guidance.

**3.68.** *The winding-up of assistance operations by the Commission where projects have been suspended for legal reasons is a complicated issue frequently representing a disproportionate workload for the departments responsible for financial management. In actual fact, the description 'suspended for legal reasons' covers a wide range of situations that differ according to the Member State concerned, the type of project involved and the nature and progress of the legal procedures in hand. Point 10 of the Commission guidelines for the closure of operational measures for the period 1994 to 1999 (Document SEC(1999) 1316) simply contains general rules and the departments must continue, within that framework, to deal with individual cases in partnership with the authorities responsible for implementing an operation.*

*The Commission is drawing up more detailed guidance on the point in order to ensure a uniform approach.*

3.69. In addition, the Commission closed Objective 2 measures for 1994 to 1996 in respect of which the Member States had not carried out the minimum checks required by Regulation (EC) No 2064/97. Although the regulation does not require a declaration of validity to be submitted for these measures, it does lay down that the minimum prescribed checks (5 % of eligible expenditure, with the possibility of a lower rate in the case of measures approved before the regulation came into force) should be carried out in respect of the entire period 1994 to 1999.

3.70. The Commission appraises final payment requests using standard procedures, which very often take the form of inter-departmental consultations where each unit acts in accordance with its own powers and no primary responsibility is clearly established. The consultations aim, in particular, to establish whether any previous checks in respect of the measures in question have given rise to observations. Various databases, which aim to keep a record of any observations made, including the Court's, have been set up without any genuine coordination. Where no previous problems have been reported, closures do not give rise to more thorough checks, for example *in situ*, based either on random sampling or on risk analysis. In actual fact, the Commission's checks when a measure is closed have not been intended, until now, to constitute efficient verification of the legality and regularity of the expenditure declared (see also paragraph 3.72).

**3.69.** *For programmes ending before 1 January 1997, the Commission has not systematically required information on the controls carried out by the national authorities either under Article 23 of Regulation (EEC) No 4253/88 or under Regulation (EC) No 2064/97 as a precondition of closure.*

**3.70.** *As part of the financial reform undertaken within the Commission, new financing channels have been put in place which identify responsibilities for effecting payment transactions, including final payments for Structural Funds programmes.*

*Prior to closure of programmes a check is carried out in relation to the follow-up of audit findings by Commission auditors and, as far as possible, by the Court's auditors. A new data base is under development to facilitate this process which should be operational by early part 2002.*

*It is not possible for the Commission to carry out on-the-spot checks on a high proportion of measures at the time of their closure. Substantially increased resources would be needed for such an undertaking. The purpose of Article 8 of Regulation (EC) No 2064/97 (taken over in Article 15 of Regulation (EC) No 438/2001 for the new programming period) is precisely to confirm the responsibility of Member States for verifying the accuracy of their declarations, through the work of an independent body.*

*Prior to closure of the 1994 to 1999 programmes in 2002, a selection of programmes will be subject to in-depth checks. The precise methodology for selecting the programmes for audit is currently under discussion.*

## THE COURT'S OBSERVATIONS

3.71. When inspection findings have been issued, the consultation procedures between departments and with the Member State often prove to be too lengthy. Thus, the Court checked a number of measures in respect of which it had made observations in various reports. In the case of two ERDF measures checked in 1995 and 1996, where the outstanding balance totalled 7,4 and 2,6 million euro, the final payment requests were submitted in 1997. Procedures were initiated only occasionally by the Commission and the files had still not been closed at the end of 2000. In the case of two measures checked in 1994, where the outstanding balance totalled 3,1 million euro, in spite of a large volume of correspondence, an UCLAF enquiry carried out in 1996 and a financial adjustment procedure initiated in 1998, final payment requests submitted in 1995 and 1997 had not yet been settled at the end of 2000.

**Checks carried out by the Commission**

3.72. The Court has pointed out on several occasions, in particular in its Annual Report concerning the financial year 1999 (paragraph 3.75), that the on-the-spot checks carried out by the Commission are inadequate. The financial year 2000, during which the Commission embarked upon its internal reform procedure, saw the transfer of the Directorate-General for Audit inspection units to the operational DGs responsible for the management of structural measures. The incorporation of these new units, together with the introduction of legislation for the new programming period, took its toll of the Commission's overall inspection capacity. Thus, in the case of the ERDF and the Cohesion Fund, the two units responsible for inspections carried out fewer checks in 2000 than in previous years. These units planned to emphasise the audit of management and inspection systems in 2001 and therefore envisage carrying out only a small number of checks in respect of OPs/SPDs and of projects.

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**3.71.** *The Commission accepts that the procedures for closing programmes where problems have been identified have been too slow. High priority is being given to completing the closure of such programmes and by late 2001 the Commission expects to have reduced the commitments for pre-1994 projects and programmes to a few contentious cases and to have made substantial progress on commitments related to later periods.*

**3.72.** *The Commission's internal reform process involving the transfer of the Financial Control Directorate-General control unit to the operational Structural Funds DGs necessarily caused some disruption in audit work planned. Control unit B.3 in the Financial Control Directorate-General nevertheless carried out 16 audit missions in 2000 (compared with 19 in 1999). Regarding the Cohesion Fund, control unit B.4 in the Financial Control Directorate-General carried out one audit mission in 2000 compared with three in 1999. In addition, the Regional Policy Directorate-General audit unit carried out 36 audit missions relating to ERDF and Cohesion Fund in 2000 (compared with 42 in 1999).*

*For 2001, the principal objectives in the work programme of the Regional Policy Directorate-General audit units are the systems audit of Regulation (EC) No 2064/97 and the audit of the management and control systems being implemented for the programming period 2000 to 2006, together with a systems audit of the management and control systems for the Cohesion Fund which are being implemented in order to comply with Council Regulations (EC) No 1264/1999 and (EC) No 1265/1999 amending Regulation (EC) No 1164/94.*

*However, a number of Cohesion Fund projects will be audited in 2001 in the context of the systems audit referred to. In addition, an enquiry relating to Article 10 projects, which involves on-the-spot audits of up to 100 individual contracts, will be completed with the assistance of external auditors. Lastly, a number of other ad hoc audits of programmes has taken place.*

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3.73. The inspection departments responsible for the ERDF and the Cohesion Fund nevertheless implemented a number of measures to improve the preparation, scope, quality and monitoring of their checks in the Member States. These measures produced no tangible results in the course of 2000.

### *Conclusions and recommendations*

#### **Conclusions**

3.74. The Court did not note a reduction in the level of errors contained in the declarations of expenditure regarding completed programming periods. As in the past, the persistence of a significant level of errors observed in respect of closed measures shows that the likelihood of errors being detected and rectified remains small. The financial control systems, which were strengthened in 1997 (eligibility forms and Regulation (EC) No 2064/97), together with more accurate closure procedures and the control protocols with the national authorities, have not yet proved to be effective.

3.75. The number of checks carried out by the Commission while measures were being implemented and at the time of closure fell in 2000. The follow-up to observations made as a result of checks, in particular the Court's, reveals shortcomings which prevent established problems from being resolved quickly. In addition, the Commission cannot content itself with resolving the periodic cases reported without extending its checks to similar situations.

3.76. The budget transactions for the financial year 2000 do not afford all of the requisite guarantees of legality and regularity. No comments are called for regarding the commitments entered in the accounts, although a significant proportion are actually chargeable to the previous financial year. On the other hand, a significant number of legally-binding decisions were taken without the corresponding budgetary commitments. Payments for the financial year corresponding to the transfer of advances in respect of measures covered by the new programming period reveal no anomalies. The number of substantial and formal errors concerning intermediate and final payments in respect of previous programmes is comparable to the number in previous financial years.

**3.74.** *It is premature to assess the impact of the closure statements required under Article 8 of Regulation (EC) No 2064/97 and the closure guidelines until a representative number of programmes from the 1994 to 1999 period have been closed. The Commission is of the opinion that the correct application of these provisions should significantly reduce the risk of ineligible expenditure being co-financed by the Structural Funds.*

**3.75.** *There was a temporary drop in the number of checks carried out in 2000 as a result of the internal reform process. It is expected, however, that the concentration of auditing capacity in the operational Directorates-General will lead to an improvement in the number and quality of checks. New systems being put in place should improve the follow-up of all audit findings, including those of the Court. This will mean that the Commission will be able to take account more systematically of previous audit findings in its risk analysis, particularly in relation to errors which may be systemic.*

**3.76.** *The Commission accepts that there are cases where the budgetary commitment of programmes approved in 2000 took place in 2001. This was the result of differences in practices in the procedure for adopting programmes (see reply to point 9.15). The Commission has not been able to complete its in-depth examination of all the cases of error identified by the Court within the limited time available, and in some cases replies from Member States have not yet been provided. The analysis carried out shows that the majority of errors concern the inclusion by the final beneficiary of ineligible or unjustified amounts in expenditure declarations. The other main category concerns the incorrect application of Community rules by the managing authority. However, in a number of cases, the Commission does not share the Court's interpretation. The Commission will in any event conclude its investigation of the cases identified by the Court and ensure that the necessary financial corrections are made.*

## THE COURT'S OBSERVATIONS

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**Recommendations**

3.77. The Commission should therefore strive to make the inspection systems introduced in recent years more effective. In particular, it should ensure that the management procedures employed by national bodies and the inspection procedures implemented under Regulation (EC) No 2064/97 do indeed guarantee the legality and regularity of the transactions funded by the Community. To this end, where the closure of measures is concerned the Commission should also introduce more effective standardised procedures entailing a sufficient number of checks carried out by its own inspectors.

**3.77.** The Commission reiterates its view set out in the reply to paragraph 3.76 of the Annual Report 1999 that the main priority must be to maintain progress in improving the financial management and control systems in Member States. The adoption of Regulations (EC) No 438/2001 and (EC) No 448/2001 provide the detailed legal framework necessary to ensure that this objective can be achieved. The result of the systems' audits currently being undertaken mainly by the ERDF on the implementation of Regulation (EC) No 438/2001, as well as on the application of Regulation (EC) No 2064/97, will provide a basis for drawing conclusions as to the adequacy of the framework management systems and for taking appropriate action where necessary.

*The programme of audits on the 1994 to 1999 programmes in view of their closure, undertaken by all Structural Funds during 2001 and 2002 will provide further assurances concerning the final payments.*

**FOLLOW-UP TO PREVIOUS OBSERVATIONS***Measure to support small and medium-sized enterprises (SMEs)***Introduction**

3.78. The Court examined the action taken by the Commission in response to past observations<sup>(25)</sup> on the implementation of measures to support enterprises, particularly SMEs, within the framework of the Structural Funds. The Court noted shortcomings, in particular in respect of evaluation, the regulatory framework, identification of measures, verification of compliance with the rules concerning competition and the coordination and also the implementation of the measures, particularly in the context of financial engineering and services provided to the enterprises. When granting discharge for the financial year 1994, the Council recommended that the SMEs' access to existing instruments should be facilitated, that actions in support of the SMEs should be reorganised in order to take their needs into account and that evaluation of the resources and results of Community action in this field should be

<sup>(25)</sup> This concerns, in particular, the Annual Reports concerning the financial years 1994 (paragraphs 5.66 to 5.104), 1996 (paragraphs 6.43 to 6.104) and 1998 (paragraphs 3.54 to 3.59).

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improved (26). In 1998, during the discharge for 1996, the Council recommended that aid procedures should be rationalised and simplified, that aid for SMEs should be made more accessible and that the Commission should ensure that the services offered to the SMEs were in response to actual requirements (27). For its part, the Parliament was alarmed by the Court of Auditors' revelation that funds had been made available in the Community budget to finance a certain number of measures which were intended to promote small and medium-sized enterprises but were potentially unmanageable (28).

### Confirmation of the failings identified by the Court

3.79. In 1997, in response to the Court's observations, the Commission launched a macro-assessment of the impact of the Structural Funds on the SMEs and, subsequently, thematic evaluations of financial engineering and the European Community business and innovation centres (EC-BIC) (29). These evaluations confirmed the Court's main observations concerning aid to the SMEs, particularly in respect of the failure to comply with the

**3.79.** While it is true that this thematic evaluation highlights a number of aspects that could be improved in terms of Structural Fund operations for the benefit of SMEs, it also finds that '... Overall it is clear from the research that Structural Funds' measures have had a significant impact on the SME sector and in so doing have made an important contribution to wider regional policy aims...'.

(26) Council Recommendation of 11 March 1996 concerning the discharge to be given to the Commission in respect of the implementation of the general budget of the European Union for the 1994 financial year.

(27) Council Recommendation of 9 March 1998 concerning the discharge to be given to the Commission in respect of the implementation of the general budget of the European Union for the 1996 financial year.

(28) European Parliament Resolution of 31 March 1998 informing the Commission of the reasons for the postponement of the discharge in respect of the implementation of the general budget of the European Union for the 1996 financial year (OJ C 138, 4.5.1998, p. 43).

(29) 'Thematic Evaluation of Structural Funds Impacts on SMEs', European Commission, Ernst and Young, July 1999. 'Evaluation of Community measures in support of European Community business and innovation centres (EC-BICS)', Madrid, Karlsruhe, February 1999, Dr-Ing Jürgen Wüst.

'Evaluation of Financial Engineering Measures in Structural Policies', European Commission, Ernst and Young, April 1998.

## THE COURT'S OBSERVATIONS

rules on information and publicity (30), the poor visibility of the measures, the shortcomings affecting the coordination of measures (31), deficiencies in the evaluation of the impact of the measures, weaknesses in the *ex ante* assessments and the absence of adequate indicators, particularly in the context of financial engineering (32). The evaluations also confirmed the necessity of improving systems for supplying services to the SMEs, such as the EC-BICs, to speed up the development of 'one-stop shop' systems, and to simplify the existing measures in order to facilitate SME access to Community financing.

**Taking the failings identified into account in the regulations**

3.80. The Court's recommendations influenced the legislative proposals submitted by the Commission for the new period and the guidelines for programmes in the period 2000 to 2006 (33). As the number of aid

## COMMISSION'S REPLIES

*The simplifying of procedures and the improvement of the arrangements for delivering services to SMEs are objectives that are shared by the Commission. The 'one-stop shop' approach referred to by the Court is one of the ways that could be used to help attain these aims.*

**3.80. The thematic evaluation on the impact of the Structural Funds on SMEs drew a range of conclusions.** As regards the conclusion quoted in this point, the Commission clearly recognises that objectives for the 1994 to 1999 period were not sufficiently clear and quantified. It was partly for this reason that the thematic evaluation was commissioned, with a view to assessing the impact of the Structural Funds on SMEs and analysing the most effective means of assisting SMEs. The results of the evaluation have been fed into the programming of the Structural Funds for the 2000 to 2006 period, in particular on the question of how to ensure better targeting of aid on SMEs. In addition, because this was a thematic evaluation undertaken mid-way through the programming period, it was inevitable that it would not be possible to draw definitive conclusions on the impact of the Structural Funds on SMEs in the 1994 to 1999 period.

In addition to the estimate of expenditure on SMEs, the thematic evaluation also estimated the number of beneficiary companies and the employment created. It concluded that between 1989 and 1999 over one and a half million SMEs were assisted by the Structural Funds, representing 21,2 % of eligible SMEs. Between 1994 and 1999, it estimated gross jobs created of 2,3 million, with net jobs estimated at 2 million.

(30) More than a quarter (25,6 %) of the SMEs covered by the thematic evaluation of SMEs which received SF assistance were unaware that the funds they had received came from Community sources. In its 1996 Annual Report (paragraphs 6.53 to 6.59), the Court drew attention to a number of practices which would explain this lack of information.

(31) The survey carried out in 1998 amongst those SMEs which had benefited from a number of Community subsidies shows that 69,7 % of them consider the relevant systems to be 'not integrated at all'. This percentage rises to 85,1 % for the SMEs which received ERDF and ESF aid. The authors of the evaluation conclude that 'At an EU level, there is a need to improve the overall coherence of different Commission programmes that have a bearing on SME development', which confirms the Court's observations (Annual Report concerning the financial year 1996, paragraphs 6.98 to 6.99).

(32) 'Financial engineering' is understood to be SF contributions to implementing measures other than the non-repayable assistance described under Article 28(3) of Regulation (EC) No 1260/1999. This covers, in particular: repayable assistance, interest-rate subsidies, guarantees, equity holdings, venture-capital holdings or another form of finance.

(33) (OJ C 267, 22.9.1999, p. 2). These guidelines stipulate that 'Assistance under the SFs to stimulate the productive sector must focus in particular on small and medium-sized enterprises'.

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measures has been reduced and the SME CI abolished<sup>(34)</sup>, the strategy for aid to SMEs should become more straightforward and more consistent. The new regulatory framework should allow improvements in the management of aid measures in support of SMEs, in monitoring and evaluation, provided that the provisions become operational as soon as possible. The new regulatory framework for the management and control systems for the Structural Funds was adopted by the Commission in March 2001<sup>(35)</sup>. Moreover, Commission Regulation (EC) No 1159/2000<sup>(36)</sup> of 30 May 2000 on information and publicity measures to be carried out by the Member States concerning assistance from the Structural Funds should improve the visibility of the aid measures. In addition, a new regulatory framework was also drawn up in the field of competition policy rules<sup>(37)</sup>. With regard to the period 1994 to 1999, with the exception of the adoption in 1997 of the datasheets on eligibility of expenditure<sup>(38)</sup> and of Regulation (EC) No 2064/97, the measures taken could not have any significant impact on the programmes already adopted and in progress.

*A further concern of the evaluation was to identify the extent of deadweight in aid schemes for SMEs. As a result of the findings of the evaluation and in order to enhance the impact of Structural Fund support to SMEs, the Commission has given greater priority to indirect support for SMEs as opposed to direct aid and this is reflected in the programmes for the 2000 to 2006 period.*

*The European Employment Strategy emphasises the importance of the role played by SMEs in providing jobs within the European Union. The combined assistance from the Member States, the different Structural Funds and the EIB is aimed at meeting the various needs experienced by SMEs upon setting up and in the context of their activities in the market place (financing, hiring of staff, providing skills for employees, etc.).*

*The late adoption of the new regulation on management and control had a limited impact on the management of the Funds, given that most operational programmes were adopted between the end of 2000 and March 2001, and that the Commission's main requirements were made known to the Member States in March 2000, and discussed in great depth in the Fund Committees between then and the vote in the Management Committee in December 2000.*

<sup>(34)</sup> In particular, with regard to the SME Initiative, the Court found (Annual Report concerning the financial year 1999, paragraphs 6.86 to 6.91) that the programmes under this Initiative either covered measures which were identical or similar to the ones in the CSFs or the SPDs or created new measures with the same objectives as the existing ones.

<sup>(35)</sup> Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds (OJ L 63, 3.3.2001, p. 21).

<sup>(36)</sup> OJ L 130, 31.5.2000, p. 30.

<sup>(37)</sup> These are Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 83, 27.3.1999, p. 1) and Council Regulation (EC) No 994/1998 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid (OJ L 142, 14.5.1998, p. 1), and also the Commission Regulations concerning State aid on the application of Articles 87 and 88 of the EC Treaty to training aid, *de minimis* aid and aid to SMEs: Regulations (EC) No 68/2001, (EC) No 69/2001 and (EC) No 70/2001 of 12 January 2001 (OJ L 10, 13.1.2001, p. 20, 30 and 33).

<sup>(38)</sup> Commission Decisions 97/317/EC to 97/331/EC of 23 April 1997 modifying the decisions approving the CSFs, the SPDs and the Community Initiative programmes (OJ L 146, 5.6.1997, p. 1).

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3.81. The eligibility of expenditure sheets allowed clarification, as from 1 May 1997, of some of the problems raised by the Court (Annual Report concerning the financial year 1996, paragraphs 6.73 to 6.76 and 6.84), in particular in respect of financing from other sources for co-financed projects and financial engineering. For the period 2000 to 2006, these sheets have been replaced by rules contained in Commission Regulation (EC) No 1685/2000<sup>(39)</sup>. However, the eligibility conditions governing financing from other sources have not been retained in the new rules and those regarding financial engineering were substantially amended<sup>(40)</sup>, which has produced uncertainty (see paragraph 3.91).

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**3.81.** During the 1994 to 1999 programming period, 'alternative financing' or 'alternative payment,' covered by datasheet 16 of the SEM 2000 eligibility sheets, was used as a management facility aimed at using as efficiently as possible the funding made available on different dates by all the financial partners: Community, national government and public sector entities.

For the 2000 to 2006 programming period, automatic annual commitments as well as a system of advances and speedier payments, have been introduced into financial procedures. For this reason the Commission saw no need to maintain the old datasheet 16 when reviewing the eligibility rules. None of the Member States challenged this and the Committee for the Development and Conversion of Regions approved the new eligibility rules before they were adopted by the Commission.

The absence of a specific rule does not imply that this cash-flow management tool must no longer be used. Obviously, Regulation (EC) No 1260/1999, and in particular Article 29, must be complied with in full. This means that all projects, independent of the physical source of public funds, are considered to be Community co-financed within the limits set by Article 29 and that grant letters must specify the exact amount of Structural Fund aid. In order to underline its character as a cash-flow management tool, the Commission prefers to call it 'alternative payment' rather than alternative financing.

The Directorate-General for Regional Policy has explained this position to Member States' authorities on various occasions, both orally and in writing.

<sup>(39)</sup> Commission Regulation (EC) No 1685/2000 of 28 July 2000 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards eligibility of expenditure of operations co-financed by the Structural Funds (OJ L 193, 29.7.2000, p. 39).

<sup>(40)</sup> The key element justifying Community co-financing was clearly set out in the forms for 1997: 'the involvement of the Community in financial engineering should be limited and, in any event, it should avoid substituting for or overlapping with the financial sector, unless it can be shown that the latter is not suited to the development needs of the region in question'. However, this basic principle was no longer retained in the rules for 2000.

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3.82. A number of provisions in the new general Regulation tackle difficulties which were pointed out by the Court. For instance, the new provisions concerning differentiation of the rates of intervention<sup>(41)</sup> define precisely how to deal with projects which generate substantial net revenue, reduce the Funds' contribution where there is investment in the enterprises (from 50 % to 35 % and from 30 % to 15 % for Objectives 1 and 2 respectively) and introduce positive discrimination in favour of SMEs (possibility of increasing assistance by not more than 10 % for forms of finance other than direct assistance).

3.83. An obligation has been included in the regulation to ensure that, from now on, the assistance repaid to the managing authority or to another public authority is reallocated to the same purpose<sup>(42)</sup>. Rules have also been incorporated both to ensure that, for at least five years, SF assistance will not be diverted away from its initial objective and to prevent firms or public bodies gaining undue advantage<sup>(43)</sup>. This gives the Commission new instruments to avoid situations which are open to dispute, such as failure to recover amounts which should have been recovered, retention by the managing authorities of the amounts recovered, changes in the location of the investments benefiting from assistance or the sale of the co-financed infrastructures (for example by privatisation) and to which the previous provisions in the regulations do not offer an appropriate response. However, the provisions mentioned in the preceding paragraphs raise problems of interpretation and the Commission should define more precisely the manner in which it intends to implement the general principles set out here in order to make these provisions operational and enable appropriate monitoring and checks to be carried out.

#### Improving identification of measures to support SMEs

3.84. Thematic evaluation in respect of the SMEs allowed better identification of those measures which offer support to the SMEs and of the resources devoted to them, as requested first by the Court (Annual Report

**3.82 and 3.83.** The Commission considers that a discounted cashflow calculation is the most appropriate method to determine the net revenue of an operation. Under that formula and considering recital 40 of the General Regulation, substantial net revenue would be deemed to be present when the net present value of the future flow of revenue, less operating costs, resulted in a figure of at least 25 % over the cost of the investment. Operating costs are the costs incurred for the operation of an investment, including costs of maintenance, but excluding depreciation or capital costs. The Commission is presently preparing a guidance note for Member States on a practicable and reasonable application of Article 29(4).

<sup>(41)</sup> Recital 40 of the preamble and Article 29 of Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds.

<sup>(42)</sup> Article 28(3) of the general Regulation and Article 8 of the new regulation on the management and control systems, which obliges the managing or paying body to keep accounts of amounts recoverable and to ensure that the amounts concerned are recovered without unjustified delay.

<sup>(43)</sup> Article 30(4) of the general Regulation.

**3.84 and 3.85.** The Commission agrees that the availability of better information depends on the improvement of monitoring systems in the Member States. In view of the current early stage of implementation of the 2000 to 2006 programmes, the Commission does not believe that progress has been particularly slow. Putting new information systems in place takes time, particularly for Member States where the implementation of measures is highly decentralised. Moreover, information collected must contribute to the management of projects at local level, and must also be meaningful in the

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1996, paragraph 6.96), then by the Council (44) and the Parliament (45). In the absence of an inventory, a global estimate of the expenditure on SMEs (21 353 million euro, i.e. 18,2 % of the entire SF for the period 1994 to 1999) had to be made. In order to discover the situation at another date, such as, for example, the end of the period, this exercise would have to be repeated, which demonstrates that the fundamental problem is still the absence of reliable data systems which allow adequate monitoring of the measures to be carried out, as the Court has pointed out on several occasions. (46)

3.85. On the basis of Article 36 of the General Regulation, the Commission proposed a new system of categorisation of the fields of SF intervention (47). The information which, according to the provisions, is to be forwarded to the Commission should allow the Commission to draw up summaries of the Fund's activities on the basis of the various assistance measures. Moreover, Article 34 (1)(a) stipulates that a system to gather reliable financial and statistical information and for forwarding this data is to be set up using, where possible, computer systems. In addition, the Commission has proposed a methodology in respect of the monitoring and evaluation indicators (48) which specifically take the SMEs into account. The Member States are now beginning to make efforts to adapt to these new initiatives. A

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*context of the national or European synthesis on horizontal issues (SME, equal opportunities, etc.). The Commission is confident that the effort put into developing those systems will pay off in better-quality information in the annual reports and particularly in the mid-term evaluation, which is due to be completed at the end of 2003.*

**3.85.** *Member States must report on the operation of these data-collecting mechanisms, administered on the responsibility of the managing authorities, in particular in their annual implementation reports.*

(44) Council Recommendation concerning the discharge to be given to the Commission in respect of the implementation of the general budget of the European Union for the 1996 financial year.

(45) European Parliament Resolution of 31 March 1998 informing the Commission of the reasons for the postponement of the discharge in respect of the implementation of the general budget of the European Union for the 1996 financial year, paragraphs 22 and 23 (OJ C 138, 4.5.1998, p. 43). The Parliament notes 'that significant funds were allocated in the SFs for helping SMEs in the programming period 1994 to 1999, but the Commission until now was totally unable to explain how this money has been allocated'.

(46) See the recent 1999 Annual Report, paragraph 3.27.

(47) This allocation was in the 'Vademecum: Plans and programming documents for the Structural Funds 2000-2006' (Commission, DG REGIO, July 1999) and is also included in the new management and control regulation.

(48) Indicators for Monitoring and Evaluation: An indicative methodology. The new 2000 to 2006 programming period: methodological working documents. Working Document No 3, European Commission, DG REGIO, July 1999.

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real improvement in the overall information available on programming, monitoring and evaluation of structural measures depends on the smooth working of these new systems.

**Initiatives taken to improve verification of compliance with competition policy rules**

3.86. The Court found shortcomings in the procedures to verify competition policy rules (Annual Report concerning the financial year 1996, paragraphs 6.46 and 6.53 to 6.68; Annual Report concerning the financial year 1998, paragraphs 3.58 to 3.59). Initiatives have recently been taken, both at Commission level and in the Member States, to improve the information available on the aid granted. In addition, in 2001 following a request by the European Parliament (<sup>49</sup>), the Commission set up a register of decisions concerning State aid. The new regulatory framework concerning State aid contains provisions on controls which reinforce the obligations in respect of the recording and forwarding, on an annual basis, of information on the assistance granted. It is too early to evaluate the impact of the provisions, which aim to simplify and enhance transparency in the field of State aid. Nevertheless, the new rules in this field should allow the Commission to improve its procedures for verifying compliance with competition policy rules, provided it allocates the necessary resources to this subject.

3.87. The Court recommended that, in order to make it easier for the economic operators to comply with the rules and the relevant procedures, the texts of the programmes should contain specific references to the legislative texts and other legal instruments which are designed to ensure strict application of the Community policies. In 2000, the Commission drew up a document setting out the principles and the procedures to be followed during implementation of the Structural Funds with regard to compliance with competition law on state aid for the new programming period (2000 to 2006) (<sup>50</sup>). The salient characteristic of the procedures is that managing charts on State aid are to be drawn up and form part of every programme. In future. It is absolutely essential for the Commission to give appropriate monitoring to the development of these tables and for

**3.86 to 3.88.** *The obligations concerning the monitoring of state aid imposed on the national authorities in the new programmes and covering both de minimis aid and aggregation with other aids ensure compliance with the rules governing, and the limits on, State aid. The implementing Regulation on the management and control systems attaches considerable importance to the arrangements for ensuring compliance with Community rules, including State aid rules. This is one aspect of systems which the Commission will be verifying closely.*

(<sup>49</sup>) European Parliament Resolution on the Commission's XXVIIth Report on Competition Policy, 18 January 2000, Report PE A5-0078/99. European Parliament Resolution on the Commission's XXIXth Report on Competition Policy, 24 October 2000.

(<sup>50</sup>) Structural Funds and State aid. Implementing procedures (DG REGIO G1, 15 May 2000).

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the managing authorities to keep them up to date and supplement them by inserting specific references to the relevant national and regional arrangements.

3.88. In some cases of infrastructure investment, in particular in the telecommunications, transport and energy sectors, the counterpart of the Community financing is made up of a contribution by a firm or body and the amounts involved do not pass through national budget channels. Measures should be taken to guarantee that this Community assistance is subjected to the same rules and the same checks as national aid (51).

### Specific aspects which concern the European Social Fund

3.89. The summary of the final ESF evaluations for the period 1994 to 1999 (52) does not supply any indication of the assistance for SMEs in the part devoted to Objective 1. It only contains heterogeneous details in the part concerning Objective 4, in spite of substantial references to the contributions by the SMEs included in the national evaluation reports concerning this objective. With regard to the period 2000 to 2006, the Commission referred, concerning Objectives 1 and 3, to ESF financial resources reserved for the 'development of entrepreneurship' pillar of the European employment strategy, which came to 8 000 million euro, i.e. 13 % of the overall ESF budget. In addition, for the Structural Funds, the obligation in the regulation (53) to take the specific needs of SMEs into account in actions implemented under the old Objective 4 has not been retained for the new period. It should be noted that the Commission adopted, in January 2001, within the

**3.89.** The ESF contributes to integrated measures and actions to promote economic development in programmes which have not all undergone a final evaluation within the framework of the partnership but which have been examined as part of thematic evaluations carried out on behalf of the Commission (thematic evaluations of SMEs, R and D).

Their 'heterogeneous' character is linked to the variety of circumstances in which final evaluations are made, including programming, timetable, terms of reference for those making the evaluations. Concerning SMEs, an important outcome is the general finding of an increase in the number of SMEs participating in Objective 4.

(51) Annual Report concerning the financial year 1996, paragraph 6.84, and the Court's recommendations in its opinion on the proposals for new regulations on structural expenditure (paragraph 7.3 of Opinion 10/98, (OJ C 401, 22.12.1998), on certain proposals for regulations within the Agenda 2000 framework).

(52) Conclusions of the final evaluations of the 1994 to 1999 period, 28 September 2000, document submitted to the ESF Committee.

(53) Article 1 of Council Regulation (EEC) No 4255/88 of 19 December 1988 laying down provisions for implementing Regulation (EEC) No 2052/88 as regards the European Social Fund (OJ L 374, 31.12.1988, p. 21), as amended by Regulation (EEC) No 2084/93 (OJ L 193, 31.7.1993, p. 39).

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framework of its competition policy (paragraph 3.86), a regulation<sup>(54)</sup> which is designed to facilitate SME access to assistance for vocational training.

3.90. Coordination between DG Employment and DG Enterprise is still inadequate and this means, in practice, the continued existence of cumbersome procedures and hinders the operation of the 'one-stop shop' which should facilitate the creation and development of SMEs. This shortcoming was also underlined by the Economic and Social Committee in its Opinion No CES 592/2000 of 24 May 2000. Moreover, the Commission communication on the analysis of the special Community financial instruments for SMEs<sup>(55)</sup> devotes no space to the ESF.

**3.90.** In March 2001, the Commission published a comprehensive review of the activities of the European Union for SMEs (Report on the activities of the European Union for SMEs from 1997 to 2000, COM(2001) 98 final of 1.03.2001).

Regarding the Opinion of the Economic and Social Committee on the 'European Charter for Small Businesses', the Commission presented a first annual report on progress achieved by Member States and the Commission on the Charter at the Stockholm Summit. For this year only, the report was in summary form. From 2002 onwards, it will contain a more detailed evaluation of progress by Member States and the Commission.

Progress on the Charter was also covered in the 'BEST' Implementation Report, presented at the Council meeting of Industry Ministers on 5 December 2000. This report addressed the issue of 'one-stop shops' under the headings of 'Improved visibility of support services' and 'Improved public administration'.

### Financial engineering and services for enterprises

3.91. With regard to Community support for financial engineering techniques, including global subsidies, the Court found deficiencies in the implementation of the measures concerned due to the absence of a precise definition of the objectives to be achieved and of the methods of implementation (Annual Report concerning the financial year 1996, paragraphs 6.75 to 6.80). In 2000 the Court also found, for example, that reimbursements of co-financed loans may be used as national counterpart funds for the Structural Funds. In addition, the implementation of the global subsidies continued to be hampered by difficulties, particularly in respect of the definition of how they are to be used, which led to considerable delays in the adoption of decisions, the signature of agreements between the Commission and the intermediaries and the payment of advances. In particular, an examination by the Commission of new financial engineering techniques to be implemented in the period 2000 to 2006 still reveals considerable difficulties concerning the compatibility with the other

**3.91.** The Commission will publish a 'Guide to financial engineering techniques' only when it is clear that assistance for venture-capital firms is compatible with the rules on competition. The compatibility of State aid for SMEs in the form of venture capital with the competition rules is a sensitive issue affecting not only the regions receiving assistance under the ESF, but the whole of the EU. The Commission will be presenting a paper on this matter shortly.

The Guide will therefore contain these new rules and obviously take account of the Commission documents referred to in point 3.85. In addition to the work mentioned in point 3.85 and work on the application of the State aid rules to public support for the development of venture-capital activities, referred to in point 3.82, the Commission has recently launched a study on the methods of co-financing, with the ERDF, the arrangements for subsidised loans the public contribution to which is paid retroactively, and whose funding needs consequently go beyond the programming period.

<sup>(54)</sup> Commission Regulation (EC) No 68/2001 of 12 January 2000 on the application of Articles 87 and 88 of the EC Treaty to training aid (OJ L 10, 13.1.2001, p. 20).

<sup>(55)</sup> COM (2000) 653 final, 18 October 2000.

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Community policies of SF assistance for risk capital funds and companies. The Stockholm European Council at last asked the Commission to clarify how State aid rules would be applied to measures designed to promote risk capital to improve the financial environment of SMEs (56).

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*The Guide will have to reflect the most recent developments in financial engineering and help the regional authorities and development bodies to apply these instruments more effectively. The Guide will offer models 'of best practice' on how to prepare, target and apply venture capital funds, loan funds, guarantee funds and other similar measures.*

*Preparation of the Guide will go hand in hand with the preparation of a plan to foster awareness of the opportunities for public funding of venture capital companies tailored to the different regions, based on the dissemination of best practice, especially between assisted regions. The practices of SMEs in those regions as regards obtaining venture capital financing vary considerably.*

3.92. With regard to support structures for SMEs and, more particularly, the European Community business and innovation centres (EC-BICs), the Court found (Annual Report concerning the financial year 1996, paragraphs 6.69 to 6.71) that the expenditure declared matched, for a large number of these measures, the financing of existing or newly created structures, or networks, and their operating costs, but this was not the result of a consistent approach. In 2000 the Commission published a guide defining the basic conditions for the creation of EC-BICs and the provisions for financing them under the ERDF (57). The general principles laid down in the guide are, at last, a response to the observations and recommendations which the Court has been making since 1993 in respect of the EC-BICs (58). However, the Commission must allocate the necessary resources to ensure that they are actually complied with.

*Special Report No 22/98 on equal opportunities for women and men*

3.93. In its discharge recommendation for the financial year 1997 (59), the Council underlines the

(56) Presidency Conclusions Stockholm European Council, 23 and 24 March 2001, p. 21.

(57) Guide to the European Community business and innovation centres. A tool at the service of regional and business development, European Commission. (ISBN 92-828-9300-6).

(58) See the Court's Special Report No 5/93 on the business and innovation centres (OJ C 13, 17.1.1994).

(59) Council Document No 5911/99, 19 February 1999.

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importance it attaches to the Community policy to support equal opportunities for men and women, asks for the weaknesses (in particular the cost of the technical assistance office) of the Community programme to be remedied in the mid-term, and calls on the Commission to avoid duplication between the mainstream ESF and the Community initiative NOW. In the operational programmes adopted by the Commission for structural measures in the period 2000 to 2006, the amounts devoted to special measures between 2000 and 2006 concerning equal opportunities total 3 537 million euro, i.e. 6 % of total ESF expenditure. This percentage is above the 1,6 % achieved during the 1994 to 1999 period but still below the objective of 15 % set by the Commission in 1998 and requested by the European Parliament<sup>(60)</sup> (paragraph 78 of Special Report No 22/98).

3.94. The financial allocation for the Employ Community initiative for the entire 1994 to 99 period was 1 846,3 million euro, of which 27 % was for the NOW (New Opportunities for Women) strand. Only 78 % of the amounts committed were paid by the end of 2000. The Employ CI was replaced by the EQUAL CI for the new programming period. The management system set up by the Commission for implementation of this new initiative and the cumbrousness of the procedures meant that the problems of delays previously noted in respect of the Employ CI could not be resolved and the programming period was thus reduced by at least one year. With regard to the transnationality strand of the projects, a strand which is the principal special feature of the Community Initiatives when compared with the normal Operational Programmes, the Commission has not yet adopted instructions for the definition and management of eligible expenditure. Moreover, in its EQUAL Communication, the Commission has not set a minimum financial framework for this strand. The Special Report on this strand had underlined that this minimum financial framework was of marginal dimensions (paragraphs 33 to 41 of Special Report No 22/98).

**3.94.** *The majority of decisions concerning the Employ Community initiative make provision for an eligibility period for expenditure beyond 31 December 2000. The corresponding programmes will only be closed during 2001 and at the latest in June 2002. The rate of cover of 78 % referred to by the Court will increase as programmes are wound up. The Commission will continue in the intervening period to encourage Member States to make the best use of appropriations allocated to them for this purpose.*

*In addition, the Commission will complete in 2001 a set of factsheets on transnationality dealing with the rules on eligibility, the minimum requirements for a transnational cooperation agreement, the administrative rules and the requirements for exchanges of good practice.*

*The Commission did not consider it appropriate to fix a minimum transnational budget in its communication containing guidelines for the EQUAL Community initiative, preferring to discuss it with the individual Member States and work it out jointly, in the light of specific national situations. During the negotiations on the EQUAL programmes, all the ESF heads of mission received information regularly about the budgets planned by the other Member States for the transnationality strand, in order that a certain degree of uniformity could be achieved.*

<sup>(60)</sup> Document COM(98) 131 of 19 March 1998. European Parliament Resolution of 4 May 1999 on the Commission's interim report to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions on the implementation of the medium-term Community action programme on equal opportunities for men and women (1996-2000): '11. [...] emphasises that the European Parliament has called for at least 15 % of the appropriations allocated to the ESF to be devoted to the promotion of projects to benefit women' (OJ C 279, 1.10.1999, p. 88).

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3.95. With regard to the implementation of the Community mid-term action programme to promote equality of opportunities (1996 to 2000), the financial reference amount, 30 million euro (<sup>61</sup>), was exceeded by 18 million euro, i.e. exceeding programming by 60 % of the amount for which provision was made. Budgetary implementation only achieved 43,1 million euro (90 %) in commitment appropriations, of which 34 million were paid (79 %). Under this programme 342 projects were implemented, of which 138 were managed by a technical assistance office outside the Commission's departments. The cost of the technical assistance contract (from 19 July 1996 to 31 March 1999) came to 7,4 million euro in commitment appropriations, which included 2,9 million for staff and operating costs, and 5,8 million euro in payment appropriations, which included 2,6 million for staff and operating costs. The cost of this external structure set up to manage this programme therefore represents 6,7 % and 7,6 % respectively of the commitments and payments carried out. These amounts are out of all proportion to the work carried out by the technical assistance office (paragraphs 54 to 65 of Special Report No 22/98).

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**3.95.** *The Commission has implemented a policy of rationalisation concerning the use of a technical assistance office. This plan has resulted in the tasks that were previously assigned to the technical assistance office referred to by the Court under the Equal Opportunities programme being transferred back over the last two years to DG EMPLOI.*

### *The Leader Community initiative*

#### **The audit of Leader I**

3.96. The Commission first launched the Community initiative 'Leader' (*Liaison entre actions de développement de l'économie rurale*) in 1991 as a complement to the rural development measures in the mainstream operational programmes. The overall objective was to find 'innovative solutions' for rural development which might serve as models for rural areas based on proximity to localities (area-based approach), to citizens ('bottom-up' approach) and to activities (decentralised interventions and financing) (<sup>62</sup>).

(<sup>61</sup>) Article 10 of Council Decision 95/593/EC of 22 December 1995 on a medium-term Community action programme on equal opportunities for men and women (1996-2000) (OJ L 335, 30.12.1995, p. 37).

(<sup>62</sup>) See the Commission's Notice to Member States (OJ C 73, 19.03.1991, p. 33) as well as the Court of Auditors' Annual Report concerning the financial year 1995, Chapter 7 (OJ C 340, 12.11.1996).

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3.97. In 1995, audits of Leader I were conducted in Italy, Spain and Germany. As a reaction to the audit findings<sup>(63)</sup>, the Council invited the Commission 'to implement measures to improve the management of this Community Initiative...' and asked the Commission 'to draw conclusions from the Court's comments, in particular as regards evaluation, for all Community initiatives'<sup>(64)</sup>. In its reply<sup>(65)</sup>, the Commission pointed out that the general audit findings have been addressed by the notification on Leader II (see paragraph 3.98) or were taken into account during the development of SEM 2000 and its data sheets<sup>(66)</sup> (e.g. the problem of bank guarantees and interest earned). Some of the weaknesses however remain unchanged (see paragraph 3.103).

**3.97.** The Commission took account of the Court's remarks on Leader I when launching Leader II. For example, innovation was introduced as an eligibility criterion for selecting Leader Local Action Groups (LAGs). Most issues the Court refers to as weaknesses of Leader II correspond to certain risks which are inherent in the extremely decentralised implementation systems such as applied under Leader and to the testing of less bureaucratic approaches to accessing Community funds in order to respond to the repeated criticisms of the EU made by citizens on this point. The Commission and the Member States are aware of these risks when monitoring the programmes and controlling that their implementation follows the principles of sound financial management.

The Commission recognises that reinforcing the *ex-ante* control of the implementation of the programmes might improve financial management. The Commission attaches much importance to the bottom-up and participative nature of the Leader Initiative, which are key features distinguishing the Leader approach from the more classic 'top-down' mainstream programmes.

### The follow-up audit of Leader II

3.98. The Commission decided to continue the Leader Community initiative (hereinafter referred to as Leader II)<sup>(67)</sup> for the programming period 1994 to 99. As part of an overall policy to stimulate rural development, Leader II was designed to help rural operators in the disadvantaged rural areas under Objectives 1, 5 (b) and 6 and their adjoining areas in developing strategies to exploit their socio-economic potential based on a bottom-up approach.

3.99. The main type of final beneficiaries that were eligible as rural operators under Leader II were the so-called *local action groups* as defined for the purposes of the

<sup>(63)</sup> See the Annual Report concerning the financial year 1995, Chapter 7 (OJ C 340, 12.11.1996).

<sup>(64)</sup> Council Recommendation concerning the discharge to be given to the Commission for the 1995 financial year, Document 5441/97.

<sup>(65)</sup> Report by the Commission on action taken on the comments accompanying the Council recommendation on the discharge for the 1995 financial year (COM(97) 571).

<sup>(66)</sup> OJ L 146, 5.6.1997.

<sup>(67)</sup> See the Commission's Notice to Member States (OJ C 180, 1.7.1994, p. 48).

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Leader I Initiative, i.e. groups of public and private partners jointly devising strategies and innovative measures for the development of a local rural area. There were almost 1000 local action groups in the CSF II period compared to 217 under Leader I.

3.100. In 1999 and 2000, audits on Leader II were carried out in Germany, Italy, Luxembourg, Portugal and Spain. The Member States and the groups were chosen for financial, demographic and geographic reasons. Audits were also carried out at the Commission as well as at the technical assistance office providing the Community rural development network.

### Financial allocations

3.101. The financial allocations for the three Structural Funds (ERDF, about 46 %; EAGGF-Guidance, about 45 % and ESF, about 9 %) for 1994 to 99 (see **Table 3.4**) amounted to about 1 790 million euro of commitment appropriations of which more than 1 070 million euro, i.e. 60 %, had been allocated to the Objective 1 regions<sup>(68)</sup>.

3.102. As **Table 3.4** indicates, the budgetary execution of Leader II was concentrated in the second half of the programming period. The delay was mainly due to the late approval of the guidelines<sup>(69)</sup> and subsequent delays concerning the approval of the operational programmes, the selection and establishment of local action groups, action plans and the project selection<sup>(70)</sup>. Programme implementation in terms of payments amounted to just 52 % of the funds available by the end of the programming period (31 December 1999). By the end of the year 2000, additional payments of 71

3.102. The Commission recognises that earlier adoption of the Community Initiative guidelines would have assisted the implementation of Leader II in the first part of the 1994 to 1999 period. However, the guidelines for each of the Community Initiatives have as their legal base the mainstream Structural Fund Regulations. It was therefore necessary for all the Community Initiatives to wait until the mainstream regulations were adopted (July 1993) before the procedure could be launched for adoption of the proposed CI guidelines by the Commission, their subsequent submission for opinion to the European Parliament, Committee of the Regions and Economic and Social Committee, followed by their final adoption by the Commission.

*This situation was compounded by the need for lengthy negotiation of certain programmes, and by the difficult selection of local action groups in certain Member States/regions, as the pressure from the grassroots to participate in the programme was very high.*

<sup>(68)</sup> The initial Community contribution for Leader II was estimated at 1 400 million euro in 1994 prices, of which 900 million euro were for the Objective 1 regions. The difference results mainly from the allocation of a reserve in 1999 as well as from the indexation.

<sup>(69)</sup> The Commission's Notice to Member States (OJ C 180, 1.7.1994).

<sup>(70)</sup> The Court noted on several occasions back-loaded programme execution in the area of structural funds, e.g. Annual Report concerning the financial year 1997 (paragraphs 3.24 to 3.34) and Annual Report concerning the financial year 1999 (paragraph 3.3 and paragraphs 3.18 to 3.22), as well as Special Report No 16/98 on the implementation of appropriations for structural operations for the programming period 1994 to 1999, paragraph 6.19.

Table 3.4 — Community initiative Leader II 1994 to 1999, EAGGF-Guidance, ERDF and ESF

(Mio EUR)

	Member State/region	Financial plan	Commitments								Payments							
			1994	1995	1996	1997	1998	1999	Total	as % of plan	1994	1995	1996	1997	1998	1999	Total	as % of plan
Objective 1	Belgium	4,18	0,00	0,00	0,00	4,09	0,00	0,08	4,17	1,00	0,00	0,00	0,00	2,05	0,00	0,02	3,07	0,49
Objective 1	Germany	95,68	0,00	75,61	7,50	0,00	7,96	4,57	95,64	1,00	0,00	22,90	11,75	9,48	20,19	3,01	68,33	0,70
Objective 1	Greece	167,65	0,00	22,56	0,00	0,00	36,55	107,98	167,09	1,00	0,00	11,28	0,00	3,49	21,23	64,10	101,10	0,60
Objective 1	Spain	340,83	0,00	69,46	4,74	46,40	68,08	136,14	324,82	0,95	0,00	24,09	5,61	17,85	46,27	87,99	182,76	0,53
Objective 1	France	5,09	0,00	3,05	0,79	1,25	0,00	-0,25	4,84	0,95	0,00	0,55	0,66	0,38	0,00	0,28	2,82	0,37
Objective 1	Ireland	87,23	0,00	7,50	0,00	1,13	53,11	5,91	67,65	0,78	0,00	3,75	0,00	0,34	24,66	23,23	52,76	0,60
Objective 1	Italy	208,33	0,00	23,09	22,30	8,14	11,09	125,37	189,99	0,91	0,00	11,54	10,95	4,07	4,54	11,77	43,78	0,21
Objective 1	Netherlands	2,90	0,00	2,02	0,00	0,09	0,00	0,22	2,33	0,80	0,00	0,61	0,00	0,03	0,34	0,00	1,78	0,34
Objective 1	Austria	3,50	0,00	2,01	0,25	0,00	0,61	0,62	3,49	1,00	0,00	0,33	0,37	0,18	0,35	1,04	3,27	0,65
Objective 1	Portugal	133,20	0,00	6,74	4,01	39,86	46,51	34,54	131,66	0,99	0,00	3,59	4,85	20,46	36,69	21,96	88,54	0,66
Objective 1	United Kingdom	28,48	0,00	18,54	4,78	0,00	2,64	2,53	28,49	1,00	0,00	1,91	4,81	3,28	5,86	1,84	18,70	0,62
<b>Total</b>		<b>1 077,07</b>	<b>0,00</b>	<b>230,58</b>	<b>44,37</b>	<b>100,96</b>	<b>226,55</b>	<b>417,71</b>	<b>1 020,17</b>	<b>0,95</b>	<b>0,00</b>	<b>80,55</b>	<b>39,00</b>	<b>61,61</b>	<b>160,13</b>	<b>215,24</b>	<b>557,48</b>	<b>0,52</b>
Objective 5b	Belgium	6,36	0,00	0,00	0,00	3,32	2,72	0,32	6,36	1,00	0,00	0,00	0,00	1,66	1,36	0,02	3,04	0,48
Objective 5b	Denmark	8,16	0,00	0,00	6,53	1,63	0,00	0,00	8,16	1,00	0,00	0,00	1,96	0,49	0,00	0,00	2,45	0,30
Objective 5b	Germany	118,57	0,00	48,96	8,39	3,21	4,25	47,69	112,49	0,95	0,00	15,92	2,50	4,37	17,18	14,94	54,91	0,46
Objective 5b	Spain	74,60	0,00	42,64	4,78	1,12	22,40	3,66	74,60	1,00	0,00	10,77	4,22	0,33	15,47	25,43	56,22	0,75
Objective 5b	France	232,33	0,00	92,51	91,95	36,12	1,89	9,87	232,33	1,00	0,00	14,98	44,94	19,42	29,83	27,21	136,38	0,59
Objective 5b	Italy	123,23	0,00	5,53	26,99	5,17	1,00	75,12	113,81	0,92	0,00	2,45	11,35	3,43	0,00	5,94	23,17	0,19
Objective 5b	Luxembourg	1,27	0,00	1,01	0,00	0,00	0,00	0,26	1,27	1,00	0,00	0,41	0,00	0,25	0,00	0,00	0,66	0,51
Objective 5b	Netherlands	9,02	0,00	6,16	0,00	0,08	2,16	0,51	8,91	0,99	0,00	1,85	0,00	0,03	1,30	1,07	4,25	0,47
Objective 5b	Austria	24,10	0,00	0,00	17,86	0,36	2,35	2,86	23,42	0,97	0,00	0,00	5,36	2,22	7,18	0,34	15,10	0,63
Objective 5b	Finland	16,66	0,00	0,00	16,15	0,00	0,00	0,50	16,66	1,00	0,00	0,00	4,85	0,00	1,37	5,50	11,72	0,70
Objective 5b	Sweden	12,48	0,00	0,00	10,03	2,05	0,00	0,00	12,09	0,97	0,00	0,00	3,01	0,62	1,21	1,82	6,66	0,53
Objective 5b	United Kingdom	52,92	0,00	37,63	5,25	0,00	0,00	8,66	51,54	0,97	0,00	2,91	9,99	6,52	0,45	15,52	35,39	0,67
<b>Total</b>		<b>679,70</b>	<b>0,00</b>	<b>234,44</b>	<b>187,93</b>	<b>53,06</b>	<b>36,77</b>	<b>149,45</b>	<b>661,64</b>	<b>0,97</b>	<b>0,00</b>	<b>49,29</b>	<b>88,18</b>	<b>39,34</b>	<b>75,35</b>	<b>97,78</b>	<b>349,94</b>	<b>0,51</b>
Objective 6	Finland	12,60	0,00	0,00	11,94	0,00	0,25	0,42	12,60	1,00	0,00	0,00	3,58	0,00	3,49	2,09	9,16	0,73
Objective 6	Sweden	4,41	0,00	0,00	3,34	0,93	0,00	0,11	4,38	0,99	0,00	0,00	1,00	0,21	0,07	2,01	3,29	0,75
<b>Total</b>		<b>17,01</b>	<b>0,00</b>	<b>0,00</b>	<b>15,28</b>	<b>0,93</b>	<b>0,25</b>	<b>0,53</b>	<b>16,98</b>	<b>1,00</b>	<b>0,00</b>	<b>4,58</b>	<b>0,21</b>	<b>3,56</b>	<b>4,10</b>	<b>12,45</b>	<b>0,73</b>	
Networking		26,04	0,29	3,46	4,09	2,90	6,93	8,37	26,02	1,00	0,00	2,88	1,84	2,88	3,07	3,32	14,00	0,54
<b>Total</b>		<b>1 799,82</b>	<b>0,29</b>	<b>468,48</b>	<b>251,66</b>	<b>157,85</b>	<b>270,48</b>	<b>576,05</b>	<b>1 724,80</b>	<b>0,96</b>	<b>0,00</b>	<b>132,71</b>	<b>133,61</b>	<b>104,01</b>	<b>242,11</b>	<b>320,45</b>	<b>932,88</b>	<b>0,52</b>

Source: Commission, DG Agriculture.

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million euro were completed. The bulk of the available funds (more than 90 %) was spent on the projects under measure (B) (71).

## Management weaknesses of Leader II

3.103. In all regions visited projects had been approved under Leader II that would also have been eligible under the mainstream activities (apart from the projects in adjoining rural areas outside the 5 (b) regions (72), as the Court's audit of Leader I had already established (73). In several regions projects were funded under the Leader II programme because they were considered too 'small' for the mainstream operational programme, or because the relevant funds in the main operational programme had already been used up. Supporting these projects under the mainstream activities would have simplified the administrative efforts required by the creation of management bodies for programme completion (local action groups, rural collective bodies).

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To address this issue for the 2000 to 2006 period, the Commission has introduced a new requirement in the guidelines for Leader+ for Member States to select all LAGs no later than two years after the programme has been approved. This should ensure that local action groups have at least five years in which to implement their strategy.

**3.103.** The Commission reacted to the Court's remarks on Leader I by adding innovation as an eligibility criterion for Leader II. However, innovation is to be assessed in Leader in the light of the whole approach of the programme and the method of implementation of the local action group strategy, and not only in terms of the final nature of individual projects supported by local action groups. So, it may be appropriate to finance under Leader certain individual projects that when viewed in isolation should be eligible under the mainstream programmes, where these projects are an essential element for the realisation of a particular local action group's innovative development programme.

That said, the Commission recognises that the demarcation between Leader and mainstream programmes was a weakness in some regions under Leader II and is seeking to improve this demarcation during the examination of programmes for the period 2000 to 2006.

The search for innovation and the bottom-up Leader approach are two elements justifying the additional administrative efforts required for implementation of Leader, and must be demonstrated in the programme of any selected local action group which should be assessed in a wider context. The capacity-building and empowerment of the local population achieved under Leader should be seen as generating additional value added for rural communities.

3.104. As every co-financed action may generate receipts, the corresponding revenue has to be taken into consideration when determining the subsidy (74). In those cases where projects had produced income, a

**3.104.** The Commission encourages Leader groups to grant a level of aid which is appropriate to the circumstances of each project, including their revenue-generating potential.

Leader groups are, typically, not a well-adapted structure for the granting and management of loans. The follow-up of these grants over several years (potentially beyond the lifetime of the local action group) and the complexity of their control goes beyond the financial management capacity of most local action groups.

(71) The eligible actions were spread over four measures: acquiring skills, rural innovation projects, transnational cooperation and networking/technical assistance.

(72) As provided in the Notice to the Member States, point 8.

(73) See the Annual Report concerning the financial year 1995, paragraphs 7.25, 7.30 and 7.59 (OJ C 340, 12.11.1996).

(74) See Article 17 of Council Regulation (EC) No 4253/88 on coordination, as amended, in connection with data sheet No 9.

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number of local action groups ignored the receipts related to the co-financed projects. In the context of profitable investments supported by Leader II, the possibility of granting loans rather than subsidies should have been taken into consideration as provided in Article 5(4) of the framework regulation.

3.105. Under Leader I about 450 million euro of Community funds were available for a four-year period for 217 beneficiaries, i.e. an arithmetic mean of about 520 000 euro of Community funds per group and per year. Under Leader II the average available budget per group and per year was reduced to about 290 000 euro of Community funds (1 750 million euro for six years and about 1000 beneficiaries). This has necessarily led to a thin scattering of Community resources contrary to the guiding operating principle for Structural Funds' interventions, which requires the concentration of funds on a limited number of priority measures and areas in order to increase their efficiency.

3.106. Flows of funds for Leader II moved extremely slowly. In one region, Lazio in Italy, the time that elapsed as measured from the date of the request for payment to the receipt of it by the beneficiaries for forwarding of Community payments to the final beneficiaries was more than two years for all projects.

3.107. Structural weaknesses in the financial management of the Leader II Initiative were evident in a number of regions. This was due to the lack of national/regional guidelines and/or instructions on the management of European Union funds forwarded to local action groups.

3.108. Extreme variations in the overhead charges of the different local action groups have been noted. While in certain regions all non-operational expenditure, including management fees etc., was excluded from eligible expenditure, in other regions overhead charges accounted for more than 80 % of the available budget of the local action group (see Annual Report 1999, paragraph 3.68). Moreover, in contradiction of Article 21(3) of the coordination regulation<sup>(75)</sup>, in one region, Alentejo in Portugal, there were ineligible

**3.105.** *Unlike Leader I, where the Commission was responsible for the selection of Leader groups, under Leader II the selection was made by the Member States, which in many cases were faced with a very large number of applications following the success of Leader I.*

*The Commission shares the Court's concern that each local action group should have an adequate budget (Community and other financial sources) to have any impact. During the discussions with Member States and other EU institutions on the draft Leader+ guidelines the Commission emphasised the need for the selection process under Leader+ to be more selective. This point is taken up in point 9 of the Leader+ guidelines. Member States have also been required to indicate the number of local action groups they envisage selecting and this number has been a point for negotiation with some Member States.*

**3.106.** *As for all Community funds in certain regions, Leader II suffered from weaknesses in the financing channels that seriously hampered the implementation of the local action groups rural innovation projects. The Commission raised these difficulties in the Monitoring Committees for the programmes concerned, with varying degrees of success among the Member States and regions.*

**3.108.** *As indicated by the Commission in its reply to the Court's 1999 report, the share of operating and technical assistance costs in the local action groups' total expenditure tends to be higher at the beginning of the period when the local action group is being set up, but diminishes once external projects start to be financed by the local action group.*

*In the negotiations with Member States for the approval of Leader+ programmes the Commission has invited Member*

<sup>(75)</sup> Article 21(3): 'the payments shall be made to the final beneficiaries without any deduction or retention which could reduce the amount of financial assistance to which they are entitled.'

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overhead costs because the beneficiaries had to repay a certain amount of the subsidy to the local action group that approved the project.

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States/regions to include in their programmes a ceiling on operating costs as a proportion of a local action groups' total budget. The Commission has insisted that this ceiling should be not more than 15 %.

As a result of the comments of the Court and follow-up action by the Commission, sums unduly collected by the local action group in the case of the Alentejo were reimbursed to the final recipients.

**3.109.** In several cases projects were selected without a formal procedure; other projects were selected without any comparative analysis of predefined, objective (quantifiable) parameters. Moreover, the objectivity and transparency of the project-selection process is doubtful in those cases where applicant and authorising institution are closely interrelated. In a number of cases close personal or professional relationships existed between the project promoter and the approving authority.

**3.109.** The Commission and the Member States are aware that project selection is a sensitive issue in Leader implementation. The Commission considers that the establishment of appropriate project selection arrangements is an issue that should be resolved at local level between the Member State/region and the local action groups. The Commission, in Monitoring Committees, encourages the use of open and transparent procedures by the local action groups for the selection of projects.

**3.110.** In many cases support for projects has been backdated. According to the Commission, this is covered by Article 15 of the coordination regulation (and data sheet No 2 respectively), since such projects are carried out within the period of eligibility fixed in the operational programmes. However, structural policy is meant to give incentives to realising projects which would not otherwise be carried out. To subsidise (productive) investments, for which the project applications are submitted only after they have been completed (in some cases years afterwards), creates nothing but dead weight effects.

**3.110.** Most Leader I groups were re-selected under Leader II. These groups started project selection at their own risk before the Commission approved the national or regional programme concerned, and before the managing authority selected them as Leader II groups. In the absence of any legal provisions which would exclude their financing, projects financed in this way are to be considered eligible. Their impact on attaining the Leader objectives is not undermined by this fact.

The Commission does not support the retroactive financing of projects which have already been completed before the application for aid was submitted. In order to avoid this possibility, for the current programming period, Article 9(2)(b) of Commission Regulation (EC) No 438/2001 limits eligibility to operations selected for co-financing under the assistance concerned.

## Conclusion

**3.111.** Notwithstanding the abovementioned weaknesses, however, Leader II has fulfilled its role as a 'pioneer' programme. The lessons learned from Leader II must influence the content of the mainstream programmes. Certain measures that Leader II has supported until now can hardly be considered 'pilot projects' any more but should be supported by mainstream policies in the future.

**3.111.** The Commission agrees that it is important to transfer those aspects of the Leader approach, which have demonstrated their worth, into the mainstream programmes. This is a process the Commission actively encouraged for the 2000 to 2006 programming period and it is already clear that a growing number of Member States have adopted Leader-type approaches, either within their mainstream Structural Fund programmes (e.g. Spain, Sweden, Ireland, Greece) or with national financing (e.g. Finland).

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3.112. The Court acknowledges the efforts by the Commission and the Member States to strengthen the innovation aspect, the regional and bottom-up oriented approach, the partnership aspect, networking and the decentralised management of funding of projects in rural areas. However, several problems remain unresolved: in particular there is still no sufficient measure of the monitoring and control of individual projects; these aspects should be taken into consideration for the new programming period 2000 to 2006 for the new Community initiative Leader +.

*Observations made in the context of the 1998 DAS in respect of the ERDF and the Cohesion Fund*

3.113. The Court verified whether the Commission had given adequate follow-up to the observations made in the context of the 1998 DAS in respect of 15 ERDF cases, of which five had been closed, and one Cohesion Fund case which had been closed. In view of the financial impact of the substantive errors found, all these cases required action on the part of the Commission. Although many of the Court's observations reveal deficiencies in the management and controls, which are common to many programmes, the Commission did not carry out supplementary investigations, in addition to the examination carried out by the Court on its sample, in order to identify errors in the declarations of expenditure, particularly in view of their foreseeable impact on expenditure under the Community budget.

3.114. With regard to the five closed ERDF sub-programmes, the audit carried out in the context of the 1998 DAS revealed errors which had a direct impact, in the five cases, on the amounts paid by the Commission. Thus, out of a total of 182,1 million euro paid for the five sub-programmes, an estimate of the amount overpaid came to 47,5 million euro (see paragraph 3.29 of the Annual Report concerning the financial year 1998). In one case, despite the numerous irregularities noted, the Court could not find evidence of any follow-up on the part of the Commission. In one case the Commission has initiated application of Article 24 of Regulation (EEC) No 4253/88 and intends to apply it in three other cases in order to recover part of the amounts paid. Nevertheless, no recovery order had been issued by the end of 2000. Furthermore, in several of these cases the Commission did not carry out in-depth checks on the expenditure declared; in one case the Commission failed to take steps to initiate recovery of an excess amount paid although its decision, taken in September 1999, recognises the necessity of avoiding payment to a Member State of an ERDF contribution which is greater than the total received by the final beneficiaries.

**3.112.** To be approved, the Leader+ programmes must contain detailed administrative provisions on the management (including financial management) and monitoring of the different actions: territorial development strategies, cooperation and networks. The programmes are carefully examined in this respect. In order to better monitor the implementation of Leader+ at Community level, the Commission is also establishing a series of common monitoring indicators, both financial and physical, to be used in all Leader+ programmes.

**3.113.** The Commission does its best to act on the Court's observations when exercising its role of managing and monitoring programmes, despite the limited funds and resources at its disposal. Looking into cases — often the more complex ones — which involve contacting the responsible national authorities and gathering data which the Commission does not automatically possess (since the audit has not been done by its own staff) is likely to take considerable time. The Commission has found it difficult with the staff available to conduct inquiries into instances of errors identified by the Court as well as carrying through its own audit programme and following up its own audit findings and DAS cases. However, as indicated in the reply to point 3.75, new systems being introduced should lead to improvements in this area.

**3.114.** Correction procedures are now in hand in the case of the five ERDF measures referred to by the Court. The closure arrangements introduced in 1999 do not apply to earlier closures. The Commission nevertheless is considering ways of recovering amounts paid to the Member State.

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3.115. In the case of the closed Cohesion Fund project, the Commission had taken no steps to recover the funds from the beneficiary although the national authorities had admitted in the meantime that the VAT declared was not eligible.

3.116. With regard to those measures which were not closed, the corrective action taken can be considered satisfactory in six cases but these actions were sometimes taken tardily. In two cases, the steps taken by the Commission proved inadequate for various reasons, such as a minimal reduction in the subsidy where the entire project concerned is ineligible, failure to take into account those cases singled out by the Court in the context of a Commission appeal before the Court of Justice concerning another similar case from the same group, failure by the Commission to check the new expenditure figures submitted. Finally, in two cases, no evidence could be found of any follow-up action by the Commission.

**3.115.** *The Commission issued a recovery order for the amount in question in July 2001.*

**3.116.** *Regarding the first two cases cited by the Court, where the steps taken proved inadequate, the Member State concerned by one of them has already agreed to make a complete correction, while the Commission is obliged to await the judgment of the Court of Justice in the other. In the former case the necessary corrections have since been made. As to the second, the Commission will be taking further action if it is required.*

## SUMMARY OF SPECIAL REPORTS

*Special Report No 1/2001 (76) on the URBAN Community initiative*

3.117. The URBAN Community initiative helped to implement many projects with the objective of assisting urban development in 118 areas of the European Union and making access to Community co-financing easier for local authorities. However, the Court considers that these projects could also have been carried out within the framework of the Community measures already in existence, thus avoiding the creation of new procedures and costly management structures.

**3.117.** *The real value added of URBAN is to make neighbourhood partnerships and the involvement of residents the linchpin of the regeneration of targeted areas. While it is true that this approach is not excluded by the general rules for Structural Funds assistance, the Court acknowledges that the URBAN Community initiative has made access to Community co-financing for local authorities easier.*

*The positive aspects of this local partnership were among the factors underlying the wish, especially in the European Parliament, to retain an URBAN Community initiative programme in the period 2000 to 2006.*

3.118. The Commission's communications laying down guidelines for the URBAN initiative focused on numerous projects which were ambitious but vague. The programmes adopted therefore lack precise and specific objectives. For *ex ante* assessments, monitoring

**3.118.** *This Initiative could not hope to resolve entirely what is in effect a major problem facing society today, i.e. depressed neighbourhoods and in some cases actual 'ghettos' in many European cities.*

(76) OJ C 124, 25.4.2001.

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and evaluation, to have a real impact on the conception and implementation of the measures, precise objectives must be set for the measures beforehand.

*The aim of the Initiative was to provide support for a number of exemplary projects in order to demonstrate that even in neighbourhoods like those it was possible to restore hope to residents and to give the local economy a boost.*

3.119. In spite of a typology of very different problems in urban areas, the measures proposed in the Operational Programmes to attempt to remedy them are very similar. Taking the scale of the programmes into account, this strategy has led to a thin sprinkling of finance which is extremely difficult to manage. The new measures, financed in future solely by the ERDF, should be simpler and more accurately targeted at the main problems of the areas concerned.

*To ensure that goals are better identified when URBAN II programmes are adopted, the Commission will promote the use of a common scale of priorities and a small number of common indicators among the measures to enhance effectiveness and simplification.*

**3.119.** While it is true that the degree of seriousness of problems differs from place to place, there are nevertheless some whose socio-economic repercussions in general are fairly similar, such as economic stagnation, a deterioration in transportation and the environment, lack of security for residents, etc.

*The value added of URBAN consists mainly in its integrated approach, which gives priority to focusing on this multi-sectoral array of problems and in so doing tackles not merely the symptoms but rather the causes of residents' disquiet.*

This, of course, brings with it a special level of difficulty but is justified as 'simpler' programmes were being implemented commonly as part of the 'mainstream' Structural Funds, previously during the 1994 to 1999 programming period, and will be in the 2000 to 2006 period in which an urban strand has been identified within Objective 2.

*The Commission agrees with the Court that the new URBAN II Initiative should be simplified as much as possible provided that this is not at the expense of the integrated approach which is its distinguishing feature.*

*In this respect the single source of funding to be provided in future by the ERDF marks a considerable step forward.*

3.120. The implementation of URBAN was characterised by considerable delays, which led to a concentration of operations at the end of the period. This is the consequence of an *ex ante* assessment which went into scarcely any detail, in fact it was almost non-existent, of programming which had little to do with reality and of poor monitoring. Furthermore, questionable techniques were applied to allow the measures to be commenced before the deadline on 31 December 1999.

**3.120.** One of the difficulties associated with the URBAN initiative was the key role local authorities were called upon to play, in many cases for the first time, in preparing programmes and implementing them.

*While this may have been responsible in some cases for delays or inefficiency, it is equally true that this drawback has been largely offset by the experience gained, through URBAN, by*

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*those authorities which in future will be able to turn it to advantage in order to become more closely involved in the whole range of Structural Fund assistance operations in their regions.*

*This learning function has already paid off in that the time taken to adopt programmes submitted in 1996 was less than half that required for programmes presented in 1994.*

*The use of these techniques does not necessarily imply that irregularities have been committed. The Commission will see to it as part of the management and control of URBAN Community initiative projects that all the legal arrangements applicable to the Structural Funds are observed.*

**3.121.** The URBAN programmes ran independently of other Community and national measures implemented simultaneously in the areas concerned. Concrete action should be taken to ensure there is awareness of the measures being carried out in urban areas, that they are consistent with one another and can be integrated.

**3.121.** *The Commission considers that the programmes adopted under URBAN take account of other Community assistance operations, in particular those co-financed under the Structural Funds, and other mechanisms to promote urban regeneration at national level.*

*Monitoring all the measures co-financed by the Structural Funds in urban areas is very difficult and covers all Community activities undertaken in a given geographical context. However, for a number of local authorities, URBAN has made it possible for the first time for various measures to be planned and implemented in a coordinated way in one area of a city.*

*In any case, the Commission is aware of the difficulty and has therefore provided that under the new Structural Funds programmes, including the new URBAN II initiative, the system of coding expenditure will make it possible for spending on urban regeneration, i.e. urban transport and investments for restoring urban areas, to be identified.*

**3.122.** The poor quality of the indicators, particularly the impact indicators, and the delays in or even absence of annual implementation reports reveal poor monitoring of the measures in spite of the volume of the co-financing granted for technical assistance. An improvement in the statistical data at local level is

**3.122.** *The Commission acknowledges that some weaknesses were uncovered during monitoring of the URBAN programmes. In future these should be prevented as a result of steps taken by the new URBAN II initiative. The Commission considers that in spite of these shortcomings the monitoring of the programmes has not been affected but has proceeded in a satisfactory way.*

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necessary and the efforts already made, as in the context of the Urban Audit (77), should be continued.

*The Urban Audit, as the Court says, is an example of the efforts the Commission is making to upgrade the quality of comparative data about urban areas and will be continued in cooperation with Eurostat.*

*Special Report No 12/2001 (78) on structural measures to improve the employment situation*

3.123. A Community employment policy has been taking shape for some years on the basis of the European employment strategy derived from the European summits of Luxembourg and Amsterdam and, in particular, from the employment chapter of the Treaty of Amsterdam. This strategy may be based on the economic and social cohesion policy given concrete form in the structural measures. It is also given adequate support in the methods used to evaluate the impact of the structural measures on employment.

3.124. The Court notes that the European employment strategy primarily concerns measures to prevent unemployment and does not take sufficient account of the remedial measures needed to deal with the problem of long-term and very long-term unemployment. In addition, the employment guidelines drawn up each year by the Council do not mention the ERDF explicitly, even though the effect of this instrument on employment is not exactly negligible. As the ERDF, unlike the ESF, is overlooked, potential synergies are not or may not be exploited.

3.125. In the area of the ERDF, the Court notes that, with regard to Objective 1 assistance for the programming period 1994 to 1999, the desired effects of employment objectives and targets are often imprecise, except as regards support for productive investments. Progress reports ran into difficulties, in particular as regards the anticipated effects on employment, arising from the unreliability or lack of data and problems with the compilation of inspection findings at regional and national levels in cases where such a compilation would have been appropriate. The reprogramming of measures

**3.124.** *The balance between the two types of measures at a given moment is determined by the long-term unemployment situation. Account has to be taken also of the range of different situations in the Member States.*

*The guidelines for Member States' employment policies are based on all the Structural Funds which contribute to the implementation of the European Employment Strategy.*

**3.125 to 3.126.** *In relation to the difficulties that the Court has highlighted regarding heterogeneity of concepts used and practices, the Commission's work in developing guidance documents and working in cooperation with the Member States aims to achieve greater understanding and agreement on such methodologies and practices. However the Commission cannot impose methodologies on the Member States. The regulations require that those responsible for programmes examine and consider the effects and the impacts of Structural Interventions in order to improve their effectiveness and impact in their regional or national context. The primary objective is not*

(77) Urban Audit is a pilot project financed by the ERDF which aims to draw up a survey of European Union towns. The results of the first phase cover 58 of the largest cities in the Member States and were published in 2000 (Reference, Volume 1: ISBN 92-828-9242-5 and Volume 2: ISBN 92-828-9244-1).

(78) OJ C 334, 28.11.2001.

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jointly financed by the ERDF was based only in exceptional cases on an analysis of the effects on employment.

**3.126.** As regards measures involving aid for productive investments:

- (a) even when they are linked to the fulfilment of job maintenance and creation criteria, these measures generally also support economic objectives for productivity and production which may lead, at least temporarily, to the reduction of the work factor. In this context, the importance accorded to employment within the framework of these measures is not always specific or appears limited;
- (b) the importance of the dead-weight and displacement effects was evaluated to varying degrees and, in the majority of cases, no proposal was made as to how these problems could be avoided;
- (c) the evaluation of the impact on employment of ERDF aid for these aid schemes is complicated and may be distorted by the fact that the financing of a national aid scheme enables the national authorities either to request joint financing for an eligible project or to finance it completely from national resources. This evaluation is also influenced by the possibility of replacing jointly financed projects which prove problematical by other eligible projects.

**3.127.** Concerning ESF measures to combat long-term unemployment, although there were improvements in the overall EU unemployment situation in recent years, progress in the long-term unemployment field has been slower. The implementation in the Member States of ESF co-financed measures in favour of long-term unemployed lacked a clear definition of target groups, and was given a low priority by national and regional administrations and in national regulatory and management provisions, thereby incurring dead-weight costs and suffering delays in implementation. As for the ERDF, the results of the assessments were not sufficiently taken into account in the reprogramming measures.

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*to feed into a uniform exercise across the entire territory of the Union. Where we can aggregate or compare data across Member States, this is useful. However, it is not the primary purpose of the programme evaluations undertaken at ex-ante, mid-term or ex-post stage.*

*The results of mid-term evaluation in relation to the measurement of effects on employment reflect the fact that programming in 1994 was not sufficiently focused, hence making it difficult to measure results. In addition, 1996, the year of the mid-term evaluation, was generally too early in the programming period to measure employment effects. Some useful work was undertaken, however, in refining macro-economic modelling techniques to enhance forecasts of likely employment effects by the end of the programming period. The ex-post evaluation of Objective 1 for 1994 to 1999 should demonstrate the appropriateness of the models used and further improvements which may need to be pursued.*

**3.127.** *The Court notes that progress in long-term unemployment has been slower than in overall unemployment. This underlines the difficulty in finding work faced by the long-term unemployed. As regards the need for a clearer definition of target groups, the Commission agrees with the comment of the Court but points out that the definition of long-term unemployed is a matter for each Member State.*

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3.128. Information about the management and control systems relating to successful pilot and demonstration projects (Article 6 of Council Regulation (EC) No 4255/88 as amended) was not made available to the Commission and Member States, with the result that similar projects were not incorporated in mainstream ESF actions.

3.129. The Court recommends that:

- (a) the administrative mechanisms of the ESF should be clarified and the procedures should be simplified;
- (b) employment strategy should be made more consistent with the ESF and the ERDF;
- (c) greater synergies should be sought between measures jointly financed by these Funds;
- (d) consistent objectives should be defined during the programming phase at the various levels, i.e. policies, programmes and sub-programmes;
- (e) for every measure (or group of measures), the techniques for gathering data on the impact of measures on employment, and aggregation methods, should be standardised;

(f) the Commission should ensure that:

- employment is systematically accorded due importance in the joint financing process;
- national mechanisms for avoiding the dead-weight and displacement effects are improved and the necessary procedures stepped up;
- the surveillance needed to ensure that jobs are created or safeguarded in a long-lasting way is intensified.

**3.128.** The Commission is prepared to recognise that evaluation, follow-up and mainstreaming of the results of projects financed in 1994 to 1997 should have been more effective for the purposes of incorporating them in mainstream European Social Fund measures.

Since then, the Commission has improved and is currently improving this transfer of information, namely by developing the description of successful projects on the Web.

**3.129.** The guidelines for Member States' employment policies should be based on all the Structural Funds which contribute to the implementation of the European Employment Strategy;

the programming of structural measures for 2000 to 2006 has appreciably improved the synergies between the ESF and the ERDF in support of jobs, in accordance with the guidelines in Regulation (EC) No 1260/1999;

with the new regulatory environment for the 2000 to 2006 programming period the weaknesses identified in the 1994 to 1999 period have been tackled, particularly in the clarification of the respective responsibilities of the Commission and Member States;

the Commission's work in developing guidance documents and working in cooperation with Member States aims to achieve greater understanding and agreement in these methodologies and practices. However, the Commission cannot impose methodologies on the Member States;

the Commission agrees with the Court's recommendations and has already taken steps to reduce dead-weight and displacement effects, particularly its stronger emphasis on providing indirect support to SMEs.

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*Special Report No 10/2001 (79) on financial controls in the context of the Structural Funds*

3.130. The Court's Audit concerned the implementation by the Commission and Member States of two regulations which aim to improve financial control in the Structural Funds: Regulation (EC) No 1681/94, which introduced a system of communicating information by Member States of detected irregularities and Regulation (EC) No 2064/97, which sets out a system of checks by Member States of expenditure incurred on projects co-financed by the European Union. The main findings and observations concerning the implementation of the latter regulation are presented in the specific DAS appraisal (paragraphs 3.44 to 3.56).

3.131. According to OLAF's statistics, detected irregularities are increasing in the Structural Funds. Weaknesses were found in the application of Regulation (EC) No 1681/94 at every level; regional, national, OLAF and other Commission services. Data on irregularities were incomplete, out of date and only of limited use, partly because the OLAF database was not working for three years in the period 1998 to 2000 and partly because what information was available was not properly followed up by the Commission.

**3.131.** *The continued action to improve the quantity and quality of the information received under Regulation (EC) No 1681/94 has been successful, as is reflected in the increased number of communications received from Member States. OLAF actually works closely with other Commission departments and Member States in order to improve persistent weaknesses.*

*Since December 2000, OLAF has been using the new software developed for reporting under Regulation (EC) No 1681/94. The new software has been tested by some Member States and is ready for use in all Member States.*

- (a) The Commission should examine the operation of the systems for the detection and communication of irregularities within and by Member States, and then monitor them with a view to ensuring timeliness, completeness and relevance, and give guidance where necessary.
- (b) Member States need to review their own systems to ensure that cases detected are communicated and progress reported.

**(a)** *The Commission White Paper on Commission reform contains details of a series of measures for 'Protecting the Community's financial interests' aimed at improving detection and cooperation systems. In addition, cooperation among Commission departments and between the Commission and Member States, particularly in the area of the Structural Funds will need to be better defined to ensure that more effective action is taken to improve the prevention and detection of irregularities, fraud and corruption. This objective of the Structural Funds has been included in Action 97 'Improving monitoring of Structural Funds' of the White Paper Action Plan. A Commission communication on this topic has been adopted.*

**(b)** *The Commission departments share the views expressed by the Court on this point.*

(79) OJ C 314, 8.11.2001.

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(c) OLAF and other Commission services should jointly define their respective responsibilities and determine whether a more effective follow-up would be ensured if communications were sent to and examined initially by the new financial units being set up in the Structural Funds DGs.

(d) The Commission should formulate proposals to combine the various aspects of Regulations (EC) No 1681/94 and (EC) No 2064/97 to provide effective and cohesive control and reporting systems on a clear and consistent basis throughout the European Union.

(c) Regarding cooperation between OLAF and the Structural Funds DGs, the Commission's newly adopted Action Plan for 2001 to 2003 on 'Protecting the Communities' financial interests — Fight against fraud' <sup>(1)</sup> clearly recognises the need for clarification of the different departments' responsibility as regards follow-up of reported irregularities and fraud cases and recovery of amounts unduly paid. The Action Plan therefore envisages that protocols will be drawn up between OLAF and the DGs responsible for the Structural Funds with regard to the follow-up of irregularities notified by the Member States under Regulation (EC) No 1681/94. It is expected that these protocols will be concluded before the end of 2001.

(d) The procedures for reporting by Member States have been harmonised at Commission level for all sectors. A uniform presentation is imposed to facilitate computer processing. All information notified on the basis of Regulation (EC) No 1681/94 is entered in the Office database. The question of combining proposals has been addressed in Action 97 Improved Financial Monitoring and Control of Structural Funds which gives details of actions to be taken and for which a communication is in preparation. Important steps have already been taken with the adoption of Commission Regulations Nos 438/2001 and 448/2001. The latter provide a clear link to Regulation No 1681/94. However, OLAF will be able to obtain maximum benefit from the deployment of the new software across the Member States.

## CONCLUSIONS AND RECOMMENDATIONS

3.132. The management and budgetary implementation of structural measures during the past years reveal several anomalies. On the one hand, the commitments are of no real significance as they only serve to formalise the annual breakdown of estimated appropriations in the financial perspective and to set out in a random fashion, over the successive years of the programming periods, the legal commitments already entered into by the Communities when the CSFs and the programmes were adopted. On the other hand, and in spite of various attempts aiming to improve the budgetary estimates, the Commission has no control over the development of payments. This explains why one financial year is affected by substantial shortfalls in appropriations whereas the following financial year is characterised by under-implementations on a matching scale. Recommendation: the Court has pointed out on several

**3.132.** A distinction should be made between the Court's observations on the regulatory framework and those that concern implementation.

As in previous years, the Court questions commitments by annual instalments as provided for in the financial provisions of the general Structural Funds Regulation. The Commission has explained already, in its reply to the Court's Report last year, the advantages that commitments of this kind may offer. Since that regulation was approved by the Council, with the assent of Parliament, in 1999, it will apply for the whole of the 2000 to 2006 period and commitments will have to be made in annual instalments in the period ahead in accordance with the financial perspectives adopted by the two arms of the budgetary authority.

<sup>(1)</sup> Document COM (2001) 254 final adopted on 15 May 2001, in particular point 1.2.2.

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occasions that budgetary commitments by annual instalment should be abolished as they destroy any interest in differentiating appropriations (sup<sup>80</sup>). In addition, the Commission should provide itself with appropriate instruments to improve its budgetary forecasts (paragraphs 3.2 to 3.8).

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The Commission broadly supports the observations of the Court concerning payments forecasts from Member States and the advantages they could have, if their quality were better, for the preparation and management of the Community budget. For that reason the Commission took the initiative, some years ago, of establishing an informal network with the Finance Ministries to collect data on payments forecasts. In view of the voluntary nature of this network, the number of Member States participating has risen gradually and all Member States took part for the first time in 2000. It was on the basis of that experience also that the new Structural Funds Regulation transformed this forwarding of data on payments into a requirement for the Member States. This should result in more detailed forecasts for each programme. The Commission will study the action to be taken as a result of this new regulatory provision in the light of the contributions from Member States in order to improve budget forecasts.

**3.133.** The implementation of the budget in 2000 was very poor. A large volume of appropriations was carried over and the financial perspective had to be amended. This reflects the difficulties in the implementation of the programming period 2000 to 2006, in particular because of the cumbersomeness of Community and national procedures. Likewise, closure of the measures of the preceding periods is very sluggish. Recommendation: the Commission should rationalise and simplify the implementation procedures for structural measures (paragraphs 3.16 to 3.23).

**3.133.** Budget implementation in 2000 was indeed low in this first year of the new Structural Funds programming period. Starting up new programmes is, of necessity, a complex procedure which cannot be rushed since it will establish the framework within which Community cohesion policy is conducted for seven years. That is why the possibility of delays was foreseen by the three institutions which are parties to the Inter-institutional Agreement (Parliament, Council and Commission). The revision of the financial perspectives which had to be made is based on a specific provision included for that purpose, from 1999, in the Inter-institutional Agreement. Once this new programming period has got under way, a progress report should be given; something the Commission has begun to do by presenting a communication on the Objective 1 programmes, and lessons should be learned for the future about the procedures for setting up programmes.

**3.134.** With regard to aid to enterprises, particularly the SMEs, the Commission has made considerable efforts in the field of evaluation by improving the overall methodological framework for 2000 to 2006 and by carrying out several in-depth thematic evaluations. A new regulatory framework will give the Commission, in future, more appropriate instruments to remedy the weaknesses found. Recommendation: the instruments recently put in place must become operational as soon as possible, the Commission must clarify all the technical aspects associated with their implementation and the managing authorities in the Member States must intensify their efforts to apply the new provisions. In particular, as the new initiatives for the collection of

**3.134.** The Commission agrees with the Court on the application of the new rules.

Regulation (EC) No 438/2001 on the management and control systems attaches considerable importance to arrangements for ensuring compliance with Community rules, including those on assistance. This, moreover, is one aspect of the arrangements the Commission is planning to check very closely.

<sup>(80)</sup> See the recent Opinion No 2/2001, paragraphs 6, 29 and 30 (OJ C 162, 5.6.2001, p.1).

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data on the public sector aid granted represent tools which are likely to improve the management of aid to enterprises, they should be generalised and implemented in a coordinated manner (paragraphs 3.78 to 3.92).

3.135. The management of the Community initiatives for the period 1994 to 1999 proved particularly cumbersome and complex because of the relatively small amounts involved and the overlapping of these interventions with other Community programmes. For the period 2000 to 2006, the number of Community initiatives was reduced from 13 to four<sup>(81)</sup>. Recommendation: the programmes must be better coordinated and integrated with other Community measures in the same regions, both in terms of programming and in terms of management, control and evaluation, in order to avoid a repetition of the difficulties noted in the period 1994 to 1999 (see paragraphs 3.96 to 3.112 and 3.117 to 3.122).

3.136. Special Report No 22/98 revealed certain weaknesses in respect of Community action in favour of equal opportunities for men and women. The Court notes that for the period 2000 to 2006 the amounts devoted to relevant special measures only represents 6 % of the ESF, a share halfway between the 1,6 % achieved during the period 1994 to 1999 and the objective of 15 % set by the Commission in 1998 and requested by the European Parliament (paragraph 3.93). The medium-term Community programme (1996 to 2000), made up of direct-expenditure projects, outside of the Structural Funds, suffered from a disproportionate rate of its payments (7,6 %) being spent on the operations of the technical assistance office (paragraph 3.95). Recommendation: the Commission should ensure that greater consideration is given to the financing of equality of opportunities in the new programming period (2000 to 2006) of the ESF. In addition, the implementation of the medium-term Community programme should be supported by adequate resources to limit recourse to external bodies for the management of these projects.

**3.135.** *In the period 2000 to 2006 the number of initiatives has been cut in order to target their specific goals better, and with the aim also of achieving better coordination and integration with other Community assistance.*

**3.136.** *The appropriations for technical assistance have been substantially reduced in the Equal Opportunities Programme for 2001 to 2005. The tasks assigned to the technical assistance office referred to by the Court have been reassigned to DG EMPLOI during the last two budget years. This policy will have to be backed up by adequate resources to allow the Commission to carry out the work concerned in optimal conditions.*

*Special attention has been focused on equal opportunities in the programming process for 2000 to 2006 in part two of the Commission Communication on 'Guidelines for programmes in the period 2000 to 2006'.*

<sup>(81)</sup> These are Leader, Interreg, EQUAL and URBAN. PEACE was reincorporated in the relevant Community Support Frameworks for the period 2000 to 2006.

## CHAPTER 4

### **Internal policies**

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## INTRODUCTION

4.1. The European Union's internal policies focus in particular on the implementation and development of the single market. They cover four complete subsections of the budget and several headings in another subsection. The responsibility for implementing the internal policies and managing the corresponding budgets is spread across 13 Directorates-General (DG).

4.2. The internal policies measures concern:

- (a) training, youth, culture, audiovisual media, information and other social operations (subsection B3);
- (b) energy, Euratom nuclear safeguards and environment (subsection B4);
- (c) consumer protection, internal market, industry and trans-European networks (subsection B5);
- (d) research and technological development (subsection B6); and
- (e) other agricultural operations, other regional operations, transport as well as other measures concerning fisheries and the sea (Titles B2-5 to B2-9 of subsection B2).

## BUDGETARY MANAGEMENT

4.3. **Tables 4.1a and 4.1b** give an overview of how available appropriations were used during the financial year 2000.

4.4. Internal policies account for a global amount of 6 583 million euro in final commitment appropriations (see **Table 4.1b**). The largest part, 4 055 million euro, relates to research and technological development and most of this to the fifth Framework Programme (fifth FP), 3 464 million euro.

Table 4.1a — Evolution and implementation of the 2000 budget

(Mio EUR)

Heading of the financial perspective: internal policies and research											
	Total internal policies and research		Of which								
			Research and technological development (B6)		Consumers, internal market, labour market, TEN (B5)		Education, youth, culture, information and social operations (B3)		Others = energy, environment and agricult. operat. (B4 and parts of B2)		
	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Commitment appropriations	Payment appropriations	Payment appropriations	Commitment appropriations	
<b>Financial perspective ceiling</b>	6 031,0										
<b>Evolution of the budget</b>											
Initial appropriations (¹)	6 027,0	5 674,2	3 630,0	3 600,0	1 162,2	997,1	831,1	708,0	211,7	286,8	
Final appropriations available (²)	6 104,1 (³)	5 767,4 (⁴)	3 710,6	3 552,8	1 179,0	1 032,3	853,3	816,0	348,3	355,3	
<b>Implementation of the budget</b>											
Appropriations used (³)	5 751,8	5 124,6	3 667,2	3 222,9	1 080,4	867,5	807,5	747,2	196,7	287,1	
% of final appropriations available	94	89	99	91	91	84	94,5	91,5	56,5	81	
Appropriations carried over to 2001	223,3	57,5	20,1	0,0	43,5	7,2	23,3	21,2	136,4	29,2	
% of final appropriations available	4	1	0,5	0	4	1	3	2,5	39	8	
Appropriations cancelled	129,1 (⁴)	585,2 (⁴)	23,3	330,0	55,2	157,5	22,5	47,6	15,1	39,0	
% of final appropriations available	2	10	0,5	9	5	15	2,5	6	4,5	11	

(¹) Budget as finally adopted by the European Parliament on 16 December 1999 (OJ L 40 of 14.02.2000) **including** the relevant provisional appropriations for Heading 3 written in Chapter B0-4 0.(²) Budget appropriations amended after taking account of supplementary and amending budgets and transfers, but **excluding** appropriations carried over from 1999, re-use of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.(³) Appropriations utilised, **excluding** appropriations carried over from 1999, re-use of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.

(⁴) Including chapter B0-4 0 (reserve).

Source: Revenue and expenditure account and balance sheet — volume II; section [III-SEC(2001) 529-FR].

Table 4.1b — Implementation of the 2000 budget

(Mio EUR)

Title/Subsection of the budget	Heading	Commitment appropriations					Payment appropriations				
		Initial budget <sup>(1)</sup>	Final budget after SAB <sup>(2)</sup> and transfers <sup>(2)</sup>	Appropriations utilised <sup>(3)</sup>	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)	Initial budget <sup>(1)</sup>	Final budget after SAB <sup>(2)</sup> and transfers <sup>(2)</sup>	Appropriations utilised <sup>(3)</sup>	Rate of implementation of initial budget (%)	Rate of implementation of final budget (%)
B2-5	Other agricultural operations	51,500	51,500	49,051	95,2	95,2	82,000	84,010	76,329	93,1	90,9
B2-6	Other regional operations	p.m.	15,000	15,000	n.a.	100,0	7,477	17,677	16,824	225,0	95,2
B2-7	Transport	20,500	20,500	18,885	92,1	92,1	18,700	16,700	11,926	63,8	71,4
B2-9	Other measures concerning fisheries and the sea	44,450	45,550	45,500	102,4	99,9	34,700	41,350	41,294	119,0	99,9
	<b>Total in B2</b>	<b>116,450</b>	<b>132,550</b>	<b>128,436</b>	<b>110,3</b>	<b>96,9</b>	<b>142,877</b>	<b>159,737</b>	<b>146,373</b>	<b>102,4</b>	<b>91,6</b>
B3-1	Education, vocational training and youth	481,500	572,279	547,996	113,8	95,8	392,700	547,584	483,730	123,2	88,3
B3-2	Culture and audiovisual media	111,500	136,592	118,943	106,7	87,1	102,800	115,363	88,196	85,8	76,5
B3-3	Information and communication	93,500	109,259	97,620	104,4	89,3	86,900	99,600	90,177	103,8	90,5
B3-4	Social dimension and employment	144,615	149,742	137,164	94,8	91,6	125,645	127,326	107,270	85,4	84,2
	<b>Total B3</b>	<b>831,115</b>	<b>967,872</b>	<b>901,723</b>	<b>108,5</b>	<b>93,2</b>	<b>708,045</b>	<b>889,873</b>	<b>769,373</b>	<b>108,7</b>	<b>86,5</b>
B4-1	Energy	36,800	40,672	2,434	6,6	6,0	35,100	36,735	28,424	81,0	77,4
B4-2	Euratom nuclear safeguards	16,700	16,700	16,674	99,8	99,8	15,400	19,400	18,919	122,9	97,5
B4-3	Environment	41,700	161,797	49,211	118,0	30,4	93,400	150,934	102,996	110,3	68,2
	<b>Total B4</b>	<b>95,200</b>	<b>219,169</b>	<b>68,319</b>	<b>71,8</b>	<b>31,2</b>	<b>143,900</b>	<b>207,069</b>	<b>150,339</b>	<b>104,5</b>	<b>72,6</b>
B5-1	Consumer policy and consumer health protection	22,500	22,912	21,660	96,3	94,5	20,000	20,107	15,066	75,3	74,9
B5-2	Aid for reconstruction	1,698	3,698	1,697	99,9	45,9	1,698	3,698	1,697	99,9	45,9
B5-3	Internal market	145,445	139,911	121,143	83,3	86,6	151,390	155,699	128,476	84,9	82,5
B5-4	Industry	2,000	2,000	2,000	100,0	100,0	88,644	103,772	103,670	117,0	99,9
B5-5	Labour market and technological innovation	213,493	225,726	193,672	90,7	85,8	106,600	108,010	46,317	43,4	42,9
B5-6	Statistical information	31,400	32,512	32,418	103,2	99,7	30,130	30,541	27,911	92,6	91,4
B5-7	Trans-European networks	688,000	676,030	663,373	96,4	98,1	536,500	565,513	507,607	94,6	89,8
B5-8	Area of freedom, security and justice	52,000	86,818	49,502	95,2	57,0	56,700	69,804	56,612	99,8	81,1
B5-9	Measures to combat fraud & support expenditure for internal policies	5,650	5,650	4,845	85,8	85,8	5,400	5,400	3,325	61,6	61,6
	<b>Total B5</b>	<b>1 162,186</b>	<b>1 195,257</b>	<b>1 090,310</b>	<b>93,8</b>	<b>91,2</b>	<b>997,062</b>	<b>1 062,544</b>	<b>890,681</b>	<b>89,3</b>	<b>83,8</b>
B6-1	Joint Research Centre — Staff and Resources	206,900	255,160	242,245	117,1	94,9	207,934	261,901	236,270	113,6	90,2
B6-2	Joint Research Centre — Direct Operating Appropriations — EC Framework Programme 1998 to 2002	38,550	51,500	36,669	95,1	71,2	35,021	39,133	25,820	73,7	66,0
B6-3	Joint Research Centre — Direct Operating Appropriations EAEC Framework Programme 1998 to 2002	14,550	18,923	14,078	96,8	74,4	10,885	12,940	8,529	78,4	65,9
B6-4	Joint Research Centre — Direct Action-Completion of Previous Joint & Supplementary Programmes [...]	p.m.	114,549	12,411	n.a.	10,8	7,160	94,146	16,948	236,7	18,0
B6-5	Indirect Action (Shared-Cost Projects) — Completion of Earlier Projects [...]	p.m.	150,639	89,931	n.a.	59,7	1 215,000	1 521,348	1 258,873	103,6	82,7
B6-6	Indirect Action (Shared-Cost Projects) [...] Fifth Framework Programme 1998 to 2002	3 370,000	3 463,914	3 424,151	101,6	98,9	2 124,000	2 156,273	1 857,519	87,5	86,1
	<b>Total B6</b>	<b>3 630,000</b>	<b>4 054,685</b>	<b>3 819,485</b>	<b>105,2</b>	<b>94,2</b>	<b>3 600,000</b>	<b>4 085,741</b>	<b>3 403,959</b>	<b>94,6</b>	<b>83,3</b>
B0-4 0	Provisional appropriations = reserve	192,098	13,000				82,348	11,000			
	<b>Total</b>	<b>6 027,049</b>	<b>6 582,533</b>	<b>6 008,273</b>	<b>99,7</b>	<b>91,3</b>	<b>5 674,232</b>	<b>6 415,964</b>	<b>5 360,725</b>	<b>94,5</b>	<b>83,6</b>

<sup>(1)</sup> Budget as finally adopted by the European Parliament on 16 December 1999 (OJ L 40 of 14 February 2000).<sup>(2)</sup> Budget appropriations amended after taking account of supplementary and amending budgets and transfers, **but including** appropriations carried over from 1999, re-use of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.<sup>(3)</sup> Appropriations utilised, **including** appropriations carried over from 1999, re-use of revenue and revenue made available as a result of participation of third parties, other earmarked revenue and appropriations made available again.

NB: p.m.= token entry; n.a.= not available.

Source: Revenue and expenditure account and balance sheet — volume II; section [III-SEC(2001) 529-FR].

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*Review of the revenue and expenditure account (1)*

4.5. The revenue and expenditure account (2) showed significant improvements in form and content compared to the document provided for the 1999 closure of accounts.

4.6. There has been an effort to harmonise the presentation of the analysis of financial management. This is, however, mainly limited to the budgetary implementation tables.

4.7. The output implementation tables are a new feature which could provide very useful information, and in some cases do. However, there is a definite need for harmonisation regarding content and level of detail.

4.8. In the case of the DG Education and Culture (EAC) budgets (Socrates, Youth for Europe, Leonardo), due to the specific nature of the mobility activities of the programme, there are a large number of figures missing in the output implementation tables. In addition, figures are reported as 'realised' although they are only estimates.

**4.5-4.7.** *The Commission welcomes the positive remarks of the Court on the revised form and content of the 'Compte de gestion'.*

*As indicated in the Foreword to the 'Compte', the year 2000 is the first annual reporting occasion on which the budget implementation output, as shown in the document, has been attempted: as such it is considered by the Commission to have been a useful preparatory exercise for the fuller and systematic presentation of the budgetary output information which will be produced in future years. The Commission is now examining to what extent the presentation of output data can be harmonised for the 2001 exercise, while nevertheless taking into account the fact that, by their nature, not all budget lines lend themselves to quantifiable outputs.*

**4.8.** *The three programmes share two characteristics (they make it possible to support mobility projects and activities; some aspects are decentralised and require management to be delegated to national agencies) the effect of which is that when the Commission establishes the compte de gestion, it cannot know exactly which outputs will be obtained from the appropriations in the budget to which it refers.*

*In future the Commission will endeavour to be more explicit in its comments on this situation, which means that the standard table is not perfectly applicable in the specific case of these three programmes.*

4.9. The selection criteria used by the Commission for a detailed review of the management of a budget line are appropriations exceeding 30 million euro and/or budget lines of particular importance and interest. However, some budgetary items representing appropriations

*It is true that certain budget lines whose appropriations are drawn from third parties were not included in those reported on. The Commission will shortly discuss this aspect with the Court in the context of the selection criteria to be applied for the 2001 exercise.*

(1) The Court has reviewed the information presented by the Commission in Volume 1 of the revenue and expenditure account. The purpose of this volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available as well as between the appropriations finally available and those utilised. The review did not seek to provide assurance as to the reliability of its contents. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

(2) SEC(2001) 528-FR.

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resulting from income from third parties of amounts over 30 million euro are not mentioned, e.g. B6-4 3 1, B6-4 4 3 and B6-5 5 1.

4.10. In several budget lines, particularly in subsection B6, the percentages given as 'total budget implementation in 2000 in % of initial budget' are in fact those of the 'total available budget for 2000'.

**4.10.** *The Court's observation is correct. All the information is provided to calculate total budget implementation in 2000 as a percentage of initial budget as well as a percentage of the total available budget for 2000.*

## SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

### *Introduction*

### **Scope of the audit and audit approach**

4.11. The objective of the audit for the 2000 Statement of Assurance (DAS) in the internal policies budgetary area was to obtain sufficient, relevant and reliable audit evidence on the reliability of the accounts as at 31 December 2000 and the legality and regularity of the underlying transactions in order to contribute to the Statement of Assurance on the general budget for 2000 (see Chapter 9 of this Annual Report) as well as, through additional work, to formulate a specific assessment of the strengths and weaknesses in internal control applicable to the fifth Framework Programme (fifth FP) for Research and Technological Development (RTD).

4.12. The system audit of the fifth FP was based on an evaluation of the system design and a verification as to the consistent, continuous and effective operation of the system. For this purpose a system description of the administrative and control procedures in the thematic and horizontal programmes of the EC section (see 4.15) as at December 2000 was established, walk-through tests on the basis of files selected by the five Research DGs concerned, namely DG Research (RTD), DG Information Society (INFSO), DG Energy and Transport (TREN), DG Enterprise (ENTR) and DG Fisheries (FISH), were performed and tests of key controls on the basis of 45 contracts were carried out.

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4.13. The first calls for proposals for indirect RTD actions under the fifth FP were published in March 1999. Given a period of about 348 calendar days from the publication of the call and about 263 calendar days from the reception of the proposal until the contract signature by the Commission, most contracts, with the exception of the Information Society Programme operated by DG INFSO, the section of the Growth Programme operated by DG TREN and the section of the Quality of Life Programme operated by DG FISH, were signed only in 2000. Since for most fifth FP actions the first cost claims are submitted after a period of 12 months, the payments for indirect RTD actions in 2000 consisted primarily of advance payments.

## COMMISSION'S REPLIES

**4.13.** 1999 was the first year of implementation of the new framework programme which was inevitably confronted with a number of running-in problems at almost every stage, in particular with regard to a new evaluation procedure.

*The need to ensure the fairness and the equal treatment of all the applications together with the need for comprehensive technical evaluation and the subsequent assessment of applications and selection of projects means that the process cannot be compressed at will:*

- for specific actions and programmes a longer publication period is justified,
- a transparent and correct evaluation procedure takes time and is a function of the number of proposals submitted,
- a serious negotiation effort will save problems later.

*Some aspects of the internal procedures have been improved over the last two years and a number of simplification measures have been introduced.*

*In addition, fast track pilot actions have been carried out for the IST programme and CRAFT proposals in 2001 significantly bringing down the time to contract. The experience gained from the pilots is being used to review the planning for future calls in order to bring down the time to contract.*

#### Nature of the expenditure

4.14. There are two distinctive fifth FPs: the European Community (EC) Framework Programme covering research, technological development and demonstration activities; and the Euratom Framework Programme covering research and training activities in the nuclear sector.

4.15. Research activities financed under both fifth FPs consist of indirect actions (about 93 % of the budget) carried out through contracts with third parties partly financed by the Community budget and direct actions (about 7 %) financed entirely from the Community budget and carried out by the DG Joint Research Centre.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

4.16. The budget lines of the four thematic and three horizontal programmes (indirect actions) in the European Community section of the fifth FP correspond to payment appropriations of 1 742 million euro in the 2000 budget, which represents almost half of the payment appropriations in subsection B6 Research and Technological Development and approximately 31 % of the payment appropriations for the whole Internal policies budgetary area. The fifth FP is therefore, in financial terms, the most important management system in this budgetary area.

4.17. The EC section of the fifth FP is operated by five Research DGs with three of the thematic programmes and one of the horizontal programmes being operated by more than one DG.

4.18. According to statistics provided by the Commission, 6 115 contracts for fifth FP indirect RTD actions with an EU contribution of 5 324 million euro were signed by the Commission before the end of December 2000. More than 90 % of these contracts are managed by DG RTD and DG INFSO with 4 701 contracts (accounting for approximately 64 % of the total EU contribution) and 1 038 contracts (accounting for approximately 29 % of the total EU contribution) respectively.

**Limitations of a system based on cost reimbursement**

4.19. In the Research Framework Programmes financial contributions are granted on the basis of costs actually incurred. The high level of detail and the complexity resulting from contractual arrangements based on a system of cost reimbursement demand a significant administrative effort both from the contractors and the Commission with regard to the proposal, contract and project management for indirect RTD actions.

**4.19.** *The funding system of the Research Framework Programmes has both strengths and limitations. The Commission has progressively addressed the limitations. Given the nevertheless evolutionary character, the participants and the Commission services are quite familiar with the system.*

*For the next framework programme the funding system is again being reviewed to make it simpler for project participants, to improve controls further within the limits of the financial and human resources of the Commission, to be focused on results and to be even better able to discourage overcharging and fraud.*

4.20. In addition, the possibilities for verification by the Commission services of costs claimed, when supporting documentation such as certified invoices for specific costs is not submitted by the contractor, are in practice limited to checks for plausibility and for formal

**4.20.** *The costs claimed are reviewed in the context of the scientific and technical reports which indicate the work carried out in accordance with the tasks identified in the technical annex and in relation to the estimated costs as identified during contract negotiation. When there are significant*

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consistency (i.e. non-eligibility of specific categories of expenditure and numerical correctness of declared costs).

4.21. Therefore, unless an audit is done on the spot, a verification of the reality and accuracy of the costs claimed is only partially possible. As suggested by the Court in the DAS 1998 (3), the Commission has intensified its ex-post audit activities. The overall target defined by the Research DGs is to audit 10 % of the contractors during the fifth FP (4). Also following recommendations of the Court in the DAS 1998 (), the Commission has introduced in the IST and CRAFT programmes pilot actions requiring audit certificates for most contractors of RTD projects. However, measurable impact will only be noted in the medium term, in fact this certificate will only be required for payments of contracts launched in 2001.

4.22. As in the previous Framework Programme, the Commission has insufficient means of sanctioning legal entities which overstate their costs, apart from reducing its financial contribution and charging interest on the amounts overpaid. No contractually-defined sanctions (for instance automatic fines in relation to costs overcharged) or administrative penalties are provided for in the model contracts of the fifth FP.

## COMMISSION'S REPLIES

*inconsistencies between the costs reported and the evidence of the work carried out, the Commission services may ask for additional detailed supporting documents. If necessary a major review of the costs, including on-the-spot controls, can be undertaken.*

**4.21.** *In 1998 the Research DGs jointly formulated a new and coherent audit strategy for all the framework programmes (see points 4.69 and 4.70). In addition, the Commission is exploring complementary measures (e.g. audit certificates).*

*The recommendation of the Court in the 1998 DAS encouraged this effort.*

**4.22.** *The legal framework for direct expenses and particularly contracts under the fifth Framework Programme of the European Community already includes measures to protect the financial interests of the Community. In the event of suspected fraud or serious financial irregularity, Articles 3.2 and 7.6, Annex II of the contract, explicitly allow the Commission not only to reduce its financial contribution but also to recover the totality of the contribution.*

*In addition to the above, the possibility to compensate between contracts has made it easier to recover the amounts due to the Commission.*

*If fraud is suspected, the Commission services refer the case to OLAF, who will take further action (Commission Decision of 2 June 1999 (1999/396/EC, ECSC, Euratom)).*

*If the overstatement is caused by error or misunderstanding then the most appropriate redress is unlikely to be a sanction. Explanation and education on an ongoing basis is more likely to be effective.*

(3) Annual report concerning the financial year 1998, OJ C 349, 3.12.1999.

(4) Annual report concerning the financial year 1999, Commission's reply, point 4.23, OJ C 342, 1.12.2000.

## THE COURT'S OBSERVATIONS

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Nevertheless, strengthening of provisions on controls is of high priority for the Commission. This is why the OLAF work-programme includes the integration of administrative measures and sanctions in the domain of direct expenditure. In addition to the already existing provisions for the reimbursement of the Community financial contribution, a complementary financial penalty clause is under discussion in the event of excessive expenses being claimed deliberately or by negligence in the area of direct expenditure.

### *Implementation problems with the fifth FP*

#### **Lack of documentation for operational procedures**

4.23. The complexity of the organisational structure of the fifth FP, with several programmes and key actions operated by different DGs, makes efficient coordination within the Framework Programme even more important. The need for a harmonised set of procedures for all DGs operating the fifth FP was addressed by the Council and the European Parliament when asking the Commission in their Decision 182/1999/EC to '[...] establish and publish [...] a detailed manual of operational procedures and guidelines for the selection of actions'.

4.24. The description of procedures in the 'Evaluation Manual' adopted by the Commission in response to the above mentioned Decision is, however, insufficiently detailed to be used as a manual of operational procedures. Furthermore some procedures leading to the selection of RTD actions, for instance the negotiation of proposals, are only partially covered by the 'Evaluation Manual'.

4.25. With the exception of DG Energy and Transport and DG Information Society, where the development of DG-specific operational manuals commenced in 2000, the administrative procedures and responsibilities were not sufficiently documented in the Research DGs operating the fifth FP.

**4.23.** All DGs concerned must implement the Research Framework Programme according to a common set of principles and procedures. However, in line with the basic orientation of the Commission Reform, each DG and programme is to remain responsible for its detailed design and implementation of internal control.

**4.24.** The 'Evaluation manual' has been adopted by the Commission in order to make the process from the pre-proposal checks to the preparation and finalisation of the contract more transparent and harmonised. On the basis of the Manual, the specific programmes derived more detailed documents relevant to the preparation and finalisation of the contracts for the use of both the Commission and the contractors.

**4.25.** DG RTD operational procedures are extensively documented. In addition to the 'core' of the existing documentation, the Evaluation manual, there are manuals detailing other aspects of the procedures. In application of standard 15 for internal control, 'Documentation of procedures', work has been undertaken to remedy the shortcomings identified and to make the manuals generally accessible on the Intranet. A working group has been set up to achieve this.

The Research DGs have reorganised the documentation of responsibilities to boost and complete the decentralised management of operational resources. Inevitably, this process has led to the revision of administrative procedures and some reassignment of responsibilities.

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4.26. Formal job descriptions outlining different activities and responsibilities, as advocated by the Action Plan for the White Paper 'Reforming the Commission', were developed by all Research DGs during 2000 and communicated to the staff. However, the present form of the job descriptions does not yet appear to be as detailed as necessary to prevent the risk of a dirigent understanding of shared responsibilities, for example between scientific project officer, negotiator and financial officer, in managing indirect RTD actions.

**Inadequate IT-support for proposal, contract and project management**

4.27. Although the management system for all Research DGs operating the fifth FP is essentially the same, the Commission has not developed a single IT system for the proposal, contract and project management of indirect RTD actions in the fifth FP. As of the end of 2000, DG Enterprise had not yet implemented an IT system for contract and project management. Furthermore the DG-specific IT systems in operation are not integrated with each other, and only the IT systems of DG Research and DG Information Society are partly integrated with SINCOM. This prevents, for example, automatic consolidation of information with regard to the legal and financial viability of contractors, cross-checks of the declaration of durable equipment by the same contractor under several contracts, or effective verification of the early warning system in SINCOM operated by DG Budget.

4.28. In addition, the IT systems are incomplete in some DGs: for instance, there is no information on the availability of certain model contracts at DG Research, the processing of contract amendments at DG Research and DG Information Society, and important functions such as the recording of project deliverables and due dates are lacking, except in the case of DG Energy and Transport and DG Fisheries.

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4.26. The Commission is currently embarking on a new human resources management system which includes more elaborate job descriptions. Research DGs are cooperating with DG ADMIN to ensure that the specific features of research are well incorporated in the different profiles that will be embedded in this new job description system. Actual implementation is scheduled for the first half of 2002.

4.27. The Research DGs have introduced a common IT system for proposal submission, an expert database and the evaluation service provider. Building upon this experience an Inter-service Working Group was established in April 2001 to develop an integrated IT system and a common database for the next Framework Programme, which will become operational on 1 January 2003.

The Working Group is also developing a new electronic proposal submission system aimed at improving the quality of proposal, and hence participant, data.

With regard to an effective verification of the early warning system, the Research DGs have used the existing system in SINCOM operated by DG Budget at different stages of the process.

4.28. For DG RTD during the first part of 2001 all contract types, with the exception of high level conferences, became available together with modules for proposal evaluation, the vetting of potential contractors (*a priori* control) and an early warning system similar to that of SINCOM. Contract data for earlier FPs were also uploaded into the system. The contract amendment module entered into service in mid-July 2001 and the project management modules (*échéancier*) are due to be introduced progressively between September and November 2001. Training schemes have been introduced on a monthly basis, particularly for new entrants into DG RTD, improving the efficiency of the use of the system.

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## COMMISSION'S REPLIES

*Completion and improvement of DG INFSO IT systems have progressed for contract production for all types of model contracts, and support for amendments and payments has been in place since mid-2001.*

**Insufficient internal control activities**

4.29. A formal risk assessment exercise, facilitated by DG Audit, identifying and evaluating the relevant risks which might impair the achievement of management objectives for the fifth FP, was conducted separately within each of the five Research DGs and completed in 2000.

4.30. Control activities helping to ensure that policies decided by the management are carried out and that necessary actions are implemented to address the identified risks were not coherently defined by the Commission for the whole Framework Programme. Important steps in the control system, for instance regarding the verification of the appropriateness of the contractor's accounting system, a check for the consistent and coherent application of a cost system across the Framework Programme or the verification of the legal and financial viability of the entities participating, were lacking or were not applied coherently and consistently by all DGs or programmes. Except for DG Information Society and DG Fisheries, the negotiation outcome was in general not subject to an authorisation.

**4.30.** *With the fifth Framework Programme, the Commission has introduced significant improvements to address potential risks, in particular with regard to the selection of proposals, a new strategy to reinforce on-the-spot controls and more effective measures in case of financial irregularities.*

*Internal controls were strengthened, in some DGs along with new organisation charts, decentralising the financial management, while at the same time formalising the financial circuits and reinforcing financial management and internal audit activities.*

*For the a priori verification of the legal and financial viability of the participating entities a more elaborate methodology has been developed in order to assure consistency of application of standard criteria for determining financial risk.*

*With regard to the contractor's cost systems, the 'Participant's choice of the cost reimbursement system for research, development and demonstration projects' provides guidelines for the participants. On-the-spot audits are the only means of verifying the appropriateness of this choice. The check on a consistent cost reimbursement model for each contractor is undertaken as part of the legal and financial viability verification within each programme. This verification will be extended beyond a specific research programme with the implementation of a common database (as referred to in the reply to 4.27).*

*The negotiation outcome is subject to an authorisation, sometimes implicit, as the agreement of different scientific and financial departments within the Directorate-General is required in order to launch the Commission selection decision for each project.*

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4.31. The tests of the operational key controls revealed that some have not been effectively operated by all DGs and all programmes. For example, deficiencies were identified with regard to the eligibility check of proposals submitted, in particular at the beginning of the Framework Programme, and the verification of the eligibility and numerical correctness of costs declared in cost statements, leading in some cases to overpayments by the Commission.

4.32. Except for DG Information Society, DG Energy & Transport and DG Fisheries, the formal documentation of the controls operated was found to be inadequate.

**4.32.** While a full documentation system of controls is not yet in place in DG RDT and ENTR, it is evident that the controls are exercised by functioning administrative/financial circuits. Some programmes operate with check lists identifying a number of successive steps in execution including verifications and controls.

*Further progress is being made with regard to formal documentation.*

### Conclusions

4.33. Given the inherent limitations of the current system based on the reimbursement of costs, in particular with regard to the limitations of the controls operated, the partial coverage of ex-post financial audits and the absence of contractually-defined sanctions, there is only a minor detection risk to beneficiaries when overstating their actual costs.

**4.33.** The Commission has progressively addressed limitations of the current system of cost reimbursement by measures such as increasing audits and introducing audit certificates. For the next framework programme, further far-reaching improvements are under consideration in the context of discussions on the legislative proposals.

*In the meantime, the Commission has expanded its explanatory efforts, including via its website, has multiplied its ex-post financial audits and can now make financial adjustments immediately. As far as the limitation of internal controls is concerned, not all of them have significant implications for the financial risk of the research programme.*

*For the future, the funding system is again being reviewed to make it simpler for project participants, to improve controls further within the limits of the financial and human resources of the Commission, to be focused on results and to be better able to discourage overcharging and fraud.*

4.34. The audit work done indicates that only a limited assurance can be derived from the internal control procedures in place for the whole of the Framework Programme.

**4.34.** The audit work done by the Court of Auditors is valuable in that it points to some problems which the Commission will address.

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## COMMISSION'S REPLIES

4.35. Given the lack of formally binding documentation of operational procedures and guidelines for the Framework Programme, and pending the effective operation of the internal audit service, the Commission lacks the assurance that internal procedures and working methods are applied consistently.

**4.35.** Although there is scope for some improvements, the Evaluation manual formally approved by the Commission continues to be an important reference document for compliance with relevant procedures. Guidelines or manuals on other aspects are maintained within the operational directorates which apply them.

4.36. The level and quality of the IT support for the administration of the fifth FP proposals and contracts showed serious, although diminishing, inadequacies. This has impaired the execution of the Framework Programme and diminished the reliability of the Commission's internal statistics in this area.

*DG INFSO and DG TREN have documented their operational procedures for evaluation and negotiation of proposals in a vade mecum, available on the intranet for their staff. Documentation, Frequently Asked Questions, and Help Desk functions are available for both contractors and Commission staff.*

**4.36.** The execution of the framework programme, particularly in its initial stages, would have been facilitated by better IT support. The late adoption of the legal basis and the budgetary need to launch calls for proposals without further delay imposed inadequacies from the outset. Since then, the IT system has been developed and now provides complete data bases and management modules for all contracts for each DG.

*In DG INFSO budget execution and programme statistics were not affected by shortcomings in IT support in FP5, as basic central tools were available from 1999 onwards.*

*An Inter-service Working Group has been established to examine statistical requests and to define standard data sets for the framework programme as a whole, covering data originating in different DGs.*

## Recommendations

4.37. Internal control activities should be strengthened across the Framework Programme and a set mandatory, minimum level of key controls to be implemented should be clearly defined by the Commission.

**4.37.** The 24 Internal Control Standards adopted by the Commission on 13 December 2000 (SEC(2000)2203) provide a reinforced framework for control activities, also with regard to the framework programme.

*All the Research DGs have made strenuous efforts to achieve the objectives set by the Commission (priority objectives for financial management) by 30 June 2001.*

*DG INFSO and DG TREN have implemented a set of checklists for processing both commitments and payments. These checklists, which are mandatory in every transaction file and are signed by both the file-handler and the management, list the key controls that need to be ensured for each individual transaction.*

## THE COURT'S OBSERVATIONS

4.38. Also, the Commission is encouraged to develop and implement, in a joint effort by all Research DGs, a standardised documentation of the control activities performed.

4.39. Furthermore, these control activities need to be monitored periodically to assess whether all feasible controls have been instituted and whether the controls are functioning effectively.

4.40. As recommended in the DAS 99 (5), the Commission is invited to introduce a legal basis for contractually-defined sanctions in the model contracts for RTD actions. If necessary, a sectoral Regulation providing for penalties should be proposed by the Commission.

4.41. Since all Research DGs operate on the same legal base and face essentially similar administration and management tasks, the Commission is invited to harmonise its administrative and financial procedures and working methods as far as possible across all programmes in order to ensure a standardised implementation of the fifth FP by all DGs involved.

4.42. The Commission should develop a cross-DG manual describing the operational procedures covering all stages of the fifth FP.

## COMMISSION'S REPLIES

4.38. In the framework of the Commission reform, in particular Internal Control Standard 15 on the documentation of procedures, the Research DGs are working to complete the documentation of their procedures, including key controls to be performed. This work is building on best existing practises. Access for all services will be facilitated via Intranet.

4.39. In the framework of the Commission reform, surveillance of the implementation of control activities is being systematically strengthened. Annual self assessments and audits by the newly created internal audit capacities will monitor their effective functioning.

4.40. An additional financial penalty clause may be introduced for excessive amounts of direct expenditure declared deliberately or accidentally. The matter is being examined seriously. Discussions are currently taking place between the Commission departments concerned, including OLAF, to assess the content of a draft sectoral anti-fraud regulation on the basis of Article 280 of the EC Treaty (codecision). The Commission is examining the scope of a regulation of this type, including the possibility of applying it to ongoing contracts.

4.41. The research framework programme is today characterised by a large degree of standardisation of procedures and standard contracts. Excessive harmonisation of internal administrative procedures and working methods may not be required, and could even be counter-productive in a dynamic process of innovation, reform and constant search for new best practice.

4.42. In particular, the Research DGs have set themselves the long-term goal of developing a basic structure which, while retaining the various procedural steps of the fifth framework programme, would refer back to the descriptions drawn up previously and would still safeguard its own specific features. The description of the fifth framework programme systems produced by the Court of Auditors should prove extremely useful in that task. In any case, the objective is to develop a consistent but adaptable reference model for internal procedures.

(5) Annual report concerning the financial year 1999, OJ C 342, 1.12.2000.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

4.43. The description and definition of activities and responsibilities in the management of indirect RTD actions should be more clearly stated in the job descriptions.

**4.43.** The Commission is currently embarking on a new human resources management system, which includes more detailed job descriptions. The Research DGs are currently cooperating with DG ADMIN to ensure that the specific features of research are well incorporated in the different profiles that will be embedded in this new job description system. Actual implementation is scheduled for the first half of 2002.

4.44. The essential functions of the current IT systems used for the proposal, contract and project management which are as yet missing or incomplete should be implemented as quickly as possible.

**4.44.** Completion and improvement of IT systems have progressed for contract production for all types of model contracts, amendments and payments.

4.45. Furthermore, with regard to future FPs, the Commission is invited to develop a single or integrated IT system based on clearly established user requirements. As far as possible the design of such an IT system should also allow for an integration of non-research programmes operated by the DGs concerned.

**4.45.** The Research DGs have introduced a common proposal submission system, expert database and evaluation service provider. Building upon this experience an Inter-service Working Group was established in April 2001 to develop a common IT system for the next framework programme which, it is planned, will enter into service on 1 January 2003.

FOLLOW-UP OF PREVIOUS OBSERVATIONS —  
SPECIAL REPORT NO 10/2000 ON THE  
MANAGEMENT OF THE PUBLIC CONTRACTS  
AWARDED BY THE JOINT RESEARCH CENTRE

*Summary of main observations*

4.46. Over the period covered by the report (1995-98) the contracts awarded by the Joint Research Centre of the Community (6) (referred to below as 'the JRC' or 'the Centre') represented an amount of 494 million euro. The report showed that the management systems were unable to provide appropriate information for the board's needs and that there was insufficient control over the contracting cycle on the part of the manager departments.

**4.46-4.48.** The Commission would point out that the Joint Research Centre launched far-reaching reforms to iron out the weaknesses noted by the Court without waiting for the finalisation of special report No 10/2000. The Court welcomed these moves in the report itself. The Commission fully intends to continue and extend these reforms with a view to consolidating the situation as indicated by the Court.

(6) OJ C 172, 21.6.2000.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

4.47. Over the years the cumulative effect of these limitations was to foster the development of some questionable practices. The following were highlighted:

- (a) the misuse of service contracts to cover the continuing employment within the JRC of people whose contracts of employment could not be extended;
- (b) excessive use of the private treaty procedure;
- (c) questionable management of the vehicles contract.

*Recommendations of the discharge authority*

4.48. In order to mitigate these shortcomings and prevent any recurrence of such malfunctions, the JRC followed the recommendations of the Council and the discharge authority and initiated a set of reforms that has started to bear fruit, but still has to be consolidated.

*Audit findings*

**The overall management system: real improvement**

4.49. The JRC organises its activity around work programmes which set out the details of the scientific projects placed with the various institutes making up the Centre. It would therefore appear to be essential for the board of the Centre to have the means of linking any given transaction to the project for whose benefit it is being funded. That was not the case when Special Report No 10/2000 was published. Since then an interface has been established between the personal accounts, the contracts database and the records of commitments and payments in the Sincom II accounting system, thus making it possible to keep subsidiary project accounts.

4.50. These new arrangements have the added advantage of adapting the information provided to the various management requirements and thus providing the key information required for management purposes. For example, it is possible to produce on demand and in real time a breakdown of the contracts awarded, not just by project but also by institute, by nature of contract (supply of goods or services), according to the award procedure followed (tendering/private treaty), or

**4.49-4.51.** The Commission is pleased that the Court has appreciated the progress made with regard to the management tools used by the JRC. New developments have been set in train to improve the integration of the computer programmes. The Infima software will be used throughout the JRC, an interface with Sincom 2 will be set up and the information contained in Infima will also be available through the data pool.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

in terms of the legal basis (contract or simply a purchase order). A module known as Datapool, which is accessible via the Intranet, completes the facility and likewise offers full and detailed information.

4.51. However, the data which the latter is capable of providing on the matter of contracts are complete only in the case of transactions handled by the Ispra site. The purchasing handled by the other sites (Geel, Karlsruhe and Petten) is, in fact, tracked by means of a software system known as Infima which, although it is efficient, has the major drawback of being available only in local mode for the time being. For that reason it is impossible for tables that are produced in real time to include full information on all the contracts awarded by the JRC.

**Control of the contract cycle: some improvement**

4.52. Control of the contract cycle presupposes that there are mechanisms for identifying needs, programmed purchasing, procedures for drawing up tender documents and preparing specifications/technical annexes and transparent and well-documented procedures for awarding contracts. Lastly, it requires systematic checks on the service rendered, before payment is made.

4.53. In overall terms, control of the contract cycle was unsatisfactory and the inquiry carried out before the publication of Special Report No 10/2000 discovered many irregularities. Despite the unprecedented, and sometimes difficult, efforts made by the JRC in endeavouring to rectify the situation (see paragraphs 4.60 and 4.61 below), as far as the Ispra site is concerned, the improvements that have been made are still quite modest.

4.54. Firstly, the description of the management procedures had been neither completed nor, *a fortiori*, formally adopted by the board of the Centre, for the Ispra site. The checks carried out during the follow-up also showed that there were descriptive errors in the draft manuals. Annual programming of requirements in the form of a summary document for each of the institutes/services was intended to provide the starting point for the JRC's implementation of a purchasing policy. Checks showed, not only that some institutes/services did not prepare such a document, but also that the quality of the documents that were produced varied widely from one institute to another.

**4.52-4.53.** *The Commission confirms that work will continue on documenting and harmonising procedures relating to public contracts awarded by the Joint Research Centre. As regards paragraphs 4.60 and 4.61, the Commission considers that any problems that might have existed in the past have been resolved, and this also applies to Ispra.*

**4.54-4.55.** *The description of all the Joint Research Centre's management procedures is well on the way, but it clearly takes time to harmonise and document the whole organisation. The approach adopted is to introduce best practice and the systems developed in the various institutes across the board. This is one of the main objectives for 2001.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

4.55. The Infima management system that was created at Petten has gradually been improved and extended to Geel and Karlsruhe during 2000. Once the interface with Sincom II and the contracts database has been completed it should be possible to provide full information on the contracts awarded, to relate them to the relevant projects and to monitor the management flows in real time. The double interface with the software for monitoring the budget accounts and the contracts database should be ready for 2002. These three sites have also prepared manuals documenting their management procedures.

4.56. Secondly, the Centre had introduced an innovative approach that was specially adapted for its own particular form of management. It is based on a fundamental distinction between the functions, or, more specifically, the professional roles, of scientists and administrators. The former are responsible for specifying the content of a contract, in terms of requirements and the drafting of the technical specifications, and then for checking the service provided in order to ensure that the contract has been properly carried out. The latter, the administrators, select the award procedure to be followed and verify the quality of the contract in terms of its administrative, financial and legal characteristics. A double line of authorisation, scientific on the one hand and administrative on the other, has been drawn on the basis of this distinction. The reform has been blocked by the Commission, however, on the grounds that the authorising officer's powers would thus be split between two officers. This seems regrettable, because a reform of this type allows everyone concerned to exercise clearly defined responsibilities and to perform well, since the responsibilities are within the scope of the individual's professional role.

4.57. The scientific managers must be able to concentrate exclusively on the execution of the projects for which they are responsible. In order to do so they must say what is required for projects to succeed and verify that services provided or goods supplied by contractors are up to specification. On the other hand, the scientists do not have the legal, financial and administrative skills to specify the purchasing procedures that are to be followed. Furthermore, leaving aside the technical aspects, it is preferable for the scientific work to be shielded from market pressures in order to safeguard its independence, by giving the responsibility for organising the tendering procedures to staff in the administrative and financial units who are not involved in the definition of requirements.

**4.56-4.57.** *The financial circuits being set up by the Joint Research Centre as part of the reform of the Commission include a system of double signatures as described in paragraphs 4.55 and 4.56 of the Court's annual report. In this way, at least two people will handle each dossier independently and in a complementary manner. Their respective responsibilities are clearly set out in the documentation of the financial circuits. The final signature in the circuit is that of the operational manager, in line with the guidelines for the reform of the Commission. The authorising officer is therefore responsible for this last signature.*

*The Commission's current accounting system (Sincom) does not officially use a double signature financial circuit as described here. However, it is planned to adapt the workflow and safety checks to enable these circuits to be set up and computerised by the end of 2001.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Contracts awarded by private treaty/negotiation**

4.58. Special Report No 10/2000 highlighted the volume of contracts awarded under these procedures which did not comply with the conditions mentioned in the Court of Justice's case law on the use of such procedures. In 1999, 403 contracts totalling slightly more than 10 million euro were awarded by private treaty/negotiation (7). These figures represent 70,1 % by number and 23,2 % by total value of the contracts for the financial year. In 2000 the value of the contracts awarded in this way declined, to 7,5 million euro, but the number increased, reaching almost 25 % by value and nearly 76 % by number (see **Tables 4.2a and 4.2b and Diagrams 4.1 to 4.4**).

**4.58-4.59.** The Joint Research Centre now implements the Directives on public procurement and the Financial Regulation correctly. These two legal bases make it possible to employ a simpler consultation procedure for public contracts involving amounts below certain thresholds. It is true that the Joint Research Centre's consumption profile includes many small purchases of material and services. However, the JRC will act on the Court's suggestion that it should conduct a more detailed analysis as part of its Internal Audit Unit's audit programme.

**Table 4.2a — Amount and number per contract award procedure 1999**

Award procedure	Amount (in euro)	Number of contracts	% amount	% number
P	7 474 961	393	17,3	68,3
N	2 541 002	10	5,9	1,7
O	17 793 769	92	41,2	16,0
R	15 429 304	80	35,7	13,9
Total	43 239 036	575	100,0	100,0
Total P+N	10 015 963	403	23,2	70,1

P= private treaty, N= negotiated procedure, O= open procedure, R= restricted procedure.

Source: Commission JRC Ispra.

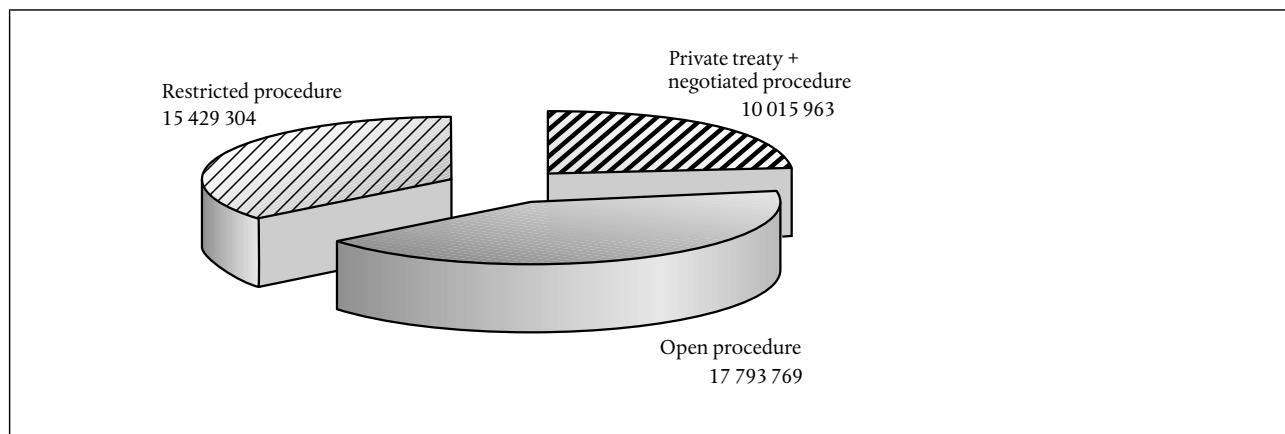
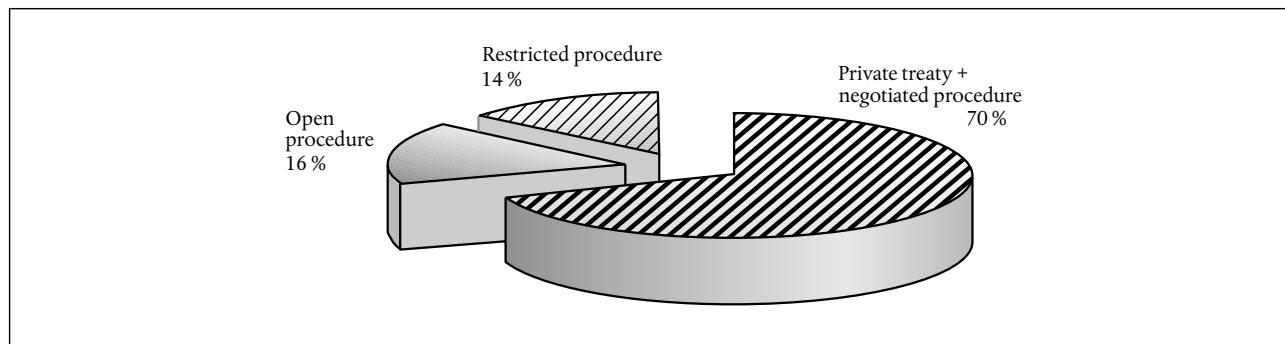
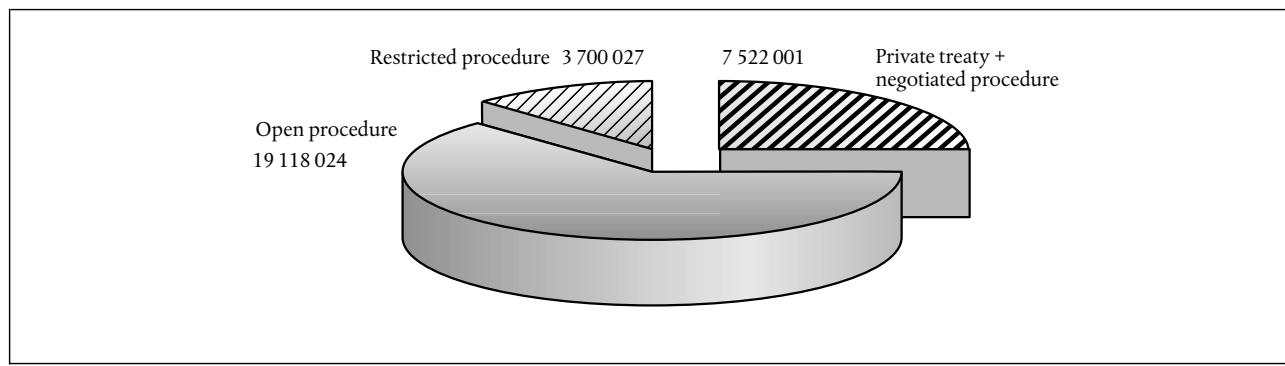
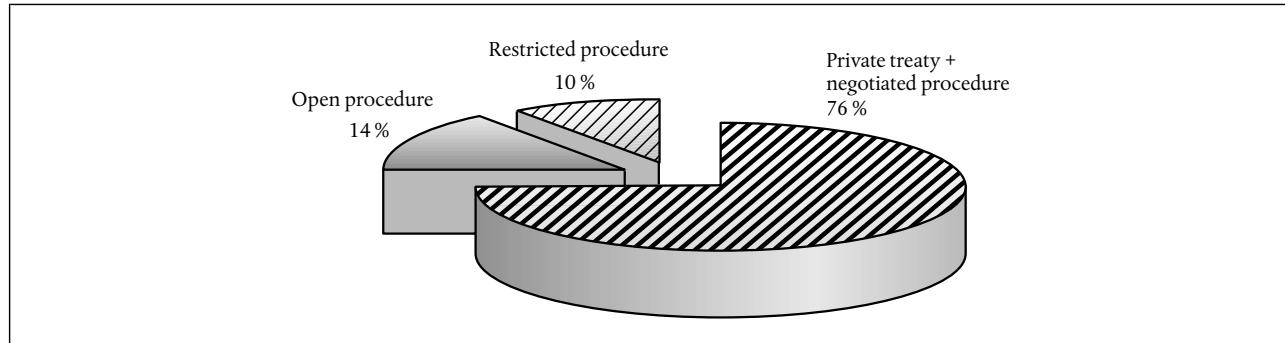
**Table 4.2b — Amount and number per contract award procedure 2000**

Award procedure	Amount (in euro)	Number of contracts	% amount	% number
P	7 350 553	557	24,2	74,1
N	171 448	12	0,6	1,6
O	19 118 024	108	63	14,4
R	3 700 027	75	12,2	10,0
Total	30 340 052	752	100	100,0
Total P + N	7 522 001	569	24,8	75,7

P= private treaty, N= negotiated procedure, O= open procedure, R= restricted procedure.

Source: Commission CCR Ispra.

(7) The term private treaty is used where the transaction is covered by the Financial Regulation and negotiation where it is the directives on public contracts that are applicable. In both cases the managers award the contract by means of a procedure that does not include any obvious competitive element.

**Diagram 4.1 — Amount per contract award procedure 1999 (in euro)****Diagram 4.2 — Distribution by number of contracts per contract award procedure 1999.****Diagram 4.3 — Amount per contract award procedure 2000 (in euro)****Diagram 4.4 — Distribution by number of contracts and order forms per contract award procedure**

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

4.59. The board of the JRC must carry out a more detailed analysis, in order to ascertain why the percentage is so high and, especially, to check that there were valid reasons for choosing this method of awarding contracts.

### Use of contracts for the provision of services

4.60. In Special Report No 10/2000 the Court commented on the use of service contracts as a way of continuing to employ people whose contracts of employment could not be extended under the current rules. Even before its report was published, the Court was able to comment favourably on the effort being made by the JRC in trying to put an end to these practices. When the exercise was finished, it was possible to see the extent of the phenomenon: it was possible to identify some 300 cases of people benefiting from this misuse of contracts for the provision of services.

4.61. The first impression is that the figure is high, although the numbers are spread over several years and the contracts vary in duration. On further consideration it also highlights the board's determination to put an end to such practices. Apart from that, the extent of the numbers involved suggests that the Commission ought to examine whether this was a device for conferring undue benefits or whether it was simply an expedient for obtaining the human resources that the Centre needed in order to carry out its mission. In the first case severe sanctions are called for, in order to prevent the recurrence of such a phenomenon. In the second, it is the personnel policy as a whole that needs to be reviewed, in order to ensure that the JRC has the human resources to carry out the work entrusted to it.

### Management of vehicle contracts (8)

4.62. The vehicles contract had been awarded to the same contractor without interruption since 1979, so that, in fact, the contractor had a virtual monopoly. The Court's report pointed out that:

**4.60-4.61.** *The problem raised by the Court can be explained by the fact that the establishment plan at the time did not reflect the needs of the Centre and, in part, by the absence of reserve lists of candidates with the right profile. These two main sources of the problem have largely been overcome.*

*The weakness of the establishment plan for the JRC in the years covered by the special report was that it contained too many B and C posts and too few A posts. For a certain time this made it almost impossible to recruit researchers with the right profile. The situation was rectified in the 1999 budget, where 57 B and 56 C posts were swapped for 113 A posts.*

*A major effort has already been made on reserve lists of candidates with the right profile and this work will continue over the coming months.*

*As regards the possible penalties referred to by the Court, the Commission has already responded to special report No 10/2000 indicating the administrative investigations and disciplinary proceedings that had been carried out, as well as the penalties imposed. The JRC's Internal Audit Unit will organise a follow-up audit.*

(8) This matter is currently under examination by the European Anti-Fraud Office (OLAF).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

- (a) the regularity of the procedure was open to question because of the conditions under which the contract had been awarded;
- (b) the authorising officer had not actually verified the service provided;
- (c) the number of kilometres invoiced was excessive. Examination of the supporting documents showed that 540 km/calendar day had been billed per vehicle supplied.

4.63. In June 2000, the JRC did not renew the contract with the company that had held it for 20 years and concluded a contract with a new supplier on terms that are more favourable for the Centre. The new contract was concluded following an open call for tenders. In parallel with this a management system for monitoring performance has been in operation since the beginning of the 2000 financial year. The system is based on software which includes the distances for all possible combinations of the 400 or so destinations covered by the contract. It gives the department concerned a total overview of operations. In effect it is possible to check the validity of the transport applications made, to arrange group transport wherever possible, to check the distance invoiced and to verify the reality of the service provided.

4.64. In monthly terms, the introduction of the new arrangements and the application of the new contract have made it possible to reduce the invoice amount by 62 %. In 1999 the previous contractor billed for 49 060 km/month, whereas the new service provider has billed only 26 903 km/month since the entry into force of the new contract, in June 2000, even though there has been a slight increase of 1,05 % per month in the number of people carried.

#### SUMMARY OF SPECIAL REPORT NO 9/2001 ON THE TRAINING AND MOBILITY OF RESEARCHERS PROGRAMME (9)

4.65. The Court's audit was focused on analysing the management systems used by the administrative

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(9) Currently being published in the Official Journal.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

services both at the Commission and at contractor level in pursuing the Training and Mobility of Researchers (TMR) programme and on examining the quality of the way they were managed. The audit of the programme, which was allocated a budget of 792 million euro for the duration of the Fourth Framework Programme, comprised auditing the procedures in place for selecting contracts, following-up on weaknesses noted in an earlier report by the Court (10) and, by means of on-the-spot audits and a postal survey, determining the level of satisfaction with the service provided by the Commission to the contractors/beneficiaries.

4.66. The main results of the audit may be summarised as follows:

(a) in the evaluation of proposals the procedures followed sometimes lacked transparency and, in the allocation of proposals to evaluators, potential conflicts may arise;

**4.66.**

(a) *The lack of transparency referred to by the Court relates only to the level of documentation of the minutes of the panel's meetings. While it is true that the minutes have not always detailed the various stages leading to the decisions, they have always set out the results correctly, ranking the panel's proposals for Commission funding in order of priority. Thus the Court's observation is merely a question of form, which had no bearing on the results of the evaluation or financing of the projects. In the fifth FP the quality of the reporting of the panel's decisions was greatly improved with the designation of a rapporteur responsible for drafting the reasoning behind the decision.*

*In an area like research, where there is often a concentration of experts at the forefront of science, the potential risk of a conflict of interests cannot be excluded from the outset. Having said that, the two-stage evaluation structure and in particular the peer review of each proposal, individually to begin with and then by the panel as a whole, guarantees a balance between the potential risk of a conflict of interests and the quality of evaluations. In the fifth FP the evaluation manual sets out detailed provisions requiring terms of reference, a code of conduct and a declaration of impartiality duly signed by the party in question to be attached to the contract of each evaluator.*

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(10) Annual Report concerning the financial year 1994 together with the institutions' replies, Chapter 9, OJ C 303, 14.11.1995.

## THE COURT'S OBSERVATIONS

- (b) eligibility criteria and user fees established for the different activities were found to be either not applied by the contractors or not adequately evidenced as checked by the Commission;
- (c) significant improvements have been noted in the training-through-research activity since the previous Court audit, despite wide divergences being noted between the success rates for Marie Curie Fellowship applications in the TMR programme and the specific thematic programmes;
- (d) from the results of the survey carried out, it was noted that the contractors/beneficiaries were, on average, satisfied with the service they received from the Commission.

4.67. On the basis of these findings, the Court recommends that the procedures in place for the evaluation of proposals and the selection of evaluators should be improved and rigorously followed. The Commission should ensure that if target criteria are included in contracts these criteria are checked and evidenced as such when the cost statements are received. Finally, the management of all Marie Curie Fellowships should be centralised in the department managing this activity under the TMR programme.

## COMMISSION'S REPLIES

- (b) The Commission services responsible for the negotiation of user fees take all necessary steps to ensure that such calculations are correctly established. As the system of user fees was new in TMR, the negotiation procedures and the corresponding documentation have been much more carefully described in the fifth FP in order to improve the general understanding of this accountancy basis.
- (c) The Commission notes the considerable improvements in the training through research activity underlined by the Court. Any divergences between the success rates for the various programmes stem from differences in the budgetary allocations made available to the specific programmes.
- (d) The Commission is interested to learn of the results of the TMR programme survey of contractors/beneficiaries carried out by the Court. It notes the large response and is pleased that they were, on average, satisfied in all sectors of the TMR programme.

**4.67.** In the fifth FP the whole evaluation procedure was improved. A single evaluation manual was adopted by the Commission and made available to all potential participants. The status of the independent evaluator, whose presence ensures that procedures are properly followed, has been codified. As regards the appointment of expert evaluators, an open call for experts and a common expert database for all programmes have been set up and have already considerably improved the process.

Before making any payments the Commission systematically checks the eligibility of costs (age, nationality). Since the fifth FP, other criteria of note (geographic balance, male/female parity, participation of less developed countries, representation of industry) are also systematically checked on the basis of replies to the questionnaires distributed to the participants.

As far as the Marie Curie Fellowships are concerned, in the project for the next framework programme, the Commission has proposed concentrating them within one activity line under the responsibility of one directorate.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## AUDITS CARRIED OUT BY THE COMMISSION

4.68. **Table 4.3a** summarises the information received from the 13 Directorates General involved in internal policies on the number of audits completed in 2000 in this field. The majority of these audits have been carried out on behalf of the Commission by external audit firms. It should also be noted that these audits are mainly financial or compliance audits at the level of beneficiaries, and not the type of audits conducted by the newly created internal audit units in the DGs, which are mainly oriented towards auditing the internal procedures. **Table 4.3b** shows the actual recovery status as at 31 December 2000 on the amounts reported as recoverable by the Commission services on the basis of their 1999 audits.

4.69. A comparison with the data for 1999 (see **Table 4.3a**) shows that, overall, the Commission has considerably increased the number of audits by 63 %, while the number of contracts audited went up by 14 %. Excluding the veterinary and phytosanitary actions, the recoverable amounts also rose from 8,64 million euro to 11,58 million euro, mainly due to the more intensive audit activities of the DGs Information Society (INFSO) and Research (RTD).

4.70. DG RTD in particular increased its audit activities by almost 200 %, with 220 completed audits in the year 2000 compared to 74 in 1999. In addition, this DG had the highest growth (152 %) in the number of contracts audited, from 126 in 1999 to 317 in 2000. As 2000 was the first year in which large fusion projects have been audited, the value of the audited contracts went up by a greater proportion. There was also a substantial increase in the recoverable amounts, from 1,9 to 5,3 million euro.

4.71. As well as the increased audit activities of DG INFSO, the number of audits completed and the number of contracts audited rose substantially in the fields of environment (DG ENV), industry (DG ENTR) and justice and home affairs (DG JAI), while a decrease in the audit activities was noted in the fields of education and culture (DG EAC) and energy and transport (DG TREN).

**4.69-4.70.** *The Research DGs jointly formulated in 1998 a coherent audit strategy for the whole Framework Programme, based on the objective of giving assurance to management and interested parties on appropriate use of research funds. The overall target is to audit 10 % of the contractors during the RTD Framework Programme. For the execution of this strategy the Commission has made use of a framework contract with an external audit firm.*

**4.71.** *With the merger of the Energy and Transport DGs on 1 January 2000, the new DG TREN inherited a large number of uncompleted contracts, particularly from the old Energy DG. To remedy the situation priority was given to paying these contracts. This was done by financial audit staff, which is why there was a fall in the number of finalised audits in 2000.*

Table 4.3a — Audits by the Commission completed in 2000<sup>(1)</sup>

Directorate-General	Number of audits completed		Number of contracts audited		Number of open contracts		Value of audited contracts (Mio EUR)		Value of open contracts (Mio EUR)		Amounts recoverable or reduced payments as a result of the audits (Mio EUR)	
	1999 <sup>(2)</sup>	2000	1999 <sup>(2)</sup>	2000	1999 <sup>(2)</sup>	2000	1999 <sup>(2)</sup>	2000	1999 <sup>(2)</sup>	2000	1999 <sup>(2)</sup>	2000
AGRI — Agriculture <sup>(4)</sup>	3	4	19	(7)	504	550	2,00	12,29	78,93	73,66	0,11	(7)
EAC — Education and Culture	119	106	211	172	5 424	25 306 <sup>(13)</sup>	114,35	56,29	469,70	654,04 <sup>(13)</sup>	3,28	0,92 <sup>(8)</sup>
EMPL — Employment and Social Affairs	5	10	18	21	2 210	2 037	4,91 <sup>(3)</sup>	10,05 <sup>(3)</sup>	124,90	204,84	0,14	0,09
TREN — Energy and Transport	49	35	194	93	3 223	4 774 <sup>(12)</sup>	269,24	209,17	2 892,07	1 656,20	1,13	1,28
ENTR — Enterprise	6	8	9	37	(7)	746	5,82	53,60	(7)	181,10	0,17	0,15
ENV — Environment	16	30	30	40	2 848	2 505	5,11	12,56	360,98	295,12	0,08	0,10
FISH — Fisheries <sup>(10)</sup>	3	5	12	13	171	188	2,54	7,04	181,46	194,53	0,03	0,03
	3	3	8	9	7 <sup>(15)</sup>	13	10,00	27,60	91,46 <sup>(15)</sup>	95,84	(7)	(7)
JAI — Justice and Home Affairs	17 <sup>(6)</sup>	64	44 <sup>(6)</sup>	65	(7)	713	10,28 <sup>(6)</sup>	4,26	(7)	31,95	(7)	0,45
SANCO — Health and Consumer Protection <sup>(5)</sup>	11 <sup>(9)</sup>	8	25 <sup>(9)</sup>	18	1 174 <sup>(9)</sup>	978	3,90 <sup>(9)</sup>	3,03	89,77 <sup>(3)</sup> <sup>(9)</sup>	85,48	0,19 <sup>(9)</sup>	0,05
	5	10	5	12	n. a.	n. a.	225,55	96,65	n. a.	n. a.	98,60	15,03 <sup>(8)</sup>
INFSO — Information Society	13	25	54	66	2 490	2 330	19,29	40,09	6 434,00	6 135,00	1,57	2,80 <sup>(14)</sup>
MARKT — Internal Market	0	1	0	1	80	175	0,00	(7)	6,92	8,79	0,00	0,00
RTD — Research	74	220	126	317	8 734	11 358	46,60	820,20 <sup>(11)</sup>	5 020,00	3 387,00	1,90	5,30 <sup>(11)</sup>
TAXUD — Taxation and Customs Union	3	5	3	5	147	164	0,24	0,58	44,35	44,10	0,04	0,02
<b>Total</b>	<b>327</b>	<b>534</b>	<b>758</b>	<b>869</b>	<b>26 865</b>	<b>50 378</b>	<b>719,83</b>	<b>1 353,41</b>	<b>15 794,54</b>	<b>12 866,55</b>	<b>107,24</b>	<b>26,22</b>

(1) Definitions used in generating this table:

- Number of audits completed: number of financial audits where a final audit report was issued during the year.
- Number of open contracts: number of contracts signed in the year that have not yet been completed, plus the total number of contracts that were open at the beginning of the year that were not completed during the year. The word 'contract' denotes both contracts (either a shared-cost action or a contract awarded through the public procurement procedures) and subsidies (where a financial agreement has been reached). A 'completed contract' is a contract where the terms of the contract have been fulfilled, all financial and technical reviews have been completed and the final payment has been made.
- Value of audited contracts: the value of only the contractor's share of the contract audited on the spot.
- Amount recoverable: amounts calculated in the on-the-spot audits as recoverable and evidenced in the audit reports.

(2) See 1999 Annual Report, Table 4.4 (except<sup>(10)</sup>).

(3) Commission's share only.

(4) Chapter B2-5 1 except<sup>(7)</sup>.

(5) Veterinary and phytosanitary actions. Value of audited contracts means here claims of the Member States.

(6) In 1999, managed by the Secretariat General; includes a budget line under B7-6 0 ('Community measures to support NGOs').

(7) Not specified.

(8) For some of the audits, the recoverable amounts have not been established as at end-2000.

(9) Including ex DG Employment and Social Affairs.

(10) Fishery control measures. Contract means here programme of a Member State; value of audited contracts means here value of audited items within a programme; value of open contracts means here the total value of the pluriannual measures 1996-2000 for all Member States.

(11) In 2000, large fusion projects have been audited for the first time.

(12) Total number of commitments; the actual number of contracts will be lower.

(13) Includes the individual contracts concluded between the Technical Assistance Offices (on behalf of the Commission) and the final beneficiaries.

(14) With reference to the Commission's answer to point 4.73, the amounts recoverable are indicative only.

(15) Modified by the Commission's service.

NB: n. a. = not available.

Source: Commission services.

Table 4.3b — Recovery status

(Mio EUR)

Directorate-General	Amounts recoverable or reduced payments as a result of the audits <sup>(1)</sup>	Actual recovery as at 31.12.2000						Total
		1999	Deducted from further payments	Actually recovered due to a recovery order	Not yet recovered; recovery order issued, but repayment outstanding	Not yet recovered; recovery order not yet issued or adjustment still outstanding	Not recoverable	
AGRI — Agriculture	0,11	0,11	—	—	—	—	—	0,11
EAC — Education and Culture	3,28	—	1,38	1,86	0,04	—	—	3,28
EMPL — Employment and Social Affairs	0,14	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.
TREN — Energy and Transport	1,13	5,49	0,17	0,09	—	—	—	5,75
ENTR — Enterprise	0,17	0,17	—	—	—	—	—	0,17
ENV — Environment	0,08	—	0,08	—	—	—	—	0,08
FISH — Fisheries	0,03	0,03	—	—	—	—	—	0,03
SANCO — Health and Consumer Protection	0,19 <sup>(2)</sup>	0,19	—	—	—	—	—	0,19
	<sup>(3)</sup>	98,60	91,30	—	—	<sup>(4)</sup>	—	91,30 <sup>(4)</sup>
INFSO — Information Society	<sup>(6)</sup>	1,57	0,34	0,02	0,98	0,57	—	1,91
RTD — Research		1,75 <sup>(7)</sup>	0,73	0,21	0,26	0,57 <sup>(5)</sup>	—	1,77
TAXUD — Taxation and Customs Union	0,04	—	—	0,06	—	—	—	0,06
<b>Total</b>	<b>107,09</b>	<b>98,36</b>	<b>1,86</b>	<b>3,25</b>	<b>1,18</b>	<b>—</b>	<b>—</b>	<b>104,65<sup>(4)</sup></b>

<sup>(1)</sup> As reported by the Commission's services; see 1999 Annual Report, Table 4.4.<sup>(2)</sup> Including ex DG Employment and Social Affairs.<sup>(3)</sup> Veterinary and phytosanitary actions.<sup>(4)</sup> An additional adjustment in the order of approximately 6 Mio EUR is still awaiting final agreement with the Member State concerned.<sup>(5)</sup> Mainly cases where an adjustment will be done with the final payment.<sup>(6)</sup> With reference to the Commission's answer to point 4.73, the amounts recoverable are indicative only.<sup>(7)</sup> Modified by the Commission's service.

NB: n. a. = not available.

Source: Commission services.

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*It is important to note that the number of financial audits fell by 30 % between 1999 and 2000, while the value of the contracts fell by only 22 %.*

*At 30 June 2001, DG TREN has already arranged 35 audits, the same number as for 2000, and plans to organise others. The value of the contracts audited for 2001 will therefore be higher than in 2000.*

*The objective is for financial audits to exceed the 1999 figure in 2002.*

As regards DG EAC, the reduction is due to the changeover from auditing projects to auditing systems. This does not mean that there were fewer checks; they were of a different type and are not comparable with those carried out in 1999. DG EAC is currently finalising a contract with a firm of auditors which should result in a significant increase in the number of financial audits.

**4.72.** Table 4.4 of the 1999 Annual Report showed that more than 100 million euro had been identified by the Commission's own audits as recoverable or deductible from future payments. **Table 4.3b** summarises the follow-up concerning these amounts. 94 % of the reported recoveries were effected by means of deductions from further payments to the beneficiaries concerned. Less than 2 % was reimbursed after final payments. As regards the reported recoveries by DG INFSO, only 19 % of the recoverable amounts identified from the 1999 audits had been either reimbursed or adjusted by 31 December 2000. For more than 570 000 euro, recovery orders had not yet been issued at the above date.

**4.73.** The actual recovery figures as at 31 December 2000 show that the recoverable amounts reported for 1999 by DGs TREN, SANCO and INFSO were apparently not final figures. For example, in the area of veterinary and phytosanitary actions, the payment reductions accepted by the Member States after the audit of their claims is more than one million euro less than the figure reported in 1999. On the other hand, the actual amount established as recoverable by DG TREN was more than 4,6 million euro higher than reported for 1999, of which about 4,3 million euro recovered by

**4.72.** As regard DG INFSO, the amount of EUR 570 000 represents recovery orders not yet issued but in preparation. Of these, EUR 234 371 have been issued during 2001; EUR 336 443 remains to be dealt with. Among these are cases where the contractor has contested the audit results and one case (EUR 32 910) in which the intervention of OLAF was necessary.

**4.73.** Concerning recoveries by DG INFSO, a distinction needs to be made between amounts found to be overclaimed in specific cost statements audited and amounts found to be recoverable when audit results are applied. Recoveries can be higher or lower than the specific amounts found to be over-claimed.

*This is due to the fact that the amount reported by the auditors as 'recoverable' does not take into account the payments already*

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ex-DG VII / TEN-Transport had originally not been reported as recoverable. Regarding DG INFSO, the actual amount established as a result of the 1999 audits is 22 % higher than reported.

## COMMISSION'S REPLIES

*made to the contractor. It merely establishes the correctness or otherwise of costs reported. Therefore, the amount to be recovered can be higher if an advance was paid in addition to the payments of the costs statements audited or lower if payments were suspended during the audit. Furthermore, the implementation of the audit results to period, which were not covered by the audit, may increase the amounts recovered.*

*As regards DG TREN, the fact that the amount established as recoverable was EUR 4,6 million higher than the figure initially reported is basically due to the fact that EUR 4,3 million less was paid in connection with the Trans-European transport projects.*

*As regards DG SANCO's recoveries/refusal of expenditure, the Commission has already drawn the Court's attention to the special nature of veterinary expenditure (eradication programmes or emergency measures in cases of animal epidemics), which means that financial audits sometimes require more than one year in certain complex cases. There may also be discrepancies between amounts initially considered by the auditors to be recoverable or to be refused and the amounts finally refused by the Commission when the file is closed. In the case in question, the EUR 1 million figure quoted by the Court represents 1 % of the EUR 98,6 million considered ineligible by SANCO following audits carried out in 1999.*

4.74. Regrettably, the information requested was not available from DG EMPL.

**4.74.** DG EMPL stresses the difficulty of using the data for 1999 — bearing in mind the departmental restructuring that went on that year (the reorganisation of DG XX's control activities and the creation of DG SANCO). It undertakes to carry out a full assessment and present the Court with details of the sums to be recovered following the 1999 audits as quickly as possible.

## CHAPTER 5

**External action**

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## INTRODUCTION

5.1. This chapter deals with the traditional forms of aid financed from the general budget and the operations adopted by the Council under the Common Foreign and Security policy (CFSP). The aid that is provided through the European Development Funds <sup>(1)</sup> appears only as a token entry in the general budget, as it is financed separately. Apart from the analysis of budgetary management and the specific appraisal in the context of the Statement of Assurance (which concentrates on the Tacis programme), the chapter includes observations on sound financial management issues deriving from the audit of Tacis. The chapter also contains sections on the follow-up of previous observations and on the principal observations in recently adopted Special Reports.

## BUDGETARY MANAGEMENT

*Introduction*

5.2. Heading 4 'External action' of the financial perspective applicable to the period 2000 to 2006 comprises subsection B7 of the budget, with the exception of Title B7-0 'Pre-accession strategy', and subsection B8 (see **Table 5.1**). The Commission's apparent overrun of the financial perspective for this heading is the result of its recourse to the flexibility instrument, which authorises the ceiling for a heading to be exceeded by 200 million euro, and of the utilisation, under Heading 4, of the emergency reserve covered by Heading 6. **Table 5.2** shows the changes in expenditure for subsections B7 and B8 over the last five financial years.

5.3. As from the financial year 2000, the new Heading 4 no longer includes the appropriations for the Phare programme, which up to that point were viewed as forming part of external aid, but are now treated as a pre-accession instrument.

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<sup>(1)</sup> See separate observations in this report.

Table 5.1 — Financial perspective heading: External action

(Mio EUR and %)

		Financial perspective ceilings	Budget changes		Implementation of the budget					
			Initial appropriations <sup>(1)</sup>	Final appropriations available <sup>(2)</sup>	Appropriations utilised	% of final available appropriations	Appropriations carried over to 2001	% of final available appropriations	Appropriations cancelled	% of final available appropriations
Pre-accession strategy for Malta and Cyprus (B7-0 4) <sup>(4)</sup>	CA		0,0	15,0	7,7	51,3	7,3	48,7	0,0	0,0
	PA		0,0	2,0	0,0	0,0	0,0	0,0	2,0	100,0
Humanitarian and food aid (B7-2)	CA		936,0	946,0	943,2	99,7	0,0	0,0	2,8	0,3
	PA		829,5	860,7	856,4	99,5	0,0	0,0	4,4	0,5
Cooperation with developing countries in Asia, Latin America and Southern Africa, including South Africa (B7-3)	CA		905,7	905,6	802,4	88,6	0,0	0,0	103,2	11,4
	PA		632,0	667,4	621,9	93,2	14,1	2,1	31,5	4,7
Cooperation with Mediterranean third countries and the Middle East (B7-4)	CA		1 142,9	1 044,1	1 005,7	96,3	8,8	0,8	29,6	2,8
	PA		435,4	510,9	472,7	92,5	17,8	3,5	20,4	4,0
Cooperation with the countries of Central and Eastern Europe, the New Independent States and Mongolia (B7-5)	CA		941,8	1 361,8	1 355,8	99,6	0,0	0,0	6,0	0,4
	PA		742,3	1 223,4	1 145,4	93,6	72,1	5,9	5,9	0,5
Other cooperation measures — Community measures to support NGOs (B7-6)	CA		356,9	355,4	337,4	95,0	13,8	3,9	4,1	1,2
	PA		360,8	329,6	272,9	82,8	37,2	11,3	19,6	5,9
European initiative for democracy and human rights (B7-7)	CA		95,4	96,9	93,8	96,9	0,0	0,0	3,0	3,1
	PA		81,9	74,9	51,0	68,1	20,9	27,9	3,0	4,0
External aspects of certain Community policies (B7-8)	CA		379,4	233,4	201,8	86,5	6,7	2,9	24,8	10,6
	PA		225,5	191,1	168,9	88,3	2,0	1,0	20,3	10,6
Common Foreign and Security Policy (B8)	CA		47,0	47,0	30,8	65,5	2,6	5,5	13,6	29,0
	PA		30,0	30,0	19,6	65,2	9,0	30,0	1,4	4,8
Total for Heading 4	CA	4 627,0	4 805,1	5 005,1	4 778,6	95,5	39,2	0,8	187,2	3,7
	PA		3 337,5	3 890,3	3 608,7	92,8	173,1	4,4	108,5	2,8
Emergency aid reserve (B7-9 1) <sup>(3)</sup>	CA		203,0	23,0	0,0	0,0	0,0	0,0	23,0	100,0
	PA		203,0	23,0	0,0	0,0	0,0	0,0	23,0	100,0
Total	CA		5 008,1	5 013,1	4 770,9	95,2	39,2	0,6	210,2	4,2
	PA		3 540,5	3 911,3	3 608,7	92,3	173,1	4,4	129,5	3,3

<sup>(1)</sup> Budget finally adopted by the European Parliament on 16 December 1999 (OJ L 40, 14.2.2000).<sup>(2)</sup> Budget appropriations amended after taking into account supplementary and amending budgets and transfers, but not including appropriations carried over from 1999, appropriations resulting from the re-use of revenue, revenue resulting from contributions by third parties and other revenue corresponding to a defined purpose and appropriations made available again.<sup>(3)</sup> The emergency aid reserve comes under Heading 6.<sup>(4)</sup> The other amounts of Chapter B7-0 come under Heading 7.

Source: 2000 revenue and expenditure account.

Table 5.2 — External action: comparison between the execution of commitments and payments under the budget for each financial year from 1996 to 2000

(Mio EUR)

Heading	Title	Description	1996		1997		1998		1999		2000	
			Committed	Paid								
4	B7-2	Humanitarian and food aid	1 218	852	1 013	892	1 058	820	1 231	955	943	856
	B7-3	Cooperation with developing countries in Asia, Latin America and Southern Africa, including South Africa	818	474	797	472	771	463	686	570	802	622
	B7-4	Cooperation with Mediterranean third countries and the Middle East	654	357	1 076	404	1 069	422	1 027	334	1 006	473
	B7-5	Cooperation with the countries of Central and Eastern Europe, the New Independent States and Mongolia (1)	1 855	1 221	1 774	1 265	1 910	1 619	2 347	1 908	1 356	1 145
	B7-6	Other cooperation measures — Community measures to support NGOs	401	280	370	317	337	282	344	302	337	273
	B7-7	European initiative for democracy and human rights	91	65	90	59	86	66	94	46	94	51
	B7-8	External aspects of certain Community policies	420	348	306	360	330	332	354	310	202	169
	B8-0	Common Foreign and Security Policy	56	51	16	16	30	22	29	27	31	20
		<b>Total for Heading 4</b>	<b>5 513</b>	<b>3 648</b>	<b>5 443</b>	<b>3 785</b>	<b>5 589</b>	<b>4 025</b>	<b>6 112</b>	<b>4 451</b>	<b>4 771</b>	<b>3 609</b>
6	B7-9	Emergency aid reserve	0	0	5	0	0	0	0	0	0	0
		<b>Total</b>	<b>5 513</b>	<b>3 648</b>	<b>5 448</b>	<b>3 785</b>	<b>5 589</b>	<b>4 025</b>	<b>6 112</b>	<b>4 451</b>	<b>4 771</b>	<b>3 609</b>
	B7-5 + B7-0 3	Cooperation with the countries of Central and Eastern Europe, the New Independent States and Mongolia + phare	1 855	1 221	1 774	1 265	1 910	1 619	2 347	1 908	2 923	2 346

(1) To enable a comparison, the headings B7-5 and B7-0 3 have been combined for the financial year 2000.

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5.4. As regards Heading 4, the management framework remained the same throughout the financial year 2000 since the Joint External Relations Service (SCR) was only replaced by the new cooperation office known as 'EuropeAid' on 1 January 2001. Similarly, the first real effects of the deconcentration process that began during the year will not become apparent until after the end of the financial year 2001.

#### *Commitment appropriations*

5.5. In the case of some sizeable amounts (1 104,7 million euro, or 22,1 % of all the appropriations provided for under Heading 4), the commitment appropriations were placed in reserve and were therefore unavailable at the beginning of the financial year (European Reconstruction and Development Programme in South Africa, Tacis Programme, former Yugoslavia, environment and fisheries). Around half of them were released by the Budgetary Authority in March (B7-52 and B7-54) and the remainder in the final quarter of 2000.

5.6. Again in 2000 <sup>(2)</sup>, proposals were submitted to the committees responsible for delivering an opinion on the 'MED' and 'ALA' projects in the second half of the year, and in one in every two cases these committees did not deliver their opinions until November and December.

5.7. For these two reasons, already stated by the Court, it was not possible to speed up the commitment rate or improve the spread of the commitments over the financial year. Consequently, it was again noted that there was a high concentration of commitments in December 2000 (see **Table 5.3**).

**5.5.** *The amounts were placed in reserve pending adoption of the legal basis. As soon as the legal basis for each particular budget line (or chapter) was adopted the Commission submitted proposals for transfers from the reserve (which were approved by the Budgetary Authority).*

**5.6.** *The Commission trusts the enhanced committee procedure introduced by the new MEDA II Regulation and the assignment or redeployment of staff to the area under the Relex reform approved on 16 May 2001 can prevent a recurrence of this scenario. It also hopes that better multiannual programming (under way) plus the devolution of management to the delegations in 2001 and 2002 will make it easier to consult the committees for MEDA and ALA projects throughout the year.*

**5.7.** *The Commission has taken steps to spread commitments more evenly throughout the year; these measures were beginning to bear fruit in 2001 but will only be fully effective from 2002.*

*Nevertheless, the fact that some budget lines lacked a legal basis for a good part of the year will again affect their execution in the same way as in 2000.*

*Forward planning efforts were made in 2001 to try and minimise the procedural hurdles to be overcome before projects go to the committees.*

<sup>(2)</sup> See the Annual Report concerning the financial year 1999, paragraph 5.4 (OJ C 342, 1.12.2000) and the Annual Report concerning the financial year 1998, paragraph 5.4 (OJ C 349, 3.12.1999).

Table 5.3 — 2000 External action — Commitment by quarter

(Mio EUR and %)

Budget Area		Commitments 1st quarter 2000		Commitments 2nd quarter 2000		Commitments 3rd quarter 2000		Commitments 4th quarter 2000		Total Commitments 2000	(Commitments December 2000)		
		Amount	%	Amount	%	Amount	%	Amount	%		Amount	%	
B7-2	Humanitarian & Food aid	82,6	8,8	201,7	21,4	360,5		298,3	31,6	943,2	200,1	21,2	
B7-3 0	Cooperation with Asian developing countries	0,0	0,0	19,3	4,2	0,0	0,0	439,3	95,8	458,6	413,5	90,2	
B7-3 1	Cooperation with Latin American developing countries	27,9	12,6	2,1	0,9	9,1	4,1	181,3	82,3	220,3	180,7	82,0	
B7-3 2	Cooperation with South Africa	0,0	0,0	0,1	0,1	0,0	0,0	123,4	99,9	123,5	121,6	98,4	
B7-4	Cooperation with Mediterranean third countries and the Middle East	72,0	7,2	2,8	0,3	31,2	3,1	899,8	89,5	1 005,7	887,3	88,2	
B7-5 2	Cooperation with the New Independent States and Mongolia	0,3	0,1	- 0,2	- 0,1	30,8	6,9	417,5	93,1	448,3	417,3	93,1	
B7-5 3	Other Community measures in Central and Eastern Europe, the New Independent States, Mongolia and the countries of the Western Balkans	20,0	23,0	0,0	0,0	22,0	25,4	44,8	51,6	86,9	44,8	51,6	
B7-5 4	Cooperation with the Balkan countries	34,0	4,1	222,0	27,1	44,5	5,4	520,1	63,4	820,6	240,8	29,3	
B7-6	Other cooperation measures	1,6	0,5	40,8	12,1	12,2	3,6	282,9	83,8	337,4	222,6	66,0	
B7-7	European initiative for democracy and human rights	0,0	0,0	2,0	2,2	12,1	12,8	79,7	85,0	93,8	71,6	76,3	
B7-8	External aspects of certain Community policies	61,4	30,4	67,8	33,6	5,3	2,6	67,3	33,3	201,8	54,7	27,1	
B8-0 1	Common Foreign & Security Policy	13,5	43,8	6,3	20,6	2,8	9,1	8,2	26,6	30,8	6,1	19,8	
		<b>Total</b>	<b>313,2</b>	<b>6,6</b>	<b>564,7</b>	<b>11,8</b>	<b>530,5</b>	<b>11,1</b>	<b>3 362,5</b>	<b>70,5</b>	<b>4 770,9</b>	<b>2 861,3</b>	<b>60,0</b>

Source: Sincom Data Ware House.

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5.8. Over a quarter of the commitment appropriations that had been set aside for cooperation with Latin America were cancelled or transferred to another chapter (114,6 million euro out of the 392,7 million euro authorised <sup>(3)</sup>) as significant unused balances from the financial year 1999 had yet to be committed. Besides the unfavourable political situation, the Court noted that in specific cases the weakness of local administrations rendered difficult the adoption of projects at central level in the beneficiary State. A way must therefore be found of increasing the aid absorption capacity by enhancing their administrative capacities and enabling them to submit projects that comply with the criteria stipulated.

**5.8.** The Commission has taken steps in connection with the multiannual programming of projects to improve forward planning of the coverage of financing requirements and improve budget execution, so the situation described for Latin America in 2000 should not recur.

The Commission is aware that in some cases weak local administrations are an obstacle to project implementation. Steps have been taken to remedy this situation by involving recipient countries more closely in the identification and setting up of projects, and at an earlier stage. In any case, administrative capacity building in itself is an area of institutional cooperation expected to have an impact in the longer term.

5.9. Greater efforts were possible in Asia (480,9 million euro were committed as against the 428,1 million euro initially authorised <sup>(4)</sup>). This constitutes an improvement on the financial year 1999 when it was only possible to commit 349,8 million euro.

5.10. The regional programme for the reconstruction of Central America (RPRCA), the overall amount for which was 250 million euro <sup>(5)</sup>, was managed in a decentralised fashion (deconcentration) with a view to accelerating its implementation. The decision was taken to commit this amount in four annual instalments, spread between 1999 and 2002. The amount entered in the accounts as commitments on this basis was neither the overall amount decided on by the Commission nor the amount normally entered in the accounts in similar circumstances, namely the amount arising from financing

Management is due to be devolved to the delegations in Latin America in 2001 and 2002, and this too should help improve the execution of appropriations for this region.

**5.10.** The Commission's plan was to commit the EUR 250 million allocated to the RPRCA in four annual instalments starting in 1999. The sums were, or will be, committed on the basis of decisions adopted by the College in accordance with Article 36(2) of the Financial Regulation. Global commitments were adopted in 1999 and 2000 but from 2001, in the interests of transparency the idea is to switch to a system of pre-commitments covering financing agreements signed with the separate recipient countries. Individual contracts will then be concluded under the financing agreements for operations or projects identified within that framework.

From 2001 individual commitments will be monitored by Sincom II using the system of pre-commitments and secondary commitments; for commitments before that date the original MIS system will continue to be used.

<sup>(3)</sup> 29,2 % on the basis of cancellations (89,6 million euro) and a transfer of 25 million euro for Kosovo, as against 335,1 million euro under the initial budget and 57,6 million euro by way of non-automatic carry-overs.

<sup>(4)</sup> 404,9 million euro under the initial budget and 23,2 million euro by way of non-automatic carry-overs.

<sup>(5)</sup> Excluding 6,6 million euro set aside for technical assistance (heading B7-3 1 3 A) and 8,2 million euro allocated to preparation of the programme, financed from heading B7-3 1 0).

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agreements corresponding to clearly defined programmes or projects. The RPRCA started with the identification of the actions to be managed, and it is expected that the first major contracts will be awarded in 2001. This will therefore mean that substantial payments can be made, since none of the 25 million euro allocated for 2000 were disbursed. The level of payments is the principal means of assessing the true state of this programme when the volume of commitments and payments is lower than that originally envisaged<sup>(6)</sup>. The budget accounts, which are the only potential source of information, do not enable comparison of the state of progress of the RPRCA, based on the legal obligations entered into, with that of a programme managed in the traditional manner, and thereby to form an initial judgement on the value of this deconcentration.

## COMMISSION'S REPLIES

*Because of delays with the detailed identification of operational data the first of the financing agreements relating to 1999 commitments were not signed until late in 2000, and this in turn meant that the first payments (EUR 435 000) were only made towards the end of the year.*

*The agreements relating to 2000 commitments will be signed in 2001 and the payments will then follow. EUR 5.6 million has already been paid in 2001 under the 1999 decisions; the forecast execution figure for this financial year is approximately EUR 20 million. As from 2002 the rate of disbursements is expected to rise sharply.*

*It was the Commission's intention from the outset that the RPRCA should be managed on a devolved basis, so it transferred the necessary resources to the Nicaragua delegation on September 2000. Further arrangements were put in place in line with requirements, on the lines already successfully pioneered in Sarajevo.*

**5.11.** In 2000, the Commission began applying the concept of a pre-commitment in some isolated cases, despite the fact that the changes in the implementing rules for the Financial Regulation<sup>(7)</sup> that had been necessary since late 1998 had still not been adopted by the end of the financial year 2000. As had also been proposed by the Commission in the context of the reform of the Financial Regulation<sup>(8)</sup>, the idea was to make a distinction between budgetary commitments and legal obligations and to assess the actual extent of the latter. The new information, which is intended to make budgetary implementation more transparent, is therefore not yet available. This information would be such as to enable more effective monitoring of the state of progress of actions such as RPRCA.

**5.11.** The Commission did indeed use overall budgetary commitments, an approach provided for in an amendment to Article 36(2) of the Financial Regulation adopted on 23 November 1998. For external operations the overall commitment (the 'decision in principle') is then followed by individual legal commitments. In practice, the overall commitment allows spending of a specific sum for a specific purpose.

<sup>(6)</sup> See Communication from the Commission to the Council and the European Parliament of 28 April 1999 on a Community action plan for the reconstruction of Central America (COM(1999) 201 final).

<sup>(7)</sup> See Regulation (EC, ECSC, Euratom) No 2548/98 (OJ L 320, 28.11.1998, p. 1) amending Article 36(2) of the Financial Regulation. Proposals for the adoption of the implementing rules were presented on 15 November 2000 in Communication SEC(2000) 1890 final. The only known 'legal basis' for this practice is the Accounting Officer's instructions of 30 January 2001.

<sup>(8)</sup> See Articles 70 and 71 of the Financial Regulation as envisaged by the Commission in its proposal for reform (COM(2000) 461 final, 17.10.2000).

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5.12. Including the commitments entered into in 2000 in respect of budget headings that already belonged to Heading 4 in 1999 (4 979,1 million euro) and for which payments amounted to just 1 022 million euro, the total for outstanding commitments amounted to 12 663,6 million euro at the end of 2000, an increase of 5 %. Efforts must continue to cancel commitments which can now no longer be utilised.

**5.12.** In the recent past the Commission has experienced serious difficulties with the absorption of outstanding commitments (RAL), leading it to undertake a thorough review of 'old' and 'sleeping' commitments. In late 1999 it drew up an action plan with the aim of reducing the overhang of RAL and the plan was renewed in 2001 under the auspices of EuropeAid Cooperation Office. By the end of 2000, a year after the plan for budget lines managed by AIDCO came into effect, the level of old (pre-1995) commitments had fallen quite markedly from EUR 1 100 million to EUR 746,5 million. The situation should improve still further in 2001 as a result of the closure of budget commitments (decommitments) and payments for projects under way. At 1 September 2001 the RAL was down to EUR 519,4 million.

5.13. Altogether, it is very difficult to determine the amount of aid promised by the Community, the amount of aid that has actually been granted, and the amount which is still to be paid, owing to the lack of consistent accounting methods and to uncertainties concerning the commitments still to be settled.

**5.13.** In order to determine the amount of aid actually granted, the Commission set up the system of 'pre-commitments' and follow-up of legal obligations incurred under those commitments. Although this measure has not been in place for very long, it will provide the more reliable information sought by the Court for financial years 2001 and after as the data feeds into the accounting management of the RAL.

### Payment appropriations

5.14. The payment appropriations for the distribution of food aid, the MEDA programme and other actions in the CEEC-NIS-M and Western Balkans were considerably increased, whilst there were sizeable carry-overs to the following financial year for cooperation with the Balkans due to transfers of appropriations made at the very end of the financial year. It was not possible to utilise 64,8 million euro, or around 17 % of the new appropriations <sup>(9)</sup>.

**5.14.** Following a series of sizeable shortfalls in payment appropriations for the Balkans the chapter received a EUR 180 million boost in the form of commitment and payment appropriations for Serbia; though all the money was committed the payment appropriations were not, despite a high repayment rate. A significant proportion (EUR 97.6 million) of the increase for MEDA is accounted for by the release of payment appropriations which were originally entered in the B0-4 0 reserve.

5.15. Payments were far more evenly spread over the year than commitments, irrespective of the area concerned, although a degree of concentration was recorded for the month of December. Some 2 200 payments were made in that month (845,7 million euro), which is two and a half times the usual monthly amount. Around fifteen of these payments, each for over 10 million euro, which were made at the very end of the year and more often than not in the form of an advance to an intermediary, alone resulted in the disbursement of 336,9 million euro, or 10 % of the overall amount paid in the financial year.

<sup>(9)</sup> 64,8 million euro were carried over out of the 392 million euro released in the financial year (10 million euro under the SAB and 382 million euro by way of transfers).

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5.16. A sum of 40,4 million euro was paid to the fund for the construction of a protective casing at Chernobyl in December 2000, yet it was not until the middle of the financial year 2001 that around two thirds of the 50 million euro paid by the Commission in 1999 were actually used. Out of the 283,6 million euro paid to the European Agency for Reconstruction (10), which were viewed as expenditure for the financial year 2000, 25,7 million euro were still in the process of being transferred from the Commission to the Agency as at 31 December 2000 and, in total, 105,7 million euro had not been paid to the final beneficiaries on that date, i.e. 40 % of the amounts transferred to the Agency in 2000. An amount of this size seems to be far beyond the Agency's immediate needs right at the beginning of 2001.

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**5.16.** As agreed between the Commission and the EBRD, the Commission's contribution to the Chernobyl Fund was paid following the signing of the contribution agreement. All other donors make their contributions in the same way. Any funding not needed immediately is set aside, and this in turn generates interest which is credited to the Chernobyl Fund. Given the diversity of activities that take place under the fund it is extremely difficult to predict them beforehand.

The situation to which the Court draws attention is attributable to the need to see that the Agency is in funds sufficiently in advance, and for a reasonable (2 to 3 months) period, in order to be able to cover its cash outgoings; this is in accordance with the regulation setting up the Agency. In this connection the Court itself, in point 5.98, praises the Agency's efficiency, and specifically its performance as regards payments.

The sum quoted by the Court includes a sizeable transfer made in late December 2000; it relates to the implementation of the winter emergency aid programme for Serbia approved by the Budgetary Authority at the end of November 2000. The financing requirements were verified in advance by a Commission audit carried out in November 2000, and supported ex post by a statement of the Agency's financial position transmitted in February 2001. Naturally, it was not possible for the Agency to utilise the money in full before year end (31 December 2000).

Note that the scale and urgency of the projects managed by the Agency mean contracts must be signed and money disbursed extremely fast.

5.17. In all the cases in which budgetary expenditure does not tally with the amounts actually received by the final beneficiaries, the accounts are not intended and are not able to give an idea of the scale of the activities being carried on in the field.

5.18. Appropriations for administrative management (type-A) expenditure were entered in the budget for the first time. The level of implementation of these payment appropriations (totalling 27,2 million euro) was particularly low (nearly 80 % of the payment appropriations were cancelled), even though commitments had been entered into for 86 % of the appropriations, albeit only at the very end of the financial year. This underutilisation is also explained by the fact that the option

**5.18.** The Budgetary Authority used 'BA' lines in the 2000 Budget for the first time with the aim of introducing transparency for the type of administrative expenditure hitherto buried in operating appropriations.

The Court notes that earlier RAL were not reallocated to the new lines, logically enough given that they were allocated previously. The RAL for 2000 are differentiated appropriations and will be cleared over the new few budget years. All 'BA' expenditure, therefore, will shortly be handled in this way provided the system remains the same in future.

(10) Based in Thessaloniki with operational centres in Kosovo, Serbia and Montenegro.

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was available to pay any unused balances for technical and administrative expenditure (ATA) under the headings that preceded the creation of this new budgetary support. In 2000, the objective of making expenditure which had been the subject of previous observations by the Court (11) more transparent was therefore not completely achieved.

*Presentation of the accounts to the discharge authority (12)*

5.19. The Court has noted for several years (13) that the presentation of Volume I, Part 2 of the revenue and expenditure account does not meet the requirement of providing the discharge authority with a summary of budgetary implementation for the financial year for the External aid field. Despite the efforts made to rationalise and improve the presentation of the financial information concerning the main budgetary headings, improvements still need to be made to the financial analysis.

5.20. For 2000, once again, there is no overall presentation introducing the field as a whole. Nor does an introduction by budget heading precede the pages covering the various types of actions (budget chapters). Yet the Commission does draw up a document containing various summary analyses for its own internal needs as well as analyses similar to those that the Court presents in paragraphs 5.8 and 5.9 concerning Latin America and Asia.

5.21. The Commission should also explain the reasons why budgetary implementation is at variance with the estimates. According to the standard presentation method chosen by the Commission, in Volume 1, Part 2 of the revenue and expenditure account it should have

**5.19.** The Commission has taken some action in respect of the Court's previous remarks about improving the financial statements and considerably more information is now shown, giving the reader all the essential data. The next stage in improving the financial statements will be the inclusion of a commentary. This has already been done for other chapters but has still to be completed for external operations.

**5.20.** For the 2001 financial year, the Commission will examine the incorporation of an introductory summary to the external aid chapter; this overview will assess the major events affecting implementation in 2001 and will identify any significant trends (e.g. lack of appropriations).

**5.21.** For 2001, together with the financial and output implementation tables which are henceforth a standard part of the report, the Commission will provide a commentary on major variances.

(11) See Annual Report concerning the financial year 1998, paragraphs 5.15 to 5.31 (OJ C 349, 3.12.1999)

(12) The Court has reviewed the information presented by the Commission in Volume I of the revenue and expenditure account. The purpose of this volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available as well as between the appropriations finally available and those utilised. This review did not seek to provide assurance as to the reliability of its contents. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

(13) See Annual Report concerning the financial year 1999, paragraph 5.3 (OJ C 342, 1.12.2000) and the Annual Report concerning the financial year 1998, paragraph 5.14 (OJ C 349, 3.12.1999).

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provided, on a systematic basis, and in addition to a presentation of the budgetary data already to a large extent shown in Volume 1, Part 1, comments on the implementation of the various headings and on the tables that would provide an understanding of the actual utilisation of the appropriations.

5.22. Much remains to be done in these areas in order for Volume 1, Part 2 of the revenue and expenditure account to be rendered useful. The figures presented contain errors and inconsistencies. Despite the Accounting Officer's instructions, the document does not provide the desired explanation of the implementation of the budget. Initially, the documents received from the Authorising Officers were of such an unsatisfactory quality that they could not be used. An express request for explanations of the main differences affecting some 30 budget headings received no reply. The use of the emergency reserve (B7-9 1) to obtain 180 million euro for the Balkans is neither mentioned nor explained under the heading for the reserve. It becomes very difficult to provide explanations when the accounting system is not supplied with pertinent data.

5.23. The adoption of new financial perspectives has resulted in a substantial change in nomenclature. Following transfer of the Phare programme to Chapter B7-0 3, residual expenditure under Chapter B7-5 4 relates to the Western Balkans. There is no explanation or comparative table enabling an evaluation of the increase in expenditure from one financial year to the next in the two newly defined spheres of action.

**5.22.** *The year 2000 was the first annual reporting occasion on which this new form of presentation, combining financial and output data, has been attempted. The inconsistencies identified by the Court should, in the light of the experience gained in 2000, not recur.*

*Whilst the transfer of aid in favour of the Balkans is mentioned in the 'Compte' at budget line B7-5 4 1 'Aid for the Republics formerly part of Yugoslavia' it is acknowledged that the explanation accompanying the transfer (from the reserve) could be more detailed: as stated in point 5.20, such aspects will receive particular attention in the 2001 financial year.*

**5.23.** *It is accepted that such movements could be better presented to the reader. The intention is to give explanations allowing the reader of the financial statements to understand any significant changes in nomenclature or budgetary allocations, and this will be done for 2001.*

## SPECIFIC APPRAISAL IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

### *Intensive audit in the field of Tacis*

#### **Description of the subject area**

5.24. Heading 4 of the financial perspective covers external measures and includes a variety of instruments:

- (a) the granting of food and humanitarian aid (Title B7-2 of the EU budget);

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- (b) the carrying-out of cooperation programmes via budget headings devoted to specific geographical areas (Latin America, Asia, and southern Africa, Title B7-3; the Mediterranean third countries and the Middle East, Title B7-4; Central and Eastern Europe, the Balkans, the New Independent States and Mongolia, Title B7-5);
- (c) co-financing measures taken by non-governmental organisations (NGOs) (the greater part of Title B7-6), as well as
- (d) other measures, the bulk of which concern international fishing agreements and the Common Foreign and Security Policy (the rest of Title B7-6, Title B7-7, Title B7-8 and subsection B-8).

**Scope and nature of the audit**

5.25. In the area of External Actions only a small number of transactions are tested for the global DAS. In order to provide the discharge authority with more focused information, the Statement of Assurance specific appraisal for external actions is based on a cycle of in-depth audits of different elements of the budgetary area each year. In 1999 the Court started this cycle with decentralised Phare expenditure (at the time, part of Heading 4), co-financed activities managed by NGOs and expenditure for aid to Bosnia. Thus, in 1999 around 13 % of the total external actions expenditure was covered by an in-depth audit. For the year 2000 the Court undertook an audit of the Tacis programme, mainly at the level of the Commission (Title B7-5 of the budget), representing almost 10 % of the total expenditure within the external actions area. The objective of the audit was to provide conclusions on the legality and regularity of contracts concluded and payments made during the year and to make observations concerning the functioning of the control systems.

5.26. The audit included an examination of the system of procedures and controls covering this area in order to evaluate their theoretical and practical effectiveness in ensuring that transactions are legal and regular. The audit also included examination of representative random samples of (i) contracts concluded by the Commission in the year 2000 drawn from the contracts database and (ii) payments made in the year 2000 drawn from the Commission central accounting system. The

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audit was based on documentary evidence available at Brussels, including contracts, invoices and certificates provided by the delegations and monitoring and evaluation reports. Due to the nature of these transactions, verifying the reality of the payment claims for services is only possible by systematically examining in detail the records of individual contractors at a time close to the provision of the services. This was not feasible. This work was supplemented by on-the-spot audits of transactions for which most of the documentary evidence was only available in the beneficiary countries, which was the case essentially for the decentralised programmes described in paragraph 5.33.

5.27. The majority of the projects in the Tacis area involve the financing of technical assistance contracts based on time spent by consultants at agreed rates, together with other expenses such as travel and subsistence. The work of these consultants can either involve the preparation of an agreed output such as a report, or can simply be a contribution to the ongoing work of a beneficiary state administration or other organisation. The inherent risk in this type of contract is the possibility that the quality and quantity (reality) of the services performed do not match with the claims made and supported by time records and performance reports. In principle, internal control systems and procedures should take this risk into account.

**The Tacis programme**

5.28. The objectives of the programme are to promote the transition of the 13 Eastern European and Asian beneficiary countries towards well functioning market economies and to reinforce democracy and the rule of law. The assistance is, in general, delivered in the form of grants financing technical assistance contracts. When a project is launched a contractor is selected to deliver services to the beneficiary organisation. The selected contractor is almost exclusively an organisation from the Member States, mainly from the private sector but also from the public sector or a non-profit organisation. In the majority of cases, the contractor receives the EU funds, while the beneficiary of the assistance, is a government institution in the Tacis country.

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5.29. The services delivered by the contractor are in the form of transferring know-how in eligible areas of cooperation, which are:

- support for institutional, legal and administrative reform,
- support to the private sector and assistance for economic development,
- support in addressing the social consequences of transition,
- development of infrastructure networks,
- promotion of environmental protection and management of natural resources,
- development of the rural economy,
- support for nuclear safety.

The new Tacis Regulation for the years 2000-2006 was adopted in December 1999 (<sup>14</sup>). Most of the payments made in 2000, and therefore selected for audit, are related to contracts awarded under the old regulation.

5.30. The amounts committed, contracted and paid in the years 1991 to 2000 are shown in **Table 5.4**.

**Table 5.4 — Tacis commitments, contracts and payments**

(Mio EUR)

Year	Commitments	Contracts	Payments
1991	397	5	1
1992	419	203	32
1993	472	349	180
1994	465	515	300
1995	511	527	374
1996	536	455	376
1997	482	691	405
1998	508	507	462
1999	428	396	514
2000	444	384	465

(<sup>14</sup>) Council Regulation No 99/2000.

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5.31. The Tacis programme is mainly managed centrally from Commission departments in Brussels. The Directorate-General EuropeAid-Cooperation Office (AIDCO) (incorporating the functions previously carried out by the Common Service for External Relations) manages all implementation aspects and is also responsible for all control functions and evaluations since 1 January 2001. Within AIDCO each technical assistance contract is assigned to a Project Manager (formerly known as the Task Manager) who manages the project, including monitoring the progress of the contract.

5.32. A consortium of specialist companies (Monitoring Units) has been contracted to monitor the contractors' performance. This monitoring covers in a systematic way the qualitative aspects of their performance. The resulting monitoring reports are sent to the Project Managers.

5.33. There are some Tacis programmes where the management is decentralised (see list in **Table 5.5**). The payments to these intermediaries represented around 25 % of total Tacis payments in 2000. These decentralised management bodies keep all financial records at their premises and have thus been audited at this level.

**Table 5.5 — Major decentralised Tacis programmes**

(Mio EUR)

Programme	Managed by	Payments in 2000
Bangkok facility	EBRD	23
Science and Technology Centres in NIS	ISTC in Moscow and STCU in Kiev	24
Exceptional Assistance Programme to Azerbaijan	Government of Azerbaijan	10
Tempus	European Training Foundation	13
Bistro	EC Delegations	3
Chernobyl Shelter Fund	EBRD	40

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5.34. As part of the current reform of EU external assistance programmes the Tacis programme has also been subject to changes in monitoring and supervision. The reform will imply a new allocation of responsibilities between DG Relex, AIDCO and the EC delegations.

**5.34.** *The EuropeAid Cooperation Office was created as a direct result of the Commission's decision to reform external aid management announced in May 2000. The External Relations Directorate General is responsible for defining the strategies, objectives, priorities and areas of cooperation in the Tacis programme; the EuropeAid Cooperation Office is responsible for management of the project cycle from identification to final project evaluation.*

*The Commission also decided in May 2000 to devolve tasks and responsibilities at all stages of the operation cycle to EC delegations. This constitutes a key component of the reform of external assistance. 22 EC delegations are included in the devolution process in 2001, among them the delegation in Russia. The Commission intends to complete devolution for the Tacis area before the end of 2002.*

### **Audit findings**

#### Contracts and payments

5.35. The audit work undertaken at the Commission level on contracts concluded by the Commission, and the underlying commitments, did not reveal material errors of legality and regularity. However, the audit of payment transactions revealed a small number of errors, including wrongly charged expenses, costs claimed for an ineligible period and costs not supported by time sheets. These errors did not have a material impact on total expenditure.

#### Observations on internal control

5.36. Given the inherent risk that Technical Assistance contracts may not always be satisfactorily fulfilled, the internal control system must cover the risk that the quality and quantity of services performed may not match the invoices and the supporting documents. The risk of major failure by the contractors to deliver is countered by the fact that the beneficiaries in the countries concerned have an interest in seeing that the contractors perform their work and are likely to complain if they do not. The monitoring reports provided to the Project Managers (as described in paragraph 5.32) can provide a further measure of assurance that the contractors are actually doing their work.

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5.37. The Project Managers have a very important role in the management and control of the Tacis programme. The Project Managers need to be highly qualified and experienced in the management of technical assistance. The workload of these Project Managers is high and the resulting strain on the individuals involved leads to high staff turnover which puts at risk the appropriate functioning of control systems. As a result, the Project Managers do not pay close attention to the content of the monitoring report which would allow them to take up with the contractors any identified deficiencies in their work before authorising payments. The Commission does not make sample inspections of ongoing contracts to check the accuracy of time records and expenses claimed.

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5.37. *The Commission recognises the importance of monitoring reports and agrees that Project Managers should use them to the greatest extent possible.*

*Under the new standard arrangements introduced in 2001, a Project Manager representing the interests of the contracting authority and responsible for monitoring contract progress is identified for every contract. The new service contract also incorporates a monthly, estimated cashflow forecast. The Project Manager can use this to ensure that deviations from the forecast correspond to changes in the actual time inputs of experts and incidental expenditure of which he/she is aware either from personal knowledge of the project or through the monitoring unit reports.*

*The payment structure of the new service contract has removed the need for the supporting documentation for contractors' invoices to be verified before interim payments are made. The actual days worked and actual incidental costs included in the invoices are verified in every service contract by requiring an audit certificate before the final payment is made. Consequently, this will reduce the workload of both Project Managers and those involved in making payments.*

5.38. During the audit the Court has taken note of some indications of improvements in the control environment. The Commission has been successful in its efforts to speed up the tendering and contracting as well as the processing of invoices for payment. Invoices are now paid within the normal 60-day period (excluding really exceptional cases) and the level of outstanding commitments fell for the second year running.

5.39. In November 1999 the Commission adopted a new manual for all external aid contracting in order to simplify the award of contracts. The manual reduced the number of different tendering procedures from 40 to eight (simplified) procedures. A 'Practical Guide' to EC external aid contract procedures was published in January 2001. These efforts should further contribute towards overcoming some of the weaknesses which were highlighted in the Court's Special Report No 16/2000<sup>(15)</sup>.

5.39. *The new practical guide to EC external aid contract procedures, based on the November 1999 manual of instructions for external aid contracts, harmonises and simplifies the management of EC external aid programmes. The Commission is now working on a complementary guide to financial procedures for external aid, which should simplify and clarify the applicable financial rules.*

<sup>(15)</sup> Special Report No 16/2000 on tendering procedures for service contracts under the Phare and Tacis programmes (OJ C 350, 6.12.2000).

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5.40. In the new 'Practical Guide' a new set of general conditions for service contracts is included. These new conditions require a similar level of detailed time and financial records to be maintained as in the old ones; however, these will no longer need to be submitted with invoices. The existence and accuracy of these records will be certified at the end of the contract by an independent auditor.

5.41. In the audited sample, 36 % of the invoices were corrected by the Commission before the payments were made. The corrections generally involved small amounts. The Court established that the control system works effectively. A significant amount of human resources is used to carry out this control task. The high percentage of corrections might indicate that guidelines for invoices and supporting documents are insufficiently clear or insufficiently adhered to.

### Conclusions

5.42. Subject to the limitation in the scope of the audit described in paragraph 5.26, the Court concludes that, taken as a whole, the Tacis contracts concluded by the Commission and payments made were legal and regular.

5.43. The Court welcomes the introduction of the new 'Practical Guide' to EC external aid contract procedures. However, these procedures do not incorporate a direct link between the control of quality and quantity of the contractors' performance and the approval of payments (see paragraph 5.37).

### Recommendations

5.44. The Court recommends that:

(a) The Commission should pay closer attention to the role and position of Project Managers to ensure that experienced staff are retained. Sufficient training must be provided in order to strengthen their management capacity.

*5.41. The budget breakdown of the new service contract has been considerably simplified to minimise the risk of calculation errors or the application of incorrect fee rates. In addition, the contractor must provide an audit certificate before the final payment is made to confirm that all the transactions invoiced by the contractor are based on the actual days worked and the actual incidental costs incurred.*

*5.43. As described in the Commission response to 5.37, from 2001 the Project Manager responsible for a contract must approve interim and final payments on the basis of personal knowledge of the project or through Monitoring Unit reports. Consequently, there is a link between the control of quality and quantity of the contractors' performance and the approval of payments*

**5.44.**

*(a) The Commission recognises the importance of retaining experienced Project Managers. In the past a high proportion of Project Managers were on short-term contracts and the Commission is replacing these with established officials. In addition, devolution to delegations will demand a longer-term commitment from the individuals involved than has been necessary for Brussels-based jobs.*

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(b) The Commission should, in line with the new General Conditions, further strengthen its system for internal control of this type of contract, for instance by:

- (i) more systematic use of monitoring reports when approving invoices for payment;
- (ii) carrying out, or having carried out on its behalf, timely inspections of Tacis technical assistance contracts, to verify the reality of the services performed and the accuracy of the time records and expenses claimed.

(b)

- (i) From 2001 Project Managers have to confirm that invoices reflect the activities actually carried out by the contractors (on the basis of personal knowledge of the project or monitoring unit reports) before approving them for payment. The removal from the new service contract of the need for supporting documentation to be verified before payment of invoices should allow Project Managers to monitor the progress of contracts more closely in future.
- (ii) Project Managers and delegation staff visit projects to carry out inspections as frequently as possible, but the availability of staff resources is a limiting factor. In addition, there are only four delegations in the Tacis region, assisted by a few branch offices. The Moscow and Almaty delegations in particular have to cover vast areas. A further constraint on inspection visits is the lack of mission funds both for Brussels and the delegations.

## FOLLOW-UP OF PREVIOUS OBSERVATIONS

*Nuclear safety***Introduction**

5.45. Both the Council<sup>(16)</sup> and the European Parliament<sup>(17)</sup> urged the Commission to remedy the inadequacies in its management of the Phare and Tacis programmes in the field of nuclear safety pointed out in the Court's Special Report No 25/98<sup>(18)</sup>. The Court's main observations concerned the following:

- (a) the Commission's confused intervention strategy;
- (b) the disparate and frequently changing human resources allocated to the management of the programmes;
- (c) the slowness of the project implementation mechanism;

**5.45.** The Commission intervention was clarified in 1998 in Communication COM(1998) 134 to the Council and to the European Parliament. Communication COM(2000) 493 of 6th September 2000 further explains this intervention and clearly spells out the priorities of the programme. There is as yet no follow-up to this Communication from Parliament or the Council. The Communication clarified the rules and procedures to be applied to the complex and specialised nuclear sector. In line with the reform of the management of external assistance programmes, the responsibility for nuclear safety has also been clarified. In order to ensure greater visibility and transparency the Commission has proposed that from 2001 onwards there should be a single budget line for financial assistance for nuclear safety in the NIS.

<sup>(16)</sup> Council Recommendation on the discharge for 1997.

<sup>(17)</sup> The Parliament's report of 21 April 1999 on the postponement of the discharge for 1997.

<sup>(18)</sup> OJ C 35, 9.2.1999.

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(d) the lack of transparency in management; and

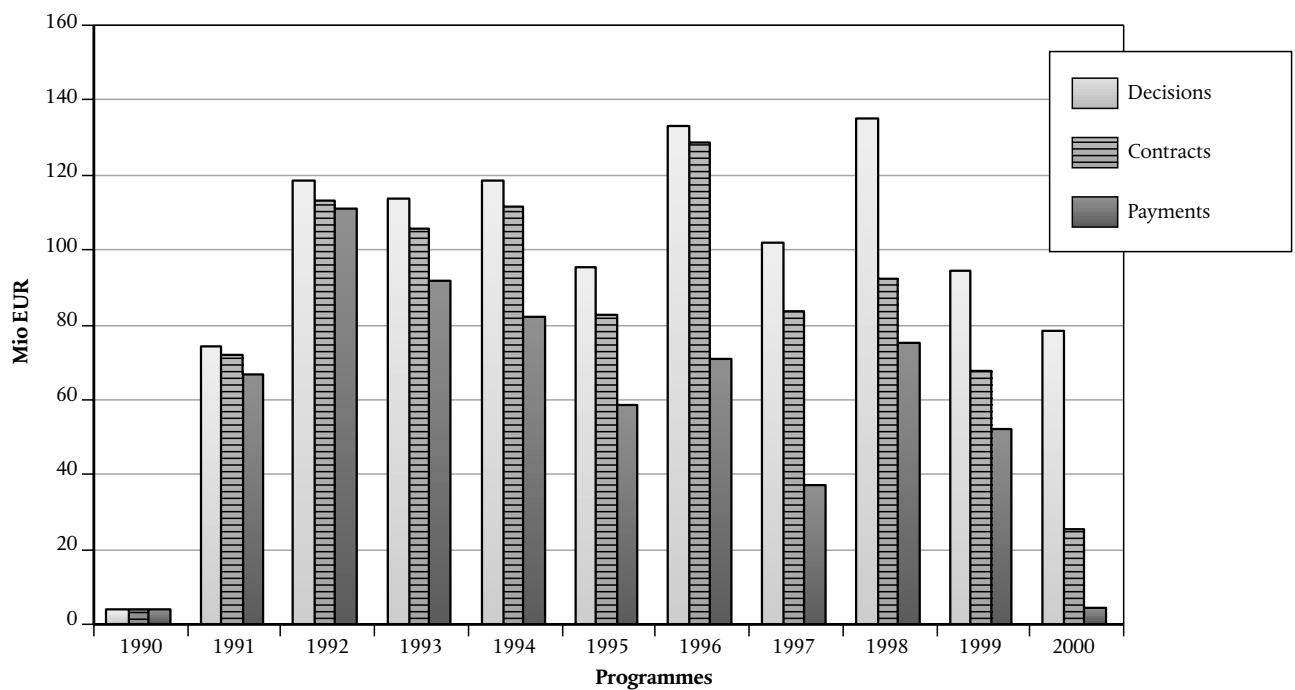
(e) the limited involvement of the beneficiaries.

In addition to the observations of the Court, this follow-up has also taken into account all the major recommendations made to the Commission by the Council and the Parliament.

5.46. At the end of 2000, 1 064 million euro were committed for Phare and Tacis nuclear safety programmes. About 83 % of those funds were contracted and 61 % paid (see **Diagram 5.1**).

**5.46.** *Payments for service contracts are usually made against delivery of the results specified in the contract, which means that payments are always behind commitments. In a complex sector such as nuclear safety, it is normal for payments to be several years behind commitments.*

**Diagram 5.1 — Phare and Tacis decisions on nuclear safety taken by the Commission since 1990**



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**New intervention strategy in the absence of qualitative standards**

5.47. Given the limited human resources available to it, the Commission has decided to reduce the number of projects and increase their size so as to be able to manage them better (19). In future it will only finance equipment projects amounting to around 5 to 10 million euro, the priority objective being the vocational training of power station staff, rather than the supply of equipment as such. The Commission has switched from an annual equipment supply programme for many sites to a multi-annual programme for a few sites.

**5.47.** Against the background of limited resources, the Commission has decided to reduce the number of projects and to focus support through larger plant improvement projects. These projects consist of physical supplies and associated technical and management support. Assistance will also be provided on a more general basis in the area of operational safety.

This operational, technical and management support will be provided by EU operators under the on-site assistance programme in the framework of multiannual contracts. This form of contracting will also help streamline implementation by Commission services.

For accession countries the number and size of the projects is also determined by the accession-driven approach to financial assistance on the basis of the priorities laid down in the Accession Partnerships.

5.48. The objective of these measures is still to help to bring nuclear plants in the CEECs and the NISs up to 'European safety standards' (20). At the end of 2000, these European standards had still not been defined, nor had the Commission yet established, as the Council and the Parliament had requested, its own indicators for the purpose of evaluating the effectiveness of the programmes and the real extent of improvements in power plant safety.

**5.48.** A methodology for defining the EU position on a 'high level of nuclear safety' in the candidate countries, for nuclear installations covered by the Convention on Nuclear Safety, has been devised by a Working Party of the Council Atomic Questions Group (AQG) and endorsed by the Committee of Permanent Representatives (Council doc 9181/01 of 27 May 2001). This methodology is not based on a formal set of 'EU standards'. However, we note that a high level of convergence has been achieved.

In this context, the Commission considers that if the accession negotiations can be conducted without reference to a formal set of EU standards, then a fortiori these should not be necessary in order to assess the effectiveness of the Commission's Phare and Tacis programmes, as the Court continues to insist.

The objective of Tacis support, as agreed by the European Parliament and the Council and laid down in the Tacis Regulation, is to help improve safety culture at the level of both operators and regulators, but not necessarily to raise safety standards to Western levels, which will not always be possible.

It is difficult to measure its impact on safety culture, or to assess the impact of technical assistance on the improvement of safety culture, particularly when Commission assistance has been supplemented by national efforts and bilateral programmes.

(19) Communication from the Commission to the Council and the European Parliament 'Commission support to nuclear safety in the New Independent States and Central and Eastern Europe' (COM(2000) 493 final).

(20) Council Resolution of 18 June 1992 on the technological problems of nuclear safety (OJ C 172, 8.7.1992, p. 2).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

A number of reports and assessments, such as the IAEA 2000 Report and the Council's Group on Atomic Questions, suggest that the level of nuclear safety has improved in the NIS in general and in a number of specific installations in particular. The assessments also confirm that the Phare and Tacis programmes have substantially contributed to this development.

Bearing in mind the inherent limitations, now that sufficient programmes have been implemented the Commission is considering a project under the 2001 programme to define ways of evaluating improvements in power plant safety in the NIS.

#### **Human resources allocated to the management of the programme and their organisation**

5.49. In line with the European Parliament's resolutions<sup>(21)</sup> calling for better utilisation of resources, the Commission restructured its departments so as to improve the planning, implementation and monitoring of programmes in the field of nuclear safety in the CEECs and NIS. DG Relex retained only the planning side and the Joint Relex Service (SCR) was given responsibility for implementation and the financial management of the projects, with the support of the Joint Research Centre (JRC) for safety projects.

5.50. In September 2000, the Commission decided to redistribute responsibilities again. DG ELARG was to be responsible for the whole project cycle in the accession candidate countries and, in the NIS, DG Relex was to take charge of planning and the SCR the rest of the project. At the end of the year 2000, this restructuring had still not been implemented and the Commission was still unable to satisfactorily clear up the backlog and implement the new projects.

5.50. The second restructuring only affected the Phare programme, accounting for no more than 20 % or so of the total nuclear safety budget. The formal transfer to the Enlargement Directorate-General of programmes relating to accession countries was completed before the establishment of the EuropeAid Cooperation Office on 1<sup>st</sup> January 2001. By May 2001, the Enlargement Directorate-General had the necessary staff to exercise responsibility for the Phare project cycle. The Commission believes, therefore, that the added value provided by a direct interface (facilitating accession negotiations, delivering pre-accession support, continuing the political dialogue) far outweighs the delays caused by the restructuring. Restructuring also put an end to the anomaly whereby the Phare nuclear safety sector was outside the normal structure.

In accordance with the White Paper on Commission reform, the EuropeAid Cooperation Office has been designed to increase the pace of programme implementation (line management, increased power of decision at lower levels, clear lines of responsibility).

<sup>(21)</sup> European Parliament Resolution on the Commission's communication to the Council and the European Parliament concerning measures in the nuclear safety sector in favour of the central and eastern European countries and Newly Independent States (COM(98) 134) (OJ C 175, 21.6.1999, p. 288).

## THE COURT'S OBSERVATIONS

5.51. The high level of staff turnover led to a loss of corporate memory, a lack of continuity in the management of the projects and some delays in project implementation. Of the 13 managers employed when the SCR was set up in July 1998, 11 had left the unit in December 2000. Other employees only stayed six months in the unit. There was also a degree of internal mobility within the unit, as some staff changed fields of responsibility.

## COMMISSION'S REPLIES

**5.51.** *The high staff turnover which affected the smooth implementation of the nuclear safety programme was partly caused by high numbers of temporary staff. New posts have been allocated and auxiliary posts replaced by permanent ones. Nevertheless recruitment of temporary staff with specialist skills (such as seconded national experts) will continue to be necessary.*

*The implementation of existing and future nuclear safety projects will require an increased number of Project Managers. The Commission has addressed this issue in the general context of the reform of its external aid programmes. Additional statutory A and B grade staff posts have been added to the nuclear safety unit in the EuropeAid Cooperation Office and the Enlargement Directorate-General.*

*The nuclear safety unit in the Joint Relex Service (SCR) was organised on horizontal lines. In the EuropeAid Cooperation Office the unit is structured by sector, each with a separate activity, such as on-site assistance, regulatory authorities, design safety, etc. This structure increases corporate memory and encourages the exchange of experience.*

5.52. Moreover, the involvement of the delegations in the programme implementation was usually fairly limited. In Bulgaria, even though the management of the Phare programme is decentralised, the delegation is neither involved in project management nor in monitoring. The Delegation in Russia was more informed of the programme implementation, but did not provide any follow-up. In 2000, the Commission had not allocated a single member of staff to the Tacis section of its Russian Delegation to monitor these projects. Moreover, delegations usually experience difficulties in recruiting or retaining high level local staff because their contracts are not sufficiently attractive.

**5.52 to 5.53.** *For the Phare nuclear safety programme, the Commission has taken measures to increase the role of its delegations as part of the shift from centrally implemented multi-country programmes to decentralised national programmes. Communication lines between headquarters and the delegations have been tightened and contact persons for nuclear safety have been designated in the delegations. The Delegation in Sofia was involved in project implementation in the past.*

*A Joint Management Unit has been set up in Moscow by Minatom and the Commission. A staff member was added to the Delegation in Moscow in summer 2001 with responsibility for nuclear safety matters.*

5.53. However, the Kiev Delegation was actively in contact with the Ukrainian authorities responsible. It recruited a local expert at the start of the programmes, who closely monitored the projects. This fact mitigated the negative effects caused by the partial absence of a manager at the Commission headquarters for on-site assistance projects in the Ukraine in 1999.

*One of the reasons which led the Commission to decide that nuclear safety should not be included in the first wave of devolution was the difficulty of recruiting high-level local or EU staff.*

*The Commission's policy in recruiting local staff has not changed: staff recruited locally are paid at market rates, taking local circumstances into account. A distortion of the local market is not in the interest of the beneficiary country.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Slow implementation of projects persists**

Clearing up the backlog, to the detriment of new projects

5.54. When the SCR was created, it took over a difficult situation (delays in most of the old projects that had been started earlier, errors that had not been corrected, numerous problems and invoices left in abeyance). Its first activity was to clear up the backlog, to the detriment of newer projects. Projects had to be cancelled or restarted because they had become obsolete or because the bidders had not been able to keep their tenders unchanged over such a long period.

5.55. Thus, at the end of 2000, only one contract and two calls for tenders for the 'design safety' projects under the 1997 programmes had been prepared. When the SCR wanted to sign the contracts for two projects in the context of the 1996 programmes, the relevant funds were not available, because they had been used up in 1997 by DGIA to finance another contract. It took five months to obtain a reallocation of funds and six and eight months respectively to sign the two contracts.

5.56. Nevertheless, despite low staff numbers (which was partly offset by the high level of involvement of the managers), the Commission did improve the situation for the Tacis programmes. Thus, the backlog of amounts committed but not yet contracted fell from 142 million euro to 117 million euro for equipment and from 82 million euro to 72 million euro for Tacis service contracts between 1998 and mid-2000. However, on this same date, the amount remaining to be contracted for Phare service projects (42 million euro) was still more or less as high as in 1998 (41 million euro).

**5.54.** *In order to tackle the backlog the Commission decided on a rigid prioritisation in launching new projects, which meant that projects in the design safety sector were delayed. Projects dating back to 1996 or before have now been completed, while 1997 and later projects are either being prepared or are being implemented.*

*A major difficulty has been the mismatch between the duration of equipment projects and that of the financing memoranda. Measures were taken to extend budget lines and negotiations undertaken with the bidders, in order to prevent loss of funding for the beneficiaries. This was eventually achieved in 1998/1999.*

**5.55.** *The decision to prioritise necessarily resulted in considerable progress in sensitive fields but, as explained above, caused delays in others, including the design safety sector. However, EUR 3m was contracted by July 2001 for this sector out of an allocation for 1997 of EUR 11m.*

*Of the two projects which the Court notes were signed late, one was delayed at the contractor's request because of staffing problems; the other was related to the completion of the tests carried out on a certain type of reactor installed both in the CEECs and in the NIS.*

**5.56.** *Since Phare programmes have a shorter life than Tacis (three years) all funding needs to be contracted at shorter notice. In keeping with normal procedure, the 1997 programme was committed prior to its closure in October 2000. Thus by October 2000, the figure for Phare was nearly EUR 3m lower.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## Time needed for the preparation of contracts

5.57. The majority of the contracts under the Phare and Tacis programmes were delayed by more than a year and the justification of some of them was even called into question because they had become out of date. In Russia, at the end of 2000, projects falling under the 1993, 1994 and 1995 programmes had still not been finalised. The contracts for many of the 1997 projects had not yet been signed and the terms of reference for the 1998 projects had not yet been established. 165 Russian projects had built up significant delays. At the current rate, it will take more than six years to make up for the delays that have accumulated.

5.57. *The remainder of design safety projects from before 1997 are all related to the supply of equipment. These projects were interrupted because of an apparent conflict of interest and were later restarted. The Commission is still confident that results can be delivered before the programme's cut-off date.*

*The 1997 projects are secured: all terms of reference have been completed and contract extensions with procurement agents have been made. For 1998 all terms of reference except two have been endorsed.*

*It is misleading to extrapolate the current rate of implementation, for the following reasons:*

- *staff increases will enable the Commission to launch more projects in parallel,*
- *new guidelines for supply contracts provide that all contracting should be terminated 150 days after the cut-off date for the submission of bids,*
- *programming of technically mature projects will lessen project fragmentation and thus lead to higher expenditure per contract.*

*Most of the 1993 to 1997 equipment can be contracted within two years.*

5.58. The first phases of the projects financed in Russia under the 1992 to 1998 programmes took a very long time to implement, as is shown by the duration of the phases set out in **Table 5.6**. A study of the most problematic cases shows that the delays observed were largely due to the large number of participants in the implementation and the cumbersome nature of the procedures. The declared intention of the Commission to discontinue the use of the procurement agencies, which the Court had recommended, should improve the situation by reducing the number of parties involved and should thereby speed up the implementation process.

5.58. *As of 1998 the Commission decided to reduce the number of actors by entrusting more responsibility to EU operators in charge of on-site assistance, for the implementation of plant improvement projects (see 1998 Communication). In 1998 the Commission decided to discontinue the use of procurement agencies for future programmes.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.59. For all the equipment supply projects the local regulatory authorities endorse the technical specifications, which must comply with the legislation of the country concerned. This endorsement, which is required before the publication of the call for tenders, is often the cause of serious delays, sometimes for no apparent reason.

5.60. Because of the unclear definition of responsibilities between the Commission departments and the procurement agencies, there are numerous exchanges of correspondence between them. These always give rise to more or less significant delays, in particular where the Finance or Contract units within the Commission are slow to reply. The acceptance of the tender evaluation can take several months.

**5.59.** For new large projects the Commission intends to request a Memorandum of Understanding which will bind the beneficiaries to shorter response times.

**5.60.** The Commission has taken measures to clarify its relationship with procurement agencies in order to avoid unnecessary correspondence and delays. In the EuropeAid Cooperation Office set up in 2001 the contracting and financial units have been combined as single units in each geographical Directorate. The rule that not more than 150 days may elapse between tender closure and contract signing has also led to a streamlining of operations between units.

**Table 5.6 — 1992 to 1998 Tacis Programmes in Russia — Duration of the first 3 phases**

Phases concluded as of 11 October 2000		Duration of the phases (in months)			
Type of project		TSs/TORs	Tenders	Negotiations	Total for the 3 phases
Operational safety	Average	3		2	5
	Maximum	3		3	6
Design safety	Average	5	10	7	21
	Maximum	13	11	19	34
Safeguards	Average	7	16	7	18
	Maximum	13	16	10	30
Equipment	Average	11	16	10	34
	Maximum	28	32	32	64
All types	Average	9	14	9	28
	Maximum	28	32	32	64

Phases not concluded as of 11 October 2000		Time passed since the start of each phase (in months)		
Type of project		TSs/TORs	Tenders	Negotiations
Design safety	Average	31	22	
	Maximum	31	26	
Safeguards	Average	19	26	
	Maximum	24	27	
Equipment	Average	32	24	23
	Maximum	52	38	50
All types	Average	30	23	23
	Maximum	52	38	50

NB: The three successive phases are: the preparation of the Technical Specifications (TSs) and the Terms of Reference (TORs), the call for tenders up to the selection of the successful tenderer and the negotiations with the latter up to the signing of the contract.

Source: Tacis Nuclear Safety Programme Joint Management Unit — Moscow.

## THE COURT'S OBSERVATIONS

5.61. Other delays are due to inadequacies in the services provided by certain on-site technical assistants — unreliable estimates of project costs, poor initial quality of technical documents, slowness in including requested amendments (on the part of the Commission or the procurement agency).

## Subcontracting

5.62. Western technical assistance firms subcontract design safety studies to local institutes. Remuneration for the services provided by these institutes is dependent on the Commission's payment to the main contractor. Because of the slowness of these payments by the Commission, the subcontractors are often not fully paid off until a year after having carried out all the planned work, which, given their often precarious financial positions, frequently causes them serious damage. Despite the Court's criticisms on this subject in its Special Report, the Commission had not yet resolved this problem in a satisfactory manner by the end of the year 2000.

## Management improved, but transparency still inadequate

## JRC technical support

5.63. Following the Court's observation concerning the excessive delegation of its responsibilities, the Commission no longer uses the European electricity producers group for technical assistance. It has made the Joint Research Centre responsible for providing technical assistance for planning, drawing up terms of reference and appraisal in respect of design safety and on-site assistance projects.

5.64. Using the JRC for technical support was well received by all the parties, who recognised its scientific quality and independence. They are relatively satisfied with the speed with which it handles its tasks. The average time for handling assignments regarding equipment (technical specifications, terms of reference, evaluation reports) went down from more than 70 working days in the first quarter of 2000 to less than 20 days at the end of the year.

## COMMISSION'S REPLIES

5.61. *The new arrangements provide that funding will be committed only when it is clear that technical specifications have reached a sufficient level of preparation. The Commission expects that this will improve matters. On-site technical assistance is now taking greater care with the preparation of new plant improvement projects, so it should be possible to improve compliance with deadlines.*

5.62. *The Commission's responsibility is to its main contractor. It is taking steps to speed up payments to contractors, which should mean there will be no reason why subcontractors should not be paid on time.*

5.63. *The Commission has indeed followed up on the commitment by the Court in 1998 on what it called an 'excessive role' of the European electricity producers group, by discontinuing contractual relations with this group and by calling upon the JRC to take over the technical advisory function.*

5.64. *This improvement was largely due to the increase in the number of JRC staff working full time on nuclear safety support.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## Supply projects entrusted to other intermediaries

5.65. The Court also criticised the use of procurement agencies for equipment supplies. In 2000, the Commission was still being assisted by such agencies for projects for which funds were allocated prior to 1998. Currently, it has decided not to manage these projects itself, but to entrust them in the future to Western on-site technical assistance firms. This solution, however, does not offer a sufficient guarantee of transparency. Already, the on-site consultants assist the beneficiaries in drawing up technical specifications and terms of reference for equipment projects and participate in tender evaluations. However, on several occasions, the Court found that these consultants did not always comply with the tendering rules and procedures, which could result in a risk of conflict of interests.

## Limited involvement of beneficiaries

5.66. The economic situation in the beneficiary countries obviously has a direct impact on the level of nuclear safety. Thus, in the year 2000, it was hard for the Ukrainian plants to find the necessary resources to purchase fuel, pay their staff (salaries were 1 to 2 months in arrears), carry out the necessary maintenance and provide their part of the funding for certain projects. Moreover, the implementation of the projects was also affected by institutional changes, in particular in Bulgaria, Russia and the Ukraine, where the regulatory authorities' lack of powers and the frequent changes of staff posed problems.

5.67. In the countries that have applied for accession, the Commission has greater powers of persuasion than in the NIS. Thus, just before the Helsinki Summit that opened the way to accession negotiations, Bulgaria, Lithuania and Slovakia accepted the Commission's requirement that they should shut down the oldest units in their plants.

5.68. In the NIS, on the other hand, the Commission is less able to bring pressure to bear. In the Ukraine, for example, it asked the various government bodies to strengthen the regulatory authority (it currently operates under the Ministry of the Environment and has

5.65. *The Commission has realised the risks of conflicts of interest and has called on the JRC and other services to become fully involved in the evaluation of supply/works projects. The first time such an approach was followed, during the complex evaluation of the Chernobyl facilities project, it proved its worth. The team of JRC-specialists working full time ensures that the cumulative experience will bear fruit.*

5.66. *The Court's comments on the effects of the economic situation and institutional changes in the Tacis area are correct. Institutional changes may be less relevant to Phare programmes, since the national aid coordinators in accession countries have responsibility for counterpart actions.*

5.68. *The context of enlargement presents a unique opportunity for the Commission to have an impact on the recipient countries, which is not the case for the NIS. EBRD projects in these countries are also affected by difficulties in the national decision-making processes.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

limited powers), without obtaining a firm commitment on their part. The EBRD is able to lay down stricter conditions because it has the G7 group's backing. For example, it can cancel a project if, after several months, it has become clear that, through some fault of the beneficiary, it will not be possible to carry the project out in accordance with the planned timetable.

5.69. The low motivation of certain NIS beneficiaries makes it difficult to implement the projects in the best possible way. This is particularly true for the regulatory authorities. The beneficiary countries have still not managed to establish strong and independent regulatory authorities, largely because they lack any real will to do so. This situation has been denounced by various institutions, such as the G7, the IAEA and the EBRD.

5.70. The question of the impact of the EU-financed projects in aid of the regulatory authorities must be looked at against this background. The '2 + 2' approach (simultaneous aid to the power stations and regulatory authorities) has turned out to be particularly difficult to implement. This concept requires commitment from all parties concerned and the synchronisation of both industrial and regulatory work. In Russia, the only framework contract that had been signed met with numerous problems and no projects of this type had got off the ground in the Ukraine by the end of 2000. The beneficiaries seem not to understand the aim of this approach and only see it as a source of funding for their regulatory authorities.

### Conclusions

5.71. On the basis of the follow-up work to the observations contained in its Special Report No 25/98, the Court recognises that the Commission has clarified its strategy for the future, but the benefits of this new approach have yet to materialise. Particularly because of the JRC's support, it also monitors the projects better. Furthermore, the Commission has slightly reduced the time needed for payments and applies the rules more strictly.

5.70. *This concept, though suitable in theory, is difficult to implement. The implementation of large projects (Plant Improvement Projects) can only start once the Western Technical Safety Organisation has reviewed all aspects of the licensing plans.*

5.71. *The Commission welcomes the Court's comments on the clarification of future strategy and the improvements in monitoring and control. Although the system of prioritising projects has been put into force, there has been no follow-up from the Parliament or Council to the new strategy.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.72. However, the Court notes that several of the shortcomings pointed out in its Special Report were still there at the end of the year 2000:

- (a) the Commission had still not specified indicators to allow the measurement of progress achieved in the field of safety standards (see paragraph 5.48);
- (b) the high level of staff turnover and the low involvement of the delegations hindered the implementation and the monitoring of the projects (see paragraphs 5.51 to 5.53);
- (c) the implementation of projects and the overcoming of accumulated delays were still very slow (see paragraphs 5.54 to 5.61);
- (d) regulations in the field of calls for tenders had not always been strictly complied with and problems linked to the management and supply of equipment had still not been solved (see paragraph 5.65);
- (e) coordination between the projects realised on site and those planned for the safety regulation and control authorities was still inadequate and the effectiveness of the '2 + 2' approach was not ensured (see paragraph 5.70);
- (f) the local institutes subcontracted to carry out studies continued to be paid very late, a fact that put them in a delicate financial position (see paragraph 5.62).

## 5.72.

- (a) *A methodology to define the EU position on 'high level of nuclear safety' has been developed. The methodology is not based on 'EU standards'. This methodology will serve in accession negotiations and it will be taken into account in the project contemplated under the Tacis programme to define ways of evaluating improvements in power-plant safety in the NIS.*
- (b) *The number of posts has been increased, temporary staff are being replaced by permanent staff, and some devolution has taken place.*
- (c) *The following measures have been taken: an increase in human resources, a stronger involvement by the JRC, strict prioritisation of projects, increased project size, an improvement in programming, and discontinuation of the use of procurement agencies. These measures have been supplemented by the general reforms undertaken when the EuropeAid Cooperation Office was set up, such as the 150-days rule laid down in the new guidelines for supply contracts and the very structure of the new office, better geared towards project implementation.*
- (d) *The Commission has simplified its rules and procedures, thus creating a more efficient framework and diminishing the risk of non-compliance. The Commission is confident that the measures summarised above will allow equipment under the 1993 to 1997 programming years to be contracted within two years.*
- (e) *The Commission will undertake such industrial projects only if clear conditionalities (e.g. approval of licensing plans by the Western Technical Safety Organisation) are met.*
- (f) *The Commission cannot interfere in the relations between its own main contractor and a sub-contractor. But measures taken by the EuropeAid Cooperation Office to speed up payments to the main contractor should lead to a faster payments to sub-contractors.*

## THE COURT'S OBSERVATIONS

5.73. These shortcomings are partly due to the fact that the Commission has still not allocated adequate human resources for satisfactory implementation and monitoring of its programmes (see paragraphs 5.51 to 5.53). At the end of the year 2000, the restructuring of its departments was still under way. Nor has it sufficiently rationalised its implementation procedures (see paragraphs 5.58 to 5.60) or sufficiently linked its aid to the fulfilment of certain conditions so as to improve the motivation of beneficiaries (see paragraphs 5.68 to 5.69).

## Recommendations

5.74. The Commission should allocate the adequate human resources to the management unit, if necessary, by recruiting experts for an appropriate period. It should also involve its delegations more and allow them to offer local staff sufficiently attractive contracts to attract and keep high quality experts.

5.75. The new instruction manual for service, supply and works contracts<sup>(22)</sup> now imposes time limits for the awarding and signature of contracts. In the future, the Commission should also impose time limits for all parties for drawing up and endorsing the documents constituting the tender files.

5.76. The Commission could increase the effectiveness of its measures by laying down stricter conditions for its intervention. These conditions could be discussed in the context of the Partnership and Cooperation Agreements (PCAs). If the guidelines laid down by the Environment, Energy and Nuclear Safety Subcommittees were examined at the level of the General PCA Committee, a consistent strategy covering social, fiscal and institutional aspects that was binding for the beneficiary State could be adopted for the energy sector.

## COMMISSION'S REPLIES

5.73. The Commission has strengthened the relevant Units in the EuropeAid Cooperation Office and the Enlargement Directorate General with permanent staff. A continuous assessment of the projects is undertaken by contracted monitors, who report to the Commission at regular intervals. With the use of new guidelines, project implementation has become more efficient and transparent.

*Only in the context of the Phare programmes can conditional-  
ity be strictly applied. Memoranda of Understanding will  
increasingly be used when dealing with the NIS.*

5.74. Action has been taken to tackle the problem of human resources by strengthening the nuclear safety operational unit in the EuropeAid Cooperation Office, and within the Enlargement Directorate General, and by recruiting staff with a strong specialisation in very specific areas for the JRC for a period of three years. Issues relating to the optimal role of the delegations are being studied, and should be solved as part of the planned devolution of the Tacis programme and the decentralisation of Phare.

5.75. The Commission expects the new guidelines to be instrumental in shortening the time taken for the various stages of the contract procedure. For future programmes it intends to establish a set of guidelines laying down explicit time limits for the various stages in the preparation of a tender file.

5.76. The Commission fully recognises that any type of assistance should be set within a broader policy framework. The Partnership and Cooperation Agreements are certainly the best tool available, both in the relevant subcommittees and in the meetings at political level. Many of the difficulties encountered are not only due to the lack of political endorsement, but also to problems in the day-to-day follow-up of project progress.

<sup>(22)</sup> The instruction manual for service, supply and work contracts concluded in the context of Community cooperation in favour of non-member countries (SEC(1999) 1801/2), adopted by the Commission on 10 November 1999.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## OTHER OBSERVATIONS

*Tacis operations***Bangkok facility**

5.77. Under the so-called 'Bangkok facility', the Tacis programme has, from 1992, provided the European Bank for Reconstruction and Development (EBRD) with grant funding to support Technical Assistance (TA) components of its operation. The TA support is mainly intended to be used for preparation and implementation of EBRD investments. The annual payments have been around 20 million euro (23 million euro since 1998).

5.78. EBRD is every year reporting a 'leverage ratio' for the Tacis-funded TA leading to EBRD investments. Depending on the definition of this ratio different figures may be reported. For instance, in the Tacis' Annual Report 1999 the ratio is reported as 1:50 while in a 1999 evaluation report two figures are given, 1:15 and 1:38. In our audit we had some difficulties in verifying the link between TA support and actual EBRD investment. Some double counting of investment was found, indicating that the real ratio is lower than reported. Given the unclear definition of this leverage ratio it is of limited use and should not be used as a justification criteria for the Bangkok facility.

5.79. Part of the Bangkok facility can be used to finance the operating costs of the Early Stage Equity (ESE) Funds and provide TA for pre-investment studies and post-investment consulting support. In the years 1999 and 2000 about 25 % of the Bangkok facility was used for this purpose (5-6 million euro). As of 31 December 2000 a total of 31,2 million euro of the Bangkok facility had been used for the TA and management of ESE Funds. The corresponding investments made and loans disbursed by the EBRD amount to only 69,2 million euro. This gives a very low investment ratio of only 1:2.

5.80. The ESE Funds were initially set up to provide small and medium sized private companies with equity capital within a specific region of operation. These conditions have not always been fulfilled. The EBRD investment is in many cases a mixture of loans and equity.

**5.78.** *The Commission believes such a performance indicator is valuable in monitoring the impact of the Bangkok facility. It agrees that care must be taken to calculate the 'leverage ratio' as precisely as possible and has already taken steps to ensure that the calculation of this ratio is reported more accurately in future. What constitutes a good result as measured by the ratio will vary with the specific activity undertaken.*

*The 'leverage ratio' is not the main criterion of effectiveness for Bangkok facility operations. The Commission and the Bank instead seek to make a broader assessment of 'transition impact' before financing operations. Measures used include business growth, creation of jobs, use of new technologies, improved business practice, and improved corporate governance.*

**5.79.** *Venture capital operations are notoriously expensive and risky, and it was understood from the outset that the ratio of technical assistance to capital invested would be high. In fact, the ratio has been significantly better than anticipated because less technical assistance was used than had been foreseen, and the Bank expects to increase the capital of some of the funds as a step towards raising private sector capital. The success of the funds in establishing themselves as credible investment vehicles has meant that the Commission will be able to withdraw its support somewhat earlier than expected.*

**5.80.** *The investment policy of the funds is decided by the Supervisory Boards, of which the Commission is a member. As is normal in private venture capital operations, the investment policy of the ESE funds provides for investments to take the form of a mixture of loans and equity.*

## THE COURT'S OBSERVATIONS

5.81. The investment funds are managed by contractors known as Fund Managers. Many of the Fund Managers are active in other investment and fund activities in Russia, which creates a risk of conflict of interests: if a Fund Manager can extensively use consultants to evaluate and control investments in one portfolio there is a risk that he could make the same investments in another portfolio, thereby providing a service to the owners of the latter portfolio. Accordingly, no assurance can be obtained that the Fund Managers' use of EU-supported TA is appropriate.

5.82. The Bangkok facility is also used to finance the Turn Around Management (TAM) programme. The primary objective of the TAM programme is to provide practical advice to the senior management of selected enterprises. This support does not have a direct link to EBRD investments at all and it is not an integral part of EBRD's banking function. Accordingly, the eligibility criteria for financing this programme under the Bangkok facility are not met.

5.83. According to the annual Financing Memoranda the EBRD is obliged to provide the Commission with a report on each annual programme. The report should include an assessment of the extent to which the objectives of the programme have been met. The latest report that could be provided was dated 12 April 1999 and pertained to the year 1998. This report, however, does not include any assessment of the extent to which the objectives of the programme have been met.

## COMMISSION'S REPLIES

5.81. *Three safeguards prevent a real conflict of interests from arising. These are:*

- the EBRD is required to support operations that are 'additional', in other words, in areas where private sector operators would not invest. This is reflected in the investment policy of the ESE funds;
- the fund manager agreements preclude cross-investments;
- EU technical assistance is managed by the EBRD, not by the fund managers. The EBRD has advised the Commission that only one of the fund managers has other venture capital interests in Russia. On no occasion has a fund manager co-invested in a company also receiving ESE investment.

5.82. *The scope of the Bangkok facility is defined by the annual financing agreement with the EBRD. In the years in question, the TAM programme was explicitly mentioned on the list of eligible projects which is annexed to the financing proposal and submitted to the Member States for approval. TAM is a valuable programme in its own right. However, the Commission agrees that the Bangkok facility is not the most appropriate funding mechanism, and has already decided that from 2001, TAM should be financed from the Tacis national programme.*

5.83. *The reports include an assessment of each of the operations supported. In the past the Commission did not insist that the Bank aggregate these to make an assessment at programme level, as it was not convinced of the added value of such an exercise. Nevertheless, from 2001 the EBRD is attempting to make such an assessment in an annual report to donors. The Commission has supplemented the annual assessments of the Bank at operation level with an independent evaluation of the programme, which reported in 1999.*

*Efforts are being made in 2001 to improve the layout and content of the reports, with an added focus on transition impact. The Early Stage Equity funds (25 % of the programme) are subject to detailed quarterly reporting, as well as six monthly reviews at the supervisory boards and an annual report, which must be approved by the Commission before funds are released for subsequent years. Agreement has been reached in principle for closer monitoring by the Commission of other recurrent projects, in particular the micro-finance operations.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.84. DG AUDIT audited the facility at the EBRD in February 2000. This was the only audit undertaken in four years. The audit identified a number of material findings and such ex-post audits should be carried out on a regular basis. The Bangkok facility projects are not monitored by the Tacis Monitoring Units nor by the EBRD itself, although the monitoring contract provides that monitoring should also be carried out on the Bangkok facility projects if requested by the EBRD. No request has been issued so far.

**5.84.** *The Commission agrees with the Court's findings relating to audits, but does not believe that it is necessary or desirable for Bangkok facility projects to be routinely monitored by Tacis Monitoring Units. The EBRD is responsible for the whole project cycle, including monitoring the quality of the services provided, and is best placed to exercise the role of monitor as it has the necessary technical expertise and presence in the field.*

*There is a role for greater Commission supervision of the outcome of some of the longer-term programmes financed by Tacis. A system of scrutiny is in place for the ESE, and will be extended to cover micro-finance operations. The Commission is considering with EBRD whether there might also be a role for some monitoring by the Tacis Monitoring Units of a sample of Bangkok facility projects.*

5.85. If it is decided to continue the facility, despite its limited impact, the Commission should take steps to improve its management: (i) the investment fund management contracts should be made more transparent; (ii) the projects should be monitored within the normal Tacis monitoring framework; (iii) the Commission should systematically require operational and financial reports and make these a condition for making payments; (iv) the reliability of the reports should be audited.

**5.85.** *The Commission agrees with the need for more frequent auditing of the Bangkok facility funds, and will continue to work to improve the quality of reporting and monitoring by its departments. It believes sufficient safeguards are in place to ensure that there is no conflict of interests in the fund management agreements. Routine Tacis monitoring would not be appropriate, nor would it improve the management of the funds. However, the Commission will ensure closer monitoring by Commission officials, assisted where necessary by external experts, along the lines adopted for the Early Stage Equity Funds.*

## ISTC and STCU

5.86. The International Science & Technology Centre in Russia (ISTC) and the Science and Technology Centre in Ukraine (STCU) provide former weapons' scientists in the NIS the opportunity to redirect their talents to peaceful activities (non-proliferation). Also the aim is to contribute to the transition to market-based economies and foster the integration of scientists and engineers from NIS states into the global scientific community. The centres are supported by a donor community of which the largest contributors are the USA, Japan and the EU. The centres employ local and international staff and produce annual reports including financial statements. The financial statements are audited by an external private audit firm.

## THE COURT'S OBSERVATIONS

5.87. Before the transfer in February 2001 of all programme implementation to the Research Directorate-General, the division of responsibilities within the Commission for the financial management of the support to the ISTC and the STCU between the Directorates-General Europe Aid (formerly the Common Service for External Relations), External Relations and Research was unclear concerning controls over payment and financial follow up. Payments from the Commission to the ISTC and the STCU are based solely on estimated cash-flow needs, with no follow up of the expenditure actually incurred. The Commission has paid 88 million euro to the ISTC between 1994 and 2000, and 5 million euro to the STCU between 1998 and 2000, without ever carrying out an ex-post audit of these funds.

5.88. The Commission should improve the follow-up of actual expenditure with regular ex-post audits. An evaluation of the impact and effectiveness of the programme should be carried out, as, for example, is done regularly by governmental branches of another large donor, the USA (23).

## COMMISSION'S REPLIES

5.87. In order to improve financial control, the Commission has asked the Science Centres to provide updated expenditure estimates for each project, in addition to their requests for cash-flow needs. This is particularly important as the Centres pay in United States dollars.

5.88. The Science Centres have a primary responsibility for auditing and monitoring every project funded by the EU, and the agreements signed between the Centres and the beneficiaries also provide for auditing and monitoring (1).

Day-to-day project monitoring is mostly performed by staff at the Centres, not by Commission staff. The Centres examine the technical reports, sometimes with the assistance of western monitors, to ensure that projects are achieving the intended results and to determine whether they are on schedule. Each EU-funded project also has at least one EU collaborator, either a national laboratory or a private company. The Tacis Moscow office has provided assistance to such monitoring on at least two occasions, in 1996 and in 1998.

## PRINCIPAL OBSERVATIONS IN SPECIAL REPORTS

*Emergency humanitarian aid for the victims of the Kosovo crisis (ECHO)*

5.89. The Kosovo crisis was characterised by large population movements in the region between March and July 1999 as well as large scale destruction. Through the European Community Humanitarian Office (ECHO) the European Union (EU) provided 400 million euro of humanitarian aid in response to the needs of the population.

5.89. The EUR 400 million, budget used in the Kosovo crisis represented almost a doubling of ECHO's original budget, with virtually no additional staff. In practice this meant that ECHO had to manage 12 additional decisions and 500 extra contracts.

(23) Latest report: US General Accounting Office 01-582, *Weapons of Mass Destruction*, p. 17, published in May 2001.

(1) This approach to auditing and monitoring has been discussed and approved by the Council Regulations (EEC) No 3955/92 (OJ L 409, 31.12.1992, p. 1), (Euratom, EEC) No 2053/93 (OJ L 187, 29.7.1993, p. 1), (EC) No 1766/98 (OJ L 225, 12.8.1998, p. 2) and (Euratom) No 2387/98 (OJ L 297, 6.11.1998, p. 4).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.90. The main objective of the Court's audit, which was undertaken between July 1999 and February 2000, was to assess ECHO's management of the EU aid for the victims of the Kosovo crisis, as well as the administrative framework for this assistance.

5.91. ECHO operates as an active donor, funding the programmes of UN and international agencies and NGOs and taking responsibility for monitoring and evaluation. A large number of actors were involved in the Kosovo crisis, which, in some areas, has caused duplication of efforts and inefficiency. The complexity of the relations between the large number of actors has caused the need for elaborate, ad hoc coordination mechanisms.

5.92. Relations between ECHO and its UN partners were tense. Differences of opinion remained on important issues such as accounting for and reporting on projects. Consequently, 15 million euro available from ECHO for food aid remained blocked during the height of the crisis situation in Kosovo. A more realistic and more active approach to the financing and to the participation in the decision-making of United Nations agencies is required.

5.93. ECHO field offices were short of staff. The experts in the field offices faced many implementation problems without having officials with decision-making powers supporting them locally. This has caused delays and created a gap between ECHO in Brussels, which had the decision-making powers, and its field offices.

5.94. Decision-making and payment procedures at Community level did not allow a rapid reaction. The contractual procedures for implementing ECHO activities took only limited account of the urgency of the situation. ECHO's administrative procedures should be tailored according to the degree of urgency.

5.90. The Commission accepts that the sample of contracts examined by the Court reflects ECHO's main partners (in terms of those partners having contracts with larger individual budgets), and the main geographical areas and sectors of intervention. However, this may have led to insufficient focus on ECHO's NGO partners, which together ultimately received more than half of the funds.

5.91. ECHO made many efforts to coordinate activities, including providing daily updates on operations to Member States. The Commission does not believe that any lack of coordination between, or with, Member States can be held to be primarily the Commission's or ECHO's responsibility.

5.92. The Commission agrees that not all the problems in EC/United Nations relations have yet been solved, indeed the EC/United Nations agreement of 9 August 1999 explicitly identified certain areas which required further review. An inter-service consultation on this issue took place in the Commission in summer 2001, but guidance notes for future control missions to be shared between the Commission and the United Nations have still to be finalised. It is hoped that a mutually satisfactory solution can be found by the end of the year.

The failure to conclude contracts for EUR 15 million at an earlier stage was largely due to a United Nations partner's initial outright refusal to allow access to original documents during an ECHO verification visit in July 1999. This led to the temporary suspension of payments in 2000. The funds were subsequently entered into contracts.

5.93. A number of ECHO headquarters staff did undertake missions to the field in order to assist with operational and administrative matters, which meant that in most cases communication between Brussels and the field was not a problem. The only gap the Commission recognises is that in some cases delays arose due to the need to get contract approvals from Brussels. Recognising the need to improve on this, ECHO has now identified specific staff within its organisation who are on standby to carry out these tasks when necessary in the future.

5.94. The Commission, at ECHO's request, has already approved the principle of a new framework decision procedure for primary emergencies to allow a faster and more flexible response to such situations. This has now been implemented.

## THE COURT'S OBSERVATIONS

5.95. Due to slow procedures, ECHO contracts continued for longer than initially planned because they were launched late. This situation, in combination with the quick and unforeseeable return of the refugees in June 1999, has reduced the relevance and usefulness of some of the measures concerned. Thus, the regulatory and procedural framework had an adverse impact on the capacity of ECHO to respond quickly and effectively to the changing circumstances.

*European Agency for Reconstruction*

5.96. The Court assessed the efficiency of the European Agency for Reconstruction, for the year 2000 at the level of its organisational structure, its operational budget management as well as its programme implementation in Kosovo. It also examined whether matters affecting economy or the effectiveness of the interventions were not neglected.

5.97. The Court concludes that in 2000 the efficiency of the Agency's administration as well as its budget management was high. It managed to achieve most of the ambitious objectives set for its first year of activity in the fields of energy, housing, transport and agriculture. At the end of 2000 more than 90 % of the funds committed before December 2000 were contracted and more than half of the committed funds for operations were paid. It tried to pay attention to the principles of both efficiency and economy. By applying the rules in force in a very flexible way the Agency managed to obtain lower prices and stimulated the regional economy.

5.98. The Court recommends to the Agency not to disperse its efforts but to continue to focus its human and financial resources on the latest reconstruction priorities. It also urges the Commission, which is funding the United Nations Interim Administration in Kosovo (UNMIK) EU pillar in charge of Kosovo reconstruction, to take much more action to set up a policy framework and a strategy to ensure the sustainability of EU-financed investments in Kosovo, which was not ensured in the prevailing circumstances.

## COMMISSION'S REPLIES

**5.95.** The Commission does not believe that delays in using funds in 1999 materially reduced the relevance or usefulness of Commission financed activities; indeed EUR 53.6 million of humanitarian aid was already contracted by April 1999. Given the complexity of the situation the Commission does not consider that the delays were unreasonable or that any other alternative was available.

**5.97.** The Commission welcomes the Court's praise for the Agency's efficient administration and budget management. Clear goals and a focus on the expected outputs enabled the Agency to achieve its objectives.

**5.98.** The Commission shares the Court's opinion that the Agency should continue to focus its efforts on key sectors in accordance with needs on the ground and the 'CARDS' Regulation.

The Commission also shares the Court's view on the need for a policy framework and long-term strategy. The Commission will pursue the issue of developing a sustainable policy and regulatory framework with UNMIK and the provisional self-government institutions which are to be elected in Kosovo.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*Tacis cross-border cooperation programme*

5.99. The Tacis cross-border cooperation programme was launched in 1996 on the initiative of the European Parliament and covers regions in Russia, Belarus, Ukraine and Moldova which border on the European Union (Finland) or the 'Phare' countries. The programme also reflects the demand of the 1994 Essen European Council for intensified cross-border cooperation in Central and Eastern Europe to promote regional cooperation and good neighbourliness.

5.100. A total of 132,5 million euro was committed to the programme over the period 1996 to 2000, which represents approximately 5 % of the total Tacis budget. According to the Commission's main policy document on the subject, the objectives of the programme are:

- (a) to promote economic and social development in the border regions by supporting sustainable projects to reduce the risk of stability in the region being undermined by the very significant difference in living standards on either side of the border. In particular, the programme should assist the border regions to overcome their specific development problems, which stem from being on the periphery of their national economies.
- (b) to finance projects which have a cross-border impact and which are supported by communities on both sides of the border, such cooperation being considered essential to ensure sustainable development.
- (c) to finance as a priority projects with a demonstrable local or regional commitment.

5.101. Although these objectives are similar to the objectives of the Phare cross-border cooperation programme, the Commission has not set up for the Tacis CBC programme the coordinating mechanisms it used for the Phare CBC programme to promote cross-border cooperation. In particular, the Joint Programme and Monitoring Committees established by the Commission to provide a forum at regional level for Member States and Phare countries to identify projects of common interest have not been set up for the Tacis CBC programme to encourage dialogue between Phare and Tacis countries.

**5.101.** *The cross-border cooperation started later than the main Tacis programme and the Phare CBC programme and it has relatively limited resources. At the beginning new procedures and practices had to be set up, and the impact of the programme will not be evident until some years after its start-up.*

*The Tacis CBC programme should be distinguished from the corresponding Phare CBC programme. Even if the basic objectives of the Tacis and Phare CBC are similar the political context is completely different, the latter being part of*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

pre-accession assistance geared towards smoothing the transition from Phare to future Interreg programmes. The beneficiaries of the Tacis CBC programme are NIS countries whose relationship to the EU is still developing. These different starting points are reflected in the decision-making procedures and management structures and the resources allocated to the two programmes.

Although no regional cross-border committees have so far been set up between Phare and Tacis, a seminar is to be held in St Petersburg in November which will be attended by representatives of all parties involved in Tacis CBC and Phare participants. At the seminar the advantages of the cross-border committees operating between Finnish and Russian partners will be presented with the aim of generating similar arrangements on the Tacis/Phare borders.

5.102. The overall conclusion was that the Tacis cross-border cooperation programme is an instrument which can play a useful role in addressing issues relating to the establishment of a new eastern border for the European Union following the next accession and giving a more concrete expression to the Northern Dimension policy. However, its impact over the first five years of the programme has been limited, not only because of implementation delays but also because of the very limited funding available, the fact that no framework for cross-border dialogue at the project programming stage was set up, the failure to provide matching funding for the Phare eastern border regions, and the insufficient priority given to projects that address the fundamental objective of the programme: namely, raising the living standards of the populations in the beneficiary regions.

#### *Common Foreign and Security Policy (CFSP) management*

5.103. The Court of Auditors has assessed the evolution of the conditions governing the implementation of expenditure under the Common Foreign and Security Policy for the period from 1997 to 1999. The average amount was 35 million euro per year during the period 1997 to 2000.

5.104. Title V of the Treaty of the European Union lays down the provisions establishing and governing the Common Foreign and Security Policy.

5.105. The Special Report focuses on joint actions, which 'shall address specific situations where operational action by the Union is deemed to be required' (Article 14) as well as the implementing decisions of common positions which 'shall define the approach of the Union to a particular matter of geographical or thematic nature' (Article 15).

**5.102.** The Commission takes the view that in December 2000 it was too early to make an assessment of the full impact of the CBC programme. Tacis CBC beneficiary countries receive cross-border aid through the Tacis regional cooperation and national programmes. The CBC budget, including the budget line for special action for the Baltic region, has remained unchanged despite an overall decline in the Tacis budget, so the CBC share of the total has actually increased. The programme's budget, which the Court finds limited, is ultimately decided by the Budgetary Authority.

*The Phare framework for cross-border dialogue and the whole Phare CBC regulation are related to the pre-accession process.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.106. Despite a number of changes in the Treaty on European Union, the Commission's role in determining the financial, legal and operational arrangements is still not clear. Depending on the action, either the Commission or the Council defines the arrangements for its implementation. In practice, this complicates day-to-day management both in the field and at headquarters level.

5.107. Criteria were laid down by the end of 1999 on the sourcing of Community funding for CFSP actions but exceptions were left open for so-called 'borderline cases'. Furthermore, the arrangements for contributions in kind and for the sharing of costs between other donors and the Union have not been adequately laid down.

**5.106.** As far as the CFSP's legal framework is concerned, Article 14 of the EU Treaty provides that joint actions 'shall lay down their scope, ... means... and the condition for their implementation'. However, the Commission retains certain discretionary powers over the arrangements for implementation under Article 274 of the EC Treaty. In any case, despite the somewhat vague wording of Article 18 of the EU Treaty, in practice a fairly logical division of labour is emerging: the Presidency has overall responsibility for achieving the objectives of the Joint Action, assisted by the Secretary General/High Representative (SG/HR), while the Commission is responsible for the proper execution of the actions, preparing and negotiating contracts with the implementing agencies and monitoring implementation as reported to the Commission.

**5.107.** The criteria adopted by the Committee of Permanent Representatives in November 1999 on the financing of an action under sub-section B8 have been followed except in two cases. Both of these were financed under budget title B8 because the implementing body was the Western European Union, a military organisation, which could not have received financing under the First Pillar budget lines. The cases in question are: the anti-personnel landmine operation in Croatia (Weudam), due to terminate in November 2001, and the operation to re-establish a viable police force in Albania (MAPE), which has since been terminated. Certain measures to support the Albanian police which are not linked to the WEU as such will be continued under the CARDS Regulation (Community Assistance for Reconstruction, Development and Stabilisation). The Commission refers to the interpretation given in point 32 regarding the need to use Article 17 for actions implemented by the WEU.

During the observation period covered by the Court's audit (1997 to 1999), there were cases where information on the contributions of other donors was lacking. Political and management considerations mean it is not always possible or desirable to flag exactly the amounts of each contributor. Pledges are often solicited in order to create the political momentum required for a specific project, but in the light of political developments on the ground they may not subsequently be honoured if the other parties are geographically or politically less concerned than the EU. It might nevertheless be in the Union's interests, for imperative reasons of conflict prevention or political stabilisation, to continue the project regardless of a shortfall in contributions.

There is, however, a clear improvement on this issue in 2000 and 2001 since contributions in kind are indicated in the Financial Statements.

## THE COURT'S OBSERVATIONS

5.108. The time lapse between the Council Decision and the first payment was considerable in the period 1997 to 1999, i.e. 173 days on average. This indicated that the speed of implementation for this type of action was rather low.

## COMMISSION'S REPLIES

**5.108.** Tailor-made solutions often need to be drawn up for the implementation of Joint Actions. Standard contracts can rarely be applied, which means that negotiation and preparation of contracts to implement Joint Actions normally takes more time than in the case of grants to NGOs or international organisations.

Furthermore, at the end of 1997 the Commission underwent internal reorganisation, separating management of the preparatory phase and the implementation phase of the project cycle between two different Directorates-General. This situation lasted until the end of 2000 and meant the time between the Council Decisions and the first payments was longer. The reunification of the project cycle in one unit at the beginning of 2001 is expected to shorten these delays.

5.109. Contracting was very complex in a number of actions as a result of an accumulation of extensions and other adjustments, to the extent that a proper follow-up of the financial situation was made very difficult.

**5.109.** To ensure a timely reaction to political events the Council usually adopts joint actions with a short time frame. CFSP actions are easily affected by political and security developments necessitating adjustments or extensions to the existing action. Minor adjustments can be made by means of contractual amendments but significant changes to the mandate or renewals of the mandates should generally lead to new contracts. This is the most practical and effective approach, even if it makes follow-up more difficult.

5.110. For remuneration and salary-related costs and allowances for Special Representatives and office staff, arrangements are not laid down or not applied unambiguously.

**5.110.** A significant effort to establish clear criteria was made with the adoption of two Communications in 1997 and 1998, defining the position of the Special Representatives. The 1998 Communication stipulates uniform treatment for people seconded to the offices of EU Special Representatives whose mandates originate from after 1998. These rules have been applied to those Special Representatives whose mandates originate from after the two Communications. In any case, from 2001 onwards the remuneration and salary-related costs and allowances for Special Representatives are financed from the administrative budget of the Council.

The Commission acknowledges that for office staff the situation is indeed somewhat ambiguous and might need to be addressed in a more coherent way. However, the indirect application of 'market rules' has so far generally produced the most cost-effective results.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

5.111. Reporting is often late and irregular, and reports in some cases present insufficient information. This forms a weak basis for any evaluation. The limited frequency of financial reports in particular forms a serious constraint to the Commission in supervising projects on a systematic basis.

**5.111.** *Financial and technical reporting by beneficiaries has indeed sometimes been inadequate and should in future be improved by closer and more interactive follow-up. The average project lasts for one year, and normally requires two financial reports. These must be submitted prior to payment, thereby allowing adequate and regular control.*

*Responsibility for evaluation depends on the nature of the action. While financial and technical evaluation fall to the Commission, sometimes a specific assessment needs to be made of the political desirability of continuing a particular operation. Such an evaluation is implicitly carried out by the Presidency and the Council working groups whenever an action is extended. This is also the main reason why the duration of most actions is so short.*

*Two audits were completed in 1999, one for the OSCE in Bosnia Herzegovina and one for the EC monitoring mission (known as EUMM since 1 January 2001). Another audit was conducted in 2001 on the three EU Special Representatives and a fourth is planned for the Joint Action in Cambodia, which has already been the subject of an evaluation by an outside expert.*

*Each Joint Action is different and not all of them require an audit. Some can well be evaluated on the basis of a final report, especially when a Commission delegation is involved in the implementation. However, the Commission has recently made efforts to improve management in these respects.*

*In general, greater attention has been paid to the monitoring and evaluation headings in the financial statements, and there are plans to organise more inspections in the field.*

*In its remarks on budget line B8-0 1 5 (preparatory actions) the Commission also proposed under the 2002 preliminary draft budget that the Commission should be able to organise evaluations and audits on its own initiative where necessary.*

## THE COURT'S OBSERVATIONS

5.112. The question of the definition of administrative versus operational expenditure is still not solved: although a budget heading was introduced from 1998 under subsection B8 to cover preparatory costs (which were previously regarded as administrative costs), the Council decided on 30 March 2000 that the costs of EU Special Representatives should be considered to be administrative expenditure, to be covered by the budget of the Council's General Secretariat.

## COMMISSION'S REPLIES

5.112. As the Court notes, one of the major points of concern it raised in its earlier report has been solved with the classification of preparatory costs as administrative.

The Court's comment is valid regarding the contributions in kind by the Council and the Commission to the offices of EU Special Representatives.

In December 2000 the Commission drew the attention of the Permanent Representatives' Committee in writing to certain problems linked to the practical implementation of the Council Decision of 30 March 2000 on EU Special Representatives. While stating its support for the aim of the new guidelines, i.e. to place the EU Special Representatives clearly under the authority of the SG/HR, it called for a better definition of administrative and operational expenditure.

In 2001, the Commission launched an audit of EU Special Representatives which it hoped would help arrive at such a definition.

5.113. On the basis of its audit conclusions, the Court makes the following recommendations:

- (a) the European Parliament, the Council and the Commission should adopt, at an interinstitutional level, clear operational principles and arrangements with regard to the Commission's role in the implementation of the CFSP;
- (b) the financing of the CFSP actions should be managed in a more transparent manner;
- (c) the Commission should launch an enquiry into the causes of long delays and reassess the action as well as the partner for the management of the action;
- (d) the Commission should amend contracts retroactively or extend them only in cases of force majeure. Certain practical measures facilitating the smooth implementation of actions should be sought;
- (e) the Council and the Commission should establish clear rules on remuneration and salary-related costs;
- (f) arrangements should be laid down for adequate reporting, audit and evaluation.

5.113. The Commission welcomes the proposal by the Court for clear operational principles and arrangements with regard to the Commission's role in the implementation of the CFSP, and fully supports the request for more transparency. Improvements can be made, notably by the rationalisation of the number of budget articles in the preliminary draft budget (PDB) 2002 as proposed by the Commission.

The Commission has already reacted, adopting the new management structure and considering further simplifications, including a decision by the College empowering the Commissioner in charge of external relations to take the required financing decisions. But sometimes delays are unavoidable. In any case they are not always a sign of bad management; they may reflect thorough contract preparation designed to avoid problems during subsequent implementation, and demands for better reports from the implementing agency.

The Commission refers to its reply under point 5.109 where it concluded that minor adjustments should be addressed by contractual amendments whereas significant changes to the mandate or renewals of mandates should generally lead to new contracts.

Clear rules on remuneration and salary related costs were adopted for the EU Special Representatives in 1998. As regards other staff, the Commission acknowledges that for office staff the situation is indeed somewhat ambiguous and might need to be addressed in a more coherent way.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

The Commission refers to its reply under point 5.111 where it concluded in particular that financial and technical reporting by beneficiaries should be improved by closer follow up. Reports are obligatory prior to payment, but it would also be possible for the Commission to initiate evaluations and audits as necessary, as proposed in the Commission's preliminary draft budget 2002 in the budgetary remarks for budget line B8-0 1 5.

*Audits are not always needed for each Joint Action, especially when a Commission delegation is involved in the implementation. The Commission has recently made efforts to improve management in these respects.*

### *International fisheries agreements*

5.114. The Court examined the management by the Commission of the international fisheries agreements, and notably the extent to which their objectives were being clearly defined and ultimately achieved. The Court's audit related to the five most significant agreements in terms of the amounts charged to the Community budget (92 % in 1999). The Court's main observations are set out below.

5.115. The Commission is still to set in place a system that enables continuous monitoring and in-depth examination of the cost-effectiveness of the international fisheries agreements. These measures should enable it to assess the extent to which the objectives of these agreements are being achieved (market supply, catch opportunities, restructuring, jobs).

— It is up to the Commission to define performance indicators and criteria for these agreements, so that their effectiveness can be gauged.

**5.115.** The Commission agrees that there are weaknesses in the system for monitoring and evaluating the international fisheries agreements that need to be addressed. An important step was taken in 1999 when the results of an outside evaluation study were forwarded to the Council for discussion. It would seem that this study was also very useful to the Court when drawing up its Special Report. Furthermore, the Commission has improved the preparatory arrangements for the negotiation of new protocols by drawing up specific assessment reports containing, among other things, data on the state of stocks, on catch levels, on the use of fishing possibilities and on the amounts allocated to targeted measures, research, control and technical aspects. These reports are available to the Council and the European Parliament. Despite the progress that has been achieved, further improvement is needed. On the question of ongoing monitoring, the Commission would like to point out that the data from the Member States needed for determining whether objectives have been attained is very often lacking. The Commission hopes that the adoption on 14 March 2001 of the implementing rules for the 'Control Regulation' will help ensure more regular and fuller information from Member States, and in particular allow better monitoring of actual catches under the various agreements. In addition, in accordance with the Financial Regulation rules, the Commission intends to launch a new external evaluation study within 2 to 3 years. In the light of the conclusions of the debate on the Green Paper on the future of the Common Fisheries Policy, and as part of the administrative reform now under way, the Commission will endeavour to establish criteria and performance indicators for the agreements.

## THE COURT'S OBSERVATIONS

5.116. The catch opportunities that the international agreements afford to Community fishermen in third country waters are not always exploited to the full. The Community has therefore paid financial compensation for fish that have only existed on paper.

- The Commission is called upon to ensure, first and foremost, that fishing opportunities are actually exploited.

5.117. The Court noted a lack of consistency and lack of coordination between these international agreements and the structural facet of the common fisheries policy.

- The Commission could, in particular, ensure that there is consistency between the restructuring objectives of these agreements and those of the Structural Fund, for example in the financing of new vessels.

5.118. Several fisheries agreements have both a commercial aim and development-aid aims. The fact that these aims are intertwined makes it difficult to assess the agreements and contributes to the lack of clarity in the sharing of responsibilities between the Community and the third countries.

- By clearly defining the various objectives of the fisheries agreements, the Commission would be able to assess the advantages and costs of these agreements and compare them on an equivalent basis.

## COMMISSION'S REPLIES

5.116. The Court refers to the agreements with Greenland and Senegal.

Article 1(2) of the new Protocol to the agreement with Greenland sets out the catch possibilities available to Community vessels for the period 2001 to 2006. These have been fixed on the basis of scientific assessments and historical catches. In the case of Senegal, the Commission has negotiated a new category of fishing in the protocol for 1997 to 2001, in the light of the negotiating directives it received from the Council. The Commission, finding that Member States occasionally overestimate their needs in terms of fishing opportunities, emphasises to them each time negotiations take place that they should keep their requests at a level which they can use up in full.

5.117. The Commission is aware of the potential for conflict between the structural and international aspects of the common fisheries policy. Together with the Member States, it will address this question in the course of the debate on the future of the common fisheries policy after 2002, in order to achieve greater consistency between the different objectives.

5.118. The fisheries agreements, which to start with were purely commercial, have gradually introduced aims for the development of the fishing industry in the countries concerned. This approach reflects, among other things, concern to ensure consistency between the Community's fisheries policy and agreements and development policy. Funding for measures to develop fisheries in the developing countries comes from the financial instruments for development cooperation (EDF and budget headings). Fisheries cooperation measures such as those contained in certain bilateral fisheries agreements (targeted measures) receive funding under the only budget heading to which fisheries agreements may be charged (heading B7-8 0 0 0) and full details are given in the terms of the agreements. Since the adoption of the conclusions of the October 1997 meeting of Fisheries Ministers the targeted measures have been extended to encourage the introduction of measures to ensure more responsible exploitation of fishery resources, in particular in the area of evaluation and the surveillance and control of fishing activities. The principal objective of the fisheries agreements concluded with non-member countries is to safeguard fishing opportunities, which themselves create jobs in the areas dependent on fishing. The conclusions of the October 1997 meeting of Fisheries Ministers provide that aspects which cannot be quantified, such as the Union's political relations and the strategic importance of the presence of the Community fleet in non-member countries, must also be taken into account.

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5.119. The management of the fisheries agreements is impaired by the weak or inappropriate application of certain provisions, and by the fact that they do not provide for the mandatory exchange of information.

— It would be appropriate for the Commission to reinforce the legally-binding nature of the agreements and improve the monitoring of them, for example by inserting provisions concerning control or by effecting payments according to the progress made. It should also review certain unjustified practices concerning the systematic unloading and reloading of frozen fish.

5.120. The Court's audit identified weaknesses in the implementation and in the monitoring of the checks carried out by the Commission and by the Member States.

— The Commission should plan its control activities and follow up previous findings more closely. It should also, in tandem with the Member States, lay down guidelines for the detailed rules applicable to the checks which they conduct.

**5.119.** In order to strengthen the legally binding nature of fisheries agreements and improve their monitoring, the Commission, when negotiating new protocols, seeks to include a requirement on the compulsory exchange of scientific information. In addition, the majority of fisheries agreements provide that where conservation or other measures affecting the fishing activities of the Community fleet are adopted by the authorities of the other country, the terms of the protocols and technical annexes, including the financial provisions, may be adjusted in consequence. In addition, in the case of targeted measures for example, reporting requirements have been included in new protocols since the October 1997 Council meeting of Fisheries Ministers. As regards landings and reloading under the agreement with Morocco, it should be noted that, although the terms of the agreement on this matter were complied with, the Commission had made known its intention of revising the clauses concerning landings during the negotiations for the new protocol, which proved unsuccessful. With a view to sound financial management and the protection of the Community's financial interests, the Budget Directorate-General, the European Anti-fraud Office (OLAF) and any other departments concerned will be involved from the start of the preparations for negotiations and will be asked to attend meetings before and during the negotiation of new protocols.

**5.120.** Council Regulation (EEC) No 2847/93 sets out the general obligations of both the Member States and the Commission regarding monitoring, inspection and surveillance of fishing activities in Community waters and Community fishing vessels operating beyond those waters. Specific obligations on these matters are contained in fisheries agreements and regulations laying down arrangements conceding regional fisheries organisations. The Commission draws up inspection priorities before the start of the fishing year, and programmes are drawn up for its inspectors as and when fishing proceeds. Each inspection assignment is carefully prepared. However, once on board, Commission inspectors may only observe the control operations carried out by the Member States and verify that they are being carried out in accordance with the agreed rules. The Commission has taken a number of steps in recent years to improve control of fisheries and considerable progress has been achieved. The Commission is well aware of the continuing weaknesses and will take further action to address them. As regards following up previous findings, the Commission examines all alleged breaches noted in the inspection reports. A decision is then taken whether to exchange information with the Member States or initiate legal proceedings. As part of the 2002 review of the common fisheries policy, the Commission and the Member States will together look at ways of improving inspection by the Commission and control by the Member States.

CHAPTER 6

**Pre-accession aid**

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## INTRODUCTION

6.1. This new chapter deals with the instruments for countries preparing for accession to the European Union, for which a separate financial perspective heading exists from 2000 onwards. It includes observations on budgetary management <sup>(1)</sup> and on the setting up of the two new accession instruments (ISPA and Sapard), because of their importance in terms of the future expenditure foreseen by the financial perspective for 2000-2006 (see **Table 6.1**). The Court reported the results of its earlier audits in respect of the existing instrument, Phare, in the 1999 Annual Report and in its Special Reports 5/99 and 16/2000.

**Table 6.1 — Financial perspective for the period 2000-2006 for pre-accession aid (2000 prices)**

(Mio EUR)

	2000	2001	2002	2003	2004	2005	2006	Total 2000-2006
Agriculture	529	540	540	540	540	540	540	3 769
Structural pre-accession instruments	1 058	1 080	1 080	1 080	1 080	1 080	1 080	7 538
Phare (Candidate Countries)	1 587	1 620	1 620	1 620	1 620	1 620	1 620	11 307
Pre-accession strategy for the Mediterranean Countries			20	20	20	19	19	98
<b>Total</b>	<b>3 174</b>	<b>3 240</b>	<b>3 260</b>	<b>3 260</b>	<b>3 260</b>	<b>3 259</b>	<b>3 259</b>	<b>22 712</b>

6.2. In December 1997, the Luxembourg European Council endorsed the reinforced pre-accession strategy,

<sup>(1)</sup> The Court has reviewed the information presented by the Commission in Volume I of the Revenue and expenditure account. The purpose of this Volume is to provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available, as well as between the appropriations finally available and those utilised. This review did not seek to provide assurance as to the reliability of its contents. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanations that might be considered misleading.

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which was part of the Agenda 2000 communication of the Commission (2). In addition to an increase in the funds for the existing Phare (3) programme, two new instruments were foreseen: ISPA (Instrument for Structural Policies for pre-accession) and Sapard (Special Accession Programme for Agriculture and Rural Development).

6.3. The purpose of these programmes is to contribute to the preparation for accession to the European Union of the ten Central and East European Candidate Countries (4) in the areas of environment and transport (ISPA) as well as in the area of agricultural and rural development (Sapard). The two new instruments should help the candidate countries to align their law as quickly as possible on the Community *acquis* and to become familiar with its different agricultural and structural instruments, preferably before accession. New management and control structures and new rules were created for each of these programmes. The addition of these new instruments meant that pre-accession aid effectively more than doubled from 1999 to 2000. Their budget amounts to 11 000 million euro for the period 2000-2006 (5).

6.4. ISPA and Sapard have some features in common with the instruments in support of the Candidate Countries (like Phare) and some others that are to be found in support of the existing Member States. ISPA has similarities with the Cohesion Fund, while for Sapard, characteristics of Structural Funds and EAGGF Guarantee are combined.

6.5. The Court adopted an opinion (6) in October 1998 on certain proposals for regulations within the Agenda 2000 framework put forward by the Commission in July 1997, including those for ISPA and Sapard (7). These were approved in June 1999, one and

6.5. Any preparations made towards mobilising financial resources before the relevant Council Regulations are adopted could lead to confusion and constitute a waste of effort on the part of, *inter alios*, the applicant countries. The second half of 1999 was devoted to preparing the legal instruments for the mobilisation of financial resources (Regulation (EC) No 2759/1999) and the Commission communication adopted on 26 January 2000, which resulted in Regulation (EC) No 2222/2000.

The Council did not take up the Court's proposal aimed at integrating the three pre-accession instruments in a single Regulation. Instead, the Berlin Summit of 24 and 25 March 1999 decided on separate Regulations and financial allocations for each instrument, as well as a coordinating Regulation.

This option reflects the scenario that applicant countries can expect upon accession, with specific policies and instruments

(2) COM(97) 2000 final of 15 July 1997.

(3) Council Regulation (EEC) No 3906/89 (OJ L 375, 23.12.1989), as last amended by Council Regulation (EC) No 1266/1999 (OJ L 161, 26.6.1999).

(4) Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia and Slovak Republic.

(5) Heading 7 — pre-accession aid of the financial perspective following the agreement of the European Council in Berlin in March 1999.

(6) Opinion No 10/98, OJ C 401, 22.12.1998.

(7) Regulations (EC) No 1267/1999 and (EC) No 1268/99, OJ L 161, 26.6.1999.

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a half years after the Luxembourg Council had endorsed these two new pre-accession instruments in December 1997. The Court:

- (a) had proposed to use the year 1999 to prepare for the mobilisation of financial resources;
- (b) had pointed out that the broad outlines of the pre-accession aid were virtually indiscernible in the proposed legislative framework, owing to the complexity and diffuseness of the latter;
- (c) had stated that the Phare programme, although radically reworked, had not been the subject of any proposal for amended legislation that would have made it possible to integrate it with the new instruments. The Court considered that a single regulation would have been the most effective way of fostering the desired unitary approach.

6.6. In view of the importance of these new instruments and the newly established rules and structures, the Court decided to perform an audit with the objective of assessing whether the Commission managed the setting-up of the new instruments successfully and of identifying at an early stage of implementation those areas where improvements are needed.

6.7. During its audit, the Court identified certain problems concerning the rules governing expenditure on the ISPA and Sapard programmes. In addition, the regulations applicable to these two programmes contain derogations from the Financial Regulation (see also paragraph 0.9), which were not adopted on the basis of Article 279 EC. The Court will make observations on this subject after consulting the Community institutions concerned.

6.8. Notwithstanding the problems mentioned in the previous paragraph, the Court has audited the Commission's management as it was carried out under the legal framework actually applied by the Commission. This is the subject of the following paragraphs.

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such as the Structural Funds, the Cohesion Fund, the CAP and the rural development assistance scheme, including the two sections of the EAGGF. The Court proposal for a single Regulation would probably undermine the institution-building objective of the pre-accession strategy, particularly in the case of Phare.

*The Phare programme was amended by Regulation (EC) No 1266/1999 in order to ensure that it was consistent with Sapard and ISPA.*

**6.7.** *In the Commission's view, the ISPA and Sapard Regulations do not derogate from the Financial Regulation. They were adopted on the basis of Article 308 of the Treaty. The Commission will readily consult with the Court in this connection.*

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6.9. Article 8, (1)(a) of the ISPA Regulation provides that 'commitments [...] shall [...] be effected in annual instalments'. This provision effectively extends the practice, already provided for in the Structural Funds Regulation, whereby the Commission takes spending decisions and concludes financing memoranda but only charges to the commitments budget a part of the obligation effectively entered into. The Court has frequently criticised this, most recently in its opinion on the recasting of the Financial Regulation (8), where the Court stated that it considers that such provisions negate the essential purpose of differentiated appropriations and of a commitments budget. Accordingly, the proposal for the Financial Regulation should be amended either to prevent such practices or to provide for a payments budget only, without commitment appropriations.

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6.9. The provisions on annual instalments of appropriations are governed by a Council Regulation which takes over the terms used for many years in the Structural and Cohesion Funds. The Court's position on this matter is well known to the Commission, which has already put forward its arguments on numerous occasions. The specific provisions proposed by way of an amendment to the Financial Regulation should also consolidate rules applied under all the structural instruments. Annual instalments allow the Commission to carry out a broader investment programme by implementing a large number of projects in tandem rather than committing in one year large amounts which will mostly remain unused in the early years because commitments cannot be turned into payments until there is real progress on the ground.

## BUDGETARY MANAGEMENT

6.10. The new heading 7 of the financial perspective includes, under Title 7-0 of the General Budget, the appropriations set aside for the new preaccession instruments (Sapard and ISPA programmes), as well as those authorising expenditure viewed to date as external aid (the PHARE programme). The pre-accession strategy for the Mediterranean countries (chapter B7-0 4) remains under heading 4.

6.11. Responsibility for the Phare Programme was transferred during the financial year 2000 from the Joint External Relations Service (SCR) to the Enlargement DG. The Commission divided responsibilities for the ISPA and Sapard programmes between the Directorates General for Enlargement (DG ELARG), Regional Policy (DG REGIO) and Agriculture (DG AGRI).

6.12. **Table 6.2** gives an overview of the budgetary implementation for the pre-accession instruments in the year 2000. After having been reduced by one quarter, and in the absence of any payments for projects, the payment appropriations for the Sapard instrument could

6.11. Responsibility for the full Phare project cycle was concentrated in DG ELARG in the year 2000. Previously, DG ELARG had been responsible for programming and the SCR for the rest of the project cycle.

6.12. Payment of sapard appropriations may go ahead only after the commission has delegated the management of programmes to accredited paying agencies. None of the applicant countries was able to obtain such delegation in 2000, which prevented payments from being made.

The use of payment appropriations under ISPA is governed by strict implementing conditions which are either general in scope (setting up of the national structures defined in the memoranda of understanding) or specific to individual projects. The main challenge in 2000 was to use commitment

(8) Paragraphs 29 to 31 of the opinion.

Table 6.2 — Pre-accession aid — Financial perspective heading: Pre-accession aid

(Mio EUR et %)

		Financial perspective ceilings	Budget changes		Implementation of the budget				
			Initial appropriations <sup>(1)</sup>	Final appropriations available <sup>(2)</sup>	Appropriations utilised	% of final available appropriations	Appropriations carried over to 2001	% of final available appropriations	Appropriations cancelled
Agriculture (B7-0 1 0)	CA		519,1	528,9	528,9	100,0	0,0	0,0	0,0
	PA		190,1	140,1	0,0	0,0	140,1	100,0	0,0
Agriculture (B7-0 1 0 A)	CA		9,9	0,1	0,0	0,0	0,0	0,0	0,1
	PA		9,9	9,9	0,0	0,0	0,0	0,0	9,9
Total B7-0 1	CA		529,0	529,0	528,9	100,0	0,0	0,0	0,1
	PA		200,0	150,0	0,0	0,0	140,1	93,4	9,9
Instrument for structural policies for pre-accession (B7-0 2 0)	CA		1 039,0	1 046,4	1 005,0	96,0	41,2	3,9	0,1
	PA		226,0	171,0	2,5	1,5	0,0	0,0	168,5
Instrument for structural policies for pre-accession (B7-0 2 0 A)	CA		19,0	11,6	11,3	96,8	0,0	0,0	0,4
	PA		19,0	4,0	0,0	1,0	0,0	0,0	4,0
Total B7-0 2	CA		1 058,0	1 058,0	1 016,3	96,1	41,2	3,9	0,5
	PA		245,0	175,0	2,5	1,5	0,0	0,0	172,5
Economic aid to the associated countries of central and eastern Europe (B7-0 3 0)	CA		1 344,3	1 358,4	1 357,1	99,9	0,0	0,0	1,3
	PA		1 035,2	1 015,2	1 010,7	99,6	0,0	0,0	4,4
Economic aid to the associated countries of central and eastern European (B7-0 3 0 A)	CA		73,8	59,7	48,8	81,7	0,0	0,0	10,9
	PA		73,8	33,8	1,5	4,4	0,0	0,0	32,3
Cross-border cooperation (B7-0 3 1)	CA		159,0	159,0	159,0	100,0	0,0	0,0	0,0
	PA		140,0	200,0	187,8	93,9	0,0	0,0	12,2
Cooperation with the associated countries of central and eastern Europe under the Euratom Treaty (B7-0 3 2)	CA		2,7	2,7	2,1	80,9	0,0	0,0	0,5
	PA		2,1	2,1	0,8	41,0	0,0	0,0	1,2
Total B7-0 3	CA		1 579,7	1 579,7	1 567,0	99,2	0,0	0,0	12,7
	PA		1 251,0	1 251,0	1 200,9	96,0	0,0	0,0	50,1
Total heading 7	CA		3 166,7	3 166,7	3 112,2	98,3	41,2	1,3	13,3
	PA		1 696,0	1 576,0	1 203,4	76,4	140,1	8,9	232,5
Pre-accession strategy for Malta (B7-0 4 0)	CA		0,0	6,0	6,0	100,0	0,0	0,0	0,0
	PA		0,0	0,8	0,0	0,0	0,0	0,8	100,0
Pre-accession strategy for Cyprus (B7-0 4 1)	CA		0,0	9,0	1,7	18,9	7,3	81,1	0,0
	PA		0,0	1,2	0,0	0,0	0,0	0,0	100,0
Total B7-0 4	CA		0,0	15,0	7,7	51,3	7,3	48,7	0,0
	PA		0,0	2,0	0,0	0,0	0,0	0,0	100,0
Total heading B7-0	CA	3 174,0	3 166,7	3 181,7	3 119,9	98,1	48,5	1,5	13,3
	PA		1 696,0	1 578,0	1 203,4	76,3	140,1	8,9	234,5
									14,9

<sup>(1)</sup> Budget finally adopted by the European Parliament on 16 December 1999 (OJ L 40, 14.02.2000).<sup>(2)</sup> Budget appropriations amended after taking into account supplementary and amending budgets and transfers, but not including appropriations carried over from 1999, appropriations resulting from the re-use of revenue, revenue resulting from third party contributions and other revenue corresponding to a defined purpose and appropriations made available again.

Source: 2000 revenue and expenditure account.

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be carried over. Those for the ISPA instrument had nearly all to be cancelled since the only payments made amounted to 2,5 million euro<sup>(9)</sup>. These were for purposes other than those explicitly covered by the ISPA Regulation. On the basis of Council Decision No 2000/474/EC<sup>(10)</sup>, the Commission decided in July 2000<sup>(11)</sup> to change the Community contribution to the Danube clearing project to budget headings B7-0 2 0 (ISPA), B7-0 3 0 (Phare) and B7-5 4 1 (Obnova).

6.13. The characteristics of the budgetary management of Heading 7 are very similar to those for Heading 4 (see paragraphs 5.2 to 5.18 for further details):

- (a) a heavy concentration of commitments at the end of the financial year, because 59 % of the 3 130 million euro committed in 2000 against title B7-0 was not committed until the month of December. To a large extent this was due to the late commitment of the ISPA and Sapard programmes, 33 % of the Phare programme having been committed in December;
- (b) the absence of any payment in respect of the Sapard and ISPA programmes had the effect of automatically increasing by 61 % the commitments outstanding against title B7-0. For the Phare programme, the increase in commitments outstanding was 18 %;
- (c) the month of December is characterised by a concentration of payments, representing 25,1 % of the year's expenditure, and
- (d) the absence of any utilisation of payment appropriations for administrative management expenditure initiated by the Commission, since only 3,2 % of the amounts set aside were actually used.

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appropriations in order to avoid losing them, given the enormous financial requirements of the applicant countries in the pre-accession phase. Some discrepancy between commitments and payments is quite normal in view of the scale of the investment projects assisted by ISPA. The next challenge will be to ensure that projects are carried out within the deadlines laid down in the financing agreements, and thus gradually use the payment appropriations available.

**6.13.** *The general observations concerning the management of Heading 7 do not differentiate between Phare, ISPA and Sapard.*

- (a) *Phare commitments in December 2000 represented 33 % (not 34 %) of the annual total.*
- (b) *The increase in the RAL for Phare — given the growth of the programme — represents an actual reduction in the number of years needed to absorb the RAL (in terms of either commitments or payments).*
- (c) *The national authorities send payment requests to the Commission when the conditions for triggering a payment are fulfilled. The Commission has no control over the time when the national authorities submit their payment requests. After checking them, the relevant departments carry out the payment as soon as possible*
- (d) *The Commission used the appropriations earmarked for the administrative management of measures in accordance with requirements. It should be noted that the statutory figure of 2 % of total appropriations constitutes an upper limit for technical assistance provided on the initiative of the Commission, and not an expenditure target. Although payments fell well short of the budgeted amounts, the bulk of unused commitment appropriations were made available through transfers to support other aspects of the instruments.*

<sup>(9)</sup> Another 42 000 euro was spent for consultants supporting DG REGIO in the appraisal process.

<sup>(10)</sup> OJ L 187, 26.7.2000, p. 45.

<sup>(11)</sup> Commission decision circulated under No C(2000)2297.

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## ISPA

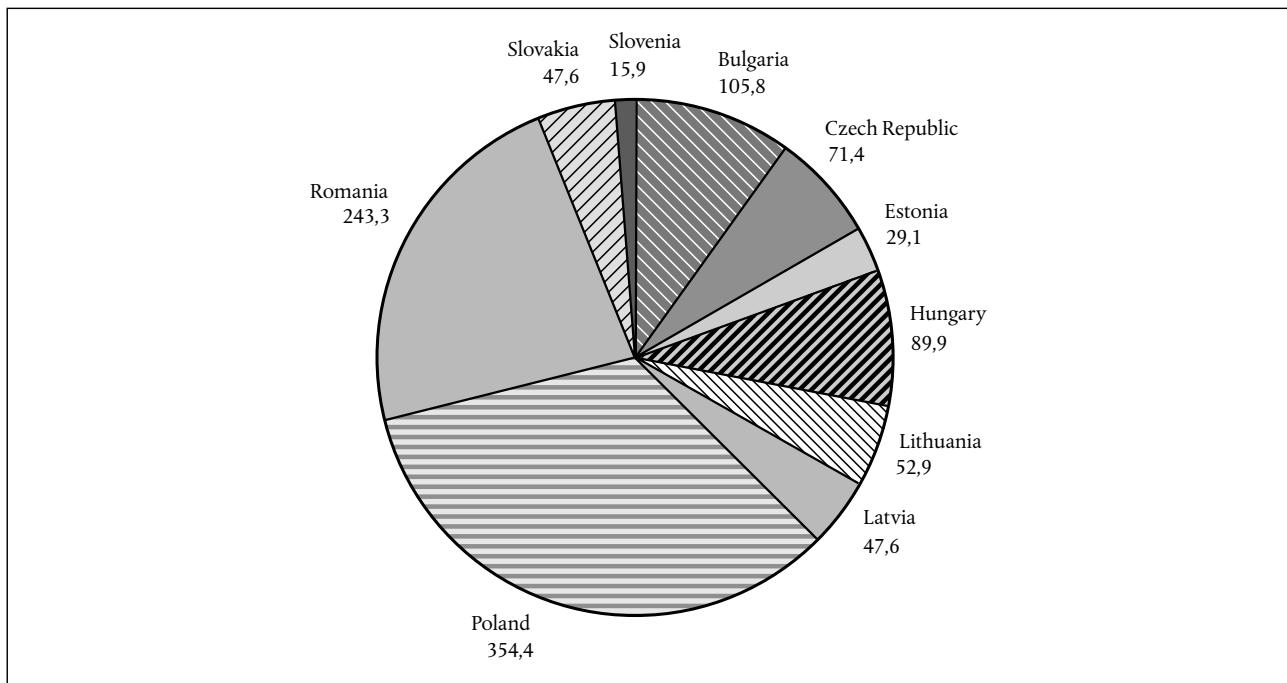
*Allocation of funds*

6.14. An indicative allocation between candidate countries was made, based on the criteria of population, gross domestic product (GDP) per inhabitant (12) and surface area (13) (see **Diagram 6.1**).

6.15. The allocation between candidate countries is expressed as a range (minimum and maximum receivable ISPA funds) in order to encourage them to propose high quality projects, and to provide some flexibility for the management of ISPA funding. Although the allocation can be adjusted to take account of performance in previous years, no performance indicators were established (14).

**6.15.** The 'performance indicator' used by ISPA is the ability of a country to produce and implement sound projects. If countries cannot do this, the Commission will commit less than the country's annual allocation. This practice was already followed in 2000.

**Diagram 6.1 — Allocation of ISPA funds for 2000 to candidate countries**



Average of the range of funds in million euro

(12) In purchasing power parities.

(13) Refer to Article 4 of Regulation (EC) No 1267/1999; Commission Decision of 7 March 2000, (OJ L 72, 21.3.2000, p. 21).

(14) The Court already identified this problem in its opinion No 10/98.

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*Commitments*

6.16. The 2000 commitments budget was used as shown in **Table 6.3**.

6.17. **Table 6.4** shows the division per country and per sector of the decisions and commitments made in 2000.

**Table 6.3 — Use of ISPA commitment appropriations in 2000**

(Mio EUR)

Purpose	Commitments
Commitments relating to 75 projects out of which 13 relate to technical assistance (TA) representing 8 million euro	997,5
Danube Clearing project	7,5
Use of framework contractors (selected for the Cohesion Fund) to assist the Commission (DG REGIO) in its project appraisal	4,2
Allocation to Heads of Delegations (DG RELEX) to finance extra staff to implement the deconcentration model established for the PHARE programme from 2001 onwards	7
<b>Total commitments</b>	<b>1 016,2</b>

Source: DG REGIO.

**Table 6.4 — ISPA Allocation**

(Mio EUR)

Candidate Country	Environment projects		Transport projects		Combined totals
	Total amount approved	Budget 2000	Total amount approved	Budget 2000	
Bulgaria	77,98	52,05	80,00	52,00	
Czech Republic	34,77	27,82	66,22	42,17	
Estonia	19,76	15,81	15,51	12,41	
Hungary	71,72	43,83	190,11	44,16	
Latvia	37,69	26,57	43,44	20,18	
Lithuania	22,75	18,20	42,55	34,04	
Poland	201,84	132,99	329,85	173,97	
Romania	181,38	120,60	346,88	118,63	
Slovakia	27,22	11,61	38,57	30,85	
Slovenia	14,19	11,36	10,35	8,28	
<b>Subtotal</b>	<b>689,30</b>	<b>460,82</b>	<b>1 163,48</b>	<b>536,70</b>	
<b>Total amounts approved</b>					<b>1 852,79</b>
<b>Total budget 2000</b>					<b>997,52</b>

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6.18. The Commission decisions taken in 2000 (75 approved projects) fix the maximum ISPA contribution at 1 863 million euro in total. In total 143 projects were presented to the Commission, which did not accept 19 and postponed 39 to be presented to the ISPA Management Committee within the coming years. The ISPA Management Committee itself gave a positive opinion for 85 projects. Out of these 85, the Commission took a decision in 2000 for 77 projects and committed 75 of them. According to the ISPA Regulation, the amount not committed in 2000 (865,5 million euro) is to be committed in the following years.

6.19. The Commission implements expenditure under ISPA on the basis of financing memoranda, to be drawn up between the Commission and the beneficiary countries for each project. Most of them, relating to the projects committed during the year, were signed at the very end of 2000.

*Delays in preparing the legal and administrative framework*

6.20. As ISPA is of a hybrid nature, situated between the existing support to candidate countries (like Phare) and the financial support to Member States (like the Cohesion Fund), it was quite a challenge for the Commission to prepare the legal and administrative framework in time. Following the 18 months taken after December 1997 to approve the ISPA Regulation it took a further nine months until March 2000 to decide on the allocation of assistance between the candidate countries. Despite these constraints, all national ISPA strategies and 75 projects were approved up until the end of 2000 thanks to the considerable effort of DG REGIO.

6.21. The preparation of ISPA legislation was a time-consuming and complicated exercise, since it involved various Directorates-General which had to find the right balance between Structural Fund and external aid rules.

**6.20.** *The Commission was already preparing the applicant countries in 1999: negotiation of strategies, project pipelines and procedures took place in tandem with the preparation of the legal/administrative framework from the very beginning in early 1999.*

*The allocation of assistance was given a favourable opinion by the ISPA Management Committee at its meeting held on 21 December 1999.*

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6.22. In addition to the time taken to adopt the Regulation, the following weaknesses were noted as regards the adoption of implementing rules:

- (a) the 'common rules for the eligibility of expenditure' (Article 7(7) of the ISPA Regulation) were adopted at the ISPA Management Committee meeting <sup>(15)</sup> of December 1999;
- (b) DG REGIO had to start with a very small team to prepare ISPA while in parallel the legal framework for implementation was developed. The ISPA directorate itself was not fully operational until April 2000;
- (c) an 'ISPA manual', which lays down implementing rules for ISPA <sup>(16)</sup>, was presented to the applicant countries in May 2000;
- (d) internal rules defining responsibilities and inter-service consultation procedures were formally agreed only in July 2000;
- (e) in contrast to the Cohesion Fund, the applicant countries are not allowed to use their own procurement rules, but must use those set out in the 'Practi

## COMMISSION'S REPLIES

**6.22.** *Implementing rules (annexes to the financing memoranda) received a favourable opinion from the ISPA Management Committee on 21 December 1999 and were introduced in the first financing memoranda agreed.*

- (a) *The eligibility rules were adopted six months before ISPA measures were presented to the Management Committee.*
- (c) *The ISPA manual concentrates on the implementation of the projects; the beneficiary countries had been informed of all aspects of project preparation in the assistance application forms at the beginning of 1999.*
- (d) *Interdepartmental consultations are governed by general rules in force at the Commission; the empowerment procedure in favour of the Commissioner responsible for Regional Policy, while very useful, is not strictly necessary to enable the Commission to take decisions (by either the written or the oral procedure).*
- (e) *The 'Practical Guide' to public procurement procedures revises and replaces — in the case of all external aid — a previous guide which applied in full to ISPA*

<sup>(15)</sup> This Committee is required to deliver an opinion on the draft of the measure to be financed by ISPA. It is composed of representatives of the Member States chaired by a representative of the Commission, and the EIB appoints a non-voting representative.

<sup>(16)</sup> Matters such as the use of interest earned on the envisaged advances of 20 % of the whole project amount are only treated in the ISPA manual and not in the financing memoranda. This underlines the importance of these rules.

## THE COURT'S OBSERVATIONS

calguide' (17). The ISPA Regulation has already had to be amended (18), because an exemption from the application of Title IX, Article 114 of the Financial Regulation (19), such as that provided for in the Phare Regulation, was not included in the initial ISPA Regulation. This caused problems with co-financing provided by the European Bank for Reconstruction and Development (EBRD);

- (f) internal administrative procedures were not clear: the confusing formulation in the ISPA Regulation caused long discussions on when commitments could be made and financing memoranda signed. As a result of administrative misunderstandings two Polish environment projects (20) of about 41 million euro, which received a favourable opinion from the ISPA Management Committee in October 2000, were not committed in 2000. Three financing memoranda (21) had already been signed by the Commission and the candidate country before the corresponding commitments were made. Consequently, part of the internal procedure for formal approval had to be restarted;
- (g) eight out of 10 Memoranda of Understanding (between the Commission and the Candidate Countries) on the utilisation of the National Fund (22), a pre-condition for disbursing ISPA funds from the Commission to candidate countries, were signed only at the end of 2000.

## COMMISSION'S REPLIES

*until the entry into force for ISPA of this new 'Practical Guide' (1 March 2001).*

*The Commission recognises that the ISPA Regulation fails to provide for the possibility of allowing for exceptions to Article 114 of the Financial Regulation. In order to remedy this shortcoming, the Commission submitted to the Council a proposal to amend the ISPA Regulation on 8 March 2001 (COM(2001)110).*

- (g) *The late signing of the Memoranda of Understanding did not delay implementation in the two countries concerned.*

(17) According to the financing memoranda, detailed procedures for tendering and contracts are laid down in the DIS (Decentralised Implementation System) manual established for Phare programmes. However, the part concerning works contracts has only been partially developed. The new 'Practical guide' was available at the beginning of 2001.

(18) COM(2001) 110 final.

(19) Bidders from countries other than Member States and recipient countries may exceptionally participate in tenders.

(20) 2000/PL/16/P/PE002 and 019.

(21) 2000/PL/16/P/PE001, PT002 and PT003.

(22) Single entity in each Candidate Country through which all Community funds granted under ISPA must be channelled.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

6.23. Although the ISPA Regulation does not require the approval of ISPA country strategies, the ISPA manual (23) considers it necessary. 60 % of the national transport and environment strategy papers were presented to the same ISPA Management Committee meeting as the corresponding projects, the others only some months before. In order to avoid further delays, strategies and projects had to be prepared in parallel. Although this required important efforts from the Commission, it is, however, not the most logical approach, since it entails the risk of not establishing the most pertinent strategies or not identifying the most suitable projects.

6.24. The delays in the decision-making process caused problems in some candidate countries where the part of the national budget relating to a particular project was approved and had to be used by starting the project (often prepared with Phare support) prior to the Commission approval. As a result, all expenditure incurred before the signature of the financing memorandum was ineligible.

#### *Lack of use of repayable assistance*

6.25. According to the ISPA Regulation, Community assistance may take the form of non-repayable direct assistance, repayable assistance or any other form of assistance. ISPA funding has so far consisted only of grants and 95 % of the projects committed in 2000 were subsidised at a rate higher than 50 %. The maximum rate of 75 % was approved for 41 projects, of which 11 concerned the environmental sector.

**6.23.** With a view to ensuring that investments financed under ISPA comply with strategic objectives for membership, the Commission requested the applicant countries to prepare strategies before projects are presented to the Management Committees. In general, the preparation of these strategies started well before the presentation of projects to the Committee and before the submission of applications to the Commission. The approach followed made it possible to present to the Committee a sufficient number of sound projects which complied with the requirements of the ISPA Regulation and strategic objectives for accession.

**6.24.** The Commission recognises that the procedures for signing the financing agreements are cumbersome. The applicant countries are fully aware that any expenditure incurred before the signature of the financing memorandum by the Commission is ineligible for ISPA funding.

**6.25.** The Commission would emphasise that the exceptional grant rate of 85 % which is allowed under the ISPA Regulation was not used for any of the projects adopted in 2000. The average rate applied in 2000 (in the order of 64 %) may be considered moderate since many projects do not generate income.

(23) 'It is evident that effective project identification requires a strategy [...]. Each beneficiary country needs, therefore, to define a national ISPA transport strategy and a national ISPA environment strategy. [...]. The national ISPA strategies should be based on and make reference to the Accession Partnerships and on the National Programme for the Adoption of the Acquis, and they should also draw on relevant national planning documents.'

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

6.26. In order to strengthen the leverage effect of the resources available, the ISPA Regulation provides that either the rate of assistance shall be reduced to take account of the availability of co-financing, the measure's capacity to generate revenues and an appropriate application of the 'polluter pays' principle or that assistance given could be repayable.

6.27. DG Budget advocated that a more thorough analysis of revenue-generating capacity be carried out at the project appraisal stage. For example, the level at which tariffs or charges were fixed should take into account the expected increase in household income. So far, the Commission has not used repayable assistance. The ISPA Regulation specifies that assistance reimbursed to the managing authority or to another public authority shall be reallocated for the same purpose. The financing memoranda should lay down the modalities for such allocations, and the applicable control mechanisms in particular.

#### *Technical assistance deficiencies*

6.28. The financial support to help candidate countries in their project preparation (including institution-building) came from different instruments <sup>(24)</sup> financed by Phare as follows:

(a) 'Special Preparatory Programmes for Structural Funds (SPPs)' were launched in 1998 with the aim helping to improve the candidate countries' capacity to develop the policy-making skills, administrative structures and budgetary procedures necessary for their future participation in EU structural programmes. Thus, Phare supported preparation for

**6.26.** The Commission bears in mind the fact that projects need to be affordable for the users of the infrastructure and take account of income levels in the applicant countries, which are only a fraction of those in the Member States. In appraising environmental projects, the Commission assesses future revenue, including the application of the 'polluter-pays' principle, and decides on a grant rate which makes the project financially viable over its lifetime. For environmental projects grant rates varied between 49 % and 75 %. Transport projects, particularly road projects, do not normally have any substantial revenue which could be taken into account for the purpose of reducing the grant rate. The application of a lower grant rate is, moreover, artificial in the case of the financing of corridor projects, since ISPA usually provides funds for only a limited section of the corridor.

**6.27.** The Commission believes that repayable assistance requires sophisticated implementing, monitoring and control structures which are not yet in place in the applicant countries. Moving on to repayable assistance schemes too early would be incompatible with the principles of sound management of Community assistance. The objectives of leverage assistance can also be achieved by reducing the grant rate, as has been done for a variety of projects.

Applicants are required to undertake a financial analysis of the project, which includes the aspects noted by the Court. The robustness and quality of the financial analysis are scrutinised in the course of the appraisal.

**6.28.** It should be noted that the objectives of these programmes were met, as is demonstrated by the fact that there is a sufficient number of well-developed projects to allow full commitment of the ISPA allocation for 2000.

<sup>(24)</sup> Implemented under the responsibility of DG ELARG and the Delegations.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

implementing ISPA and Sapard and establishing the relevant national strategies. SPPs could be implemented by so-called 'twinning projects' (25) as the principal tool for assistance in institution-building;

(b) the Large Scale Infrastructure Facility, Part 4 (LSI-F IV) (26);

(c) other national programmes financed by Phare supported the candidate countries in ISPA project identification and preparation.

The implementation of these programmes was delayed by problems with consultants as well as a lack of commitment on the part of the candidate countries themselves. In the case of some of the ISPA twinning projects within SPP, there was insufficient guidance from the Commission.

6.29. From 2000 onward, ISPA funds have also been available for technical assistance. A few projects were prepared with bilateral support from Member States or by candidate countries on their own.

6.30. The Commission has neither properly assessed the needs for technical assistance nor defined priorities. The Court was unable to obtain a complete overview of the EU-funding spent in 2000 for all these different kinds of technical assistance related to the preparation of ISPA projects.

**6.30.** *The Commission emphasises that the real measure of the quality of technical assistance is the quality of the application that follows.*

For Phare, the Commission can only readily extract contract data sorted by existing codes. Preparation for ISPA is not one of the existing codes. Compiling the information sought by the Court would, therefore, require a manual, ad hoc search through both the Désirée and Perseus contract databases for all the programmes indicated by the Court in 6.36. This is technically possible but very time-consuming and the Commission considers that the benefits of such a search would be disproportionate to the cost. The development of a more sophisticated management information system is foreseen under the 2000 Phare review.

(25) Provides the framework for administrations and semi-public organisations in the Candidate Countries to work with their counterparts in the Member States.

(26) Precursor to ISPA funding.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

6.31. Therefore, country strategies and applications for ISPA projects finally presented to the Commission did not meet the Commission's criteria and the different Commission services involved needed to put in a lot of work to bring them to an acceptable standard. In particular, there were shortcomings in the preparation of economic and financial analyses.

*Coordination needed to complete the decentralisation process*

6.32. The creation of two new pre-accession instruments (ISPA and Sapard), with different regulations and implementing rules, alongside the existing Phare programme, resulted in a big challenge to the candidate countries, who had to handle these funds while at the same time trying to reform their internal administration (27).

6.33. Identification of transport projects was based on the Transport Infrastructure Needs Assessment (TINA), which identified network components for a future Trans-European Network (TEN) in the candidate countries. No equivalent needs assessment was carried out in the environment sector. Therefore, the Commission decided to concentrate — as for the Cohesion Fund — on specific sub-sectors. The Priority Environmental Programme for Accession (PEPA), which has a wider scope than ISPA, is developing a database of potential environmental projects to help candidate countries to identify priority projects for the medium and long term. PEPA was launched in late 1999 and the first country reviews were presented in late 2000.

6.34. A key factor determining the success of ISPA is the establishment of appropriate programming and management structures in each beneficiary country (28). The coordination Regulation provides that the requirement for ex ante approval by the Commission of project selection, tendering and contracting may be waived as soon as project management capacity, financial control procedures and public finance structures in the candidate countries are considered appropriate.

**6.34.** From the outset, ISPA has been implemented on the basis of the Decentralised Implementation System (DIS) similar to that applicable under Phare. That means that, in addition to the ex ante approval of the tendering and contracting process by the Commission, the applicant country is responsible for the implementation of the project following the signature of the financing memorandum, and in particular for financial management and control. Article 12(2) of the coordinating Regulation provides for the waiver, by a Commission decision, of the prior approval requirement for tendering and contracting procedures where certain criteria and conditions are fulfilled, resulting in extended decentralised implementation (EDIS). In 2000, the Commission was concerned to ensure that the bodies responsible were setting up the structures necessary to manage ISPA in accordance with DIS, so that they would be fully in place by the time implementation of ISPA projects began. For that reason, the request of July 2000 was transmitted to the applicant countries.

(27) See the Court's conclusions in paragraph 5.73 of the Annual report concerning the financial year 1999, OJ C 342, 1.12.2000.

(28) Article 9 of the ISPA Regulation requires the beneficiary countries to establish proper management and control systems as from 1 January 2000 and in any event not later than 1 January 2002.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*The Phare review set out the main principles for EDIS. The Commission prepared a single working document for Phare and ISPA containing a checklist for each of the preconditions defined in Council Regulation (EC) No 1266/1999 and this document was sent to applicant countries in January 2001 to help them prepare for EDIS. This has been followed up in 2001 with meetings with applicant countries in order to explain in detail the requirements for EDIS and the measures to be carried out.*

6.35. This matter is closely related to the accession negotiations regarding 'Chapter 28 (Financial control)'. For those countries where a provisional closure of this chapter has been agreed on, it is important to complete the process of decentralisation, in order for them to be ready when accession takes place. In the 'Phare 2000 Review' paper<sup>(29)</sup> it is planned to fully decentralise responsibility for ISPA implementation to the candidate countries from 2002 and to reinforce support to implementing authorities that have been approved by the Candidate Countries and the Commission. Only in July 2000 did DG REGIO request the Candidate Countries to produce an assessment of their capacity for decentralised management.

#### *Coordination needs to be improved*

6.36. The coordination Regulation specifies that the Commission is responsible for the coordination of the three instruments (Phare, ISPA and Sapard), and in particular for the establishment of pre-accession guidelines for each country. In practice, this resulted in the 'General assistance documents' of March 2000 and April 2001, which, however, did no more than describe the state of preparation in the candidate countries at that date.

6.37. For the transport infrastructure projects, at the start no link was established between the different TINA/TEN Steering Committees and the ISPA Management Committee to guarantee a harmonised implementation of projects.

6.38. The interservice coordination of the appraisal of national ISPA strategies and project applications is functioning well, especially since the formalisation of these procedures in mid-2000.

**6.35.** The General Assistance Document for 2001 was discussed with and welcomed by the Phare Management Committee on 26 April 2001. This document provides information about priorities and indicative allocations for each country and each instrument, about coordination with the EIB and IFIs, and about progress and prospects for decentralised management.

**6.36.** A large number of the Member State representatives sitting on the ISPA Management Committee also fulfil the role of Chairman or Vice-Chairman of the TINA/TEN Steering Committees. For the purpose of coordinating the projects, the Commission has appointed from among its staff one person to be responsible for each of the ten corridors. Within this context, it has been cooperating with the Steering Committees for the different corridors since September 2000.

<sup>(29)</sup> Communication from Mr Verheugen, C(2000)3103/2 of 27 October 2000.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

6.39. The approach to the appraisal process varied between the Directorates-General:

- (a) DG ENV contracted a consultant to develop check-lists for the approval procedure. The same consultant is available to give advice on complex projects;
- (b) DG TREN does not have the resources to concentrate on anything other than the question of coherence between projects and EU and national transport strategies;
- (c) DG REGIO's ISPA directorate sometimes uses external consultants for project appraisal. In addition, a framework contract was concluded with the EIB, which provides technical support in the case of a limited number of project applications.

6.40. No clear guidelines providing approval criteria, apart from the generally formulated requirements in Annex I and II of the ISPA Regulation, could be identified. A harmonised approach to the appraisal procedure within DG REGIO or between the different Commission services was not apparent, nor was there a clear follow-up of comments made by the different DGs.

**6.39.**

- (b) DG TREN's contribution to the ISPA transport guidelines has been extremely valuable, particularly that contained in a technical paper dated 28 August 2000, which was presented for information purposes to the ISPA Management Committee in February 2001. Moreover, in the course of interdepartmental consultations, DG TREN normally checks that transport projects comply with a number of European agreements (AGR, AGTC, TEM) and with the provisions of Council Directive 96/53/EC as regards axle weight and dimensions.

**6.40.** *The assessment criteria for projects are clearly described in the Regulation and in the assistance application forms. Projects are assessed by all Commission departments on the basis of their respective responsibilities and in accordance with a well-established, interdepartmental dual consultation procedure. The follow-up to the comments made by the different DGs is governed by these same rules of procedure and is specified in the empowerment procedure drawn up in favour of the Commissioner responsible for Regional Policy.*

## SAPARD

*Consequences of the complex legal framework*

6.41. The Sapard Regulation is complex, because it combines elements of three different policy areas: Structural Fund multiannual programming, EAGGF Guarantee financial control procedures and external aid international agreements. In addition, as such management and control procedures did not exist in the beneficiary countries, the legal basis had to be developed by the Commission.

**6.41.** *The Commission set up a financial framework to implement rural development programmes in third countries with adequate guarantees governing the use of Community funds and accountability for them. It pursued the dual aims of managing the system in a manner which had already proved to be effective within the Community and of familiarising the applicant countries with the application of internal Community rules prior to accession.*

## THE COURT'S OBSERVATIONS

6.42. The Sapard Regulation did not clearly define the legal and management framework and it took the Commission seven months to reconcile the heterogeneous requirements and to apply the principles for the implementation of Sapard. The Commission had considered making a new proposal to the Council in order to provide a legal basis, but did not do so on the grounds that this was not necessary.

## COMMISSION'S REPLIES

6.42. Council Regulation (EC) No 1268/1999 lays down that Sapard must be implemented in accordance with the principles of Community legislation on the EAGGF and external aid. Moreover, the Financial Regulation provides under Title IX (External Aid) for ex-ante approval by the Commission of management tasks (such as project selection, tendering and contracting). Implementing Regulation (EC) No 1268/1999 will entail many applications for often small projects, so that the delegation of management tasks to the applicant countries, as provided for in Council Regulation (EC) 1266/1999, was necessary. The framework for such a novel system inevitably took time to establish.

6.43. The Regulation required the Commission to adopt detailed financial rules; this was done in June 2000. Because the Regulation could not be directly applied in candidate countries, the Commission had to transform the rules into an international agreement (the 'Multiannual Financing Agreement'). The process of drafting and negotiating the agreement with the 10 candidate countries took six months, and the document setting out the rules was approved by the Commission on 29 November 2000.

6.44. The financial management and control procedures stipulated in the international agreement are those of EAGGF Guarantee (including paying agencies and the clearance of accounts procedure). Financial management and control procedures governing similar programmes in the Member States are those of the Structural Funds. Although the systems being set up will provide the candidate countries with relevant experience, it appears that certain procedures being introduced are temporary and will not be needed upon accession.

6.44. At the time of accession, the system created for Sapard would require only minor amendments in order to fulfil responsibilities relating to both the existing Structural Funds and EAGGF Guarantee requirements.

*The Commission's management*

6.45. It is clear that the Commission was working within a very tight timetable, in order to set up the legal framework and put in place the Sapard rural development programmes. It was an achievement, for both the Commission and the candidate countries, that all rural development programmes were approved in a timely manner. Furthermore, the procedure of drafting and signing the international agreements was concluded successfully.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Problems faced by candidate countries in setting up the systems**

6.46. Candidate countries had no experience of setting up the management and control systems required for EU funds. Furthermore, since there are differences between these systems and those of the Member States, the Commission should have prepared specific working methods to help candidate countries in setting up the required systems, as had been done for EAGGF Guarantee paying agencies in Member States. The Commission should have laid down clear and simple rules with the associated guidance before the candidate countries started setting up their systems. Instead, the Commission provided the candidate countries with the guidelines that it issued to Member States advising them on obtaining accreditation of their paying agencies.

6.47. A further complication was that the Commission drafted the implementing regulations and the agreements with the candidate countries (which contain the legal basis for management and payment of funds) at the same time that the candidate countries were drafting their rural development programmes and setting up their systems. This has meant that management has in fact been on an ad hoc basis with problems being addressed and advice given only when the candidate countries actually faced them.

6.48. All 10 candidate countries received considerable financial support from the Phare programme to help with the implementation of Sapard. For example, 3,6 million euro had been committed by the end of 2000 for Bulgaria, and an additional 1 million euro is planned for 2001. This reflects the lack of experienced people in the administrations in the candidate countries, and has required a large input from EU experts, particularly in the setting up of the management systems. Phare also financed, for more than 1 million euro, support costs of the Sapard (Paying) Agencies in beneficiary countries, for items such as computer equipment. This is not in accordance with the explanatory remark for the budget line concerned (B7-0 3 0), which specifies that 'irrespective of the beneficiary', no administrative expenditure against this article is authorised. The Commission interprets this as authorising administrative expenditure. The Court does not agree with this interpretation.

**6.46.** The relevant working method devised for Member States, namely the guidelines for setting up paying agencies, was made available to the applicant countries. The Commission did not deem it appropriate to provide the applicant countries with further working methods. However, where an applicant country sought guidance, each individual problem received an appropriate response.

*The framework for the financial implementation of Sapard was already defined by the Commission communication of 26 January 2001. That framework was further developed in Commission Regulation (EC) 2222/2000 of 7 June 2000. In the Commission's view, this approach constitutes 'clear and simple rules', as requested by the Court.*

**6.47.** Forging ahead with the setting up of Sapard in tandem with the drafting and approval of the financial rules and Multiannual Financing Agreement was in the interests of the applicant countries. Waiting until the financial rules and MAFA were finally adopted could have laid the Commission open to criticism for delaying and for being too formal and inflexible in cooperating with applicant countries.

**6.48.** The Commission regards institution-building support aimed at helping countries prepare and implement Sapard as a key condition for its success. Since such support cannot legally come from Sapard, it comes from Phare, in accordance with Council Regulation (EC) No 1266/1999 on coordinating pre-accession assistance. Assistance from Phare is granted in the context of support for institution building in order to develop an effective capacity for implementing the *acquis*. The supply of computer equipment for Sapard Agencies in the initial phase is an integral part of this process. The example of Bulgaria as cited by the Court is correct, except that the EUR 1 million project is part of the 2000 Phare programme for Bulgaria, and the 2001 Phare programme for this country does not include additional funding for this purpose.

*The comment on budget line B7-0 3 0, that 'irrespective of the beneficiary, no administrative expenditure against this article is authorised', should be read in conjunction with the comments on Phare budget line B7-0 3 0 A (expenditure on administrative management). This means that any administrative expenditure relating to the management of Phare should be financed under administrative line B7-0 3 0 A. In the case in point, the initial installation of computer equipment is not administrative expenditure connected with the implementation of the project, but the Phare project itself.*

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Shortcomings in the Commission's analysis of management and control systems**

6.49. The legal basis for Sapard requires that the Commission's decision on decentralised management should be based on an analysis of the management and control systems of that candidate country. In view of the importance of the accreditation decision and in order to ensure that a favourable accreditation decision is soundly based, this review should be carried out by persons who are functionally independent of the staff who have advised the candidate countries in setting up those systems. In the Commission, however, the advice and control activities have not always been clearly separated in the context of the Sapard programme.

**6.49.** *An auditor may not carry out or participate in the management of the auditee's activities or, in this specific case, be responsible for setting up the procedures and structures for the management of the Sapard programme over and above his operational responsibilities. In practice, therefore, an auditor may:*

- (a) perform auditing and accounting tasks and give advice in this connection,*
- (b) give advice in areas which are closely connected with the audit function and in which the auditor has the necessary competence.*

*Auditing has, by its very nature, resulted in exchanges of views between the authorities and the auditors on procedures and structures during fact-finding missions and in the course of the auditor's examination that is carried out on the basis of a decision by the Competent Authority.*

6.50. It is general audit practice for the analysis of a system to be based on the identification of risks. However, the checklist used by the Commission to verify whether the conditions specified in the Multiannual Financing Agreement (which includes the financial rules) are fulfilled, is not based on risk analysis. As a result several risk areas are not addressed, in particular: the overlap between Phare and Sapard and the quality of staff of the competent authority in each of the Candidate Countries, which are responsible for granting accreditation to their national Sapard (Paying) Agencies. Moreover, no specific checks are included for the requirement in the Multiannual Financing Agreement that expenditure shall be eligible only if the use of the assistance is in accordance with the principles of sound financial management, in particular those of economy and cost-effectiveness.

**6.50.** *The Commission decided to base its checks on a 100 % verification of the elements specified in the MAFA rather than on a risk analysis.*

*The possibility of an overlap between Phare and Sapard is covered by the audit programme, 'The receipt of Project Proposal, Accounting of Contracts and Notification of Approval'. In the Commission's view, the verification of these proposals on the basis of a sample provides reasonable assurance that any overlaps will be detected.*

*The curricula vitae of the staff performing the work at the National Fund have been checked for 'quality', although this aspect is not explicitly mentioned in the checklist.*

According to Article 4 of the MAFA, sound financial management and, in particular, economy and cost-effectiveness constitute an eligibility criterion. Verification includes the means used by the Agency to assess the processes and related controls which cover this concept on an operational level. Although the checklist does not specifically mention checks in this area, this aspect is nonetheless verified as far as eligibility criteria are concerned.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## CONCLUSIONS

6.51. In 2000, the Commission faced the difficult task of implementing two new programmes in candidate countries, while at the same time preparing these countries for accession. Nevertheless, it succeeded in approving 75 projects for ISPA, 10 Rural Development Programmes for Sapard, and committed almost all of the available appropriations. However, hardly any payment appropriations were used (see paragraphs 6.12, 6.18 and 6.43).

6.52. No project could start in 2000, due to the late adoption of the legal framework and delays in setting up applicable administrative structures and procedures within the Commission, all of which delayed the preparatory work. Additional delays were caused for Sapard, because the Commission first needed to clarify the legal and management framework which had not been clearly defined in the Regulation (see paragraphs 6.20-6.24 and 6.39-6.41).

— The Commission should analyse and develop the manner in which it will implement new expenditure programmes while the legal basis is being developed, in order to ensure that these programmes can be implemented in a timely and effective manner.

**6.51.** *The level of payments is not abnormal and reflects the early phases of project implementation. Payments will increase as the projects advance and expenditure is incurred.*

**6.52.** *ISPA and Sapard followed normal Community practice, whereby a new policy is defined by a Council legal framework, which requires subsequent implementation on the basis of Commission manuals, provisions or regulations. In accordance with the relevant institutional procedures, Commission regulations could be drawn up only after the Council had adopted the basic legal framework.*

*After adoption of the Council legal framework, both the Commission and the applicant countries needed some time to set up appropriate administrative structures, submit and approve programmes and select projects. This period compares favourably with that required for similar tasks in Member States.*

*ISPA is providing Community assistance for infrastructure investment on an unprecedented scale. Large infrastructure projects generally require a lengthy, well-prepared start-up phase. Implementation of several projects already got under way in 2000 with the preparation of tendering and contracts.*

*The adoption of financial rules for Sapard and the assessment and Commission approval of Sapard programmes were carried out simultaneously, the process having been completed long before any country was ready to begin implementing projects. The time taken by most countries to set up the Sapard Agencies can be attributed to various causes, the majority of which derive from the scale of the task. However, Sapard Agencies are now in operation in two countries, while in others even the national accreditation process is not yet in its final stages.*

## THE COURT'S OBSERVATIONS

6.53. The national administrations in the candidate countries had great difficulty in trying to manage more than double the previous amount of pre-accession aid, to familiarise themselves with new and different regulations and to reform their own administrations all at the same time. This required a strong commitment from each candidate country, which was not always evident, and a significant input from the Commission, which was not always provided in time (see paragraphs 6.27-6.31 and 6.44-6.45).

- The Commission should provide the maximum guidance and technical advice in time, in the form of manuals, specific working methods and rules, in order to assist the candidate countries in making the necessary commitment.

## COMMISSION'S REPLIES

**6.53.** *The Commission has provided applicant countries with the legal framework for implementing aid, and with considerable guidance and technical assistance from its own departments and under several specific measures financed by Phare and other sources.*

*The Commission acknowledges the efforts made by applicant countries confronted with the task of setting up structures and procedures adapted to their own internal structures, while complying with the *acquis communautaire*. Manuals, specific working methods and rules provided by the Commission could cover only common factors, while specific national aspects had to be dealt with in the context of technical assistance programmes financed under Phare.*



## CHAPTER 7

**Administrative expenditure**

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## THE COURT'S OBSERVATIONS

## ADMINISTRATIVE EXPENDITURE OF THE INSTITUTIONS AND COMMUNITY BODIES

*Introduction*

7.1. Heading 5 of the financial perspective, 'Administrative expenditure', contains the institutions' and bodies' administrative appropriations (Part A of the budget in the case of the Commission), the implementation of which is detailed in **Table 7.1**. These appropriations are managed directly by these authorities and are used primarily to pay the salaries, allowances and pensions of persons working for the Community institutions, as well as rent, property purchases and miscellaneous administrative expenditure. The breakdown of staff receiving these payments is shown in **Tables 7.2 and 7.3**. In the Commission's case, these appropriations also enable subsidies to be given to associations and organisations that assist in the implementation of various aspects of the European Union's activities.

*Budgetary management*

7.2. The Court has reviewed the information presented in Volumes I to IV of the revenue and expenditure account. Volumes I and III provide a commentary on budgetary management for the year and, in particular, explanations of variations between the initial approved budget and the appropriations finally available, as well as between the appropriations finally available and those utilised. This review did not seek to provide assurance as to the reliability of these explanations. Rather, it sought to identify any significant variations for which explanations are not provided and to identify any explanation that might be considered misleading. The review did not reveal any case where the explanations appeared to be implausible, except at the Council, where mission costs totalling some 0,5 million euro relate to missions carried out in 1999 in the absence of any appropriations and pre-commitment.

**7.2. THE EUROPEAN PARLIAMENT'S REPLIES**

*Parliament is always willing to continue, together with the other institutions, the efforts which have been made to improve the transparency of the information presented in the revenue and expenditure account. However, it draws the Court's attention to the information in the revenue and expenditure account which concisely justifies each variation between initial and final appropriations. These variations, incidentally, arise from transfers approved by the budgetary authority on the basis of the more detailed information forwarded to it.*

**7.2. THE COUNCIL'S REPLIES**

*In the section on budgetary management the Court highlights the 1999 mission expenses of EUR 0,5 million that had to be financed from the 2000 budget. In fact, the Council had found that the relevant departments had taken internal measures to avoid a recurrence of this in future, and those assurances had enabled it to approve the transfer in question.*

Table 7.1 — Administrative expenditure 2000 <sup>(1)</sup> (summarised by section)

(Mio EUR)

	Total	Section I	Section II	Section III - Part A (including the Publications Office)	Section IV	Section V	Section VI	Section VII	Section VIII
		Parliament	Council	Commission	Court of Justice	Court of Auditors	ESC	COR	European Ombudsman
<b>Financial perspective ceiling</b>	4 798	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>2000 budget development</b>									
Initial appropriations	4 704	965	348	3 069	131	70	81	35	4
Final available appropriations <sup>(2)</sup> <sup>(3)</sup>	4 725	980	354	3 069	131	70	81	35	4
<b>Implementation of the 2000 budget <sup>(3)</sup></b>									
Appropriations used <sup>(4)</sup>	4 656	973	350	3 025	129	66	76	32	3
% of final available appropriations	99	99	99	99	99	94	94	91	82
Appropriations carried over to 2001 <sup>(5)</sup>	0	0	0	0	0	0	0	0	0
% of final available appropriations	0	0	0	0	0	0	0	0	0
Cancelled appropriations	71	7	5	44	2	4	5	3	1
% of final available appropriations	1	1	1	1	1	6	6	9	18

<sup>(1)</sup> Under the financial perspective.<sup>(2)</sup> Budget appropriations amended after taking into account supplementary and amending budgets and transfers.<sup>(3)</sup> Not including appropriations carried over from 1999, appropriations from the reuse of revenue, revenue resulting from third-party shareholdings and other revenue corresponding to a specific use and appropriations made available again.<sup>(4)</sup> Sums committed which gave rise either to payment during the financial year, or to an automatic carry-over to the financial year 2001.<sup>(5)</sup> Non-automatic carry-overs.

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

Source: 2000 revenue and expenditure account.

## THE COURT'S OBSERVATIONS

7.3. The general approach adopted by the institutions to the analysis of budgetary management fails to inform readers of the most significant features of expenditure for the year. All of the institutions focus on explaining variances between outturn and the budget, sometimes in great detail. The way they do this is, however, inconsistent both within and between institutions. The analysis often obscures key issues in budgetary management: for example, Parliament does not explain the operation of the procedure to apply unused appropriations on other budget lines to capital repayments on buildings; the Commission has not explained the significant variations affecting Chapter A-7 0 (decentralised expenditure on support staff and administration); and none of the institutions explains the differences between sums committed and payments made. It is desirable for the institutions to provide a more global analysis in the future, focusing on the main trends in expenditure, and the major capital items, as well as offering key measures of economy and efficiency.

## 7.3. THE EUROPEAN PARLIAMENT'S REPLIES

*On this subject, too, Parliament is willing to continue its efforts. As regards, in particular, the early payments for buildings, it is out of a concern to make optimum use of the appropriations made available to it and to ensure sound financial management that Parliament uses unused appropriations to increase the appropriations for financing of buildings. This results in significant savings which enable Parliament to meet new needs without increasing its share of the financial perspective. At all events, the increases made are first approved by the budgetary authority on the basis of the information supplied to it.*

## 7.3. THE COMMISSION'S REPLIES

*The Commission will explore with the other institutions a coordinated approach on administrative expenditure and,*

**Table 7.2 — Staff numbers by institution and by category as at 31 December 2000**

Institution	Officials	Temporary staff	Auxiliary staff	Local employees	DYEs <sup>(7)</sup>	SNEs <sup>(8)</sup>	Advisors	Total
European Parliament and Ombudsman <sup>(1)</sup>	3 283	587	219	32	—	—	—	4 121
Council	2 505	38	—	—	—	—	—	2 543
Commission <sup>(2)</sup>								
— Administration (Brussels, Luxembourg <sup>(3)</sup> , Strasbourg)	15 414	512	976	—	—	529	26	17 457
— Joint Research Centre <sup>(4)</sup>	759	922	219	—	—	—	—	1 900
— Shared-cost research	416	972	369	—	—	—	—	1 757
— Representation in the EU and staff seconded to satellite bodies	445	13	23	187	—	—	—	668
— External Delegations, representations and offices	690	3	—	2 142	—	10	—	2 845
Court of Justice	758	223	20	—	—	—	1	1 002
Court of Auditors	405	119	22	—	—	—	1	547
Economic and Social Committee <sup>(5)</sup>	470	66	23	—	—	—	1	560
Committee of the Regions <sup>(6)</sup>	165	59	12	—	—	—	—	236
<b>Total</b>	<b>25 310</b>	<b>3 514</b>	<b>1 883</b>	<b>2 361</b>	<b>—</b>	<b>539</b>	<b>29</b>	<b>33 636</b>

<sup>(1)</sup> Ombudsman : 11 temporary and 6 auxiliary staff.

<sup>(2)</sup> Commission total: 24 627 (i.e. 17 724 officials, 2 422 temporary staff, 1 587 auxiliary staff, 2 329 local employees, 0 delegated young experts, 539 seconded national officials and 26 special advisors).

<sup>(3)</sup> Including EUR-OP.

<sup>(4)</sup> JRC staff and Commission staff at the JRC.

<sup>(5)</sup> Economic and Social Committee.

<sup>(6)</sup> Committee of the Regions.

<sup>(7)</sup> Delegated young experts (DYEs).

<sup>(8)</sup> Seconded national experts (SNEs).

Source: The relevant institutions.

Table 7.3 — Staff numbers by institution and by place of employment as at 31 December 2000

Place of employment	European Parliament and Ombudsman		Council		European Commission												Court of Justice		Court of Auditors		ESC/ COR <sup>(7)</sup>		Total		
	1999	2000 <sup>(2)</sup>	1999	2000	Administration <sup>(4)</sup>		Representations in the EU and staff seconded to the satellite bodies		Delegations <sup>(5)</sup>		Shared-cost research <sup>(6)</sup>		Joint Research Centre <sup>(6)</sup>		1999 total	2000 total	1999	2000	1999	2000	1999	2000	1999	2000	
					1999	2000	1999	2000	1999	2000	1999	2000	1999	2000											
Member States (headquarters)																									
— Brussels	1 641	1 716	2 495	2 515	14 623	14 548	—	—	—	—	1 570	1 554	63	59	16 256	16 161	—	—	1	1	762	796	21 155	21 189	
— Luxembourg	2 252	2 202	—	—	2 884	2 909	—	—	—	—	64	79	1	1	2 949	2 989	966	1 002	552	546	—	—	6 719	6 739	
— Strasbourg	53	63	3	3	1	—	—	—	—	—	—	—	—	—	—	1	—	—	—	—	—	—	—	57	66
Member States (outside headquart.)	132	140	—	—	—	—	721	668	—	—	104	107	1 911	1 840	2 736	2 615	—	—	—	—	—	—	—	2 868	2 755
<b>Total for Member States <sup>(1)</sup></b>	<b>4 078</b>	<b>4 121</b>	<b>2 498</b>	<b>2 518</b>	<b>17 508</b>	<b>17 457</b>	<b>721</b>	<b>668</b>	<b>—</b>	<b>—</b>	<b>1 738</b>	<b>1 740</b>	<b>1 975</b>	<b>1 900</b>	<b>21 774</b>	<b>21 765</b>	<b>966</b>	<b>1 002</b>	<b>553</b>	<b>547</b>	<b>762</b>	<b>796</b>	<b>30 799</b>	<b>30 749 <sup>(1)</sup></b>	
Outside the Member States	—	—	24	25 <sup>(3)</sup>	—	—	—	—	2 523	2 845	24	17	—	—	2 547	2 862	—	—	—	—	—	—	—	2 571	2 887
<b>Grand total</b>	<b>4 078</b>	<b>4 121</b>	<b>2 522</b>	<b>2 543</b>	<b>17 508</b>	<b>17 457</b>	<b>721</b>	<b>668</b>	<b>2 523</b>	<b>2 845</b>	<b>1 762</b>	<b>1 757</b>	<b>1 975</b>	<b>1 900</b>	<b>24 321</b>	<b>24 627</b>	<b>966</b>	<b>1 002</b>	<b>553</b>	<b>547</b>	<b>762</b>	<b>796</b>	<b>33 370</b>	<b>33 636</b>	

<sup>(1)</sup> Member States: Belgium: 21 377, Denmark: 34, Germany: 340, Greece: 33, Spain: 111, France: 168, Ireland: 170, Italy: 1 422, Luxembourg: 6 730, Netherlands: 185, Austria: 33, Portugal: 29, Finland: 24, Sweden: 25, United Kingdom: 63.

<sup>(2)</sup> Ombudsman: Brussels 3, Strasbourg 14.

<sup>(3)</sup> Outside the EU: Geneva 15 and New York 10.

<sup>(4)</sup> Including EUR-OP.

<sup>(5)</sup> External Delegations, representations and offices.

<sup>(6)</sup> Brussels: 1 613, Luxembourg: 80, Ispra: 1 227, Karlsruhe: 216, Geel: 184, Petten: 157, Seville: 55, Naka: 17, Garching: 48, Culham: 3, Frascati: 8, Cadarache: 28, Jülich: 6, Padua: 2, Vienna: 2, Madrid: 4, Utrecht: 2, Bologna: 1, London: 2, Rome 1, Stockholm: 1 (including shared-cost staff).

<sup>(7)</sup> Economic and Social Committee and Committee of the Regions.

Source: The relevant institutions.

## THE COURT'S OBSERVATIONS

*provided an agreement can be reached with these other bodies, will develop a consistent approach on programme expenditure to be applied by all.*

*Management of the appropriations entered in Chapter A-7 0 is decentralised. At the beginning of the year each DG/service receives a 'total allocation' of administrative appropriations, including appropriations for employing external staff, broken down between the various headings of Chapter A-7 0. Each DG/service can then reallocate their appropriations to various items as needs be. These adjustments are made by way of transfers during the financial year. Overall, the lines 'external staff' were increased by EUR 3,3 million from other administrative lines in Title A-7. In practice, the increase went mainly to line A-7 0 0 0 (auxiliaries), with transfers coming from line A-7 0 0 2 (Service providers). The reasons for increase for line A-7 0 0 0 were certain one-off measures not known about when the preliminary draft budget 2000 was drawn up, the efforts made to speed up the clearance of the outstanding commitments in the field of external relations, the return of certain tasks previously carried out by the technical assistance offices and increases in order to meet one-off requirements arising from large-scale redeployment of staff in various Commission departments.*

*In 2000, the budgetary authority also made two transfers: first, EUR 2 283 000 was transferred from item A-7 0 0 0 (Auxiliaries) to Title A6 (Delegations) in support of the process of decentralising the implementation of aid programmes for third countries; second, the EUR 2 000 000 which the European Parliament had entered in reserve was transferred from Chapter A-10 0 to line A-7 0 0 2 (Seconded). The net result was a reduction of EUR 283 000 in the appropriations available in Chapter A-7 0.*

*Specific appraisal within the framework of the Statement of Assurance*

**Scope of the audit**

7.4. The Court's audit focused on all the accounts and operations involving administrative expenditure (heading No 5 of the financial perspective).

## THE COURT'S OBSERVATIONS

**Reliability of the accounts and legality and regularity of the underlying transactions**

7.5. The samples and analytical tests carried out have revealed a situation which, save for some specific observations, remains satisfactory overall.

7.6. The **budgetary accounts** and financial statements supporting the **consolidated balance sheet** faithfully reflect the administrative expenditure of Community institutions and bodies. The **off-balance-sheet commitments** present future pension costs in a more informative manner. The annual cost of pension rights acquired during the financial year is now shown. However, in the view of the Court it would be better for the liability to be presented in the balance sheet and the annual charge included in the calculation of the economic result, in accordance with international accounting standards. The presentation of fixed assets has improved, but is still affected by the incorrect accounting treatment noted in paragraphs 7.8-7.10, 7.12, 7.13-7.14 and 7.17.

**7.6. THE EUROPEAN PARLIAMENT'S REPLIES**

Parliament is willing to comply with the Court's recommendations concerning the presentation of the balance sheet if all the institutions decide to adopt the proposed approach. As regards fixed assets, see replies to paragraphs 7.8 to 7.10.

**7.6. THE COMMISSION'S REPLIES**

*The Commission feels that, at this stage, what is most important is to provide full information about pension commitments in the financial statements. As the Court acknowledges, the Commission included exhaustive information in the Annex to the financial statements.*

*At the moment, there is no consensus at international level with regard to the procedure to deal with the public entities' pension debt. A very thorough accounting analysis is required. The procedure recommended by the Court is by no means applied by the Member States or other non-member countries with sophisticated public accounting systems.*

*The Commission would also add that the IFAC (International Federation of Accountants) has not yet adopted standards to be applied to public sector pensions.*

7.7. Except for the matters discussed in paragraph 7.6, the Court accordingly considers that the accounts of the European Union institutions are reliable in their presentation of administrative expenditure and related assets and liabilities. It further considers that the underlying transactions are, taken as a whole, legal and regular. The Court notes that its own accounts are the subject of a comparable report provided by independent auditors (¹).

(¹) OJ C 312, 7.11.2001.

## THE COURT'S OBSERVATIONS

**Parliament**

7.8. Parliament has for the first time entered the Louise Weiss building in Strasbourg under the heading 'Leasing' in its balance sheet, for a net accounting value of 367,4 million euro, in accordance with the provisions adopted by the Commission on the accounting management of non-financial fixed asset accounts<sup>(2)</sup> and the Court's previous observations. The notes to the balance sheet do not mention that this is an estimated value or that costs of around 21,5 million euro are contested by Parliament. Moreover, the value of this asset is to some extent underestimated, since this amount includes the value of the land, amounting to 8,8 million euro, for which, contrary to the applicable rules, a cumulative depreciation sum of 1,2 million euro has been calculated. Furthermore, 20 million euro of this amount comprises the value of special equipment which Parliament has depreciated at a maximum annual rate of 25 %, producing a cumulative value at the end of the financial year 2000 of 60 million euro, without disclosing the nature of the equipment concerned and the depreciation rates that should actually be applied.

7.9. The management of the other tangible fixed assets has improved significantly as a result of using a new inventory management system (ELS) and applying depreciation, measures which will enable a more reliable valuation of these assets to be presented than in the past, especially when the physical inventory programme, which had progressed considerably by the end of the financial year 2000, has been completed and taken into account in the accounts inventory databases. At the end of the financial year 2000, assets not yet identified during a physical inventory accounted for a total of 1,4 million euro, or around 4,1 % of the value of assets subject to inventory that are shown in the balance sheet.

7.10. However, the inventory does not show assets purchased by Parliament's political groups using appropriations made available to them.

**7.8. THE EUROPEAN PARLIAMENT'S REPLIES**

*If the definitive value of the building were not known at the end of 2001, the Court of Auditors' remarks would be taken into account in the preparation of the notes to the balance sheet on the item 'leasing of the Louise Weiss building'. As soon as the breakdown of assets is available, the calculation of depreciation will be brought into line with the Court's recommendations.*

**7.9. THE EUROPEAN PARLIAMENT'S REPLIES**

*The improvement brought about by the new inventory management system (ELS) is indeed significant. The percentage represented by the value of assets whose inclusion in the inventory is required and which were entered in the balance sheet without being identified referred only to movable items (excluding, therefore, the value of immovable property likewise included in the balance sheet).*

**7.10. THE EUROPEAN PARLIAMENT'S REPLIES**

*Parliament is aware of the problem raised by the Court and will try to find a solution with the assistance of the political groups.*

(<sup>2</sup>) Commission Regulation (EC) No 2909/2000 of 29 December 2000 on the accounting management of the European Community's non-financial fixed assets (OJ L 336, 30.12.2000, p. 75).

## THE COURT'S OBSERVATIONS

7.11. Overtime costing a total of 0,54 million euro for the financial year 2000 was paid, even though it was not authorised beforehand, there was no evidence that it had not been possible to take compensatory leave for overtime worked and, in around a quarter of the cases, there was no documentary evidence of the justification for such overtime work.

## 7.11. THE EUROPEAN PARLIAMENT'S REPLIES

*Overtime is inherent in the nature of Parliament's work, with its peaks, and is therefore unavoidable, has to be worked regularly and is kept within the limits of budget allocations, which partly explains the absence of written authorisations. However, detailed records are kept of the hours worked, signed by the hierarchical superior, and payment for them is limited by the provisions in force. However, the directorates-general have had their attention drawn to the absence of justification which the Court noted, and since then they have abided by their obligations in this respect.*

## Council

7.12. Although the Justus Lipsius building was commissioned in 1995, it is entered, for an amount of 339,1 million euro, under the heading 'Fixed assets under construction' on the grounds that the official deed has still not been signed, and as a result it has not been depreciated at all. The fact is, however, that this building has been paid for in full and the property's inherent risks and benefits have actually, in substance, been transferred to the Council. This asset should therefore have been entered under the heading 'Land and buildings' for a net accounting value of 257,7 million euro, allowing for cumulative depreciation amounting to 81,4 million euro. In addition, the absence of a physical inventory means that it is not possible to check that the accounting inventory (8,52 million euro) for the other tangible fixed assets corresponds to reality.

## 7.12. THE COUNCIL'S REPLIES

*Regarding the issue of how the Justus Lipsius building was included in the budget, the Council agrees with the Court's analysis, but would explain that the heading 'Fixed assets under construction' was chosen because of the legal complexity of the situation coupled with the fairly long time it had taken to finalise the relevant accounting rule. Also, the Council is currently making a physical inventory (in the context of 2001), which will resolve the problem of the reliability of the accounts inventory.*

## Court of Justice

7.13. Leased buildings are shown in the balance sheet for the first time. Their net accounting value, i.e. 96 million euro, is underestimated by some 2,1 million euro because, in the case of Annex B, depreciation was calculated on the basis of the financial year following that in which it was commissioned. In addition, the notes to the balance sheet make no reference to the provisional nature of this value, since negotiations are still underway to determine the financial consequences of certain construction faults.

## 7.13. THE COURT OF JUSTICE'S REPLIES

*When the balance sheet is drawn on 31 December 2001, the net accounting value will be amended in order to take account of the overvaluation of the buildings pointed out by the Court of Auditors. Furthermore, the financial repercussions which might result from the present negotiations concerning certain defects are to be taken into account in that balance sheet. If the negotiations are not completed on time, a note to that effect will be added to the balance sheet.*

## THE COURT'S OBSERVATIONS

7.14. The reliability of the value of the other tangible fixed assets, i.e. 9,8 million euro in total, cannot be guaranteed. Contrary to what the Court of Justice stated in its replies to the observations made by the Court in its Annual Report concerning the financial year 1999 (3), it has still not implemented the new inventory management system or conducted a full physical inventory. In drawing up its balance sheet it has also failed to apply depreciation which, according to the documents forwarded to the Commission for it to draw up the consolidated balance sheet, amounts to 6,1 million euro.

## 7.14. THE COURT OF JUSTICE'S REPLIES

During the financial year 2000, the Court implemented its new computerised fixed-assets system together with a physical inventory. That work, which was not completed until the beginning of the financial year 2001, has revealed inconsistencies between the physical inventory and the data recorded in the new computerised system. Given that those data are not sufficiently reliable, it was decided in February 2001 not to calculate the amount of depreciation of the tangible fixed assets to be entered in the balance sheet which was then forwarded to the Commission of the European Communities. However, having regard to the progress made in the attempt to reconcile the data in the inventory system with those in the physical inventory, it was possible in April 2001 to estimate the amount of depreciation and forward it to the Commission for inclusion in the consolidated balance sheet. It should also be noted that the necessary alterations to the computerised database will be completed by the end of the year 2001. In those circumstances, for the balance sheet as at 31 December 2001 depreciation will be calculated using the new computerised fixed-assets system.

## Commission

7.15. The administrative expenditure of the Commission and the related assets and liabilities form a small part of the overall consolidated financial statements, the audit of which is reported in Chapter 9 of this document. The following observations relate solely to the administrative expenditure elements.

7.16. The Court notes that for the first time the financial statements mention the liabilities taken on by the Commission in connection with the renovation work on the Berlaymont building, which is estimated at 374 million euro. This real-estate operation also calls for examination with regard to sound financial management, given, *inter alia*, the Commission's lack of control over these renovation costs.

## 7.16. THE COMMISSION'S REPLIES

*The Commission will use the interinstitutional and interdepartmental working party set up to prepare the implementing rules of Regulation (EC) No 2909/2000 of 29 December 2000 on the accounting management of the European Communities' non-financial fixed assets, to ensure that the accounting standards included in the above Regulation are interpreted in the same way by the various departments in the institutions.*

*With regard to training, the Commission accepts the Court's comment and will study the possibilities of organising the appropriate courses.*

(3) OJ C 342, 1.12.2000, p. 172.

## THE COURT'S OBSERVATIONS

7.17. The reliability of the value of the tangible fixed assets cannot be guaranteed. The Directorate-General for External Relations entered all the computing software installed in the Delegations in the accounts itself, at a net accounting value of 0,13 million euro, whereas at the Commission itself, only software covered by a site licence or large-account contract was included in the accounts. Conversely, the cost of licences for the Translation Service, forming part of a contract valued at 1,25 million euro, was not entered in the balance sheet. Decentralisation of administrative management brings with it an increased risk of disparate practices in the various Commission departments, some of which are probably not yet familiar with preparing financial statements. The Administration and Budget DGs must ensure that the requisite consistency is achieved and that the necessary training and supervision are provided.

7.18. The long-term liabilities include an amount of 8,8 million euro for the unemployment fund for temporary officials, the reliability of which cannot be guaranteed, since there has been no reconciliation with the contributions made and allowances paid since 1998.

## 7.18. THE COMMISSION'S REPLIES

*The Commission acknowledges the importance of taking the appropriate steps to monitor the unemployment fund in order to guarantee long-term budgetary equilibrium. It undertakes to get back on schedule in analysing the receipts and expenditure of the unemployment fund in the coming months.*

### Procurement procedures

#### Scope of the examination

7.19. The Court examined the design and operation of the controls over procurement procedures used by the institutions to purchase services, supplies and works. This included:

- (a) a review of the controls in place at the institutions for ensuring compliance with the relevant articles of the Financial Regulation, the implementing measures and the public procurement directives in the purchasing of all services, supplies and works;
- (b) an examination of the procurement procedures associated with the payments in an intensified sample of transactions at the institutions.

## THE COURT'S OBSERVATIONS

## Legal basis of procedures and controls over procurement

7.20. The Financial Regulation sets out the responsibilities of the different actors in the procurement process and the framework for ensuring that appropriate tendering procedures are followed:

- (a) the authorising officer alone has the responsibility for entering into financial commitments on behalf of an institution and hence responsibility for ensuring that appropriate procedures are followed. These must comply with the Council directives on the coordination of procedures for the award of public works, supplies and services contracts;
- (b) the system of control envisaged by the Financial Regulation is provided jointly by an Advisory Committee on Procurements and Contracts (ACPC) and Financial Control. The ACPC delivers an opinion prior to the signing of a contract on whether the procedure followed for selection of the successful tenderer and the proposed terms of contract are correct;
- (c) Financial Control attends ACPC meetings as an observer and checks that the commitment, the authorisation of the expenditure and the payment are in order and comply with the regulations.

## Audit findings

*Operation of control systems*

## Implementation of the system envisaged by the Financial Regulation

7.21. The system of control envisaged by the Financial Regulation has been implemented. Each institution operates an ACPC, composed in compliance with the Financial Regulation, which meets regularly during the year. At each institution Financial Control is represented at ACPC meetings and reviews tendering procedures.

7.22. No interinstitutional ACPC has been set up even though many procurement needs are common to several institutions. Occasionally ad hoc interinstitutional tenders are launched by the larger institutions, with which the smaller institutions are invited to associate themselves.

## 7.22. THE EUROPEAN PARLIAMENT'S REPLIES

*The lack of an interinstitutional ACPC is offset by the recognition of a lead ACPC, namely the ACPC of the institution which is assuming primary responsibility for the invitation to tender. The opinion of this ACPC is in principle accepted by the other ACPCs.*

## THE COURT'S OBSERVATIONS

## 7.22. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

*The Economic and Social Committee occasionally uses the results of tenders organised by other institutions. However, the ESC is often unable to use the results of the tendering procedure organised by other institutions either for official reasons or because they do not take account of the ESC's specific needs. The ESC therefore proposes that tendering procedures, in particular those organised by the larger institutions, are more systematically organised between institutions.*

## 7.22. THE COMMITTEE OF THE REGIONS' REPLIES

*Wherever possible, the Committee of the Regions uses the results of tenders organised by other institutions. However, the COR is often unable to use the results of the tendering procedure organised by other institutions either for official reasons or because they do not take account of the COR's specific needs. The COR therefore proposes that tendering procedures, in particular those organised by the larger institutions, are more systematically organised between institutions.*

## Operation of these controls at the institutions

7.23. In general, the Court found systems operated as intended at each of the institutions, but the following weakness was found to apply to all institutions. The ACPC and Financial Control, although they operate *ex ante* (i.e. prior to the commitment being entered into), are detective controls designed to highlight errors in procedures already carried out. When problems with procedures are identified, the options for remedial action available are often very costly and impractical for the institution. Therefore, in practice, ACPCs' opinions reflect the overall interests of the institutions and are not limited to giving an opinion on whether the tendering procedure was in order. This is one element contributing to the low rate of negative opinions given at the larger institutions and the adoption of policies of never giving negative opinions by some of the other institutions. As a result, in a number of cases ACPCs gave favourable opinions combined with explicit criticism of certain aspects of the tendering procedure and recommendations aimed at improving future practice.

## 7.23. THE EUROPEAN PARLIAMENT'S REPLIES

*The Court of Auditors observes that, out of a concern for the overall interests of the institutions, ACPCs deliver very few unfavourable opinions in order to avoid a procedure's having to be started afresh after reaching the final stage. This seems to underestimate the pre-referral system introduced by the Secretary-General in 1997. Authorising officers are required to submit to the ACPC the texts of invitations to tender governed by the public procurement directives before initiating a procedure so that problems can be detected in advance and in order to ensure, wherever possible, that the procedure selected is the most appropriate with a view to concluding a contract at the best price. If a problem emerges subsequently, the case is referred back for a reconsideration of the tenders, which enables the irregularity identified to be remedied.*

## 7.23. THE COMMISSION'S REPLIES

*It is true that in the great majority of cases, the ACPC and Financial Control give their opinion on procedures already carried out. However, authorising officers have the possibility of submitting procurement files to the ACPC at any stage of the procedure, e.g. before publishing a tender or sending out the terms of reference.*

## THE COURT'S OBSERVATIONS

## 7.23. THE COURT OF JUSTICE'S REPLIES

*In so far as it is concerned by the Court of Auditors' observations, the Court of Justice must point out that it is in no way the policy of the institution's Advisory Committee on Procurement and Contracts (ACPC) never to give a negative opinion. It is true that, in keeping with its advisory role, the ACPC may in certain instances append to its opinion remarks critical of various features of the procedure followed in such and such a proposed procurement contract; however, the facts which give rise to those remarks are not such as could have justified a negative opinion on the proposed procurement contract in question.*

## 7.23. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

*The wording used by the Court of Auditors could give the impression that, as a small institution, the ESC's ACPC never gives negative opinions. In actual fact, the ACPC gave a negative opinion for 5 % of the dossiers presented in 2000 and also gave a number of negative opinions in 2001.*

## 7.23. THE COMMITTEE OF THE REGIONS' REPLIES

*The wording used by the Court of Auditors could give the impression that, as a small institution, the COR's ACPC never gives negative opinions. In actual fact, the ACPC gave a negative opinion for 4 % of the dossiers presented in 2000 and also gave a number of negative opinions in 2001.*

7.24. The operation of the ACPC and Financial Control at two institutions shows the following specific features:

- (a) at the Commission, the absence of identification of procurement expenditure in the accounting system combined with the sampling approach to select commitment and payment proposals for testing make it difficult for Financial Control to ensure that all contracts that should have been submitted to the ACPC before signing have actually been submitted and that points raised by the ACPC have been followed up;

## THE COURT'S OBSERVATIONS

## 7.24. THE COURT OF JUSTICE'S REPLIES

(b) the Court of Justice interprets the Financial Regulation and the public procurements Directive differently from the other institutions by applying a threshold of 200 000 special drawing rights (SDR), rather than 130 000 SDR, when assessing whether a proposed procurement falls within the scope of the services and supplies directives.

**(b)** *The interpretation relied upon by the Court of Justice in determining the applicable threshold is based on the following considerations.*

*Article 56 of the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities<sup>(1)</sup> provides that 'When concluding contracts for which the amount involved is equal to or greater than the threshold provided for by the Council directives on the coordination of procedures for the award of public works, supplies and services contracts, each institution shall comply with the same obligations as are imposed upon bodies in the Member States by those directives'.*

*Article 7 of Council Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts<sup>(2)</sup>, as amended by Directive 97/52/EC of the European Parliament and of the Council of 13 October 1997<sup>(3)</sup>, and Article 5 of Council Directive 93/36/EC of 14 June 1993 coordinating procedures for the award of public supply contracts<sup>(4)</sup>, as amended by Directive 97/52/EC, set the Directive's application thresholds at 130 000 special drawing rights ('SDR') and 200 000 SDR respectively, depending on whether or not the contracting authorities are listed in Annex I to Directive 93/36/EEC.*

*Since the directives relating to the coordination of procedures for the award of public service contracts are addressed to the Member States and not to the Community institutions, Annex I to Directive 93/36/EEC lists only the contracting authorities of the Member States and not the Community institutions, which are contracting authorities within the meaning of Article 128 of Commission Regulation (Euratom, ECSC, EC) No 3418/93 of 9 December 1993 laying down detailed rules for the implementation of certain provisions of the Financial Regulation of 21 December 1977<sup>(5)</sup>.*

*Since Directives 92/50/EEC and 93/36/EEC, amended by Directive 97/52/EC, provide for two thresholds, it is necessary to determine which threshold is applicable to the Community institutions (which, by virtue of Article 56 of the Financial Regulation, are obliged to comply with the same obligations as are imposed upon bodies in the Member States) on the basis of that difference in threshold. The 130 000 SDR threshold was introduced as a result of the Agreement on Government Procurement concluded at Marrakesh on 15 April 1994. Article 1(1) of that agreement defines its scope. It provides: 'This Agreement applies to any law, regulation,*

<sup>(1)</sup> OJ L 356, 31.12.1977, p. 1.

<sup>(2)</sup> OJ L 209, 24.7.1992, p. 1.

<sup>(3)</sup> OJ L 328, 28.11.1997, p. 1.

<sup>(4)</sup> OJ L 199, 9.8.1993, p. 1.

<sup>(5)</sup> OJ L 315, 16.12.1993, p. 1.

## THE COURT'S OBSERVATIONS

procedure or practice regarding any procurement by entities covered by this Agreement, as specified in Appendix I. Annex I to that Appendix lists the bodies to which the 130 000 SDR threshold applies. In the section reserved for the European Communities, the entities listed are divided between the bodies of the European Communities and the contracting authorities of the Member States. The first paragraph, headed 'European Community entities', refers exclusively to the Council of the European Union and the European Commission as being the bodies of the European Communities subject to the threshold of 130 000 SDR provided for in that agreement.

Lastly, the interpretation above cannot be contradicted by any indications which may appear in the *vade-mecum* of the Commission's ACPC. Since that document is internal to that institution it cannot be binding on the other institutions. Moreover, that *vade-mecum* specifically states that the Commission is one of the contracting authorities subject to the Marrakesh Agreement on Government Procurement without taking any view on the status of the other Community institutions in this respect.

*Results of compliance and substantive testing*

7.25. The Court examined a sample of payments related to the provision of services, supplies or works with a view to determining whether, where appropriate, the right tendering procedures had been correctly carried out prior to the signing of the contract and whether the system of controls in place had operated effectively.

7.26. The Court found only one case in the conduct of a tendering procedure which presented serious problems: that concerning the provision of a security service at the European Parliament buildings in Strasbourg, which Parliament asked the Court to examine. The ACPC gave a favourable opinion. However, Financial Control withheld its visa because the successful candidate, who was already under contract, was favoured by the fact that the relevant department of Parliament had not given all tenderers full information about the pay of those employed, whom another contractor would have been obliged by national law (under the Transfer of Undertakings Directive) to employ if he had tendered successfully. Parliament had no means within the terms of the previous contract of compelling the contractor to provide information which he regarded as commercially confidential. Financial Control was overruled by the institution. The Court shares the concerns expressed by Financial Control and considers that in future

**7.26. THE EUROPEAN PARLIAMENT'S REPLIES**

*In the case in question the authorising officer, aware of the need to ensure that tenderers were on an equal footing as far as possible, managed to obtain the total wage bill for the staff employed at the time, and the wage scales on which it was based, from the then contractor despite having no means in law of compelling the contractor to supply that information to his competitors. The ACPC took the view that that information would make it possible to ensure equal treatment and that the firms which had withdrawn would be able to submit realistic tenders. On that basis, and in the light of an opinion from the Legal service which confirmed that the authorising officer had no means of demanding additional details and that he had acted in accordance with the legislation applicable, Parliament's Bureau decided to overrule the Financial Controller's withholding of approval in this case. The opinion from the Legal service which was in favour of the application of the 'transfer of undertakings' Directive after the contract*

## THE COURT'S OBSERVATIONS

Parliament should take into consideration national law and ensure that all tenderers are put on an equal footing.

*had been awarded is also confirmed by the interpretation given by the Court of Justice in its judgement of 25 January 2001 (Oy Liikenne Ab v Pekka Liskojärvi and Pentti Juntunen).*

*With regard to the future, the ACPC first recommended that, in connection with subsequent invitations to tender when existing contracts expire, authorising officers require new contractors to communicate the relevant information to tenderers, but subsequently had to rescind this recommendation upon the advice of the Legal service, which showed that authorising officers had no legal basis for compelling a successful tenderer to supply such information and that such an obligation would inflict unequal treatment on the service provider concerned. Parliament therefore introduced the practice of making explicit reference, in the terms applicable to all similar contracts, that the conditions governing any take over of staff by a new contractor will be governed by the applicable national legislation.*

*Lastly, it should be pointed out that, as the Court indicates, Parliament considered that the questions raised by this case merited detailed examination by the Court, to which, accordingly, it was referred by letter of 8 May 2000 from the President. The issue has also been raised with the relevant national authorities.*

7.27. In addition, the Court found a number of cases of apparent weaknesses in the system for ensuring compliance with the regulations and directives:

## 7.27. THE COUNCIL'S REPLIES

*In connection with public contracts, where the Court points to some cases in which the rules were not correctly applied, the Council would point out that that the Deputy Secretary-General has made a fundamental overhaul of internal practice on public contracts, particularly in order to ensure from 2002 onwards that for any substantial purchase a fully independent unit composed of deputy authorising officers will be responsible for determining the procedure to be followed and for implementation of that procedure. This, then, is an additional precaution to ensure that the rules are respected.*

## THE COURT'S OBSERVATIONS

## 7.27. THE COURT OF JUSTICE'S REPLIES

- (a) five cases where the grounds for claiming exemption from tender procedures were questionable or not supported by evidence submitted to the ACPC (Court of Justice: four, Council: one). Four of these cases were service contracts in technical domains where exemption was claimed under Article 59(d) of the Financial Regulation;
- (b) one case where a procurement need appeared to have been split into several contracts with the effect that the provisions of the directives were not applied to part of the procurement (Court of Justice);
- (c) a rental contract on a building also covered refurbishment work which was not put out to tender (ESC and COR);
- (d) four cases of contracts with a value exceeding the ACPC threshold had not been submitted to the ACPC (Commission: two, Council: one, ESC and COR: one);
- (e) one case of an annual indicative notice being published in the middle of 1997, rather than at the beginning of the year as implied by the public procurement directives, in order to speed up the procurement process (Commission).

## Conclusion and recommendations

7.28. In general, the procurement procedures applied by the institutions are legal and regular. Infringements, where they occur, result, in the main, from the lack of experience/expertise in the domain of tendering for particular services, and pressures on departments to adopt administratively convenient solutions, e.g. exemptions from tendering on 'technical grounds' to facilitate the commitment of funds before the year end.

- (a) *Of the four contracts which are the subject of observations, two are for a total amount over the 130 000 SDR threshold but below the 200 000 SDR threshold. Accordingly, no contract notice was published for those two, as is made clear in the explanation given in reply to paragraph 7.24(b).*

*So far as the other two contracts are concerned, the Court of Justice is not of the same opinion as the Court of Auditors which considers that it was incorrect to apply Article 59(d) of the Financial Regulation. It is the view of the Court of Justice that in either case only a particular supplier could perform the contract, which justified making a contract with that person by private treaty.*

- (c) *The Court of Justice considers that the special circumstances of the contract referred to in this observation demonstrate that there was no splitting of a contract and that the provisions applicable to public procurement were not disregarded.*

## 7.27. THE COMMISSION'S REPLIES

- (e) *Not all procurement plans are known at the beginning of the year. In these cases, indicative notices can also be published during the year.*

## THE COURT'S OBSERVATIONS

7.29. Institutions need to introduce a system of preventive measures, such as training authorising officers in procurement procedures and developing checklists, to complement the roles the ACPC and Financial Control currently play if compliance with the directives is to be improved further. Internal control systems reviews and compliance testing by the internal auditors will also be important in the future, due to the planned abolition of the ACPC and Financial Control.

## 7.29. THE EUROPEAN PARLIAMENT'S REPLIES

*Parliament currently offers a course concerning public contracting procedures. However, its content will need to be expanded in future. In addition, the pre-referral system introduced in 1997 (see point 7.23) makes it possible to avoid problems in advance of the procedure.*

## 7.29. THE COMMISSION'S REPLIES

*Intensive training in public procurement and contracting procedures is already taking place for Commission departments.*

## 7.29. THE COURT OF JUSTICE'S REPLIES

*Back in May 2001 the administration of the Court of Justice organised training in public procurement procedures, especially for managers in the departments authorised to pass accounts. That training dealt both with the Financial Regulation and its implementing rules and with the various directives concerning public procurement contracts.*

## 7.29-7.30. THE COURT OF AUDITORS' REPLIES

*It has already been several years since the Court of Auditors set up a system of internal control to ensure the regularity of its procedures for awarding contracts.*

*In the first place, it trained a specialist in this field whose role is to advise and support the various authorising officers concerned. Although this official has been appointed to a special department of the Secretariat-General, he is still available to other departments if needed; a recent example that may be quoted is that of the invitation to tender concerning the audit automation project.*

*Furthermore, before an invitation to tender is issued formally, the authorising officials consult the Legal service on their draft invitation to tender with regard to both the actual specifications and compliance with the regulatory provisions in force, particularly the directives concerning open invitations to tender in relation to the planned procedure (pre-information notice in the Official Journal, publication in the Official Journal, etc.).*

## 7.29. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

*The ESC accepts the Court's suggestion to introduce measures to improve expertise in tendering (i.e. training authorising officers and developing checklists).*

## THE COURT'S OBSERVATIONS

*Given that expertise in the domain of tendering is concentrated at the European Commission and given the need for interinstitutional harmonisation, the Committee proposes implementing these measures in close cooperation with the Commission.*

**7.29. THE COMMITTEE OF THE REGIONS' REPLIES**

*The COR accepts the Court's suggestion to introduce measures to improve expertise in tendering (i.e. training authorising officers and developing checklists).*

*Given that expertise in the domain of tendering is concentrated at the European Commission and given the need for interinstitutional harmonisation, the Committee proposes implementing these measures in close cooperation with the Commission.*

7.30. All institutions should apply the same thresholds when deciding whether a proposed procurement of services or supplies falls within the scope of Public Procurement Directives 92/50/EEC and 93/36/EEC.

**7.30. THE EUROPEAN PARLIAMENT'S REPLIES**

Parliament supports all initiatives designed to harmonise the institutions' practices. However, it believes that the maximum amount which determines whether the contract-awarding procedure comes under the directives on services and supplies is EUR 200 000. This opinion is based on the fact that the Agreement on Government Procurement (Annex 4 to the Agreement establishing the World Trade Organisation) only expressly lists the Council and the Commission as Community contracting authorities subject to the Agreement. This distinction is carried over into Commission Regulation (EC) No 1687/2001 amending the detailed application rules.

**7.30. THE COURT OF JUSTICE'S REPLIES**

*See the reply to paragraph 7.24(b).*

## THE COURT'S OBSERVATIONS

7.31. With the proposed changes to the implementing measures likely to raise the threshold for the ACPC to between 300 000 euro and 500 000 euro, the institutions should consider introducing an interinstitutional ACPC. This would have the benefit of concentrating expertise, simplifying the process, increasing the independence of the ACPC vis-à-vis particular institutional objectives, and improving the consistency of the interpretation of the Financial Regulation and directives.

## 7.31. THE COMMISSION'S REPLIES

*The concept of an interinstitutional ACPC has been the repeated subject of interinstitutional discussion. The overall conclusion has been that an interinstitutional ACPC, while offering obvious potential advantages in economic terms, tends to be cumbersome in practice. It also raises issues of institutional responsibility and autonomy. However, the Commission agrees that the potential benefits of interinstitutional cooperation could be explored further, e.g. the use of tender clauses which allow other institutions to draw on existing contracts.*

## 7.31. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES

*Given the expertise required and the need to handle dossiers in cooperation with the other institutions, in principle the ESC supports the Court's proposal to introduce an interinstitutional ACPC.*

## 7.31. THE COMMITTEE OF THE REGIONS' REPLIES

*Given the expertise required and the need to handle dossiers in cooperation with the other institutions, in principle the CoR supports the Court's proposal to introduce an interinstitutional ACPC.*

7.32. Institutions should focus, in particular, on controlling the following risk areas in order to improve compliance with the Financial Regulation and directives on procurement:

- (a) the late identification and incorrect valuation of purchasing needs;
- (b) the use of negotiated procedures without fully demonstrating that goods and services could only be provided by one particular contractor or supplier.

## 7.32. THE EUROPEAN PARLIAMENT'S REPLIES

*The ACPC is devoting all necessary attention to subparagraphs (a) and (b). Negotiated procedures are monitored very stringently, whatever the grounds for them.*

## 7.32. THE COURT OF AUDITORS' REPLIES

*The Court of Auditors is in complete agreement with this recommendation, which it is already applying.*

## THE COURT'S OBSERVATIONS

**Other observations**

7.33. The respective balance sheets of the ESC and the Committee of the Regions (COR) neither disclose the value of the buildings worth 225 million euro for which they signed long-lease contracts with an option to purchase in December 2000, nor even the advance of 26 million euro that was paid (which the Commission nevertheless included in the consolidated balance sheet). A formula for apportioning these joint assets between the ESC and the COR has still not been determined.

**7.33. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES**

*The value of the Montoyer building will be included in the 2001 review, as will the value of the Belliard building once the environmental and building permits necessary for carrying out the work have been granted. The Committee has already mentioned these two building leases in its comments on the review.*

*The correction concerning the advance of EUR 26 million, made by the Commission while the ESC's accounts were being consolidated (i.e. after they had been closed), will be entered in the ESC's accounts.*

*The distribution key for these joint ESC and COR assets will be fixed before the end of the financial year 2001.*

**7.33. THE COMMITTEE OF THE REGIONS' REPLIES**

*The value of the Montoyer building will be included in the 2001 review, as will the value of the Belliard building once the environmental and building permits necessary for carrying out the work have been granted.*

*The correction concerning the advance of EUR 26 million, made by the Commission while the COR's accounts were being consolidated (i.e. after they had been closed), will be entered in the COR's accounts.*

*The distribution key for these joint COR and ESC assets will be fixed before the end of the financial year 2001.*

7.34. The Commission has removed computer equipment that has disappeared over the past five years, with a net accounting value of 80 000 euro, from its assets. This does not call for observations concerning the reliability of the balance sheet, but does raise concerns about the fact that such thefts even take place, some of which involved new equipment stolen immediately upon delivery, as the value of such equipment purchased over the five-year period was over one million euro. Even though the equipment stolen only represented annually 0,15 % of the quantity and 0,126 % of the value of all the IT hardware, the loss of new equipment not yet installed shows that the Commission must take action to ensure that such assets are protected.

**7.34. THE COMMISSION'S REPLIES**

*In order to comply with the Court of Auditors' recommendations relating to the 1999 Statement of Assurance, the Commission changed the way in which it deals with stolen computer equipment for the 2000 Statement of Assurance.*

*In future, the Commission will comply with the Court of Auditors' recommendations and the requirements of the Inventory Regulation and at least once a year it will present a file listing equipment stolen during that period which is to be removed from the inventory.*

## THE COURT'S OBSERVATIONS

7.35. The problems with the budgetary nomenclature and the classification of expenditure, which the Court noted in its Annual Report concerning the financial year 1998 (4), result in a lack of transparency as regards the nature of the institutions' expenditure on buildings. The budgetary nomenclature should be amended to follow the example of the Court of Justice's accounts (5), which distinguish between rent, costs of acquisition and other types of expenditure, such as lease payments where there is an option to purchase.

*The Commission Protocol and security service (DG ADMIN) is responsible for protection against and prevention of theft. Apart from direct measures, such as, for example, increased surveillance during removals, this Service regularly conducts campaigns to alert Commission officials and other servants to the problem of theft, in particular, by means of posters and warnings sent through the internal mail.*

## 7.35. THE EUROPEAN PARLIAMENT'S REPLIES

*In order meet the Court's wish, Parliament created a sub-item for each type of expenditure in the budget for 1998. The budgetary authority subsequently decided to delete all the sub-items from the budget, so that it only preserved the distinction between 'Rent and annual lease payments' and 'Acquisition of immovable property'. However, the sub-items were retained in Parliament's accounts, so that information is available per type of expenditure. Nonetheless, Parliament will consult the other institutions over a change in nomenclature so as to clarify expenditure on immovable property and will submit a proposal to the budgetary authorities for the budget for 2003.*

## 7.35. THE COUNCIL'S REPLIES

*The Council will consider the question of budgetary nomenclature when preparing the 2003 PDB.*

## 7.35. THE COMMISSION'S REPLIES

*The Commission will look into the possibility of complying with the Court's recommendation and will, where necessary, change the budgetary nomenclature from the financial year 2003 onwards in order to create a distinction between expenditure linked with:*

- rent
- acquisitions
- long-term lease/purchase payments.

(4) OJ C 349, 3.12.1999, paragraph 6.5.

(5) The Court of Justice's budget distinguishes between rent (heading 2000) and lease/purchase payments (heading 2001).

## THE COURT'S OBSERVATIONS

**7.35. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES**

*Following the Court's suggestion, during 2003 budget preparations the Committee will propose creating a budget line entitled 'Building rent'.*

**7.35. THE COMMITTEE OF THE REGIONS' REPLIES**

*Following the Court's suggestion, during the 2003 budget preparations the Committee will propose creating a budget line entitled 'Building rent'.*

7.36. There are differences in the way the institutions calculate the basic minimum pension. These arise from differences of interpretation of the fourth paragraph of Article 77 of the Staff Regulations, which provides that 'the amount of the retirement pension must not be less than 4 % of the minimum subsistence figure per year of service'. The Court of Justice and, to a lesser degree, the Council apply a broader interpretation than the other institutions, since, in addition to the number of years of service, they take account of any annual contributions acquired following transfers of pension rights acquired outside the department. Harmonisation is needed to put an end to this unequal treatment of officials working in the various institutions.

**7.36. THE EUROPEAN PARLIAMENT'S REPLIES**

*Parliament will approach the other institutions with a view to harmonisation.*

**7.36. THE COUNCIL'S REPLIES**

*Finally, regarding the differences of interpretation in calculating the minimum basic pension, the Council cannot but agree with the need for harmonisation in this area; its departments are ready to participate in any interinstitutional discussion that may be organised for that purpose.*

**7.36. THE COMMISSION'S REPLIES**

*Differences in applying some provisions can occur. In order to limit the negative effects of this, interinstitutional meetings of the departments involved are organised regularly. The Commission undertakes to relaunch the interinstitutional debate on the matter of the particular interpretation of the fourth paragraph of Article 77 by the Council and the Court of Justice.*

**7.36. THE COURT OF JUSTICE'S REPLIES**

*The observations of the Court of Auditors relating to the interpretation given by the administration of the Court of Justice to the fourth paragraph of Article 77 of the Staff Regulations are correct. It is the opinion of that institution that to take less favourable account of the years credited under a*

## THE COURT'S OBSERVATIONS

transfer would be tantamount to depriving an official of part of the benefit of the contributions which he paid into the national pension scheme before entering the service of the Communities and which have been transferred to the Community scheme in order to be taken into account in the calculation of his Community pension. With the exception of the 10 years' service required for entitlement to a pension, the Staff Regulations do not, moreover, draw any distinction between the years of service which are accomplished in the service of the Community and those credited following a transfer.

In 1995 this matter was the subject of interinstitutional discussions in which it became apparent that the Court of Justice's interpretation was followed by the Council also, but not by the other institutions. Given the limited number of cases (at the Court, for example, there have been three), the institutions merely noted the differences of interpretation. The administration of the Court of Justice is of course willing to take part in further consultation with the other institutions for the purpose of making a fresh attempt to reach a common position.

*Follow-up to previous observations***Follow-up to Special Report No 8/98 concerning the Commission departments specifically involved in the fight against fraud**

## Introduction

7.37. The Court examined the operation of the Commission departments specifically involved in the fight against fraud in 1997 and published its findings, together with the response of the Commission, in its Special Report No 8/98<sup>(6)</sup>. This Report contributed to the debate on the future of the anti-fraud unit (UCLAF), which led to Commission Decision 1999/352/EC, ECSC, Euratom<sup>(7)</sup> of 28 April 1999, replacing UCLAF with the European Anti-fraud Office (the Office). In early 2001 the Court visited the Office to assess the progress made on the issues identified in the 1998 Report.

<sup>(6)</sup> OJ C 230, 22.7.1998.

<sup>(7)</sup> OJ L 136, 31.5.1999, p. 20.

## THE COURT'S OBSERVATIONS

## Principal conclusions of Special Report No 8/98

7.38. The principal conclusions of Special Report No 8/98 were that

- (a) the administrative framework in which UCLAF operated and its own organisational structure were not always appropriate;
- (b) UCLAF was not appropriately staffed;
- (c) databases were not always operational or effective, management information was insufficient, and some published information on the fight against fraud was unreliable;
- (d) procedures for dealing with cases of corruption and of internal fraud were ill-defined and incomplete.

## Progress since 1998

*Establishment of the Office*

7.39. In early 1999 the Commission brought forward proposals for the replacement of UCLAF by an independent Anti-fraud Office. Following extensive consultations with the Council and Parliament, which took account of Special Report No 8/1998 and the Court's Opinion No 2/99 (8), the Commission approved Decision 1999/352/EC, ECSC, Euratom (9). This established the new Anti-fraud Office (the Office) as a part of the Commission. The Commission transferred all existing staff of UCLAF to the Office on its approval in April 1999. A Director for the Office (with the status of Director-General) took up his post on 1 March 2000, at the conclusion of a procedure involving the Council and Parliament.

*The new arrangements for the European Anti-fraud Office provide a more appropriate administrative framework*

7.40. The Office forms part of the Commission and can use Treaty powers granted to the Commission. It relies on Commission services for a significant element of logistical support (for example, the provision of office space). However, the arrangements concerning the appointment of the Director, the existence of a

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(8) OJ C 154, 1.6.1999.

(9) OJ L 136, 31.5.1999, p. 20.

## THE COURT'S OBSERVATIONS

Supervisory Committee, and the grant of appointing officer power to the Director all serve to strengthen the investigative independence of the Office.

*Staffing has increased, but more slowly than expected*

7.41. The Director of the Office has the power to appoint staff and to move staff within the Office. He has little scope to remove staff. The difficulties in staffing the Office take three main forms:

(a) the Commission transferred staff *en bloc* from the former UCLAF to the Office before the Director was appointed;

(b) additional recruitment has been slow;

(c) the Office and the Secretary-General of the Commission failed for a considerable time to agree on a procedure for appointments at Director level.

#### 7.41. THE COMMISSION'S REPLIES

*The Director of the Office is bound by the Staff Regulations and therefore in principle also by the rules providing for the removal of staff. OLAF has more temporary staff than other DGs; this makes the management of staff more flexible.*

(a) *It should be noted that the reason for transferring UCLAF staff 'en bloc' to the newly created Office was in order to ensure continuity. There was no realistic alternative at the time of the creation of OLAF, since any other solution would have meant a complete disruption of the Office's activities for a considerable period of time.*

(b) *Shortly after its establishment in mid-1999, the Office had a total of 149 posts in its establishment plan. According to the Court's report, 126 were occupied on 15 September 1999. In 2000, the establishment plan was brought up to 224 posts and on 30 March 2001 the posts in place totalled 189. The high occupation rate in 1999 would not have been possible without the transfer to OLAF of the UCLAF staff in place.*

*At the beginning of 2000, when the Director of OLAF took up his post, DG ADMIN launched together with OLAF a number of selection procedures for temporary agents in order to allow OLAF to recruit the specialist staff needed. These selections, involving some 1 100 candidates, led to the establishment of reserve lists with 150 candidates in A and B grades together in December 2000.*

(c) *It should be noted that the Commission as a whole, not solely the Secretary-General, insisted that candidates for Director-level posts in OLAF, performing classic Commission tasks, representing the Commission vis-à-vis the other institutions as well as the outside world and possibly working at a later stage in other parts of the Commission than OLAF, should also have been assessed in the framework of the Commission procedures in force, notably the 'CCN', the final decision on the candidates*

## THE COURT'S OBSERVATIONS

*remaining entirely with the director of the Office. Further, most senior posts have in the end been attributed on a temporary basis, which means that the Commission did not participate at all in these appointments.*

7.42. The appointment of all former UCLAF staff to the Office can be usefully contrasted with the action taken in setting up the new Internal audit service. In the case of the Internal audit service the Commission did not transfer staff *en bloc* from existing services. Instead it created a small team (including expert assistance from other organisations) to recruit the nucleus of the organisation on the basis of the response to a vacancy notice. In the case of the Office, however, a considerable element of continuity was essential: it was not a feasible option to halt ongoing investigations pending the completion of reorganisation. But this transfer made it difficult for the new Director to choose his own team and replace staff members with inappropriate skills and aptitudes.

7.43. Recruitment of new staff has not progressed as quickly as expected, as is shown in **Table 7.4**. Meanwhile the budgetary authority changed the balance between permanent and temporary posts in a way which was not consistent with the Office's actual recruitment.

**Table 7.4 — Staff resources**

	Staff at 15.9.1998 (UCLAF)	Authorised posts for 1999 (UCLAF)	Staff at 31.12.1999 (UCLAF)	Authorised posts for 2000 (OLAF)	Staff at 31.12.2000 (OLAF)	Authorised posts for 2001 after SAB No 3/2001	Staff at 30.6.2001 (OLAF)
Permanent A	26	64	50	83	71	59	69 (2)
Temporary A	38	7	1	15	1	61	37
Permanent B	18	43	33	60	41	50	40
Temporary B	17	5	1	15	1	66	21
Others	27	30	21	51	39	64	40
<b>Total</b>	<b>126</b>	<b>149</b>	<b>106</b>	<b>224</b>	<b>153</b>	<b>300 (1)</b>	<b>207 (2)</b>

(1) 38 posts in total remain blocked out of the 300.

(2) Includes 10 staff reassigned to posts elsewhere in the Commission who will have left OLAF before 1 October 2001.

Source: European Anti-fraud Office.

## THE COURT'S OBSERVATIONS

7.44. As the Office now has the status of a Directorate-General, more staff are allocated to support services such as Administration, Human resources and Budget (19 posts at March 2001). Although it has a budgetary allocation of 300 posts for 2001, Parliament has blocked 76 of these posts, until the Office has reviewed the suitability of all current staff, and the Commission accepted the resulting transfer decision (10). This conditional grant of staff curtails the independence both of the Director and of the Office as a whole.

7.45. The problems involved in appointing directors arose because a Director appointed within the Office becomes a Director of the Commission at large: the Secretary-General of the Commission therefore considered that he should be represented in the appointment procedure to ensure that a candidate appointed would be capable of fulfilling a directorate role elsewhere in the Commission.

*Databases and management information have not improved significantly since the publication of Special Report No 8/98*

7.46. In Special Report No 8/98 the Court noted that UCLAF made limited use of its databases (IRENE), which led to their contents being unreliable. UCLAF foresaw that full implementation of a new system and integration of this with the previous system would resolve the problems found.

7.47. In its examination of own resources (11) and Structural Funds (12) the Court found that UCLAF and the Office did not update relevant databases with cases notified by the Member States in the period 1997 to 2000. In 2001 usage of databases has begun to improve, and new procedures in the investigations directorate mean that the staff input new cases on a more systematic basis. However, databases were still not reliable or complete and did not provide the full range of information required for effective management of investigations.

## 7.44. THE COMMISSION'S REPLIES

*With the adoption, on 12 July 2001, of supplementary and amending budget No 3/2001, 38 posts were unblocked.*

## 7.45. THE COMMISSION'S REPLIES

*OLAF's operational independence, combined with the need for adapting recruitment to the specificity of the functions exercised by OLAF, argue for an 'ad hoc' composition of the comité consultatif des nominations (CCN) in the framework of procedures for filling management posts, as was confirmed by the Commission on 24 January 2001.*

## 7.47. THE COMMISSION'S REPLIES

*Since the introduction of the case management system (CMS) in May 2001, the reliability and completeness of data concerning cases newly under investigation by OLAF have significantly improved.*

*The support unit is at present in the process of cleaning up data imported from IRENE into CMS and completing an update of all the data recorded.*

*With the introduction of the ECR (the former 'external part' of the old IRENE system) in March 2001, the situation regarding cases communicated by the Member States has equally progressed.*

*The Court's findings with regard to the ECR only relate to the updating of data concerning own resources and Structural Funds. Following the migration to the ECR system, these data are being updated and completed.*

(10) OJ L 56, 26.2.2001, p. 159.

(11) Annual Report, Chapter 1, paragraphs 1.88 to 1.90.

(12) Special Report No 10/2001 on the financial control of the Structural Funds (OJ C 314, 8.11.2001).

## THE COURT'S OBSERVATIONS

7.48. The Office now expects the required improvements to be achieved through two developments: the case management system, introduced in May 2001, and the service platform, which has provided Commission DGs and national administrations with access to formal communications under the sectoral regulations since March 2001. The case management system seeks to provide management with a means of tracking progress. Basic statistics for cases under investigation in March 2001 are given in **Table 7.5**.

## 7.48. THE COMMISSION'S REPLIES

*The CMS database not only seeks to provide management with a means of tracking progress, but is also intended to systematically record and account for all investigative activities of the Office.*

*In accordance with the procedure laid down in the OLAF manual, all incoming mail relating to investigations is now forwarded to the support unit, which maintains the CMS. The registration of cases is now centralised in the support unit (individual investigators no longer have the possibility of opening or closing files) and is performed independently of the investigator pools. In the event that a new case needs to be created, this is systematically performed on the same day correspondence is received by the support unit. Regular reconciliations are performed between the internal mail registration system and new entries in the CMS database, to ensure that all relevant data is captured in the CMS database.*

*Given that the database only came into operation in May 2001, it should be stressed that the figures given in Table 7.5 (basic statistics for cases under investigation in March 2001) are not based on the CMS.*

*The 'service platform' is a concept aimed at furthering cooperation with other services and the Member States. As part of the service platform, a database has been set up (ECR) which provides access to formal communications under sectoral regulations. Member States do not yet have direct access to the data recorded in the ECR. At present, this is only the case for other Commission services.*

**Table 7.5 — Staff resources and cases under investigation as at 21 March 2001**

Sector	Awaiting validation	Under investigation	(of which internal cases)	Cases presented to judicial/other authorities	(of which internal cases)	Number of investigators
Anti-corruption and expenditure	42	136	(33)	213	(14)	
External aid	159	39	(5)	32	(1)	31
Trade	24	108	(1)	51	(0)	
Agriculture	19	20	(0)	7	(0)	
Customs	101	78	(0)	102	(0)	52
<b>Total</b>	<b>345</b>	<b>381</b>	<b>(39)</b>	<b>405</b>	<b>(15)</b>	<b>83</b>

Source: European Anti-fraud Office.

## THE COURT'S OBSERVATIONS

7.49. The new Director has sought to ensure that there is now clear management control of the assignment of investigators to cases and the priorities for investigations and that investigating teams are no longer left to make these decisions themselves. However, the Office has no time-recording system to measure directly resources applied to each investigation. In addition, it currently lacks a comprehensive system for recording the outcome of the different investigations, and amounts recovered. At the time of the audit visit, the Office had no plan to record such information in the case management system.

## 7.49. THE COMMISSION'S REPLIES

*As regards the definition of priorities for investigation and the assignment of investigators to individual cases, a meeting is held once a week by the Board of the Operational Directorate, which is also attended by at least one representative from the Magistrates' unit. The duties of this Board include ensuring a quality control function by reviewing all proposals to open and close investigations and assessing whether the proposed staffing of an individual investigation is appropriate.*

*With a view to recording the outcome of investigations and amounts recovered, two further sections of the CMS — a follow-up section and a recovery section — are currently being defined.*

7.50. In 1998 the Court criticised the quality of information presented in UCLAF's annual report. In 2000 the Annual Report on the Fight against Fraud presented more prudent figures. The Office no longer puts forward unsustainable estimations of the extent of fraud, and the impact of investigations, for example, in the area of excise duty and VAT fraud. The reliability of published information should improve further if the Office successfully introduces the planned case management system, and systematically records the outcome of all cases.

*There is now a legal basis for investigations and procedures are being improved*

7.51. Regulation (EC) No 1073/1999 gives a legal basis for investigations performed by the Office, and establishes its rights and responsibilities. On the basis of this Regulation, the Director of the Office is required to reach a decision as to whether a *prima facie* case exists which merits an investigation. Although the Director has instructed the staff to present a proposal on opening an investigation within one week of the receipt of an indication or allegation of fraud, in early 2001 decisions were taking 16 weeks on average: this was partly explained by the presence of a number of old cases, pre-dating the introduction of new procedures.

## 7.51. THE COMMISSION'S REPLIES

*The one week period referred to is a best guide. In some cases, it is not possible to meet this deadline, due for example to the fact that the information received may require more than five days to analyse. The manual specifically states: 'As the time needed for an initial assessment depends largely on the volume of the material received, and its linguistic accessibility, no formal deadline is applied'. There is a clear trend towards a reduction in the time needed for the initial assessment of a case. Since the introduction of the OLAF manual, the average time needed for an initial assessment has been halved. This downward trend is expected to continue as new staff are recruited and the backlog of old cases is gradually reduced.*

## THE COURT'S OBSERVATIONS

7.52. The Office has begun to create a unit made up of prosecution experts from all Member States. This unit should ensure that investigations always result in admissible evidence in national courts, and that information is passed to prosecution services in the Member States in a usable way. At the time of the audit, this project had not, however, advanced significantly compared to the situation in 1997.

*The investigation of cases within the institutions does not entail a heavy drain on resources, but is hindered by staff rules and procedures*

7.53. The investigation of cases within the institutions has not hitherto required the commitment of substantial staff resources. Only seven of the staff of the Office had ever been involved in the investigation of cases of corruption and internal fraud at the time of the Court's visit in March 2001. None of these worked full time on internal cases. Such cases represent less than 5 % of the workload.

7.54. The new arrangements for the investigation of internal cases<sup>(13)</sup> provide for the Office to inform the institution concerned when an investigation involves a member of its staff (although notification can be waived where absolute secrecy is required). Notification of an enquiry poses a dilemma for the institution involved: it is difficult to suspend a staff member simply because an investigation is under way. On the other hand, the failure to do so, and to exclude the individual from access to his office, may lead to the destruction of relevant evidence. The Staff Regulations can discourage a rapid administrative response to an investigation. Although they allow for an official to be suspended with immediate effect on half pay in the case of allegations of serious misconduct, such a suspension triggers a four-month deadline for the resolution of the issue<sup>(14)</sup>, which is often difficult to meet. If the issue is not resolved within this timescale, the official returns to full pay, and receives the balance of pay withheld. In this situation

## 7.52. THE COMMISSION'S REPLIES

*The staffing of the unit of prosecution experts has progressed considerably. In addition to the head of unit, five prosecution experts have started working in this unit. Three additional prosecution experts will take up their posts in October, and two will do so before the end of the year. As regards the prosecution experts from the four remaining Member States, the recruitment procedure has been relaunched.*

## 7.53. THE COMMISSION'S REPLIES

*At least 16 people are currently working or have worked on internal investigations. A policy of zero tolerance is now in operation concerning suspected cases of fraud within the institutions, meaning that all suspected cases will be investigated without exception.*

## 7.54. THE COMMISSION'S REPLIES

*Regulations (EC) No 1073/1999 and (Euratom) No 1074/1999 provide that the Office's investigations extend to serious matters relating to the discharge of professional duties liable to result in disciplinary or criminal proceedings. In practice, internal OLAF enquiries often result in disciplinary proceedings. However, these proceedings, including the possibility of suspending officials, are the competence of the appointing authority (AIPN)<sup>(6)</sup>. The suspension issue was addressed in the consultative document on discipline (SEC(2000) 2079/5), where it was proposed that the time limit be raised from four to six months. Article 88 of the Staff Regulations provides that an official can only be suspended if an allegation of serious misconduct is made against this official by the appointing authority. In view of the serious consequences that a suspension may have for the person concerned, the Staff Regulations strike a balance between*

<sup>(13)</sup> Article 4 of Regulation (EC) No 1073/1999 of the European Parliament and of the Council.

<sup>(14)</sup> Article 88 of the Staff Regulations.

<sup>(6)</sup> The Director-General of Personnel and Administration in respect of officials of grade A 3 and below and the Commissioner in charge of Personnel in respect of those of grades A 1 and A 2. For officials of grade A 3 and below paid from the research budget, the competent appointing authority is the Director-General of RTO or of the JRC.

## THE COURT'S OBSERVATIONS

institutions have apparently been inclined to wait until further information was available before suspending an official.

7.55. In addition, the Staff Regulations (14) rule out all disciplinary action until the conclusion of any criminal case. This creates very lengthy delays. As the burden of evidence is not the same for a disciplinary case as for a criminal prosecution, and as gross negligence may be apparent in a case in which criminal intent is difficult to prove, such a rule limits unnecessarily the institution's freedom of action.

## Conclusions

*The Office needs more freedom of action on staff issues*

7.56. The Office needs more freedom of action on staffing matters. This might encompass an agreement with the wider Commission to accept transfers of staff from the Office, more flexibility in the appointment of Directors, the possibility of making greater use of temporary staff and the right to determine an appropriate mix of permanent and temporary posts. The Court notes that supplementary and amending budget No 3/2001 converted three of the five Director posts from permanent to temporary, thereby ruling out any question of the appointees to these posts having any right to work elsewhere in the Commission at the end of their fixed-term contracts.

*the presumption of innocence that officials must enjoy, and the need to ensure that investigations can be conducted efficiently.*

*It should be noted that the Office is obliged to inform the institution concerned when an investigation involves a member of its staff but not the member of staff concerned.*

**7.56. THE COMMISSION'S REPLIES**

*As regards staffing policy, the Commission decision of 28 April 1999 (Article 6) has conferred the power of AIPN to OLAF's Director, with regard to his personnel. As a result, the Director enjoys the necessary independence in the appointment and management of staff. The Director of the Office uses his power in full respect of the Staff Regulations and, in principle, in accordance with the rules and practice established by the Commission. Exceptions to these rules are possible whenever these are essential for the fulfilment of OLAF's specific mandate.*

*In line with these principles, a number of steps have been taken in order to accommodate the Court's views with regard to the Office's staffing policy:*

- a number of officials have been reassigned to other Commission services,*
- the procedure for appointing OLAF's directors has been adjusted,*
- the Office currently has more than one half of its total A grade resources in the form of temporary posts.*

## THE COURT'S OBSERVATIONS

*The Office should determine priorities and strategies on the basis of Commission competencies and the direct risk to the budget*

7.57. The value added by the Office varies significantly between different areas of activity. In the area of expenditure, in particular direct expenditure, the Office has direct responsibility and a key role. In areas such as excise duty and VAT, the Office has no direct competence but can provide support to the Member States, even though the Community budget is, at most, only indirectly affected by fraud in these areas. There should be scope for the Office to become more proactive in launching investigations in expenditure areas, for example, on the basis of risks identified from other cases.

*The Staff Regulations should be amended to facilitate the suspension of individuals subject to investigation and to speed up disciplinary action*

7.58. It would be appropriate to change the Staff Regulations to:

- (a) lengthen the period over which officials under investigation can be suspended on half pay;
- (b) provide for their immediate exclusion from Community premises, thereby reducing the risk that the officials will destroy relevant evidence.

*Management information and published information must become more reliable, pertinent and comprehensive*

7.59. The deficiencies identified in databases in 1998 are, in general, still present, although several developments are in the pipeline. Management information needs to be sufficient to track all cases throughout the investigation process, to record the resources devoted to different classes of enquiry, and indeed, individual cases (for example, through the introduction of a time-recording system) and record fully the outcome of investigations.

## 7.57. THE COMMISSION'S REPLIES

*The Office agrees with the need to adopt a proactive attitude to launching investigations in expenditure areas, on the basis of risks identified from other cases. The recent creation of a specific Directorate for Intelligence, which will, on the basis of risk analysis, establish guidelines for investigation priorities, is expected to further this aim.*

## 7.58. THE COMMISSION'S REPLIES

*(a) The suspension issue was addressed in the consultative document on discipline (SEC(2000) 2079/5), where it was proposed that the time limit be raised from four to six months.*

## 7.59. THE COMMISSION'S REPLIES

*The deficiencies identified in 1998 have for the largest part been corrected. The new CMS, in conjunction with the OLAF manual, provide for significant improvements in the reliability and completeness of management information (see replies to 7.48 to 7.50 above).*

## THE COURT'S OBSERVATIONS

*A period of stability is now required*

7.60. The investigation units of the Commission have been reorganised on two occasions in the last seven years. Each time a change has been made at the top level, with a relatively minor impact at the level of investigators. Following the creation of the Office in April 1999, nearly one year passed before a new Director was able to take up post, and subsequent changes to procedures and to staffing are only now being made. Given the length of most investigations, it will take some time for these to have a significant impact on the results of the Office. In the view of the Court, the Office will always require a substantial number of expert temporary staff on medium-term secondment from national authorities responsible for investigating and prosecuting fraud.

**7.60. THE COMMISSION'S REPLIES**

OLAF also needs a reasonable number of permanent staff, taking into account the specific role of the Office, which is not only an investigative body, and the need to manage staff turnover. As the Court itself stressed in its conclusions to Special Report No 8/98, a balance needs to be found between the number of permanent and temporary staff, in order to ensure the necessary stability, continuity and independence of the Office.

*In addition to the permanent posts, the Office has a high number of temporary posts and can also employ 13 national experts on secondment.*

*The one year it took to appoint the Director of OLAF can partly be explained by the wish of the European Parliament for the new Commission, which took office in September 1999, to participate in the appointment decision and not the old one. The decision on the person of the new Director was made before the end of 1999; the new Director could, however, not take up his new position before March 2000.*

7.61. Regulation (EC) No 1073/1999 of the European Parliament and of the Council (<sup>15</sup>) provided for a review of its operation by 31 May 2002. Given the delays experienced in appointing the Director, and increasing the staffing of the Office, it now appears that such a review will be premature, as it will be difficult to determine whether the new approach to fraud investigation is proving successful until the second half of 2002 at the earliest.

**7.61. THE COMMISSION'S REPLIES**

While the Commission shares the view that most of all a stable regulatory and institutional framework is needed for OLAF to develop its full potential, the Commission nevertheless believes that the review foreseen in Regulation (EC) No 1073/1999 offers a useful opportunity for assessing the progress made so far and possible improvements.

<sup>(15)</sup> OJ L 136, 31.5.1999, p. 1.

## THE COURT'S OBSERVATIONS

**Follow-up to various previous observations made by the Court concerning the institutions' management of expenditure on buildings**

7.62. In its Special Report No 5/2000 (16) on the Court of Justice of the European Communities' expenditure on buildings, the Court made the following recommendations to all the institutions:

**7.62-7.65. THE EUROPEAN PARLIAMENT'S REPLIES**

*Once the requisite amendments to the Financial Regulation have been adopted, Parliament will support the Court in its recommendations concerning the institutions' buildings, particularly the possibility that they might take out direct loans to finance the acquisition of buildings.*

*Parliament is already doing everything necessary to maintain full control over its building projects, particularly in Brussels and Luxembourg, and will continue its efforts in this respect.*

**7.62. THE COMMISSION'S REPLIES**

- (a) Community institutions should obtain the budgetary authority's prior authorisation before undertaking an extensive building project;
- (b) the Communities should set up a multiannual investment budget and look into the advantages of making direct use of loans to finance construction programmes;
- (c) the Communities should have full administrative, technical and financial control over their construction projects;
- (d) in the event that the Communities wish to delegate their powers as project owner, the delegation procedures, ceiling price and the rights and obligations of the authorised agents should be stipulated in a contract beforehand.

**(a)** *Every major or sensitive buildings file will first be the subject of a communication to the budgetary authority before any undertaking is given. Furthermore a communication from Mr Kinnock to the full Commission on buildings policy and its implementation is being prepared and will be presented in autumn 2001.*

**(b)** *See replies to 7.64.*

**(c)** *The Commission shares the Court's opinion with regard to the control of buildings projects and took it into account in its action plan for the setting up of an office for logistics and operational support on which it will take a decision shortly.*

**(d)** *Should the Commission delegate its function of project owner, any adjustments made by the authorised agent are in its own name within a fixed budgetary allocation for a work programme covered by a contract.*

(16) OJ C 109, 14.4.2000.

## THE COURT'S OBSERVATIONS

## 7.62. THE COURT OF AUDITORS' REPLIES

*The Court of Auditors' administration agrees entirely with the recommendations set out in this paragraph and, what is more, has used them in the context of its current building project, in so far as is possible under the current rules. I.e.:*

- (a) *the budgetary authority's prior approval was obtained before the project was undertaken;*
- (b) *not applicable, given the current rules;*
- (c) and (d) *as the Court did not have enough staff to enable it to exercise complete administrative, technical and financial control, it delegated these tasks on a contractual basis.*

7.63. In the wake of these recommendations, the Commission included the option, where necessary, of contracting a loan to finance such expenditure<sup>(17)</sup> in its proposal to amend the Financial Regulation.

7.64. This idea, which is also put forward by the Court in the opinion it delivered prior to the amendment of the Community Treaties in Nice, was not taken up by either the Intergovernmental Conference or the Council. The result is that several institutions continue to finance their property purchases by means of 'special purpose vehicles', which bear the same principal features as loans, but cost more than if had they been contracted directly.

7.65. The process of reviewing the Financial Regulation is not conducive to prompt introduction of the widespread use of differentiated appropriations and, at present, the appropriations authorised for property transactions still have a limited two-year life (a year, plus one for carry-overs) during which time the commitments, signing of contracts, performance of the work and subsequent payments have to be effected. None of the institutions is in a position to have any sort of

## 7.63, 7.64 and 7.65. THE COMMISSION'S REPLIES

*In spite of the difficulties referred to by the Court, the Commission is continuing to press for the possibility of raising loans to finance buildings expenditure. In its amended proposal for the recasting of the Financial Regulation, the Commission maintains and clarifies its proposal (Article 14(2): the Communities may not raise loans to cover a budget deficit. They are, however, authorised to raise loans for the sole purpose of acquiring land and buildings and on the strict condition that such loans offer every guarantee of sound financial management).*

## 7.63-7.65. THE COURT OF AUDITORS' REPLIES

*The Court of Auditors was indeed obliged to spend the appropriations by paying advances against future work because the current text of the Financial Regulation makes no provision for either dissociated appropriations or recourse to borrowing.*

<sup>(17)</sup> See also Opinion No 4/97.

## THE COURT'S OBSERVATIONS

construction completed within such a short space of time. The Committees (ESC and COR), as well as the Court, thus found themselves in a position where they were spending their committed appropriations in the form of advances against future work.

7.66. The institutions in Luxembourg (Parliament, Court of Justice, Commission and Court of Auditors) have begun to explore the possibility of setting up a joint structure to take charge of the various technical and financial aspects of construction matters. The Court hopes that a similar approach will be taken in Brussels.

## 7.66. THE EUROPEAN PARLIAMENT'S REPLIES

*There is indeed likewise a technical working party for Brussels by means of which representatives of the institutions present at the location exchange information, compare their views and try to agree common positions on specific issues of mutual interest.*

## 7.66. THE COMMISSION'S REPLIES

*The meeting between Secretaries-General of institutions that took place on 9 July 2001 endorsed the recommendations (see below) contained in the report prepared by the interinstitutional working group on buildings policy. The working group is invited by the Secretaries-General to pursue its reflections as regards the possible pooling of resources, and a specific report on the buildings policy in Luxembourg has been drawn up and will be circulated to Secretaries-General for their comments.*

*The working group recommends the following courses of action to the Secretaries-General.*

- *The institutions should further develop a common strategy with respect to the appropriate public authorities of the host Member States on the questions of common interest. In particular, they should make common cause in Brussels for the conclusion of an accord de siège in order to provide a stable framework for their collective relations with the Belgian authorities.*
- *A regular information and consultative structure should be established through which the institutions exchange information on their buildings policy and intentions vis-à-vis the property market. To secure such a continuous information flow, the existing formal and informal meetings on information exchanges at the administrative level should be more structured, and held regularly (i.e. twice a year) with a fixed agenda and a rotating presidency. This could evolve into a consultative committee, following the example of the IT sector.*

## THE COURT'S OBSERVATIONS

- The institutions should draw up a charter for the provision of mutual assistance in the field of building policy. Such assistance should take the form of service provisions in connection with specific buildings-related dossiers, allowing all to make use of expertise available in each institution: framework contracts, contractors already in place or individual specialists.
- The institutions should jointly negotiate future utility contracts where their collective weight would enable much better conditions to be obtained, in particular in view of the planned market liberalisation in certain sectors.
- Renewed efforts should be made to arrive at mutual recognition procedures between the various institutions for tendering and other pre-contractual and contractual arrangements. The Presidents of the ACPC of each institution should be asked to draw up a common document on the necessary conditions to be fulfilled in order to achieve this mutual recognition in full compliance with the Financial Regulation and the relevant directives for public tendering.
- The institutions should further examine how their obligations under health and safety legislation can be implemented on an interinstitutional basis in an effective and legally secure manner, whilst respecting the legal obligation for each to retain responsibility for its own premises.
- Since environmental obligations and standards are common to all, each institution will benefit from the results of the interinstitutional study currently being carried out on the environmental impact assessment of buildings. This study forms part of the overall 'green housekeeping' activities that already are subject to regular interinstitutional consultations. The result of the study should lead to specific proposals and initiatives with regard to the equipment and management of buildings with an interinstitutional environmental dimension.
- A common software system for inventory management designed for interinstitutional use should be implemented in all the institutions as soon as possible.

There is a need for the creation of a particular regulatory framework for property acquisition by the institutions. The financial and budgetary mechanisms currently in place are not well suited to the financing of a building policy, especially since there is a shift from a purely rental policy towards the acquisition of buildings.

## THE COURT'S OBSERVATIONS

**7.66. THE COURT OF AUDITORS' REPLIES**

*The Court's administration has, along with the other institutions located in Luxembourg, committed itself fully to setting up a logistical structure for building matters which would pool all the resources available to each institution. It has also expressed its preference at a meeting of Secretaries-General for an interinstitutional structure that is common to all the main places of employment (Brussels, Luxembourg and Strasbourg) as far as technical matters are concerned.*

**7.66. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES**

*The ESC welcomes the Court's suggestion to create a joint structure responsible for the various technical and financial aspects of premises in Brussels.*

**7.66. THE COMMITTEE OF THE REGIONS' REPLIES**

*The COR welcomes the Court's suggestion to create a joint structure responsible for the various technical and financial aspects of premises in Brussels.*

7.67. The Court's Report (paragraph 20(f)) also drew attention to invoicing anomalies that called for additional investigation. The Court of Justice replied that it intended to conduct the investigations concerned to ensure that there had been no irregularity. The Court of Auditors notes that these investigations had only just started in June 2001.

7.68. The Court notes that the Committees (ESC and COR), when renewing and renegotiating the contract concerning the Belliard building formerly occupied by the European Parliament, found themselves in a difficult position as a result of an obligation placed on them by Parliament, i.e. that of taking over this building, for which Parliament had signed a lease running until 2007. Nevertheless, they succeeded in reintroducing an

**7.67. THE COURT OF JUSTICE'S REPLIES**

*An expert has been appointed, by common agreement with the Luxembourg authorities, to undertake further investigations concerning invoicing anomalies, in order to respond to the observations in paragraph 20(f) of Special Report No 5/2000 of the Court of Auditors on the expenditure of the Court of Justice of the European Communities on immovable property. Those further investigations were still under way in October 2001.*

**7.68. THE ECONOMIC AND SOCIAL COMMITTEE'S REPLIES**

*Following the Court's suggestion, the ESC and COR have reopened negotiations with the owner with a view to possible early repayment if the financial terms are reasonable.*

## THE COURT'S OBSERVATIONS

element of negotiation by deciding to refer to the market in the summer of 2000. The prices finally agreed are more in line with those offered on the Brussels market for this type of building. This new contract contained an early repurchase clause, but no provision was made for reducing the balance to be paid in the case of early repayment of the illiquid capital by the owner. It would be advisable for this aspect of the contract to be renegotiated forthwith to provide the option of an early repurchase under economically reasonable conditions.

*The pay system applicable to EU employees***Introduction**

7.69. As shown in **Tables 7.2 and 7.3**, the European Communities employ some 33 600 permanent and temporary staff members. The gross annual cost of salaries amounts to about 2,5 billion euro, or nearly 3 % of the budget. Taxes and other charges levied upon staff amount to nearly 0,5 billion euro, and are treated as a budgetary receipt.

7.70. The Court audits salary payments each year and has found very few cases of mistakes. This year the Court has also performed an analysis of certain aspects of the efficiency and effectiveness of the pay system. It should be recognised that there are strong interactions between the pay system and other aspects of staff management, including in particular promotion policy and arrangements for reporting on the performance of staff. The Court's aim was to assess whether the pay system, together with other personnel management arrangements, facilitates the effective recruitment, motivation and retention of staff<sup>(18)</sup>. The Court has not sought to form a judgement about the appropriateness of the overall level of pay.

**7.68. THE COMMITTEE OF THE REGIONS' REPLIES**

*Following the Court's suggestion, the COR and ESC have reopened negotiations with the owner with a view to a possible advance payment of the rent on financially more advantageous terms.*

<sup>(18)</sup> An effective retention policy should lead to staff resources being appropriately balanced in terms of age, experience and gender. It does not necessarily seek to ensure that all staff remain in post until retirement age.

## THE COURT'S OBSERVATIONS

7.71. In performing this audit, the Court has examined the legislative instruments (<sup>19</sup>) which set out the personnel system. It has also tried to identify areas where the application of these legislative instruments fails to achieve their intended objectives. In order to evaluate the Community system, the Court has visited five Member States, reflecting the full range of administrative traditions present within the Community. It has also visited a number of international organisations which face challenges close to those of the institutions. Information has been gathered on the basis of interviews with representatives of these administrations and organisations.

**The current pay system**

7.72. The current pay system is relatively simple. It is essentially made up of:

- (a) a basic salary (determined by individual category, grade and step) (see below);
- (b) plus family allowances:
  - a household allowance (5 % of basic salary),
  - a dependent child allowance (at 1 July 2000, 2 688 euro per year per child);
- (c) plus other allowances:
  - expatriation allowance (16 % of basic pay, paid to staff whose country of origin is not that of their place of work), or
  - 4 % paid to staff recruited locally, but who are not nationals of their place of work,
  - secretarial allowance (for those with specific secretarial skills);

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(<sup>19</sup>) Council Regulation No 259/68 of 29 February 1968 (OJ L 56, 4.3.1968, p. 1), as subsequently amended on numerous occasions, contains the main provisions concerning the Staff Regulations of officials and the Conditions of employment of other servants. It was last amended by Regulation (EC, ECSC, Euratom) No 2805/2000 (OJ L 326, 22.12.2000, p. 7).

## THE COURT'S OBSERVATIONS

(d) less social security contributions:

- pension,
- sickness insurance (1,7 % of basic salary),
- accident insurance (0,1 % of basic salary),
- unemployment insurance (for temporary staff) (0,4 % of basic salary);

(e) outside Brussels and Luxembourg, a correction coefficient (over, equal to or under 100 %) is applied, in combination with an exchange rate fixed annually for the countries which have not adopted the euro, to compensate for the difference against Brussels' cost of living;

(f) all officials, permanent and temporary, are subject to progressive income tax (top marginal rate of 45 %) on their remuneration and this revenue accrues to the EU budget. In addition, they pay a temporary contribution of 5,83 % on all remuneration in excess of a basic minimum.

7.73. Grade and step depend largely upon recruitment level and seniority. Staff are usually recruited at entry levels (A 7/A 8, B 5, C 5, D 3/D 4) depending on their education levels. In theory, they receive an automatic increase ('step') every two years until they reach the top of the scale for their grade. Thus, staff have the right, on appointment or promotion, to incremental pay increases of up to 25 % to 30 % within their new grades. Most staff receive some credit for previous experience and, if promoted, are ranked at a step above the one corresponding to their previous salary and so are paid above the scale minimum. Hence, it is rare for staff to pass through more than four seniority steps in any one grade, which implies a 20 % increase in salary. Relative pay rates for the various grades and steps are set out in **Table 7.6**.

7.74. Promotion is, in principle, based on the ability and performance of staff. Under the Staff Regulations, officials become eligible for promotion after two years' service in a grade. The Commission calculates that the

Table 7.6 — 100-based salary scale index

Standard posts	Grade	Steps								Total percent- age increase available
		1	2	3	4	5	6	7	8	
Administration (A) and language service (LA) University education										
Director-General	A 1	580,03	610,85	641,66	672,47	703,28	734,10			26,6
Director	A 2	514,73	544,13	573,54	602,94	632,34	661,74			28,6
Head of Division	A 3/LA 3	426,29	452,01	477,73	503,45	529,16	554,88	580,60	606,32	42,2
Principal administrator	A 4/LA 4	358,13	378,20	398,28	418,35	438,43	458,50	478,57	498,65	39,2
Principal administrator	A 5/LA 5	295,26	312,75	330,24	347,74	365,23	382,72	400,21	417,71	41,5
Administrator	A 6/LA 6	255,16	269,08	283,00	296,93	310,85	324,77	338,69	352,61	38,2
Administrator	A 7/LA 7	219,64	230,57	241,50	252,43	263,36	274,29			24,9
Assistant administrator	A 8/LA 8	194,25	202,09							4,0
Administration and technical service (B) Advanced secondary education										
Principal administrative assistant	B 1	255,16	269,08	283,00	296,93	310,85	324,77	338,69	352,61	38,2
Senior Administrative Assistant	B 2	221,08	231,44	241,81	252,17	262,54	272,90	283,26	293,63	32,8
Senior Administrative Assistant	B 3	185,44	194,06	202,67	211,29	219,91	228,53	237,15	245,76	32,5
Administrative assistant	B 4	160,39	167,86	175,33	182,81	190,28	197,76	205,23	212,70	32,6
Administrative assistant	B 5	143,36	149,41	155,46	161,51					12,7
Secretariat and clerical service (C) Standard secondary education										
Executive secretary/principal clerical officer	C 1	163,59	170,18	176,78	183,38	189,97	196,57	203,17	209,76	28,2
Secretary/clerical officer	C 2	142,29	148,33	154,38	160,42	166,47	172,51	178,56	184,60	29,7
Secretary/clerical officer	C 3	132,73	137,91	143,09	148,27	153,44	158,62	163,80	168,98	27,3
Typist/clerical assistant	C 4	119,93	124,79	129,64	134,50	139,36	144,22	149,08	153,93	28,3
Typist/clerical assistant	C 5	110,58	115,11	119,64	124,18					12,3
Messenger and driver services Primary education										
Head of Unit	D 1	124,97	130,44	135,90	141,37	146,84	152,30	157,77	163,23	30,6
Skilled employee/worker	D 2	113,95	118,81	123,66	128,51	133,37	138,22	143,07	147,93	29,8
Skilled employee/worker	D 3	106,06	110,60	115,14	119,68	124,22	128,76	133,30	137,84	29,3
Unskilled employee/worker	D 4	100,00	104,10	108,20	112,30					12,3
Average increase (%)										28,3

NB: The Court carried out its 100-based indexation with reference to the lowest salary paid (D 4, step 1).

With effect from 1 July 2000, the monthly value of the index point is 19,8129 euro, i.e. 1 981,29 euro for a member of staff at Grade D 4/1 (index 100).

## THE COURT'S OBSERVATIONS

average career period needed from A 7 to A 4 is just over 15 years. Those staff who reach grade A 3 have on average 18 years' experience within the Commission, with very few achieving this in less than 14 years. Although the Staff Regulations make some provision for appointment of staff at levels above the entry grades, as a matter of policy institutions have made relatively little use of the facility. However in recent years the Commission has arranged a number of competitions at A 4/A 5 level in order to recruit different categories of specialists.

## Recruitment

7.75. The institutions do not generally find it difficult to recruit sufficient candidates to fill most posts: often hundreds of candidates apply for every post available. However, certain nationalities are underrepresented in open recruitment competitions for general service permanent posts <sup>(20)</sup>. In general, the structure of remuneration interacting with local economic and fiscal conditions results in employment in the institutions being very attractive to candidates who live close to a centre of activity and less attractive to candidates who will need to move to take up employment. Lower numbers of candidates apply from regions with high levels of pay. In the case of specialist competitions aiming to recruit staff with professional skills which are well rewarded across the EU, there are again relatively fewer applicants, plus geographical imbalances.

## 7.75. THE COMMISSION'S REPLIES

*The Commission acknowledged this problem (underrepresentation of certain nationalities) in its consultation document on recruitment policy of 28 February 2001, but is willing to continue its efforts to reach a better geographical balance. Visits in Member States are regularly organised to raise awareness amongst possible candidates from all countries.*

*The Court refers to the lower number of candidates from regions with high pay levels. This is true in respect of the United Kingdom, the Netherlands, Germany and Sweden despite great publicity efforts by the Commission. The imbalance in candidates from different regions leads inevitably to imbalances in the recruits subsequently. Therefore, there is a close link to pay level, not only to recruitment.*

*A further reason is linked to family situation: moving from remote regions often means that spouses or partners need to give up their job without any guarantee of equivalent career possibilities at the site of the European institutions.*

<sup>(20)</sup> The Commission told the Court that there are notably lower numbers of candidates from regions with high pay levels. For example, in the last B competition on financial management there were 2 056 candidates, of whom only 26 were from the United Kingdom and 117 from Germany, and in the last B competition on information technology there were 1 228 candidates, but only 14 from the United Kingdom and 50 from Germany.

## THE COURT'S OBSERVATIONS

## Motivation

7.76. Other than through the scope for promotion, the Community pay system does not seek to motivate staff through targeted financial rewards. There is no provision for any responsibility allowance or performance bonus. Nor is there any clear association between grades and defined levels of responsibility. Within the Commission, for example, heads of unit may be of grades A 3, A 4 or A 5. They may have higher graded (and higher paid) staff within their team.

## 7.76. THE COMMISSION'S REPLIES

*In reply to the statement on motivation, financial rewards, performance bonus, it is necessary to point out that superiors having higher graded staff in their teams, is rather an exception and that the fact of having higher paid staff is mostly a result of seniority steps.*

*In its orientation paper of 28 February 2001, the Commission endorsed the ideal of introducing position-related premiums. The results of the concertation with staff representatives on such premiums need to be awaited. Premiums could in particular be relevant for rewarding heads of unit.*

*The introduction of a performance bonus has expressly been rejected as inappropriate in the multicultural context in which the institutions operate.*

*Article 7(2) of the Staff Regulations allows in principle higher payment for an official temporarily in a posting above the grade held. In addition, Article 99 of the Staff Regulations provides for a bonus system for scientific staff.*

*In terms of staff, the Commission employs two thirds of all staff falling under the Staff Regulations. The need for heads of units (nearly 800 today) is greater than in any other institution. Another option would be to employ all these heads of unit at A 3 level as in the other institutions, which would increase the wage bill.*

*Careers should not only be seen from the point of view of management functions. Firstly, a career-based system should allow each average official in category A to reach A 4. Secondly, providing careers for top specialists up to A 3 is important.*

*According to the consultation document on middle management, the Commission intends to move, in the medium term and after a reform of the career structure, towards a system where A 3 appointments are only promotions of heads of unit or advisers at A 4 grade thus excluding selection to vacant A 3 posts.*

## THE COURT'S OBSERVATIONS

## Stability

7.77. Among permanent officials, staff turnover is very low. 532 staff left the Commission during 2000. This represents around 3 % of the total permanent staff at the Commission at the end of 2000. This experience is consistent with a pay system which enables staff who have achieved some limited promotion to continue to receive automatic increases until the end of their career, and pension entitlements are earned at a faster rate between the age of sixty and sixty-five. There is no ongoing scheme for early retirement: the terms on which officials over 50 with a minimum of 10 years' service can choose to retire with actuarially reduced immediate pensions are not attractive, with the result that, at the Commission, fewer than 10 people a year follow this course as against 350 normal retirements and 130 invalidity retirements.

7.78. A high proportion of officials have served in the institutions for many years. For instance, within the Commission, 54 % of A 4 grade staff and above have been with the institutions for at least 20 years. The corresponding percentages for B 1 and B 2 grade staff and C 1 and C 2 grade staff are 58 % and 70 % respectively.

**The EU system compared with other systems**

7.79. The Court sought to compare the Community system with the systems of some of the Member States and of certain international organisations. This examination focused upon whether:

- (a) staff were generally expected to have a job for life;
- (b) staff received automatic increases based on age/seniority;
- (c) performance bonuses are paid;
- (d) responsibility allowances are paid;
- (e) recruitment is open to all levels.

## 7.77. THE COMMISSION'S REPLIES

*The Commission would like to add that since the first waves of staff are about to retire now, the future figures should be awaited (pension problems) before taking the figures of 2000 as representative.*

## THE COURT'S OBSERVATIONS

7.80. Pay structures differ widely among the organisations examined. All Member States have some element of flexibility not present in the EU system in that they use some combination of performance bonuses, responsibility allowances and open recruitment at all levels. The international financial institutions share many of these features and tend to make particularly extensive use of performance bonuses. The other international organisations operate systems which are closer to the EU system, although still taking the more flexible approach on at least one of the points listed above.

7.81. All the Member States' systems examined, except for Sweden, offered civil servants the prospect of a job for life; in the United Kingdom, however, civil servant numbers have been considerably reduced through compulsory redundancy, early retirement or privatisation of functions. No Member State has fully automatic bonuses based solely on age or seniority. France and Germany come closest to the EU system, but vary the date on which increments are paid on the basis of performance. All these Member States pay performance bonuses of some kind, with these being least common in Sweden. In Sweden, however, pay is set individually each year for each civil servant, taking performance into account. In Germany performance bonuses are not paid to staff working in ministries at Federal level, as a fixed allowance is paid to all such staff. All these Member States pay some form of responsibility allowance. Open recruitment at all levels is possible in Italy, Sweden and the United Kingdom. In Germany this is only the case for public sector workers who are not classified as statutory civil servants. The EU position is clearest on all points: EU civil servants have a guaranteed job for life; they receive fully automatic increments every two years, regardless of performance; they are not paid performance bonuses or responsibility allowances. In general, recruitment in the EU is at entry level.

7.82. Among the international organisations only the EIB offers a guaranteed job for life to staff. In the United Nations, staff usually work for six years on temporary contracts, but may then be granted continuing contracts. Automatic increases based on seniority are paid by Europol, the OECD and the United Nations, but not by the Investment Banks. In contrast, only the Investment Banks pay performance bonuses. None of these institutions pays responsibility allowances, and all recruit at all levels. The United Nations does not usually offer expatriate terms to general service staff, and recruits locally to fill the bulk of such positions.

## THE COURT'S OBSERVATIONS

7.83. **Tables 7.7 and 7.8** seek to classify the comparative systems on a simple yes/no binary schema. In practice, personnel arrangements form a broad continuum, and to that extent the classification represents an oversimplification. The footnotes to these tables give an indication of the extent to which certain Member States and international organisations occupy an intermediate position.

**Table 7.7 — Some Member State and EU pay systems**

	Job for life	Automatic increases based solely on age/seniority	Performance bonuses	Responsibility allowances	Open recruitment at all levels
France	Y	N <sup>(1)</sup>	Y	Y	N
Germany	Y	N <sup>(1)</sup> ( <sup>(2)</sup> )	Y <sup>(3)</sup>	Y	N <sup>(4)</sup>
Italy	Y	N	Y	Y	Y <sup>(5)</sup>
Sweden	N	N	Y <sup>(6)</sup>	Y	Y
United Kingdom	Y <sup>(7)</sup>	N	Y	Y	Y
EU	Y	Y	N	N	N <sup>(8)</sup>

(<sup>1</sup>) The date upon which the increment is paid is variable, dependent on performance.

(<sup>2</sup>) No incremental progression after age 53.

(<sup>3</sup>) Not paid to federal civil servants in the ministries.

(<sup>4</sup>) However, this is an option for the largest group of public sector employees who are not classed as civil servants.

(<sup>5</sup>) Italy has radically reduced the number of grades, increased the rate of responsibility allowance and permitted the recruitment of outside managers on fixed-term contracts.

(<sup>6</sup>) Provided for, but not common in practice.

(<sup>7</sup>) In practice most civil servants have continuing contracts and can expect life-time employment if they wish to remain in the civil service, however there is significant movement in and out of the public sector.

(<sup>8</sup>) Recruitment is concentrated at the basic levels, except for the most senior posts, although the Commission has recently made some use of A 4/A 5 competitions.

**Table 7.8 — International organisations' and EU pay systems**

	Job for life	Automatic increases based on age/seniority	Performance bonuses	Responsibility allowances	Open recruitment at all levels
EBRD	N	N	Y	N	Y
EIB	Y	N	Y	N	Y
Europol	N	Y	N	N	Y
OECD	N	Y	N	N	Y
UN	N <sup>(1)</sup>	Y <sup>(2)</sup>	N	N	Y
EU	Y	Y	N	N	N <sup>(3)</sup>

(<sup>1</sup>) Staff are usually employed on temporary contracts for the first six years of employment. Thereafter, they are employed on continuing contracts.

(<sup>2</sup>) In theory, incremental progression is dependent on satisfactory performance, although, in practice, such progression is quasi-automatic.

(<sup>3</sup>) Recruitment is concentrated at the basic levels, except for the most senior posts, although the Commission has recently made some use of A 4/A 5 competitions.

## THE COURT'S OBSERVATIONS

**Assessment of the EU system**

## Strengths of the EU system

7.84. Pay at all levels is generally transparent. The rules are relatively simple, and few errors occur in the determination of pay. Overall, pay levels attract a sufficient number of suitable candidates for general service recruitment competitions.

7.85. The emphasis on seniority may form a protection against discriminatory treatment of staff. This arguably is a particular risk in the Community context, given the difficulty of establishing objective measures of performance, and the apparent low levels of confidence in systems for staff evaluation.

7.86. The dissociation between grade and responsibility, which is particularly apparent in the Commission, can be seen as a recognition of staff merits which overrides the grade and pay structures.

## Weaknesses of the EU system

7.87. Apart from the uncertain prospect of eventual promotion, the current system does not provide a financial incentive for staff to accept additional responsibilities, and does not reward staff who perform well, but who cannot, for whatever reason, be promoted. The very extensive provision for automatic increases, combined with large overlaps between grades, results in a system which gives a great deal of weight to length of service as compared to other factors.

**7.87. THE COMMISSION'S REPLIES**

*As a matter of fact, the Commission having noticed weaknesses in the current personnel policy is engaged in a reform process, one of whose main objectives is to provide a better link between career development and the performance and merit of officials while continuing to reward experience. Although it is true that in the existing pay system there are no salary increments based on performance, the proposals contained in the consultative document on a new staff appraisal and promotion system provide for a reward for performance through a yearly assessment of merit. Merit would be appraised on the basis of staff's performance, competencies and conduct. In turn, performance would be assessed against predefined objectives. The impact of performance on career development reports and the direct link between merit and promotion would result in a significant reward of performance. It is not entirely true that the same salary scale applies to all staff, both generalists and those with particular specialist qualifications is concerned, as Articles 92 to 101 of the Staff Regulations contain special provisions for officials in the scientific or technical services of the Communities. Besides, the reform proposals contain more flexibility for the initial grading.*

## THE COURT'S OBSERVATIONS

7.88. While the system helps institutions to retain staff and thereby ensure continuity in their activities, the low turnover of staff means fewer promotion opportunities and less scope for the introduction of new ideas. The ongoing arrangements do not facilitate early retirement and thereby bring younger people more quickly into management positions.

## 7.88. THE COMMISSION'S REPLIES

*The Commission does not entirely share the opinion of the Court of Auditors and would like to make the following comments.*

- Fresh ideas are not intrinsically linked to new recruits. The principle of life-long learning has been highlighted in the orientation paper on career. This principle is also expressly endorsed by Member States. In addition, seconded national experts make important contributions in this context.
- The Commission is always open to recruitment at intermediary level, in particular A 5/A 4. It is organising external competitions in 2001 to recruit specialists.
- A permanent 'early retirement scheme' is being considered among Commission reform ideas.

7.89. The same salary scales apply to all staff, both generalists and those with particular specialist qualifications. This makes it relatively more difficult to recruit people whose specialist qualifications are more highly rewarded in the wider market.

**Concluding remark**

7.90. The Commission is currently consulting on possible changes to the pay and career structure. In reaching decisions on eventual changes, a careful balance will need to be struck which addresses some of the problems associated with the present system, without at the same time calling into question its essential strengths.

## 7.90. THE COMMISSION'S REPLIES

*The Commission basically agrees on the concluding remark drawn by the Court of Auditors in point 7.90. In the consultative documents of 28 February 2001 on the reform of the personnel policy, the emphasis was on remedying problems of the current pay and career structure whilst not detracting from its strengths. Continued attention is given to this particular concern during the current consultation process*

## AUDIT OF THE COMMUNITY SATELLITE BODIES

*Introduction*

7.91. The annual audits of the Community satellite bodies have been reported on in specific annual reports (21).

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(21) Currently being published in the Official Journal.

## THE COURT'S OBSERVATIONS

7.92. The satellite bodies may be divided into three categories:

- (a) the 'first generation' satellite bodies, whose management boards are granted discharge by the Council and the European Parliament;
- (b) the 'second generation' satellite bodies which are not self-financing and whose discharge authority is their own board of directors or management board;
- (c) the 'second generation' satellite bodies which are wholly or partly self-financing and whose discharge authority is their own management board.

7.93. The European Agency for Reconstruction, like the first-generation satellite bodies, is granted discharge by the Council and the European Parliament. Its purpose is to implement Community aid programmes for Kosovo and other regions in the former Yugoslavia (see paragraphs 5.96-5.98).

#### *Implementation of the budget*

7.94. The budgetary implementation of most satellite bodies (SBs) is characterised by carry-overs, which remain significant in number, despite the efforts made to reduce them. This situation is most frequently due to the mismatch between the rate at which decisions are taken and work programmes for which the SBs are responsible are implemented and the rate at which the budget is implemented. Thought should be given to the approaches to be adopted to achieve a better correlation between the programming of work and the principle of annuity of the budget.

#### **7.94. THE COMMISSION'S REPLIES**

All decentralised bodies (except the Translation Centre in Luxembourg) have operating appropriations entered in Title 3 of their budget. Most of these appropriations are used to conclude service contracts or make financial contributions to third parties to carry out their work programme. These contracts often overrun the end of the year in which they were concluded. Thus the appropriations committed have to be carried over in part. Since most cases involve multiannual projects, the decentralised bodies should take the initiative to propose an amendment to their Financial Regulation to the effect that the appropriations in their Title 3 can be entered as differentiated appropriations.

#### *Financial statements and the keeping of the accounts*

7.95. The SBs' budgets totalled 976,8 million euro in 2000, compared with 266,9 million euro in 1999 (see **Table 7.9**). This increase is due to the creation of the European Agency for Reconstruction (with a budget of 682,3 million euro). The SBs' staff has increased similarly, numbering 1 634 in 2000, as compared with

## THE COURT'S OBSERVATIONS

1 304 in 1999, i.e. an increase of 330 staff, 258 of whom work for self-financing bodies. The increase in the number of posts for the remaining SBs is due essentially to the creation of the European Agency for Reconstruction.

7.96. The Court's audits confirmed the reliability of each of the SBs' financial statements and did not give rise to any significant remarks concerning the legality and regularity of the underlying transactions.

**Table 7.9 — Budgets and staff for 1999 and 2000 — The Community satellite bodies (SBs)**

Name	Headquarters	Year of creation	Budget (Mio EUR)		Permanent posts	
			1999	2000	1999 (1)	2000
<b>I. First-generation SBs</b>						
european centre for the development of vocational training (Cedefop)	Thessaloniki	1975	15,3	13,3	81	81
European Foundation for the Improvement of Living and Working Conditions	Dublin	1975	14,8	15,0	84	85
<b>II. Second-generation SBs which are not self-financing</b>						
European Environment Agency (EEA)	Copenhagen	1990	18,5	18,9	68	76
European Training Foundation (ETF)	Turin	1990	16,2	16,2	130	130
European Monitoring Centre for Drugs and Drug Addiction (EDMC)	Lisbon	1993	8,2	8,2	45	48
European Agency for Safety and Health at Work (EASH)	Bilbao	1995	6,6	7,0	24	26
European Monitoring Centre on Racism and Xenophobia	Vienna	1997	3,9	4,9	19	26
<b>III. Second-generation SBs which are wholly or partially self-financing</b>						
European Agency for the Evaluation of Medicinal Products (EMEA)	London	1993	42,6	55,3	203	210
Office for Harmonization in the Internal Market (OHIM)	Alicante	1994	115,4	133,0	490	713
Community Plant Variety Office (CPVO)	Angers	1994	8,1	7,2	29	44
Translation Centre for the bodies of the European Union (TCBEU)	Luxembourg	1994	17,3	20,7	131	144
<b>IV. SBs for implementing Community programmes</b>						
European Agency for Reconstruction	Thessaloniki	2000	—	682,3	—	51
			<b>Total</b>	<b>266,9</b>	<b>981,9</b>	<b>1 304</b>
						<b>1 634</b>

(1) The 1999 figures had to be adjusted in relation to those published in the previous report to take account of information received after it had been published.

## THE COURT'S OBSERVATIONS

7.97. The presentation of the SBs' financial statements should be harmonised. The SBs should consider jointly developing their accounting systems and the principles, methods and rules on which the accounts they keep are based, so that the presentation of their financial statements is uniform. As the Court recommended in its Opinion No 2/2001 (Title VI) (22), the basic accounting framework should be in line with the generally accepted standards.

7.98. Inventory-keeping suffers from shortcomings in most of the SBs. In order to apply a consistent approach, the SBs should take the necessary steps to improve their inventory systems and make the requisite adjustments to their own Financial Regulation to incorporate the provisions on the accounting management of non-financial fixed-asset accounts adopted by the Commission in December 2000 (23).

**Financial provisions**

7.99. Taken as a whole, the SBs adhere to the provisions of their Financial Regulations. The rules concerning *ex ante* approval by the Financial Controller have been simplified considerably at the European Agency for Reconstruction, but steps were taken to ensure that *ex ante* checking was carried out in the second half of 2001.

*Follow-up to previous observations*

7.100. Up until December 1998 the general Financial Regulation provided for expenditure to be charged to the budget inclusive of VAT, allowing the VAT to be reused after its repayment. Since that time (24) the general Financial Regulation has stipulated that expenditure is to be charged net of VAT. Some SBs, such as the Alicante and Angers Offices, have undertaken to adapt their Financial Regulation. The Court once again (25) calls on the SBs that have not yet done so to take the necessary steps to change their respective Financial Regulations.

**7.97. THE COMMISSION'S REPLIES**

*The Commission will ask the decentralised bodies to take an initiative in this respect.*

(22) OJ C 62, 5.6.2001, p. 1.

(23) Commission Regulation (EC) No 2909/2000 of 29 December 2000.

(24) See Article 27(2)(a) of the Financial Regulation applicable to the general budget of the European Communities, as amended by Council Regulation (EC, ECSC, Euratom) No 2548/98 of 23 November 1998 (OJ L 320, 28.11.1998, p. 1).

(25) Annual Report concerning the financial year 1999, paragraph 6.38 (OJ C 342, 1.12.2000, p. 166).

## THE COURT'S OBSERVATIONS

7.101. During 2000, most of the SBs implemented the SI2 budgetary accounting system and were able to interface it with their general accounting systems (26). The SBs must continue to improve their accounting systems and, in particular, ensure that they develop analytical accounting systems that better enable them to determine the cost of their activities, as well as ensure that the manner in which these costs are monitored is improved. In the case of self-financing agencies, these systems should also enable them to improve the basis on which charges for their services are decided.

7.102. All of the SBs' Financial Regulations require that their budgets be published in the Official Journal. Out of 12 bodies, only eight published their budget for 2000, seven on 23 October 2000 (27) and one on 22 December 1999 (28). Even though the publication date has been brought forward, it is still overly tardy and the situation is little better than it was in 1999 (29).

*Employment in the satellite bodies and the growth of their activities*

7.103. The audits concerning the financial year 2000 examined the rise in employment in the SBs in greater detail than in previous years. The findings of these audits were compared with the data available on the SBs' activities in an attempt to draw conclusions concerning their global productivity.

**The staff of the satellite bodies**

7.104. **Table 7.10** provides a description of the employment situation in the SBs as at 31 December 2000. It shows that, in general, the SBs are able to fill most of the posts provided for in their establishment plans and to make up any shortages by using auxiliary staff (AS), local employees (LEs) or even seconded national experts (SNEs). Generally speaking, in 2000 the SBs had a staff complement comparable with that provided for in their establishment plans, making up shortfalls by using supplementary staff, and especially auxiliary staff. The high number of unfilled posts observed at the CPVO (Angers) is due mainly to the fact that the recruitment procedures launched in 2000 had not been completed

(26) Annual Report concerning the financial year 1999, paragraphs 6.37 and 6.38 (OJ C 342, 1.12.2000, p. 166).

(27) OJ L 270, 23.10.2000, p. 1.

(28) OJ L 330, 22.12.1999, p. 13.

(29) Annual Report concerning the financial year 1999, paragraph 6.40 (OJ L 342, 1.12.2000, p. 167).

## THE COURT'S OBSERVATIONS

by the end of the same year. In the case of the European Agency for Reconstruction, the large number of staff recruited outside the establishment plan is due to the special procedures for managing administrative expenditure laid down in its Financial Regulation.

**Staff recruitment and management**

7.105. Generally, the SBs' recruitment procedures should be rendered clearer and more transparent, so that the principle of equal access to the European civil service is promoted.

7.106. Some SBs, the OHIM (Alicante) being the most typical example, have developed a recruitment model whereby staff are first recruited on insecure contracts (as auxiliaries or even agency staff) and, by means of internal procedures and calls for applications that are not widely publicised, are then taken on as temporaries and later as permanent officials, provided that this is possible under the establishment plan.

7.107. Other SBs, such as the EEA (Copenhagen), do not use this model, but carry out most of their recruitment using a model similar to that of the institutions, which is based on open competitions that are publicised as widely as possible.

**Table 7.10 — Employment in the satellite bodies — Situation as at 31 December 2000**

Agencies	Posts provided for (establish- ment plan)	Posts occupied	Occupancy rate (%)	Other staff	Total employment	Actual occupancy rate (%)
	a	b	c = b / a	d	e = b + d	f = e / a
EMEA — London	210	189	90	9	198	94
OHIM — Alicante	713	540	76	87	627	88
CPVO — Angers	44	26	59	2	28	64
TCBEU — Luxembourg	144	125	87	5	130	90
Cedefop — Thessaloniki	81	82	101	26	108	133
Foundation — Dublin	85	72	85	3	75	88
EEA — Copenhagen	76	61	80	16	77	101
ETF — Turin	130	115	88	13	128	98
EDMC — Lisbon	48	47	98	18	65	135
EASH — Bilbao	26	24	92	9,5	33,5	129
Monitoring Centre — Vienna	26	24	92	2	26	100
European Agency for Reconstruction — Thessaloniki	51	47	92	50	97	190
<b>Total</b>	<b>1 634</b>	<b>1 352</b>	<b>83</b>	<b>240,5</b>	<b>1 592,5</b>	<b>97</b>

## THE COURT'S OBSERVATIONS

7.108. Improvement of the management of the agencies' staff is dependent on improving the staff information systems. The upkeep of personnel files should be more systematic to better ensure that the information required for good management is complete.

**Increase in staff and growth of the satellite bodies' activities**

7.109. For the purposes of the audit, staff were placed in two categories:

- (a) those responsible for support activities (support staff), i.e. activities that ensure the SBs' operational continuity (e.g. administrative and accounting departments, secretariat, etc.);
- (b) so-called 'operational' staff, who are directly involved in achieving the SBs' objectives.

7.110. **Table 7.11** shows the distribution of both grade A and all other staff appointed to operational and support activities respectively. In general, the proportion of operational staff tends to be higher in self-financing SBs. The situation varies more in the other SBs. There is a discernible trend regarding SB staff in that the smaller the SB, the more it is able to concentrate its staff on operational activities. Taking the staff as a whole, the division between operational and other staff seems to be determined by the nature and type of the individual SBs' activities.

7.111. **Table 7.12** shows the amount of actual revenue generated per head in self-financing SBs. Given the varied nature of these bodies' activities, the disparities found cannot be considered very meaningful.

7.112. With regard to the other SBs, whose purpose is to provide support in respect of specific EU policies, the table shows the amount of actual operating expenditure per head. The differences noted reflect various factors, such as the efficiency in managing operating appropriations or the extent to which the various SBs make use of outside services to implement their work programmes. In the case of the Turin Foundation, the particularly low level of expenditure per head is explained by, *inter alia*, the fact that the figures do not include Commission programmes managed by the Foundation.

**Table 7.11 — Number of operational staff — Situation as at 31 December 2000**

Agencies	Grade A operational staff	Grade A staff	Percentage of operational staff (%)	Operational staff of all categories (%)
	a	b	c = a / b	d
EMEA — London	89	102	87	72 (1)
OHIM — Alicante	90	132	68	57 (1)
CPVO — Angers	4	4	100	33 (1)
TCBEU — Luxembourg	71	73	97	60 (2)
Cedefop — Thessaloniki	28	44	64	30 (1)
Foundation — Dublin	19	27	70	23 (2)
EEA — Copenhagen	32	36	89	43 (2)
ETF — Turin	33	48	69	60 (1)
EDMC — Lisbon	23	27	85	35 (2)
EASH — Bilbao	11	12	92	40 (1)
Monitoring Centre — Vienna	8	10	80	55 (1)
European Agency for Reconstruction — Thessaloniki	28	34	82	29 (2)

(1) Percentage estimated on the basis of a sample.

(2) Percentage estimated on the basis of all staff.

**Table 7.12 — Revenue and/or expenditure by Title — 2000**

Agencies (1)	Indicator	Amount (Mio EUR)	Total staff	Amount per head (1 000 EUR)
		a	b	c = a / b
EMEA — London	Real revenue	38,0	198	192
OHIM — Alicante	Real revenue	108,9	627	174
CPVO — Angers	Real revenue	6,8	28	245
TCBEU — Luxembourg	Real revenue	20,6	130	158
Cedefop — Thessaloniki	Operating expenditure (2)	4,8	108	44
Foundation — Dublin	Operating expenditure (2)	6,0	75	80
EEA — Copenhagen	Operating expenditure (2)	9,4	77	122
ETF — Turin	Operating expenditure (2)	4,7	128	37
EDMC — Lisbon	Operating expenditure (2)	3,4	65	52
EASH — Bilbao	Operating expenditure (2)	3,1	33,5	92
Monitoring Centre — Vienna	Operating expenditure (2)	1,5	26	56

(1) The European Agency for Reconstruction has not been taken into account, owing to the very special nature of its activities in relation to the other SBs.

(2) Real operating expenditure against appropriations for the financial year and appropriations carried over from the previous financial year (Title III).

## THE COURT'S OBSERVATIONS

7.113. **Table 7.13** compares the average increase over the period 1998 to 2000 in the following areas: staff at the SBs, these bodies' expenditure on support activities, i.e. the expenditure required for an SB's activities to be carried out (Titles I and II expenditure), and either their revenue, in the case of self-financing SBs, or their operating expenditure (Title III expenditure), in the case of the other SBs.

7.114. Generally speaking, for the majority of the SBs the increase in support expenditure is greater than that in the number of staff. The reasons for this difference in increase are attributable in part to unavoidable factors, such as cost-of-living adjustments, seniority increases and the increasing proportion of permanent and temporary staff (whose salary costs are higher) and, in some cases, the size of the investments the SBs have been forced to make in recent years.

7.115. In the case of two of the self-financing SBs, the OHIM (Alicante) and the EMEA (London), their actual revenue increased at approximately the same rate as, or even faster than, their support expenditure. This trend may be regarded as satisfactory and should enable these SBs to deal more easily with changes in the economic climate. With regard to the CPVO (Angers) and the TCBEU (Luxembourg), it is difficult to draw conclusions because of the high proportion of support expenditure accounted for by investments made over the period examined.

**Table 7.13 — Average annual growth rate (1998 to 2000): total staff, support expenditure and operating expenditure/revenue**

	Agencies <sup>(1)</sup>	Total staff (%)	Support expenditure (%) <sup>(2)</sup>	Revenue/operating expenditure (%) <sup>(3)</sup>
Self-financing bodies	EMEA — London	11	23	53
	OHIM — Alicante	30	27	27
	CPVO — Angers	33	47	20
	TCBEU — Luxembourg	29	46	33
Other bodies	Cedefop — Thessaloniki	6	9	9
	Foundation — Dublin	- 2	3	2
	EEA — Copenhagen	6	7	5
	ETF — Turin	- 1	- 2	12
	EDMC — Lisbon	17	8	7
	EASH — Bilbao	58	20	67

<sup>(1)</sup> Given their recent creation, the data concerning the Vienna Monitoring Centre and the European Agency for Reconstruction cannot be regarded as significant.

<sup>(2)</sup> Actual staff and administrative expenditure against appropriations for the financial year and appropriations carried over from the previous financial year (Titles I and II).

<sup>(3)</sup> Actual operating expenditure against appropriations for the financial year and appropriations carried over from the previous financial year (Title III).

## THE COURT'S OBSERVATIONS

7.116. As far as the other SBs are concerned, in four cases, i.e. Cedefop, the Dublin Foundation, the EEA (Copenhagen) and the EMCDDA (Lisbon), the average rates of increase in their support and operational expenditure are of the same order of magnitude over the period examined. This situation gives reason to think that the extent to which these SBs use outside services has remained stable. The increase in staff at three of these SBs (Cedefop, the Dublin Foundation and the EEA (Copenhagen)) is lower or of the same order of magnitude, which tends to suggest that the situation is stable or even improving in terms of productivity. In two other cases (the ETF (Turin) and especially the EASH (Bilbao)), the increase in operational expenditure was greater on average than that in support expenditure, which suggests an increase in the use of outside services. In both cases a comparison between the increase in staff and that in the various types of expenditure seems to indicate that productivity has increased.

### Conclusion

7.117. In most cases, the SBs have been able to find the staff needed to carry out their activities, sometimes by resorting to auxiliary staff. In general, the SBs should ensure that their recruitment procedures are rendered more straightforward and transparent so that the principle of equal access to the European civil service is applied more effectively. They should also improve the system for managing and monitoring their staff. It would be advisable, either as part of the reform of the Staff Regulations or by means of specific regulations applicable to all the SBs, for the institutions' and the SBs' recruitment policies to be harmonised further and possibly managed jointly.

7.118. In terms of productivity, the SBs should monitor their staff structure with a view to optimising the ratio of operational to support staff. The growth in administrative expenditure and salary costs in particular should also be monitored closely so that productivity increases at least offset the rise in salary costs per head.

### 7.117. THE COMMISSION'S REPLIES

*The decentralised bodies have a separate legal personality from that of the Community and accordingly they have complete autonomy with their own appointing authority. Naturally, they must exercise this power in total compliance with the Staff Regulations.*

*The Commission plays an advisory role with a view to ensuring consistency in their policies on human resources, without, however, the legal authority to impose them.*

*As the decentralised bodies differ enormously in their tasks and situations, it is difficult at this point to see how harmonisation other than that provided for in the Staff Regulations can be achieved. The Commission intends to continue to play its advisory role in full compliance with the Staff Regulations and to encourage the agencies to coordinate their staff policy.*

## THE COURT'S OBSERVATIONS

7.119. In order to achieve this, the SBs' programming of their activities must be more rigorous (see paragraph 7.94) and their analytical accounting systems must be developed so that cost trends are monitored more effectively (see paragraph 7.101). It should be noted that this aim calls for more particular attention in the smallest of the SBs, which are unable to achieve substantial economies of scale because of their limited size.

## AUDIT OF THE EUROPEAN SCHOOLS

7.120. The Court's audit of the European Schools is the subject of a specific annual report sent to the Board of Governors of the European Schools. In line with the cyclical audit plan foreseen for the European Schools, the audits carried out in 2000 focused on the schools in Karlsruhe, Luxembourg and Mol. The findings of these audits and those of previous years allow the conclusion that the system for the financial management of the schools is of adequate quality. Nevertheless, the audits carried out in 2000 gave rise to the following remarks.

*Financial provisions*

7.121. The audits revealed shortcomings in the running of the inventory system. The inventory procedures should be more rigorous and applied properly. In this regard, it would be advisable for the schools to review their rules in this area, with a view to making the necessary amendments, on the basis of the Commission regulation adopted in December 2000 (<sup>30</sup>) detailing the accounting provisions concerning tangible and intangible fixed assets.

7.122. Computer equipment accounts for a substantial proportion of the purchases made by the schools. Going beyond the three schools audited, the Court recommends that all the schools look into the scope for grouping their purchases so that they are able to benefit far more from invitation-to-tender procedures and to improve their management of procurements.

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<sup>(30)</sup> Commission Regulation (EC) No 2909/2000 of 29 December 2000 (OJ L 336, 30.12.2000, p. 75).

## THE COURT'S OBSERVATIONS

7.123. Teachers seconded by the Member States are only paid their basic national salary by the latter, whereas the salaries they earn in their own countries are made up of the basic salary plus various supplementary amounts based on their seniority, level of training, position in their home school, etc. This situation results in the schools having to finance a larger share of their salaries. In order to harmonise the Member States' practice concerning the paying of national salaries to teachers seconded abroad, the Board of Governors of the European Schools should re-examine this matter.

*Contributions to school fees*

7.124. The pupil population of some schools is made up mostly of children (up to 90 %) whose parents have no working relationship with the institutions and Community bodies. These children's school fees are covered by financing agreements concluded with the school or the parents themselves. However, the latter category, which is the most predominant, is granted exemptions and school fee reductions which are determined on the basis of the parents' income.

7.125. With regard to the exemption thresholds, these vary according to the school with no apparent justification, as is shown in **Table 7.14**, which compares the thresholds in force with those that would apply if the Brussels schools' exemption threshold were to be applied, while also taking account of the weighting applicable to the places in which the schools are located. This matter should be examined, so that the exemption thresholds are fixed in a fair and rational manner.

7.126. In 2000 the schools' operating costs amounted to 187 million euro, or 11 357 euro per pupil. The average contribution per non-entitled pupil is quite different. It amounts to 7 966 euro for category II pupils and 1 556 euro for those in category III. The proportion of pupils in the last category is particularly high in some schools (around 80 % in four of them). This for the most part explains the fact that the Commission subsidy paid per pupil to the various schools ranges from 6 126 euro (Luxembourg) to 10 698 euro (Bergen).

**7.125. THE COMMISSION'S REPLIES**

*The exemption thresholds were fixed by the various administrative boards of the European Schools. Only the Board of Governors, on the Commission's initiative, can revise them along the lines desired by the Court.*

**7.126. THE COMMISSION'S REPLIES**

*Under the rules approved by the Board of Governors, in the exercise of the powers granted by the Convention of 15 April 1957, category I pupils are exempt from school fees, category II pupils pay a fee set in the agreements signed by the bodies and the Board of Governors and category III pupils pay a fee ('minerval'), the amount of which is determined by using a formula approved by the Board of Governors. Accordingly the amounts of these fees vary.*

## THE COURT'S OBSERVATIONS

*The fact that the Commission grant for each category III pupil varies from one school to another is explained by the different number of these pupils in the different schools. The Convention of 1957 provides that the admission of these pupils to the European Schools depends on the number of places available, which in turn explains the differences, for example, between the Luxembourg and Bergen Schools.*

7.127. Under these conditions and given these schools' purpose, which is to facilitate the operation of the institutions and Community bodies, the Commission should examine whether some of the schools should not now be closed. It should also ensure that the costs which should normally be borne by the host Member State are not charged to the Community budget.

## 7.127. THE COMMISSION'S REPLIES

*In accordance with the criteria for establishing and closing European Schools, approved by the Board of Governors on 24 and 25 October 2000, the existence of a European School is warranted as long as it is indispensable to the proper functioning of an essential Community activity; its existence can be called into question when it no longer helps to meet that objective.*

**In the Commission's opinion, the existing 10 European Schools continue to be indispensable.**

*The European Schools and, most particularly, the Commission ensure that the host States ~~pay~~ their share of the costs of the European Schools located in their countries.*

**Table 7.14 — Comparison of exemption thresholds**

(EUR)

Schools	Exemption threshold for first child	Weighting	Threshold calculated on the basis of the Brussels threshold and the relevant weighting	Difference
	Value			
	(a)	(c)	(d) = 15 528 * (c)	(e) = (a) - (d)
Brussels I, II, III	15 528	100,0	15 528	0
Mol	19 555	100,0	15 528	4 027
Luxembourg	17 325	100,0	15 528	1 797
Karlsruhe	20 486	97,4	15 124	5 362
Munich	20 486	108,0	16 770	3 716
Bergen	17 078	114,5	17 780	- 702
Culham	22 203	127,6	19 814	2 389
Varese	13 919	95,3	14 798	- 879

(a): Net revenue, except for Culham where gross revenue is used to calculate the exemption.

## CHAPTER 8

**Financial instruments and banking activities**

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## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

## GUARANTEE FUND FOR EXTERNAL ACTIONS

*Introduction*

8.1. The decision to set up the Guarantee Fund for External Actions was taken at the Edinburgh European Council of December 1992. The Fund was established on 31 October 1994 by Council Regulation (EC, Euratom) No 2728/94<sup>(1)</sup> and was built up by contributions from the budget in the following years. The Fund is drawn on if the beneficiary of a loan granted or guaranteed by the Community to or in a third country defaults. If the beneficiary is still in default three months after the date on which payment was due, the Fund reimburses the Community cash resources that were previously used to service the borrowing.

8.2. The Court audited the Fund for the financial year ended 31 December 2000, at the Commission as regards the administrative management and at the European Investment Bank (EIB) as regards the financial management. Without prejudice to the observations made in paragraph 8.9, the Court has no comments to make on the results of the audits.

*Situation and development of the Fund*

8.3. Since the Guarantee Fund was set up, it has received funds from the budget totalling 1 824,7 million euro as at 31 December 2000 (see **Table 8.1**). Calls on the resources of the Fund in its role as guarantor amounted to 458,9 million euro (including 16,5 million euro in default interest), while late recoveries from defaulting debtors totalled 327 million euro (including 41,3 million euro in default interest).

8.4. At 31 December 2000, the balance of defaults stood at 215,1 million euro, which represents the differences between calls on the Fund and recoveries for capital and interest plus the balance of default interest. The details are given in **Table 8.2**.

<sup>(1)</sup> OJ L 293, 12.11.1994, p. 1.

**Table 8.1 — Guarantee Fund operations and situation**

(Mio EUR)

Financial year	Payments <sup>(1)</sup>	Activation of guarantees <sup>(2)</sup>	Late repayments	Result <sup>(3)</sup>	Remuneration paid to EIB	Repayments to budget	Total fund resources at 31 December <sup>(4)</sup>	Total guarantee outstanding <sup>(5)</sup>	Coverage (%)
1994	293,7	—	—	0,5	—	—	294,2	6 017	4,9
1995	250,8	(303,1)	35,6	23,4	0,2	—	300,9	5 882	5,1
1996	235,4	(52,5)	55,7	18,0	0,2	—	557,4	6 715	8,3
1997	286,1	(54,3)	45,0	27,5	0,3	—	861,8	7 960	10,8
1998	272,4	(15,4)	185,3	42,6	0,5	(66,0)	1 280,7	9 834	13,0
1999	300,1	(16,3)	5,3	41,1	0,6	(297,8)	1 313,1	12 052	10,9
2000	186,3	(17,4)	—	57,4	0,7	(107,9)	1 431,6	14 069	10,2
<b>Total</b>	<b>1 824,7</b>	<b>(458,9)</b>	<b>327,0</b>	<b>210,5</b>	<b>2,5</b>	<b>(471,7)</b>			

<sup>(1)</sup> Payments to Guarantee Fund pursuant to Regulation (EC, Euratom) No 2728/94 of 31 October 1994.<sup>(2)</sup> The Guarantee Fund has been operating since January 1995 to reimburse defaults.<sup>(3)</sup> The result is the difference between the interest on the Fund's deposits and the management fees levied by the EIB.<sup>(4)</sup> After deduction of EIB fees not paid at 31 December.<sup>(5)</sup> Including default interest incurred but not paid at 31 December.

Source: Commission.

**Table 8.2 — Cumulative total of operations since the creation of the Guarantee Fund and the default situation at 31 December 2000**

(Mio EUR)

Country	Calls on fund			Recovered by fund			Balance of defaults		
	Capital	Interest	Default interest	Capital	Interest	Default interest	Capital	Interest	Default interest <sup>(1)</sup>
							(1)	(2)	
Armenia	57,6		0,9	57,6		9,3			
Georgia	113,3	14,9	2,1	113,3	14,9	17,0	0,0		
Kazakhstan		1,6	0,0		1,6	0,0			
Kyrgyzstan		0,7	0,0		0,7	0,0			
Tajikistan	54,5	8,7	1,3			3,5	54,5	8,7	14,9
Turkmenistan	44,9	1,0	0,8	44,9	1,0	2,7			
Ukraine	31,9		1,0	31,9		1,6			
Former Yugoslavia	46,3	67,0	10,3	6,2	13,6	7,2	40,1	53,5	43,5
<b>Subtotal</b>	<b>348,6</b>	<b>93,9</b>	<b>16,5</b>	<b>253,9</b>	<b>31,8</b>	<b>41,3</b>	<b>94,6</b>	<b>62,1</b>	<b>58,4</b>
<b>Total</b>	<b>458,9</b>			<b>327,0</b>			<b>215,1</b>		

<sup>(1)</sup> This column includes interest accrued between the date of the call on the Fund and the end of the financial year; comparison of the three 'default interest' columns is thus not possible.

Source: Commission.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

8.5. In 2000, 186,3 million euro were transferred to the Fund from the reserve for guarantees, while a sum of 107,9 million euro was repaid in March 2000. This represented the difference between the actual level of the Fund at 31 December 1999 (1 313,1 million euro, or 10,9 % of the guarantee outstanding) prior to remuneration of the EIB (0,6 million euro) and the target amount of 1 205,2 million euro, or 10 % of the guarantees outstanding on 31 December 1999 (2).

8.6. The ratio of the Fund's liquid assets (1 431,6 million euro) to its outstanding capital liabilities for loans and loan guarantees for third countries plus unpaid interest due (14 068,8 million euro) was 10,2 % at 31 December 2000 (see **Table 8.1**). On the basis of a target amount of 1 266,2 million euro (9 % of the guarantees outstanding on 31 December 2000), 165,4 million euro have to be refunded to the budget in 2001.

8.7. During the financial year there were three calls on the resources of the Fund as guarantor, totalling 17,4 million euro (including 1,6 million euro in default interest). These three calls concerned loans mostly drawn up in currencies other than the euro. The evolution of the foreign exchange rates during the three-month period between the notice of default and the intervention of the Fund resulted in an additional charge of 1,1 million euro to be paid by the Fund according to the Regulation.

8.8. Guarantee Fund activities generated 57,4 million euro in net interest revenue in 2000, representing an average overall yield of 4,2 %.

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(2) Article 3 of the Regulation stipulates that: 'The Fund shall rise to an appropriate level, hereinafter referred to as "the target amount". The target amount shall be 10 % of the Community's total outstanding capital liabilities arising from each operation, increased by unpaid interest due. If, at the end of a year, the target amount is exceeded, the surplus shall be paid back to a special heading in the statement of revenue in the general budget of the European Communities.' Since 1997, this ratio has consistently exceeded the rate of 10 % set as the target amount. As of 1 January 2000, the target amount was lowered to 9 %. Council Regulation (EC, Euratom) No 1149/1999 of 25.5.1999 amending Council Regulation (EC, Euratom) No 2728/94 of 31.10.1994 establishing a Guarantee Fund for external actions (OJ L 139, 2.6.1999).

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

*Follow-up of previous observations*

8.9. The 0,05 % annual fee for 2000, an amount of 0,7 million euro, was paid to the EIB for its financial management of the Fund. This rate of remuneration has not changed since 1995 <sup>(3)</sup>. In its Annual Report on the financial year 1999, the Court recommended that 'in the light of the financial management experience acquired and the Fund's level of resources, this annual fee should be reviewed' <sup>(4)</sup>. Despite the Commission's expectations an overview of the costs has not yet been provided by the EIB. The rate remained unchanged in 2000.

**8.9.** *A new fees structure for the year 2001 is shortly to be agreed between the EIB and the Commission services.*

## EUROPEAN INVESTMENT FUND ('EIF')

*Introduction*

8.10. In accordance with the wishes of the Edinburgh European Council of December 1992, the European Investment Fund was established in 1994. Its shareholders were the European Investment Bank (EIB), the Community and several financial institutions (see paragraph 8.11). It was set up to contribute to the pursuit of Community objectives by providing additional financing capacities in support of the development of Trans-European Networks (TENs) and small and medium-sized enterprises (SMEs). During 2000, for the first time since its establishment, the EIF underwent a thorough reform.

*Reform of the EIF*

8.11. By acquiring non-allocated shares and shares from financial institutions, the EIB became the majority shareholder of the EIF. Thus the EIF is now more than 90 % owned by European public bodies and institutions. 20 % of these shares were paid in before the reform and this percentage remained the same after the reform.

<sup>(3)</sup> Since the Fund had reached 300 million ECU at 31 December 1995, the rate of remuneration paid to the EIB was reduced from 0,125 % to 0,05 % of the Fund's average monthly assets, with retrospective effect to 31 December 1994. Since its inception, the Fund has paid the EIB 2,5 million euro in management fees.

<sup>(4)</sup> OJ C 342, 1.12.2000, p. 175.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**EIF shareholders (total capital 2 000 Mio EUR)**

	Before reform (%)	After reform (%)
EIB	40	60,75
European Community	30	30
Financial institutions	19,25	9,25
Non-allocated shares	10,75	0
Total	100	100

8.12. As a consequence of the reform, the EIF became an EIB subsidiary specialising in risk-capital activities. The management of the portfolio of venture-capital operations signed by the EIB in its own name (922 million euro) was transferred to the EIF. In addition, up to 1 000 million euro were made available from EIB reserves to back the new venture-capital operations to be concluded by the EIF. At the end of 2000 the EIF was entrusted with managing an amount of up to 2 493 million euro of participations.

8.13. According to the Council Decision of 1994 (5), the Commission is supposed to represent the Community as a member of the EIF. The Community representatives should therefore take care to ensure that there is a balance between the pursuit of Community objectives and the commercial basis (6) of the Fund's activities.

8.14. In June 2000, the EIF General Meeting approved the new statutes and rules of procedure proposed by the Supervisory Board.

8.15. As a consequence of the new statutes:

(a) the managing body of the EIF was the Financial Committee, consisting of three members, one of them representing the Commission. No decision could have been taken without his presence. Now, the Financial Committee has been replaced by a single Chief Executive, nominated by the member of the Fund with the highest number of shares (7) (i.e. the EIB);

**8.15.** *The new statutes have been brought into line with standard rules of corporate governance. The Board of Governors now decides on all operations, with the possibility of delegating this power in whole or in part.*

*The Financial Committee has been replaced by a Chief Executive, who acts independently, serves the best interests of the Fund and is accountable only to the Board of Directors.*

*The Community is represented on the Board by two members. The stipulation that these two members act independently and serve the best interests of the EIF is in line with normal governance (cf. EIB and EBRD).*

*The EIF statutes stipulate that members of the Fund may dispose of their shares by transferring them either to another member or to a third party. The necessary consent of the EIB, as the majority shareholder, reflects normal governance practice, as stated above.*

(5) Decision 94/375/EC of 6 June 1994.

(6) Article 2.3 of the new statutes: 'The activities of the Fund shall be based on sound banking principles or other sound commercial principles and practices as applicable.'

(7) Articles 10 and 24 of the original statutes and 17 of the initial rules of procedures; Article 21 of the new statutes and 16 of the new rules of procedures.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

(b) the Supervisory Board has been replaced by a Board of Directors. The concept of Community representation on the Board, which was mentioned in the former statutes, has been deleted in the new statutes<sup>(8)</sup>. The two out of seven members designated by the Commission shall now 'act independently and serve the best interests of the EIF. They shall be accountable only to the General Meeting' (of the EIF);

(c) while there was no provision on this matter in the original statutes, now the Commission cannot dispose of its share without the consent of the EIB<sup>(9)</sup>.

*Budgetary management of measures under mandate*

8.16. During 2000, the EIF managed three measures financed by the Community budget: the 'Growth and Environment Pilot Project'<sup>(10)</sup>, the 'European Technology Facility - Start-up' ('ETF Start-up') and the 'SME Guarantee Facility'. The two latter measures, along with the 'European Joint Venture scheme', which is directly managed by the Commission, are the constituent parts of a programme of financial assistance for innovative and job-creating SMEs<sup>(11)</sup>.

8.17. A budgetary appropriation amounting to 391,56 million euro<sup>(12)</sup> has been 100 % committed by the Commission. Payments from the Community budget to the EIF for these measures stood at 145 million euro at the end of 2000, the same amount as in 1999, namely 60 million euro for the European Technology Facility - Start-up, 60 million euro for the SME Guarantee Facility and 25 million euro for the Growth and Environment Pilot Project. No new payment was made in 2000.

<sup>(8)</sup> Article 16 of the original statutes, Article 18 of the new statutes.

<sup>(9)</sup> Article 7 of the new statutes.

<sup>(10)</sup> Parliament Amendment No 0233 to the draft Community budget for 1995 (OJ C 18, 23.1.1995, p. 317).

<sup>(11)</sup> Council Decision 98/347/EC of 19 May 1998 on measures of financial assistance for innovative and job-creating small and medium-sized enterprises (SMEs) (OJ L 155, 29.5.1998, p. 43).

<sup>(12)</sup> ETF Start-Up: 168 million euro for the years 1998, 1999 and 2000; SMEs Guarantee: 198,56 million euro for the years 1998, 1999 and 2000; Growth and Environment Pilot Project: 25 million euro for the years 1995 to 1997.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**ETF Start-Up Facility**

8.18. The objective of the measure is to develop risk-capital participation in innovative and job-creating SMEs by investing in specialised venture capital funds, particularly smaller or newly established funds, funds operating regionally or funds focused on specific industries or technologies, or venture capital funds financing the exploitation of R & D (research and development) results. The EIF receives Community funds and invests in equity participations in Venture Capital Funds (VCFs). Those funds invest in SMEs.

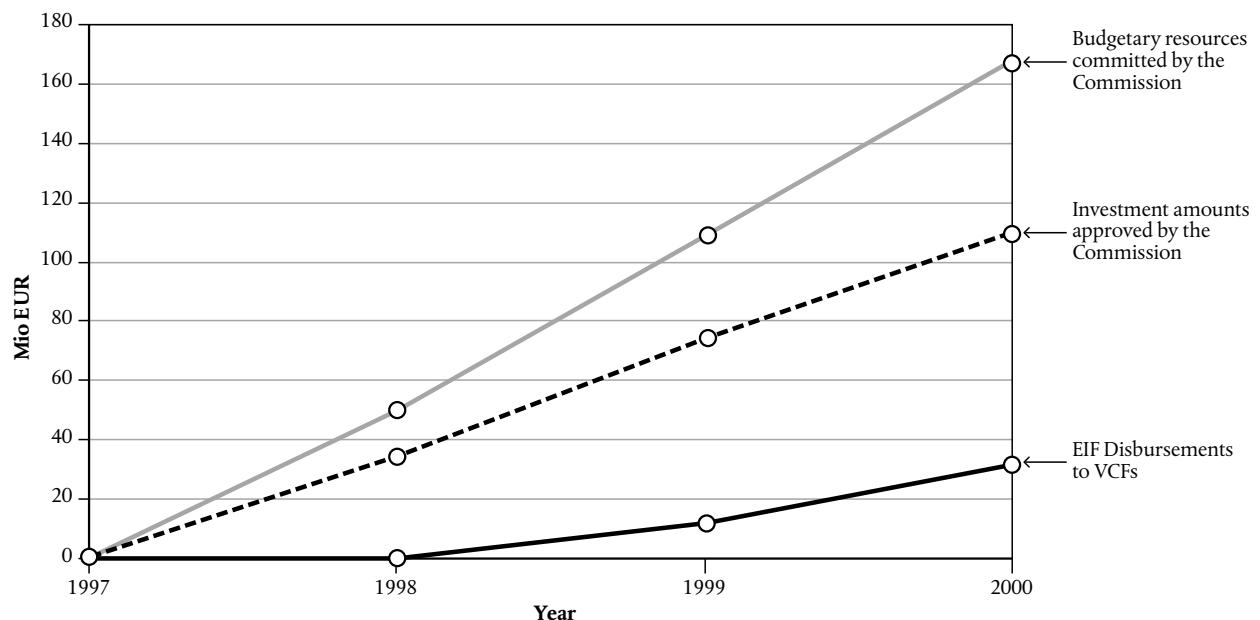
8.19. For the years 1998, 1999 and 2000, the total of the budgetary resources committed by the Commission for the Facility amounts to 168 million euro, i.e. 100 % of the appropriation. At 31 December 2000 the EIF had paid 32,2 million euro into VCFs (see **Table 8.3**).

**8.19.** *At the end of 2000 the EIF had signed contracts with VCFs for a total of 71,7 million euro, of which 12,8 million euro are conditional on further fund-raising by the VCFs. Of the 58,9 million euro 'unconditional' commitments, the EIF had paid in 32,2 million euro.*

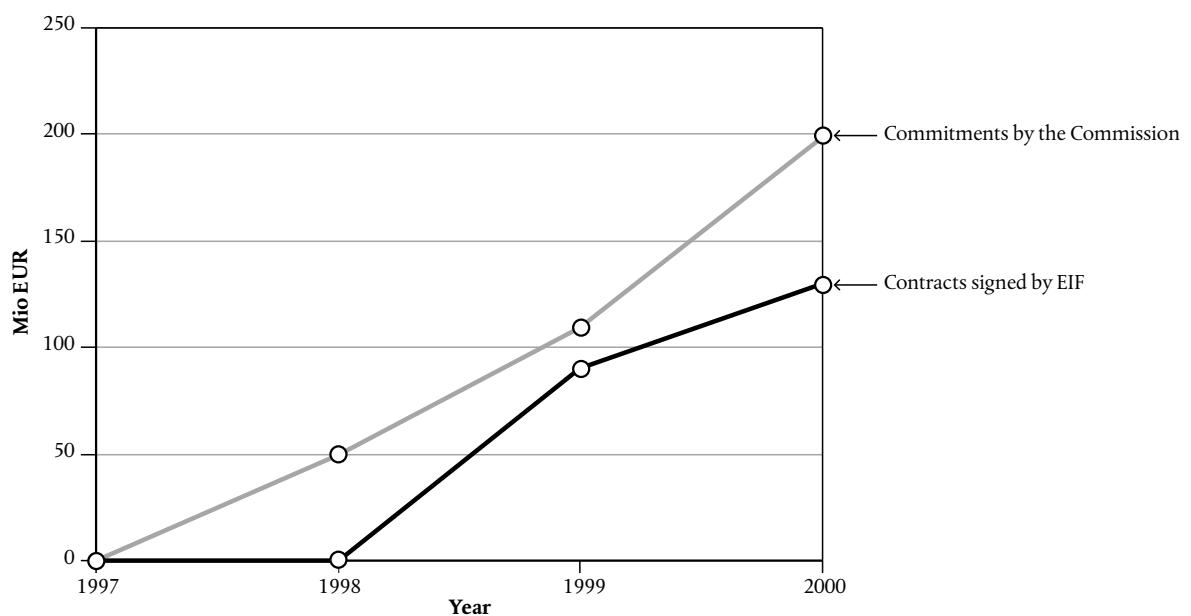
**SME Guarantee Facility**

8.20. The aim of the facility is to cover the cost of guarantees and counter-guarantees issued by the EIF in order to promote an increase in the loans granted to innovative and job-creating SMEs, by increasing the capacity of guarantee schemes operating in the Member States, in the public or private sector, including mutual guarantee schemes. The budgetary allocation is to cover the full cost of the facility, including the EIF's guarantee losses and any other eligible costs or expenses of the facility. The cost of the facility to the Community budget is capped for each financial intermediary so that it does not under any circumstances exceed the budgetary allocations made available to the EIF.

8.21. For the years 1998, 1999 and 2000, the total of the budget allocation committed by the Commission for the facility amounts to 198,56 million euro, i.e. 100 % of the appropriation. At the end of 2000, the EIF agreed with their contractors a maximum of 130 million euro (see **Table 8.4**). The amount spent so far was 0,45 million euro for defaulted loans and 2,6 million euro in management costs.

**Table 8.3 — 'ETF Start-up' — Accumulated commitments and investments into venture capital funds ('VCFs')**

Source: Commission/EIF.

**Table 8.4 — SME guarantee facility — Accumulated commitments**

Source: Commission.

## THE COURT'S OBSERVATIONS

## COMMISSION'S REPLIES

**Growth and Environment Pilot Project**

8.22. The Growth and Environment Pilot Project was launched in 1995 as an initiative of the European Parliament. It aims to facilitate access for SMEs to bank financing for new environmental investments. The scheme provides for guarantees of up to 50 % of financing granted by financial institutions in the Member States. Under this scheme, the Commission provides subsidies designated to cover premiums for guarantees and costs to promote the scheme. The appropriations of 25 million euro for this project during the years 1995 to 1997 were 100 % committed by the Commission and paid over to the EIF. At the end of 2000 the EIF had signed guarantee contracts involving potential guarantee fees of 24,4 million euro, corresponding to a maximum guaranteed amount of 674,6 million euro and a maximum loan volume of 1 353,5 million euro. The total of guarantee fees and promotion costs amounted to some 9,4 million euro, of which 6,4 million euro had been disbursed to the EIF by the end of 2000.

*Management of own funds*

8.23. The Commission, which acts as the Community shareholder in the EIF and holds 30 % of the shares, has signed an agreement with the Court, to which the EIF itself is also a signatory, concerning the auditing of the EIF's operations that are financed from its own funds. This agreement, which was signed in September 2001 for a period of two years, defines the Court's right of access to the documents and information it needs, including those of other auditors. The Court believes that this agreement constitutes a useful basis for the purpose of giving concrete form to the auditing of the Community participation, bearing in mind the special context in which it is held.

*Follow-up of previous observations*

8.24. As already pointed out by the Court in 1998 and 1999, a budgetary implementation rate of 100 % calculated on the basis of the Community budget alone might conceal an under-utilisation of budgetary funds by the agent, and, in practice, lower implementation of the programme financed.

**8.23.** *The Commission is satisfied that an agreement has been signed.*

**8.24.** *The Commission is aware of the problem of the disparity between budgetary implementation and actual implementation. In order to improve the information provided in the financial statements as well as their readability, the Commission has included data in the annex relating to the funds granted to public or private financial intermediaries which they had not used at 31 December 2000. The Commission has for the first time set out the information by budget heading so that actual budget consumption can be identified.*

## THE COURT'S OBSERVATIONS

8.25. The Commission committed itself (13) to insert an explanatory note in the balance sheet identifying the amounts corresponding to funds held by the EIF. However, this note had not yet been included in the 2000 balance sheet. In the Revenue and Expenditure Account and Balance Sheet for 2000, the information is limited and not transparent. This document does not show those amounts on the treasury accounts of each of the financial intermediaries which had not yet been transferred to the beneficiaries.

## COMMISSION'S REPLIES

8.25. It is true that the Commission undertook in the reply to the 1999 annual report to provide the figure for the amount managed by the European Investment Fund. Nevertheless, in view of the number of intermediaries managing Community funds, and for the sake of transparency and harmonisation, the Commission has preferred to provide, in the Annex to Volume IV – consolidated revenue and expenditure account and balance sheet (see pages 68 and 91), an overall explanatory note for all the intermediaries concerned rather than refer just to certain intermediaries. The funds held by the EIF at 31 December 2000 are included under headings B5-3 and B5-5 and total EUR 112 million, which accounts for only 17 % of total funds held by intermediaries.

8.26. In its Annual Report for 1998 (14) the Court drew the attention of the Commission to the need to improve its control of the Growth and Environment Pilot Project, in particular the implementation costs and the eligibility criteria. In 2000 the Commission carried out an internal audit on the basis of the Court's recommendations. After this audit, the Commission launched a renegotiation of the fiduciary agreement for the Growth and Environment Pilot Project with the EIF, defined procedures for a systematic control and decided to launch an evaluation of the scheme. However, these measures were not yet effective at the end of 2000.

8.26. The Commission wishes to point out that in 2001 the measures referred to by the Court have become effective: following extensive negotiations, an amendment to the Fiduciary and Management Agreement is in the process of being signed, the evaluation of the scheme has started and sample-based controls at the level of financial intermediaries are under way.

(13) OJ C 342, 1.12.2000, p. 183.

(14) OJ C 349, 3.12.1999.



## CHAPTER 9

**The Statement of Assurance and supporting information**

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## STATEMENT OF ASSURANCE CONCERNING THE GENERAL BUDGET FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2000

I. The European Court of Auditors ('the Court') has examined the consolidated accounts of the European Communities for the financial year ended 31 December 2000. The accounts consist of the consolidated revenue and expenditure account and balance sheet as well as explanatory notes <sup>(1)</sup> and are the responsibility of the Commission. Pursuant to the Treaties <sup>(2)</sup>, the Court is required to provide the Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions which underlie these accounts.

II. The Court carried out the audit in accordance with its audit policies and standards. These adapt generally accepted international standards to the Community context. The audit comprised an appropriate range of procedures designed to examine, on a test basis, evidence relating both to the amounts and disclosures in the consolidated accounts and the legality and regularity of the transactions underlying the accounts. It also included an assessment of the accounting principles used and of significant estimates made by management, as well as of the presentation of the accounts. Through the audit the Court obtained a reasonable basis for the opinion expressed below. The scope of the Court's opinion is limited in relation to own resources (see paragraphs 1.11 and 1.69) and external actions (see paragraphs 5.25 to 5.26).

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\* \* \*

### *Reliability of the accounts*

III. Except for the effects of the matters summarised below, the Court is of the opinion that the revised accounts for the financial year ended 31 December 2000 as published in the Official Journal reflect reliably the Communities' revenue and expenditure for the year and the financial situation at the end of the year:

- (a) a net understatement of fixed assets by about 140 million euro (see paragraph 9.5);
- (b) an incomplete presentation of advances and payments on account at the year end (see paragraphs 9.9 and 9.10);
- (c) an overstatement of commitments still to be settled by some 1 680 million euro (see paragraph 9.12);
- (d) an omission of commitments of 213 million euro (see paragraph 9.15) and a net overstatement by 1 343 million euro (see paragraph 9.16);
- (e) an absence of certain information necessary for the calculation of the economic result (see paragraphs 9.34 to 9.37).

<sup>(1)</sup> Volume IV of the documents was submitted by the Commission to the European Parliament and the Council and to the Court on the official date of 1 May 2001 (shortly available in the Official Journal; available on the site: [http://europa.eu.int/eur-lex/fr/com/cpi\\_index\\_en.html](http://europa.eu.int/eur-lex/fr/com/cpi_index_en.html)).

<sup>(2)</sup> Article 248 of the EC Treaty, Article 160c of the Euratom Treaty and Article 45c of the ECSC Treaty with regard to the ECSC's former administrative budget, which was incorporated into the general budget by the Merger Treaty of 8 April 1965.

*Legality and regularity of underlying transactions*

IV. The audit of the principal management and control systems <sup>(3)</sup> applicable to agriculture and structural measures (see paragraphs 9.52 to 9.65 and 9.73 to 9.76) revealed weaknesses in the functioning of control procedures aiming to secure the legality and regularity of the transactions.

The audit of operational expenditure revealed an unacceptable incidence of error affecting the amount of the payments, the reality or the eligibility of the underlying transactions (see paragraphs 9.56, 9.60 and 9.75).

In view of all the results of its audit, the Court is of the opinion that the transactions underlying the financial statements, taken as a whole, are legal and regular in respect of revenue, commitments and administrative expenditure but declines to provide this assurance in respect of the other payments.

10 October 2001

Jan O. KARLSSON  
President

European Court of Auditors  
12, rue Alcide De Gasperi, L-1615 Luxembourg

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<sup>(3)</sup> Integrated Administrative and Control System for Agriculture, Regulation (EC) No 2064/97 for Structural Funds and fifth framework programme for research and development.

## THE COURT'S OBSERVATIONS

## INTRODUCTION

9.1. Pursuant to Article 248 of the Treaty, the Court of Auditors provides the European Parliament and the Council with a Statement of Assurance (DAS) concerning the reliability of the accounts and the legality and regularity of the underlying transactions. The approach the Court has applied, whilst still abiding by generally accepted auditing practices, has been broadened to encompass a larger range of audit evidence to support its conclusions. For the financial year 2000, the Court has endeavoured to provide more diversified information on the nature, location and causes of the problems affecting the management of Community funds.

9.2. The aim of the work on the reliability of the accounts is to obtain a reasonable assurance that all the revenue, expenditure, assets and liabilities have been entered in the accounts correctly and accurately. In particular, the auditing work involves an analytical review and a detailed scrutiny of the Communities' consolidated revenue and expenditure account and balance sheet.

9.3. The aim of the work on the legality and regularity of the underlying transactions is to obtain enough evidence of a direct or indirect nature to prove that the underlying transactions have been dealt with in accordance with the regulations or contractual provisions in force and that the corresponding Community funds have been correctly calculated. Various techniques are used, such as in-depth audits of certain selected areas or systems, the evaluation of horizontal audit procedures and substantive tests on transactions. The detailed findings of this audit work are set out in the specific appraisals for the various headings of the financial perspective, contained in the preceding chapters.

## RELIABILITY OF THE ACCOUNTS

*Comments on the consolidated financial statements*

9.4. The Court notes the efforts made by the Commission's accounting departments as regards the presentation and amplification of the data contained in the consolidated financial statements. Nevertheless, the official version of the financial statements presented by the Commission on the statutory date of 1 May 2001 was marred by omissions and inconsistencies such that a corrected version had to be presented in September 2001 for publication in the Official Journal.

**9.4. THE COMMISSION'S REPLIES**

*The Commission did indeed make some major improvements to the 2000 consolidated financial statements presented on 1 May 2001. However, as that version still contained some imperfections, it thought it preferable to produce a new version for publication in the Official Journal.*

## THE COURT'S OBSERVATIONS

**Fixed assets**

9.5. The total value of the tangible fixed assets (3 261 million euro) shown on the balance sheet is both understated (by 225 million euro) because it does not take sufficient account of buildings which the Economic and Social Committee (ESC) and the Committee of the Regions (COR) are renting, with an option to buy, and overstated (by about 81 million euro) because it does not take account of the depreciation on the Council's building. The lack of a physical check on movable property, in particular on the Joint Research Centre's (JRC) various sites apart from Ispra, for goods with a purchase value of some 96 million euro, impairs the quality of the accounting inventory.

**9.5. THE COMMISSION'S REPLIES**

*The Commission stresses that progress has been made by all the institutions in improving the reliability and accuracy of the amount shown on the balance sheet for non-financial fixed assets. This represents a significant advance over previous years.*

*The two buildings being rented by the Committees with an option to buy were not included on the assets side of the balance sheet since, at 31 December 2000, they did not meet the necessary conditions laid down by the Regulation on the accounting management in the accounts of the European Communities' non-financial fixed assets. The value of one of the buildings will be included in the 2001 balance sheet since the contract takes effect on 1 January 2001. The other building will be included on the balance sheet as soon as the risks and rewards are transferred to the Committees. In the meantime, information on these two buildings is included in the off-balance-sheet commitments.*

*As far as the Council's building is concerned, the Commission explained in the notes to the balance sheet the reason why it had not been possible to allow for depreciation on this building.*

*As regards the physical inventory on the JRC sites other than Ispra, the Commission would point out that a full physical check on property is under way. The objective is to finalise this exercise before the end of 2001 and to enter the result in the 2001 balance sheet.*

**Amounts receivable and potential assets**

9.6. In response to one of the Court's observations (4), a lump-sum reduction in value based on age (139 million euro) has been applied for the first time for the sundry debtors (2 217 million euro) which have not undergone a specific value reduction. The Commission has not been able to supply the details of how this

**9.6. THE COMMISSION'S REPLIES**

*The Commission has taken steps to ensure that, in future, clear and full information on the value adjustment for sundry debtors will be provided.*

(4) Annual Report concerning the financial year 1999, paragraph 8.5 (OJ C 342, 1.12.2000, p. 187).

## THE COURT'S OBSERVATIONS

reduction was calculated, but amounts receivable relating to fines imposed for infringements of open competition (973 million euro) have been excluded. The Commission, once it has made an analysis, should lay down specific rules for this category of amounts receivable.

*Amounts receivable relating to fines imposed for infringement of the competition rules were excluded from the value adjustment calculation since past experience shows that these fines have, as a rule, been collected without any loss. The fines which are not the subject of an appeal against the businesses concerned are recovered on the date shown in the decision imposing the fine. Fines which are subject to an appeal to the competent court are recovered after the final ruling. Furthermore, the risk of insolvency of the business on which fines have been imposed is limited and does not warrant a lump-sum reduction in value. The Commission will lay down rules in the accounting and consolidation manual.*

9.7. The Court notes the efforts made by the Commission to identify the financial intermediaries managing Community funds and to determine the amount recorded in the balance sheet under *sundry debtors* (792 million euro). Nevertheless, this inventory is incomplete and, since this is an amount entered on the balance sheet on the basis of a non-accounting record, the central accounting departments are also not in a position to carry out an adequate check on this amount.

The Court has taken note of the Commission's undertaking<sup>(5)</sup> to lay down minimum rules, for the accounts for 2001, for the management and control of these funds. However, it considers that the Commission should also have updated balances available in the accounts on an ongoing basis and should avoid non-accounting inventories (see paragraphs 9.28 and 9.29).

9.8. The amount shown as off-balance sheet commitments concerning the potential assets relating to cases of fraud and irregularities in the area of the EAGGF-Guarantee (1 099 million euro) has several flaws. Thus, pending the entry into force of the regulations concerned, the amounts which may duplicate those entered in the EAGGF-Guarantee debtors general ledger have only been deducted for the Member States that have presented these data. Furthermore, the respective data are not drawn up on the same date, and the deduction has been made without any individual reconciliation.

## 9.7. THE COMMISSION'S REPLIES

*The Commission would like to emphasise the significant progress made in the financial statements both in terms of presentation and in terms of the content of the report compared with previous years. In line with its undertakings, it has compiled a list of financial intermediaries managing Community funds and has included additional relevant information on this type of activity in the financial statements. It will continue its efforts to specify the proper procedure for the collection and checking of information and to make the amount to be taken over onto the 2001 balance sheet more complete.*

*This problem will be dealt with in work on modernising the Commission's accounting in order to move towards a new integrated accounting system.*

## 9.8. THE COMMISSION'S REPLIES

*For the year 2001 onwards, changes have been made regarding the information to be communicated by the Member States to the EAGGF Guarantee Section which will enable debtors, who have also been notified to OLAF as cases of fraud or irregularity, to be identified. This information will help to eliminate any double counting.*

<sup>(5)</sup> Annual Report concerning the financial year 1999, the Commission's replies, paragraph 8.8 (OJ C 342, 1.12.2000, p. 196).

## THE COURT'S OBSERVATIONS

**Advances and payments on account**

9.9. The only information as to whether the payments borne by the budget are definitive or not relates, firstly, to payments to intermediate financial bodies which have not yet been transferred to the final beneficiaries (see paragraph 9.7), and, secondly, to advances concerning the new programming period (2000 to 2006) paid out of the budget for the financial year 2000 for the Structural Funds.

9.10. In its replies to the Court's observations on the financial year 1999 (6), the Commission said that it would consult the administering departments to lay down detailed rules for each sector of activity and that it would apply the classification of the different types of payment provided for in the proposal for a revision of the Financial Regulation (7) even before this revision is approved. The Court has not noted any progress in these areas.

**Commitments and potential liabilities**

9.11. At 31 December 2000, commitments against differentiated appropriations totalling 65 596 million euro remained to be settled, 2 166 million euro of which were covered by payment appropriations carried over from 2000 to 2001.

9.12. At the year-end, the amounts relating to commitments outstanding from before 1999 total around 18 574 million euro, of which some 7 400 million euro were not subject to any payment during 1999 and 2000. Of the latter amount, the Court considers that some 1 680 million euro (23 %) no longer represent an obligation to make payments.

**9.10. THE COMMISSION'S REPLIES**

*The Commission is aware of this problem. Thus, in the proposed new accounting framework, the accounting departments work together with the main DGs concerned to find the best accounting procedure to follow in future.*

**9.12. THE COMMISSION'S REPLIES**

*The Commission has started analysing and managing the outstanding commitments in order to eliminate the abnormal component. It has also undertaken to keep the budgetary authority regularly updated on progress in this area.*

*With a view to providing relevant information, the Commission specified in the financial statements that the amount of outstanding commitments corresponded to a maximum potential commitment and estimated the abnormal component at EUR 4,9 billion (except for the Structural Funds).*

(6) Annual Report concerning the financial year 1999, the Commission's replies, paragraphs 8.11 to 8.13 (OJ C 342, 1.12.2000, p. 197).

(7) Proposal for a Council Regulation (EC, ECSC, Euratom), presented by the Commission on 17 October 2000, on the Financial Regulation applicable to the general budget of the European Communities COM(2000) 461 final of 17 October 2000, Article 75.

## THE COURT'S OBSERVATIONS

9.13. In the area of Structural Operations, the Commission's budgetary commitments, in accordance with the regulations, only show the annual tranches that are outstanding and that have fallen due. The amounts of the multiannual legal commitments that have been entered into are, however, disclosed as potential liabilities. For all other areas of expenditure, the regulations do not make any distinction between legal commitments and budgetary commitments. These differing definitions result in inconsistencies in the financial statements.

9.14. For Structural Operations too, certain practices that are open to criticism still persist<sup>(8)</sup>. Firstly, in certain areas, intermediate payments are systematically charged to the oldest annual tranche, with the result that the commitments still outstanding are thus closed before the final payment of the balance has been made. Secondly, the Commission does not systematically adjust the commitments in the event of reprogramming.

9.15. For the budget headings relating to the international fisheries' agreements, the Commission has entered into legal obligations which exceed available appropriations by 39 million euro. The same is true in the area of External Actions, where a sum of 174 million euro is involved. As a result, the legal obligations entered into by the Commission exceed available appropriations by a total of 213 million euro. The amounts concerned, however, are disclosed as potential liabilities.

## 9.13. THE COMMISSION'S REPLIES

*In accordance with the legislation, structural operations are undertaken by annual tranche, hence there is a difference between the legal and budgetary commitments. This is why the Commission presents the legal commitments which are not yet committed in the accounts in the off-balance sheet commitments.*

## 9.14. THE COMMISSION'S REPLIES

*The Commission maintains that it would have been difficult to do it differently. For the period 2000 to 2006, Regulation (EC) No 1260/1999 provides specifically for the posting of payments to the earliest open commitment made. The question of the adjustment of commitments in the event of reprogramming does not arise since changes to a programme's financial plans can only affect subsequent years.*

## 9.15. THE COMMISSION'S REPLIES

*The fisheries agreements and certain other agreements in external relations constitute legal frameworks which, while extending over several financial years, define the obligations for each party (Community — third countries) for each year. The Community's financial obligation is thus clearly divided into annual tranches in the basic text (the financial protocol). This is why, during the year in question, the Commission commits only the individual tranche for that year.*

*In the light of the Court's repeated comments and for the sake of transparency, every year since 1997 the Commission has included in the off-balance sheet commitments all the amounts not yet committed corresponding to the legal obligations under the agreements in force.*

*Furthermore, in order to provide a definitive solution to this problem, the Commission included in its proposal for the recasting of the Financial Regulation, both under Title I, General Provisions, and Title II, Implementation of the Budget, the possibility of annual instalments for commitments where the action extends over several financial years, as long as the basic instrument provides for this, as it does in the case of the international fisheries' agreements.*

<sup>(8)</sup> See, for example, the Annual Report concerning the financial year 1998, paragraph 8.17 (OJ C 349, 3.12.1999), the Annual Report concerning the financial year 1997, paragraphs 8.23 and 8.56 (OJ C 349, 17.11.1998) and the Annual Report concerning the financial year 1993, paragraph 14.10(b) (OJ C 327, 24.11.1994).

## THE COURT'S OBSERVATIONS

*Aspects relating to the implementation of the budget*

9.16. In its Annual Report concerning the financial year 1999, the Court pointed out that reprogramming decisions (2 377 million euro) taken before 31 December had not given rise to the required budgetary commitments<sup>(9)</sup>. Similarly, 1 034 million euro corresponding to the 2000 tranche of 16 programmes for the new 2000 to 2006 period for which Commission decisions had been taken before 31 December 2000 had not been the subject of budgetary commitments in 2000. The amounts not committed are shown off-balance-sheet. The lack of any budgetary commitment parallel to the legally binding commitment is contrary to Article 36 of the Financial Regulation. The appropriations carried over from 2000 to 2001 to cover these decisions do not satisfy the conditions stipulated in Article 7(2) of the Financial Regulation. Non-automatic carry-overs of commitment appropriations are to be used only in the case of files which are virtually completed by 31 December, which does not apply to the decisions taken.

**9.16. THE COMMISSION'S REPLIES**

*The Court rightly points out that the legal commitments were entered into without the corresponding budgetary commitment for the first tranche being made. The Commission acknowledges the existence of this problem, which is the result of varying practices in the programmes' adoption procedures.*

*In these circumstances, it is correct that such commitments which have not yet been committed in the accounts should be included in the off-balance sheet commitments.*

*The Commission then carried over the corresponding appropriations in order to make the accounting commitment in 2001. In any case, from an operational point of view, in this particular case there are no other solutions within the framework of the existing financial perspective.*

*Since certain legal commitments were not covered by budgetary commitments at the end of the financial year, the only alternatives to carrying over appropriations would have been to leave the legal commitments not covered by budgetary commitments, which would not have been acceptable, or to revise the financial perspective.*

9.17. The payments on account made on the non-committed part of the programmes decided in 2000 (see paragraph 3.32), which amount to 507,4 million euro, have de facto been carried over to the financial year 2001. Furthermore, for 15 of these operations and 10 programmes for which the 2000 tranche was committed for all the Funds concerned, the corresponding payments on account were not carried out as soon as the commitment was made, which is contrary to Article 32(2) of Regulation (EC) No 1260/99. As a result, 1 027,1 million euro in payments due in 2000 were carried forward to 2001.

**9.17. THE COMMISSION'S REPLIES**

*The reason why payments on account were not made in 2000 for a number of programmes which had already been approved during the course of the financial year is that the commitments for these programmes were made at the end of 2000. The short time available and the large number of end-of-year decisions made it physically impossible to make all the corresponding payments on account; they were made at the beginning of 2001.*

<sup>(9)</sup> Annual Report concerning the financial year 1999, paragraphs 3.41 and 8.17 (OJ C 342, 1.12.2000).

## THE COURT'S OBSERVATIONS

9.18. A new budgetary nomenclature was adopted in the 2000 budget. Title B2-1, 'Structural Funds', is subdivided into chapters, no longer by Fund, but by the priority objectives of the Structural Funds. This new arrangement has the advantage of identifying the appropriations of the new programming period more clearly and it is consistent with the cofinancing of multifund programmes by objective. However, as regards the preceding periods, for which commitments representing 41 600 million euro were still outstanding at the end of 1999, the new nomenclature means, for example, that one single article (completion Objective 1) encompasses the total payment appropriations for the four Structural Funds under Objective 1 (12 000 million euro). As already pointed out by the Court (10), for the headings to which such amounts are allocated, the principle of the specificity of the budget loses some of its meaning.

9.19. Negative expenditure on agriculture totalled 3 798 million euro for 2000, according to the consolidated financial statements. In order to eliminate this practice, which undermines the transparency of the budget and the accounts, the Commission has suggested that in future these items of negative expenditure should be treated as earmarked revenue and be charged, indiscriminately, to the EAGGF in order to finance any item of expenditure regardless of its nature, as of the time when it can be assigned to the Guarantee Section (11). In the Court's opinion, the most orthodox solution in terms of the budget would be to enter the items of agricultural revenue, hitherto shown in the budget as negative expenditure, in the general statement of revenue (12) (see paragraphs 2.12 to 2.16).

9.20. Because Italy failed to pay the additional levy charged due to overruns on milk quotas, reductions in advances were imposed on it for a total of 380,6 million euro (134,7 million euro for the 1998 to 1999

(10) Opinion No 2/2001 on a proposal for a Council Regulation on the Financial Regulation applicable to the general budget of the European Union (submitted pursuant to Article 279/EC), paragraph 6 (publication pending). Opinion No 4/97 on the proposal for a Council Regulation (Euratom, ECSC, EC) amending the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities, paragraph 15 and Annexes 1.20 and 1.21 (OJ C 57, 23.2.1998).

(11) Proposal for a Council Regulation amending Council Regulation (EC) No 1258/1999 on the financing of the common agricultural policy as well as various other regulations relating to the common agricultural policy. Commission document, reference 2000/0204 (CNS) — COM(2000) 494 final.

(12) Opinion No 1/2001 of the Court of Auditors (OJ C 55, 21.2.2001).

## 9.18. THE COMMISSION'S REPLIES

*The point of the budget structure is to group together the appropriations intended for any given category of operations. The 'completion' lines mentioned by the Court group together programmes decided on before the current period for a specific objective, this objective being the logical link between them. On the other hand, the amounts on these lines is not such a fundamental criterion. Furthermore, the amounts to be entered should decline rapidly over the next few years and frequent changes in nomenclature should be avoided. Furthermore, implementation can be monitored, if necessary, at a more decentralised level since there are subdivisions in the accounts.*

## 9.19. THE COMMISSION'S REPLIES

*The Commission does not share the Court's opinion that negative expenditure should be entered in the general statement of revenue. Instead it considers that these amounts, which are repayments of amounts which have already been financed by the EAGGF, should be treated as earmarked revenue to be used by the EAGGF, as proposed in the recasting of the Financial Regulation.*

## 9.20. THE COMMISSION'S REPLIES

*Where the Member State does not respect the Community legislation, the Commission, in application of the provisions regarding budgetary discipline, recovers the amounts due by reductions of the advances. In such cases, the Commission has no other choice than to book the amounts recovered to the special budget item which is provided for this purpose in the Community budget (B1-3 7 0 1).*

## THE COURT'S OBSERVATIONS

marketing year and 245,9 million euro for the 1999 to 2000 marketing year). Charging these amounts to the item 'reductions of advances' instead of to the item 'additional levies' is an infringement of the principle of the specificity of appropriations and leads to a lack of transparency in the accounts. Furthermore, the reduction in an advance of 134,7 million euro, due to a delay in notifying the figures for 1999, was entered in the accounts for 2000, which is an infringement of the principle of the annuity of the budget (see paragraph 2.18).

9.21. Several observations need to be made in the light of the examination of transfer of appropriations No 79/2000 concerning the EAGGF-Guarantee, which had to be submitted to the budgetary authority for a decision and involved a total of 544 million euro, of which 310 million euro were to be transferred to the monetary reserve (see paragraphs 2.9 to 2.11).

9.22. The Commission sent this proposal to the Council on 10 January 2001 whereas, according to the regulations, it ought to have sent it at the latest by the end of October 2000 for the part transferred to the monetary reserve<sup>(13)</sup>. As a result of the fact that it was sent late, the Commission had to record the transfer before its formal approval by the Council so as to be able to enter the budgetary operations in the accounts by the deadline laid down in the regulations.

9.23. Moreover, when the transfer to the monetary reserve was made, the Commission withdrew most of the 310 million euro from Chapter B1-3 7, 'Clearance of previous years' accounts and reduction/suspension of advances', and not from the items where savings had been made, following favourable developments in the euro/dollar parity. This practice, on which the Court has already made an observation<sup>(14)</sup>, means that it is not possible to present to the budgetary authority all

*The late transmission of data by the Member State made it impossible to book the reduction of EUR 134,7 million in 1999. Steps were taken in 2000 to prevent a recurrence of this problem (see point 2.18).*

**9.21 to 9.22. THE COMMISSION'S REPLIES**

*The transfer to the monetary reserve was carried out following receipt and examination of the final declarations of expenditure from the Member States, which permitted identification of the budget lines from which it was appropriate to transfer these appropriations (see point 2.10). This approach avoided unnecessary recourse to other procedures such as a supplementary and amending budget.*

*For the other transfers, the proposal was transmitted to the Council by the deadline of 10 January 2001 as laid down in Article 104 of the Financial Regulation. The transfers, which were regularisation transfers aimed at permitting the booking of expenditure which had already taken place, were registered following approval by Coreper on 25 January 2001, some four days before formal approval by the Council. This enabled the Commission services to proceed with consequential transfers necessary for the closure of the accounts by the deadline of 31 January as laid down in the Financial Regulation.*

**9.23. THE COMMISSION'S REPLIES**

*A careful reading and comparison of the second and third sentences of Article 11 of Council Regulation (EC) No 2040/2000 shows that the Regulation on budgetary discipline does not require that transfers to the monetary reserve be effected solely and entirely from those lines where expenditure is influenced by changes in the euro/dollar parity (see point 2.11).*

<sup>(13)</sup> Article 11 of Council Regulation (EC) No 2040/2000 concerning budgetary discipline (OJ L 244, 29.9.2000, p. 27).

<sup>(14)</sup> See Annual Report concerning the financial year 1998, paragraph 2.28 (OJ C 349, 1.12.1999).

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the transfers from chapter to chapter which ought to have been submitted to it (see paragraph 2.11) and leads to expenditure having to be financed by exchange-rate differences arising from other headings.

*In the case of a fall in the dollar against the euro, the Regulation clearly specifies that '... transfers shall be made to the EAGGF Guarantee section headings affected by the fall in the dollar' (third sentence of Article 11). However, where the dollar strengthens against the euro, as was the case in 2000, the Regulation merely states that '... savings in the Guarantee section of up to EUR 500 million... shall be transferred to the monetary reserve' (second sentence of Article 11), without specifying the origin of these savings. This is in contrast to the more precise wording of the third sentence of Article 11. The order of the two sentences is also significant.*

*The Commission has pointed out in previous reports and transfer proposals concerning the impact of movements in the dollar exchange rate (for example, in the Report and Transfer Proposal for 1998 — SEC (1998) 1893 final of 13 November 1998) that the savings for each sector need not necessarily result in identical end-of-year availabilities. Indeed the Commission drew attention to such factors in its reply to point 2.28 of the Court's Annual Report for 1998 (OJ C 349, 3.12.1999, p. 53).*

9.24. Some items of expenditure have been declared either before their actual payment or very belatedly and have therefore been booked to a financial year other than that which has actually borne the said expenditure. For example, Spain declared some expenditure (Aid to bee-keeping) as effected in one financial year whereas it had in fact been paid in the following financial year. Conversely, Italy and Spain were very late, in relation to the stipulations of the regulations, in paying advances (aid for the processing of citrus fruit and aid to fruit and vegetables), which meant that the expenditure was not booked until the following financial year. Lastly, in France, transport costs relating to public storage were not declared until more than six months after their actual date of settlement, with the result that their booking was deferred until a subsequent financial year. In the latter three cases, however, the Commission could, over and above the specific provisions in Commission Regulation (EC) No 296/96, have made a corresponding reduction in the advances in accordance with Council Regulations (EC) No 2040/2000 and (EC) No 1258/99.

**9.24. THE COMMISSION'S REPLIES**

Article 14 of Regulation (EC) No 2040/2000 provides for the reduction or suspension of advances where expenditure does not comply with Community rules; it applies, in conjunction with Article 4 of Regulation (EC) No 296/96, to all cases of failure to respect the payment deadlines laid down in the legislation. For the year 2000, 233 budget lines were checked and reductions of EUR 15,7 million were made from the monthly advances.

However, the deadline for certain payments depends on the date applications are received or checked in Member States and can only be verified by checking individual files in the Member States. It would only be possible to discover cases such as those referred to by the Court under the clearance of accounts procedure under Article 7(4) of Regulation (EC) No 1258/1999, and even then only if the sector in question has been selected for audit on the basis of risk analysis and if the transaction in question is selected in the sample chosen for audit.

## THE COURT'S OBSERVATIONS

9.25. As in previous years, an analysis of the entry in the budget of the monthly adjustment payment orders for the EAGGF-Guarantee operations has revealed that for eight out of twelve months (corresponding to a total of 33 286 million euro, i.e. 82,4 % of payments) these payment orders were approved and validated outside the time-limits laid down in the regulations. The delays were found to fluctuate between 16 and 70 days (see paragraph 2.47).

9.26. According to Article 10 of the Financial Regulation (15), the budget and the supplementary or amending budgets (SAB) have to be published in the Official Journal, at the instance of the President of the European Parliament, 'normally within one month of the date of the declaration of final adoption of the budget'. SAB No 1/2000, adopted on 2 August 2000, was not published until 17 April 2001, i.e. more than seven months later than the deadline laid down in the regulations. SAB No 2/2000, adopted on 6 July 2000, was not published until 2 October 2000, i.e. almost two months late.

*Accounting framework and practices***Keeping of the accounts**

9.27. Pursuant to the provisions of the Financial Regulation and of the corresponding implementing rules (16), the accounting officer is required to keep budgetary cash-based accounts for drawing up the consolidated revenue and expenditure account and general accounts for drawing up the consolidated balance sheet. The transactions are first charged to a budget heading and then, in the case of transactions to be included in the balance sheet, recorded in the general accounts and in the consolidated balance sheet, on the basis of non-accounting inventories.

**9.25. THE COMMISSION'S REPLIES**

*For a variety of administrative and technical reasons, the accounting registration of the monthly regularisation payments for eight months suffered delays of 39 days on average. However, these problems have now been addressed and, since August 2000, only two delays have been encountered, of 1 and 5 days respectively.*

**9.26. THE COMMISSION'S REPLIES**

*The Commission is endeavouring to provide all the necessary technical assistance to the relevant services of the European Parliament in order to speed up the publication of the SAB.*

**9.27. THE COMMISSION'S REPLIES**

*The Commission is aware that it does not have a proper accounting framework conforming to the usual standards on the basis of which the institutions' accounts could be drawn up in a harmonised, consistent fashion. This shortcoming will be addressed by putting in place a new accounting framework, which is now an essential task. It will be implemented in successive phases corresponding to the financial statements of several financial years.*

(15) Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities (OJ L 356, 31.12.1977), as amended by several regulations.

(16) Articles 6, 69, 70, 70a and 72 of the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities (OJ L 356, 31.12.1977), as amended by several regulations. Articles 133 to 136 of Commission Regulation (Euratom, ECSC, EC) No 3418/93 of the detailed rules for the implementation of certain provisions of the Financial Regulation (OJ C 315, 16.12.1993).

## THE COURT'S OBSERVATIONS

9.28. These non-accounting inventories, in particular as regards capital expenditure, stocks or advances paid to financial intermediaries but not yet transferred to the final beneficiaries (see paragraph 9.7), are drawn up by the managers without any reconciliation being made with the corresponding amounts charged to the budget. The debts, which are a factor needed for calculating the economic result (see paragraphs 9.34 to 9.37), are not systematically recorded.

**9.28. THE COMMISSION'S REPLIES**

*The information on the non-accounting inventories was compiled by managers on the basis of precise, detailed standards, in particular the Regulation on the accounting management of the European Communities' non-financial fixed assets and Accounting and Consolidation Manual (manual designed to establish a uniform set of rules for accounting and presenting the accounts of the European institutions), even if they have not actually been reconciled with the budget accounts.*

*The new integrated accounting framework will make it possible to gradually eliminate non-accounting inventories.*

*Given that the accounts are cash-based, debts are not recorded regularly. The central register of invoices (in the process of being set up) will enable debts to be systematically entered in the accounts in future, which is not the case under the current organisation of accounts (see point 9.36).*

9.29. The lack of continuous, detailed entries in the general accounts makes it impossible to close accounts at regular intervals and within reasonable time-limits as a significant proportion of the necessary information is lacking from the central accounting system.

**9.29. THE COMMISSION'S REPLIES**

*As explained in the following points, the new accounting framework will solve the current shortcomings in the European Communities' accounting.*

**Changes in the accounting framework**

9.30. Since 1994, the part of the Statement of Assurance (DAS) which concerns the reliability of the accounts has included reservations and observations, many of which have been repeated year after year. They often stem from the fact that no suitable accounting framework has been defined for budgetary transactions and transactions relating to assets.

**9.30. THE EUROPEAN PARLIAMENT'S REPLIES**

*Final adoption of supplementary and amending budget (SAB) No 2/2000 took place on 6 July 2000. The Parliament department responsible forwarded the budget to the Office for Official Publications of the European Communities (OPOCE) the following week.*

*As Parliament had adopted an amendment to SAB No 1/2000 which required the Council's agreement, final adoption of SAB No 1/2000 did not take place until 2 August 2000; that budget was forwarded to OPOCE at the start of September.*

*However, reversing the 'natural' order of the two supplementary and amending budgets gave rise to technical difficulties concerning the basic amounts. The process of publishing SAB No 1/2000 was suspended at the request of the Commission*

## THE COURT'S OBSERVATIONS

to enable it to carry out the necessary checks in liaison with Parliament's Committee on Budgets. The definitive texts were forwarded to OPOCE, for publication, on 26 February 2001. Following a number of subsequent corrections, the Commission validated the budget file on 5 April 2001.

Parliament will ensure that delays such as these in the publication of the budget or of SABs are avoided, by closely monitoring the physical publication process and calling on the bodies responsible for publication to work more quickly if a risk of delay arises.

## 9.30. COMMISSION'S REPLIES

The Commission has embarked upon a process of modernising the European Communities' accounting system in order to develop from an accounting system, based only on the description of the impact in terms of cash movements for budget implementation, towards integrated accrual accounting the objective of which is to present the Communities' financial situation in a more complete and reliable way. The new integrated accounting framework will make it possible to gradually eliminate the use of non-accounting inventories.

9.31. The Commission has for several years been undertaking to define a new accounting framework based on the principles of accrual accounting. A group of high-level independent experts finalised and presented a study in July 2000. The timetable drawn up by the Commission did not enable it to include the proposals contained in this study in its proposal for an amendment to the Financial Regulation of 17 October 2000 (17) (18).

## 9.31. THE COMMISSION'S REPLIES

*The new accounting framework must change on several fronts:*

- (1) *evolution towards an integrated system of accounting which contains all the information necessary for presenting the accounts;*
- (2) *adoption of the generally accepted accounting principles;*
- (3) *evolution towards a general accounting system based on accrual accounting and maintenance of cash-based budget accounting. This will involve comprehensive lines between the budget accounts and the general accounts;*
- (4) *adoption of accounting methods and rules of evaluation which flesh out the accounting principles adopted;*

(17) Proposal for a Council Regulation (EC, ECSC, Euratom), presented by the Commission on 17 October 2000, on the Financial Regulation applicable to the general budget of the European Communities (COM(2000) 461 final).

(18) See also Opinion No 2/2001 of the Court of Auditors on a proposal for a Council Regulation on the Financial Regulation applicable to the general budget of the European Communities, paragraphs 41 to 43 (OJ C 162, 5.6.2001).

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(5) improvement of the financial statements so that they give an accurate picture of assets, the financial situation, budget execution, the entity's outturn and the cash flow for the year. The aim is to follow the International Federation of Accountants (IFAC) recommendations;

(6) extension of the scope of consolidation.

All these elements will be included in the amended proposal for the recasting of the Financial Regulation and in the Regulation laying down the implementing rules.

As the Court rightly points out, the draft accounting project needs time. It is essential to prepare it properly, analyse it and evaluate it before making it effective. An action plan has just been drawn up by the Commission's accounting officer. A group of accounting specialists, made up of officials on the one hand and external consultants on the other, will be formed to carry through the accounting project.

Furthermore, contacts have been made with the national administrations of the Member States that are most advanced in the field of public sector accounting; these contacts will continue throughout the project. It makes sense to take advantage of the experience acquired by these countries.

In conclusion, reforming the European Communities' accounts is an ambitious project which fits in with the direction which is being taken by accounting developments in different countries and is recommended by the international accounting institutions.

9.32. Since then, progress on this matter has been made at a snail's pace. The detailed action plan has not yet been approved, and provisions relating to the basic accounting framework, the keeping of the accounts and the presentation of the financial statements for inclusion in the draft revision of the Financial Regulation have not yet been finalised.

9.33. The Commission is invited to take urgent action to remedy these shortcomings, whilst at the same time bearing in mind the practical impact that a project of this scale and this complexity is likely to have both in terms of the human and technical resources needing to be deployed and at organisational level, given that it will concern the whole of the Commission.

### 9.32. THE COMMISSION'S REPLIES

There has been a report on this project detailing the various aspects of the project, including a detailed action plan which will be approved by the Commission's new accounting officer.

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**Economic result**

9.34. This year, for the first time, the institutions have calculated a broader result, called the economic result in the consolidated financial statements. In accordance with the amendments made to the Financial Regulation in November 1998 (19), it comprises the balance of the budget and the outturn of the adjustments. It aims to make the link between the budgetary cash-based accounts and the general accounts, which are moving towards accrual accounting. It reveals the impact on the balance sheet of expenditure and revenue not originating in budgetary management.

9.35. The adjustments made to the budgetary balance mainly concern the rebooking of purchases and sales of fixed assets and stocks charged in the first instance to the budgetary accounts, payments and repayments of loans or holdings against budgetary appropriations, and the allocations, withdrawals of depreciations and reductions in value relating thereto. They also concern the entry in the accounts of budgetary amounts receivable, allocations and withdrawals of reductions in value against these receivables, and allocations and withdrawals concerning provisions.

9.36. Calculating an economic result represents a step forward, which is in line with the general trend observed in the public sector at international level. A number of items of information are missing, however, owing, in particular, to the present accounting system which does not allow the comprehensive recording of all the data needed for calculating the result. For example, the Commission is not able to put a figure on the amount of the debtors to be entered on the consolidated balance sheet. Of the off balance sheet commitments, certain provisions for risks and liabilities are not taken into account for the calculation of the economic result, such as the provision to be made for the costs of decommissioning the JRC's nuclear installations still in operation and disposing of their waste (at 31 December 2000, 220 million euro), or the commitments for pensions, to be estimated on the basis of an actuarial calculation (see paragraph 7.6).

**9.36. COMMISSION'S REPLIES**

*The Commission will analyse in detail the examples given by the Court, in order to determine the best procedure to be followed in the light of the following.*

*Debts: as indicated, the European Communities' accounts are cash-based. As a result, debts are not systematically recorded. The Commission is in the process of developing the project of a central register of invoices which will make it possible in future to enter debts in the accounts. Furthermore, as already explained, the draft new integrated accounting framework provides, among other things, for debts to be entered in the accounts.*

*Pensions: the Commission's opinion is that, at this stage, the most important thing is to provide complete information in the financial statements on commitments entered into with regard to pensions. As the Court acknowledges, the Commission included exhaustive information in the annex to the financial statements. There is as yet no international consensus on the procedure to be followed for the debt relating to public sector pensions, and this requires in-depth accounting analysis. The procedure recommended by the Court is far from*

(19) See the amended Article 70 of the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities (Council Regulation (EC, ECSC, Euratom) No 2548/98 of 23 November 1998 (OJ L 320, 28.11.1998, p. 1)).

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*being followed by the Member States or by other third countries which are very advanced in matters of public sector accounting.*

*The Commission would also point out that the IFAC has not yet adopted a standard for pensions applicable to the public sector.*

*The costs of decommissioning the JRC's nuclear installations: the Commission has made a provision of EUR 230 million for the cost of decommissioning installations that are already closed down (including the cost of nuclear waste processing).*

*For the other installations which are still in use, the Commission undertakes to enter a provision in the accounts as soon as it has sufficient information to do so. In the meantime, it has estimated the cost in the off-balance sheet commitments.*

9.37. The Court is well aware that the move towards accrual accounting, which produces an economic result, can only be made gradually. Pending its full implementation, the result that is shown only partly reflects the true economic situation.

#### *Follow-up of observations on the Sincom 2 accounting system*

9.38. Most of the observations made by the Court in its Annual Report concerning the financial year 1999 (20) are still relevant.

#### **9.37. THE COMMISSION'S REPLIES**

*The calculation of the economic result represents an important development in the European Communities' accounting system. It will continue to be gradually improved as the draft new accounting framework progresses.*

#### **9.38. THE COMMISSION'S REPLIES**

*The Commission would point out that the quality of Sincom 2 is an ongoing concern and that it is making regular and major efforts to improve the performance of the horizontal financial applications.*

*However, it acknowledges that certain planned actions have been delayed because of the technical complexity of the solutions that are to be implemented. However, measures are being taken to strengthen the management of the financial information systems.*

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(20) Annual Report concerning the financial year 1999, paragraphs 8.41 to 8.56 (OJ C 342, 1.12.2000, p. 193).

## THE COURT'S OBSERVATIONS

9.39. Despite the complexity of the Sincom 2 accounting system, the Commission still does not make comprehensive, periodic reconciliations between the data in the three Sincom 2 subsystems. The Commission's central departments have also not issued any written instructions to the managing departments nor made any systematic reconciliations between all the local systems and the central system, despite the undertaking given in the replies to the Court's observations<sup>(21)</sup>. There is therefore a lack of consistency between the data in the subsystems, and the reliability of the information made available to the administrators for management purposes cannot be guaranteed.

## 9.39. THE COMMISSION'S REPLIES

*The Commission has started analysing a new approach for the regular reconciliation of the data of Sincom 2's three subsystems. An initial test on the consumption of commitment appropriations was conducted in the context of the 2000 closure.*

*The Commission acknowledges that it has got behind in sending written instructions to the departments for which it is carrying out regular checks between the local system data and the Sincom 2 data. Since the transactions input from local systems are only validated in the central system (Sincom 2), it is up to the authorising officer to make sure that their local system has in fact taken over the central data. Departments will be sent written instructions in October 2001.*

9.40. The operational shortcomings pointed out by the Court have only very partially been rectified. The problems concerning the processing of dates and accounting periods, the management of part payments for own resources and amendments being made to commitments in a way which obscures the audit trail are all problems which still persist. No consideration seems yet to have been given to integrating certain basic accounting functions available in the software, such as control accounts for debtors and receivables or for fixed assets. The drawing-up of reports, in particular as regards revenue and monitoring of receivables, continues to pose problems.

## 9.40. THE COMMISSION'S REPLIES

*The Commission would point out that it has made significant progress in 2001 on alleviating the operational deficiencies indicated by the Court, although there have been problems meeting the deadlines previously notified.*

*The Commission has planned measures to improve the management of transactions using accounting dates and periods. The software supplier has made a new version available to the Commission which, since August 2000, has made it possible to get a history of transactions. A data search tool is now operational. The takeover of historical data from Sincom 1 (1990-98) and Sincom 2 into Data Warehouse started in 2001: data on commitments and payments have been available since May 2001, while data on appropriations will be available by the end of 2001. A report will then make it possible to monitor the various amendments made to a commitment.*

*Various measures have been undertaken by the Commission in order to incorporate certain accounting functions available in the software. A first prototype of the central invoice register application (Action 11 of the White Paper) was launched in the autumn of 2001. This is the first stage towards putting in place third-party accounting.*

*The management of partial collection in own resources and other functions concerning revenue management became partially operational in September 2001.*

<sup>(21)</sup> Annual Report concerning the financial year 1999, the Commission's replies, paragraph 8.48 (OJ C 342, 1.12.2000, p. 200).

## THE COURT'S OBSERVATIONS

9.41. The data-recovery testing which the Commission had undertaken to carry out by the end of 2000 has been postponed several times, most recently at the end of July 2001. Without an operational disaster recovery plan, the Commission would not therefore be able to recover data and continue the functions in progress if a major incident were to occur. On the basis of a risk analysis made by the Commission departments, the direct loss that might arise from such a breakdown of the system has been estimated at some 100 million euro, owing in particular to late-payment interest, penalties and double payments.

9.42. Although the Commission has started to take remedial action in the area of access security, a large number of important shortcomings persist, as confirmed by the producer of the software for the Sincom 2 reference system after a review made in February 2001. There is still no strict procedure as regards supervision and monitoring of defects recorded by the system, access management is not correctly documented and the number of users holding administrator or developer profiles continues to be too high.

9.43. The Court has noted the frequent occurrence of technical interventions in the system, which may consist of removing blockages caused by inconsistencies in the design of the system, and also of changing the key details of transactions, such as the amount or the budget heading. Very often there is virtually no documentation at all to back up these interventions and they thus involve a risk of losing the audit trail. Furthermore, these matters are no longer referred back to the Financial Controller and the accounting officer for their approval. The Court has also found a persisting problem with the granting of user profiles that are too broad. As a matter of urgency, the Commission must now give higher priority to strengthening the internal control mechanism relating to this system.

**9.41. THE COMMISSION'S REPLIES**

*A complete test of the contingency plan had to be postponed following the replacement of a number of computers at the Computing Centre, since it can only be fully carried out on the new configuration. The Commission informed the Court of this in full transparency. Partial tests were none the less carried out pending the definitive implementation of the overall contingency plan.*

**9.42. THE COMMISSION'S REPLIES**

*The Commission has drawn up an action plan to strengthen security. A great many individual measures were taken in the first half of 2001 (e.g. blocking inactive users and stepping up password management). The Commission will continue to make the necessary efforts to complete this action plan.*

*The Commission will develop standard reports to identify users' rights of access to the application.*

*The Commission has started taking steps to reduce the number of users with the broadest access profiles to what is strictly necessary.*

**9.43. THE COMMISSION'S REPLIES**

*The complexity of the system makes technical interventions necessary in order to both unblock transactions and align the data from the authorising officer's module (SI2) on the accounting data (R/3).*

*The Court is mainly referring to two types of operation: synchronisation of the outstanding commitments and reallocation. As far as taking over outstanding commitments is concerned, at the beginning of the financial year the commitments expressed in national currencies which are subject to a monthly revaluation in euros are taken over from the previous year to the current year. Because there is a specific revaluation mechanism for each national currency, there may be differences of cents of euros; this means that the value of the commitments outstanding must be synchronised in the authorising officer's module (SI2) with the values determined in the accounting*

## THE COURT'S OBSERVATIONS

*module (R/3). This synchronisation in no way changes the facts approved by the Financial Controller and validated by the Accounting Officer.*

*Another category of interventions concerns rebooking operations, consisting of moving a commitment from one budget line to another, either to take account of transfers of competence between Directorates-General decided by the Commission at the beginning of the financial year, or to take account of changes in the budget nomenclature. The Commission will ensure that approval by Financial Control is included in the workflow.*

*With regard to the documentation of these interventions, although there is a whole array of information on them in the system, the Commission will make it an absolute priority to improve the quality of the documentation on them and to formalise the procedures to make the audit trail easier.*

*As regards referring the other types of amendment to the Financial Controller and the Accounting Officer, consultations will begin in the near future in order to better define the types of intervention on operations falling within their respective area of competence. If amendments to Sincom 2 do prove to be necessary, they will be implemented as a matter of priority.*

*The Commission would point out that any software application must allow technical intervention to unblock transactions or correct programmes. A limited number of system administrators or officials in charge of security must therefore be given extensive access.*

*The Commission has already limited its user access. In order to guarantee the security of interventions, they are confined to a given module; they never refer to both of the two modules making up the Sincom 2 application. The Commission will ensure that intervention is limited to the strict minimum.*

LEGALITY AND REGULARITY OF THE  
UNDERLYING TRANSACTIONS*Introduction*

9.44. One of the features of the way in which the European Union budget is implemented is that the many very different parties involved are superimposed at

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several levels. They range from the centralised management of the Commission authorising officers to the large number of local aid recipients who are very scattered geographically and in terms of their function. Between the two are several types of national or regional decentralised management. In the areas of agricultural policy and structural operations, which account for more than 80 % of the budget, the Community measures are managed, at their level, by national/regional authorities and bodies. In the areas of internal policies, research and external actions, the funds and the associated operations are directly managed by the Commission departments through numerous intermediate or recipient bodies in Europe or other parts of the world.

9.45. The way in which the budget implementation process is split up in terms of place and time thus makes the task of verifying the legality and regularity of all the transactions a particularly complex one. The Commission, which, under Article 274 of the EC Treaty, is responsible for implementing the budget, is dependent on the good cooperation of the national authorities and other bodies involved. This system is characterised by great diversity in terms of the administrative and accounting cultures, traditions and practices involved.

9.46. One of the means available to the Commission to ensure the smooth functioning of the whole process is to adopt regulations or standard provisions stipulating the minimum checks to be carried out by the national authorities, accompanied, if need be, by procedures for accrediting competent bodies and by penalties. Such regulations exist in the agricultural sector, with the clearance of accounts, including the procedure for certifying the accounts of the paying agencies, and with the integrated administration and control system (IACS) (22), and in the area of structural operations, with Regulations (EC) No 2064/97 and (EC) No 438/2001 (23) laying down detailed rules for the implementation of the management and control systems for the assistance granted. The other areas of the financial perspective are not governed by any such framework control regulations.

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(22) Council Regulation (EEC) No 3508/92 of 27 November 1992 (OJ L 355, 5.12.1992, p. 1). Commission Regulation (EEC) No 3887/92 (OJ L 391, 31.12.1992, p. 36) laid down detailed rules for its application.

(23) OJ L 290, 23.10.1997, p. 1 and OJ L 63, 3.3.2001, p. 21.

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9.47. The Court's work for the financial year 2000, namely an audit of underlying transactions and an analysis of certain management and control systems (see paragraphs 9.1 to 9.3), has revealed that there are high risks of dysfunction, particularly at the final beneficiary level. The audit findings are summarised below according to the major areas of the budget.

*Own resources*

9.48. The majority of own resources (around 83 % of the total) derive from VAT and GNP. Amounts are based on complex financial models which use statistics provided to the Commission by Member States. Two principal factors affect the calculation of these resources: the reliability of the statistics themselves, and the quality of the Commission's system for handling the data. As the overall income from own resources has to match overall expenditure, with the GNP resource funding the balance, errors in the calculation can only affect each Member State's share of the total.

9.49. The Court examined the approach taken by the Commission to ensure the quality of the systems of procedures and controls established in Member States for collection of VAT, including the prevention and detection and correction of fraud or other irregularity. It found that the Commission could improve the coordination and execution of its work in this area, in particular in monitoring and evaluating the performance of the national systems (see paragraphs 1.19 to 1.36).

9.50. Following the Court's earlier work on the Commission's control of the reliability and comparability of Member States' GNP data, a follow-up audit was undertaken on the remedial action taken by the Commission. The Court concluded that, whilst a sound and adaptable framework for the management of quality control of GNP data is now in place, it is not being systematically applied. Furthermore, the communication of the data to users is often incomplete, leading to risk of misinterpretation (see paragraphs 1.50 to 1.65).

## 9.47. THE COMMISSION'S REPLIES

*See conclusions. The Commission's view is that it is making considerable efforts to put in place coherent verification systems and ensure effective implementation of them, particularly in the fields of agriculture, structural operations, research and external action. The reform of the Commission and the recasting of the Financial Regulation are important elements here.*

## 9.49. THE COMMISSION'S REPLIES

*The Commission is neither required, nor has it the resources, to undertake more in this area. It explained its role with regard to VAT own resources in its comments on Chapter 1 of this annual report. It will continue to play its part in this area in cases where it considers that a Community dimension will strengthen action by Member States' national administrations. However, apart from the specific obligation under Article 12 of Regulation (EEC) No 1553/89, the present Community legal framework does not make the Commission responsible for monitoring and evaluating Member States' VAT control.*

## THE COURT'S OBSERVATIONS

9.51. Traditional own resources account for around 14 % of the total and essentially consist of customs duties paid on the importation of goods into European Union territory. The responsibility for collecting such duties resides with Member States' customs authorities. One of the critical aspects of this process is to ensure that duty is completely and accurately identified and paid. It is the responsibility of customs authorities to establish sufficient procedures and controls to adequately cover this risk. In undertaking its audit work on anti-dumping, which comprises one of the types of customs duties, the Court examined the systems established to counteract the high risk of exporters to the European Union attempting to evade such duties. The Court's work revealed a number of weaknesses in the concept and application of the systems in place at both Commission and Member State levels, including inadequate technical tools used in the risk-based selection of customs declarations for detailed checking.

**9.51. THE COMMISSION'S REPLIES**

*Regarding the remarks concerning the 'weakness in application and inadequate technical tools' the Commission would point out that, as already mentioned at points 1.31 to 1.34 and 1.40 of Chapter 1, the Commission makes specific data related to the published anti-dumping legislation available to Member States via TARIC, in order to ensure the uniform and simultaneous application of anti-dumping measures.*

*Furthermore, since 1997 there has been a published 'Guide to risk analysis and customs control', in which specific risk indicators for goods subject to anti-dumping and countervailing duties are defined (Chapter 3, subsection 3). These indicators should cover the risk indicated by the Court's audit.*

*In addition, since risk analysis is an important tool for customs control, the Commission promotes a Community approach to risk management under the Customs 2002 programme including the development of risk indicators for the customs clearance process on import, export and within the transit regime.*

## Agricultural policy

9.52. The Agriculture Guarantee Fund is the largest area of the budget (representing some 47 % of the total). Expenditure is indirectly managed in cooperation with Member States through their paying agencies. Millions of payments are made by the agencies to a multitude of beneficiaries, in general individual farmers or agricultural enterprises. The payments are based on claims made, in which the claimants attest to the eligibility of their actions, such as sowing areas of land to certain crops or maintaining a number of animals for a given period. In such an environment, management and control systems must be sufficiently robust to handle different categories of risk of legality/regularity errors. The Court's systems evaluations and audit findings confirm for 2000 a situation of insufficient management of these risks. A brief analysis of a key system is presented below.

9.53. The integrated administration and control system (IACS) was introduced after the common agricultural policy reform of 1992 and requires that national authorities apply systematic logic and reasonableness checks on aid applications, systematic cross-checks

**9.52. THE COMMISSION'S REPLIES**

*On the basis of its own audit work, as well as its analysis of the DAS 2000 exercise, the Commission does not agree that there has been insufficient management of the risks of errors of legality or regularity.*

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between aid applications and a permanently updated database of agricultural parcels or animals, standardised processing of calculations, accounting and payments of aid, timely on-the-spot sample checks on claimants, to verify the physical reality of aid applications, and a system of penalties for incorrect declarations.

9.54. The risk concerning incorrect beneficiaries' applications is only partially covered as errors concerning the physical reality of the declarations, i.e. the actual crop type sown to the whole area or the actual number of animals kept, can only be detected by physical inspections on the spot. The regulation requires only a limited minimum coverage (5 % to 10 %) by such physical inspections.

## 9.54. THE COMMISSION'S REPLIES

*Physical inspection remains a key method to ensure compliance with the rules and provide assurance that databases have been properly notified. The Court cites the minimum requirements for on-the-spot checks as only 5 % for arable crops and 10 % for animals. However, these levels constitute the absolute legal minimum expressed as a percentage of aid applications, and the proportion of areas or animals actually inspected is always greater and sometimes far greater. It must also be stressed that on-the-spot checks are generally risk-based, and the rate of on-farm checks must be increased if significant irregularities are revealed.*

*The system for granting direct aids is based on producers' applications but the Court seems to overlook the very complete (100 % administrative) cross-checking, and other verifications facilitated by databases to which they are subjected. These exhaustive administrative controls do lead to selection for on-the-spot inspection, do result in the application of sanctions and can result in delayed payments for offending producers. The dissuasive effect of the administrative checks can therefore be considered one of the key elements of the IACS.*

9.55. A number of weaknesses still occur in certain Member States (see Special Report No 4/2001), including some of the most important requirements not always being respected. In overall terms, IACS can be seen as a good basis for managing the risk of incorrect or inaccurate claims but the Commission should better ensure a full and consistent application. Furthermore, it only applies to certain budget headings (representing some 60 % of total expenditure), and not to all agricultural expenditure.

## 9.55. THE COMMISSION'S REPLIES

*The Court's positive appraisal of the IACS is welcomed. The Commission has also established continuing weaknesses in some Member States and deals with them fully in the context of the clearance of accounts procedure, which the Court has elsewhere (in the Court's recent BSE draft report — point 1.69) considered to be a good way of encouraging Member-States to take corrective action.*

*Having set out the regulatory framework for effecting expenditure under the IACS and providing guidelines and advice to Member States on their IACS systems, the Commission closely*

## THE COURT'S OBSERVATIONS

monitors the work, allowing any shortcomings in the operation of the system to be identified, so that the Member States take the necessary steps to remedy the situation. If the IACS systems put in place by a Member State prove to be unsatisfactory, the Commission refuses, under the clearance of accounts procedure, to finance all or part of the expenditure concerned.

Moreover, the Commission has been reviewing the IACS legislation since the end of 2000, which will result in a new codified Regulation in 2002, and would also draw attention to the regular experts' group meetings, which provide an excellent forum for harmonisation, improvement and exchange of information.

9.56. In conclusion, the system provides a sound basis for controlling most of the EAGGF-Guarantee Section expenditure, but at present does not function in such a way that sufficient assurance can be derived from it. The weaknesses identified in the operation of IACS and in the management of other agricultural markets are also confirmed by the results of the Court's checks on the EAGGF transactions (see paragraphs 2.29 to 2.52).

## Structural Operations

9.57. The objective of the Structural Funds (the ESF, ERDF, EAGGF-Guidance, FIFG) and the Cohesion Fund, representing about 35 % of the budget, is to contribute to the strengthening of the economic and social cohesion of the European Union. Structural Fund expenditure passes through a complex structure, involving a multitude of managing entities implementing thousands of projects. Structural Fund rules are often complicated, difficult to apply and open to misinterpretation. Under the regulations that govern the 1994-1999 programming period for which the closure process is under way, the Commission has no clear legal basis for sanctioning or imposing financial corrections for shortcomings in the management and control systems of Member States. The latter weakness has been remedied in the legal framework of the 2000 to 2006 programming period.

## 9.56. THE COMMISSION'S REPLIES

As regards the weaknesses identified by the Court in respect of agricultural expenditure generally, the Commission considers that these should be put into proper context, both qualitatively and quantitatively. In particular, it must be reiterated that farmers sometimes face great difficulty in measuring their plots precisely. It is not, therefore, surprising that the Court's on-the-spot controls, conducted 18 months after the aid declaration, when plots may have been re-grouped or re-formed, often reveal differences (usually relatively minor) — hence the need for regulatory and technical tolerances.

## 9.57. THE COMMISSION'S REPLIES

The Commission shares the view of the Court that the implementation of the Structural Funds is a complex process which necessarily involves many different bodies in the execution of the many thousands of projects which are co-financed from the Community budget. There have to be detailed rules to ensure that the objectives of the Funds are attained, and there is a risk that problems of interpretation will arise. The Commission has made efforts to improve the clarity of the rules for the period 2000-2006, for example through the adoption of Regulation (EC) No 1685/2000, and provides Member-States with advice on questions which are raised.

It is the Commission's view that, under Article 24 of Regulation (EEC) No 4253/88, it can not only impose corrections

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9.58. Previous audits of the Court have revealed that, prior to the declaration of expenditure or the closure of forms of interventions, Member States either did not carry out the necessary verifications at all or did so only to a limited extent. The introduction of Regulation (EC) No 2064/97, setting out requirements for Member States' management and control procedures, represents an important initiative by the Commission to improve financial control of Structural Funds by Member States.

9.59. The regulation stipulates that the checks to be carried out before the closure of each form of assistance must cover at least 5 % of the total eligible expenditure. No clear guidance has been provided on the objectives of these checks or on the selection of the operations covered. As a matter of fact, a balance has to be struck between risk-based checks which offer the best prospect of finding and correcting errors, and representative checks which both indicate the incidence of errors and deter incorrect claims. The Court's audit on the implementation of this control framework revealed that although progress has been achieved, there remain significant weaknesses in the implementation of the checks provided for in all the Member States visited. Insufficient clear and timely guidance has been given by the Commission, despite the guidance given in two Appendices of the audit manual distributed in October 1999, which provides a useful basis for the implementation of the regulation. The Commission had carried out little assessment of the Member States' efforts by the end of 2000 (see paragraphs 3.47 to 3.52).

9.60. The weaknesses identified are also confirmed by the results of the examination of transactions underlying the expenditure declarations and by the Court's detailed audits of selected closed programmes. The high proportion of ineligible expenditure in the final declarations presented by the Member States has resulted in a loss to the Community budget (see paragraph 3.39).

*for individual cases of irregularity, but can also apply larger-scale corrections which take account of the wider risk to Community funds in duly justified cases. This is indicated in the internal guidelines on financial corrections of 15 October 1997.*

**9.58 to 9.59. THE COMMISSION'S REPLIES**

Checks by Member States were established as a requirement by virtue of Article 23 of Council Regulation (EEC) No 4253/88, although it was Regulation (EC) No 2064/97 that established in detail the nature and minimum number of checks required. Since Regulation (EC) No 2064/97 entered into force, the Commission has made great efforts to give detailed guidance to Member States on the implementation of its provisions, notably through the Structural Funds audit manual, first presented in June 1998, and through systematically dealing with questions on the regulation in the bilateral coordination meetings with Member States, the annual meeting of EU Financial Controllers in 1998, 1999 and 2000, and on other occasions.

*In particular, the Commission has given guidance on the checks to be carried out and the selection of operations in the Structural Funds audit manual. The Commission is currently reviewing the manual and will take account of the findings of its own audit work as well as the observations of the Court, and will discuss the detailed methodology with Member States.*

*As regards assessment of the application of the regulation, a number of audit missions have been carried out since 1999 by Structural Funds departments covering compliance with certain aspects of the Regulation. In preparation for the closure of programmes from the period 1994 to 1999, a full enquiry was launched at the beginning of 2001 on the implementation of the regulation by all Member States. Where problems have been identified in the course of this enquiry, the national authorities are being informed so that they are able to take remedial action.*

**9.60. THE COMMISSION'S REPLIES**

With regard to the closed programmes cited in paragraph 3.39, the financial consequences are under examination on the basis of the information supplied by Member States. In one case, the Court accepts that there is no impact on the Community budget.

## THE COURT'S OBSERVATIONS

9.61. Unless the Commission and the Member States undertake prompt action to ensure correct application of the regulation by Member States, there will not be sufficient reliable information to form the basis upon which to close the forms of assistance of the Community support framework (CSF) for the period 1994 to 1999 in such a way as to prevent the co-financing of ineligible expenditure.

**9.61. THE COMMISSION'S REPLIES**

*As indicated in the replies to points 3.47 and 9.59, the Commission is currently carrying out an enquiry into the implementation of the regulation. Closure of forms of assistance is conditional upon the submission of the closure statement by the independent body under Article 8 of the regulation. Where control requirements have not been complied with, this body will have to give a qualified opinion. The Commission has the power under Article 8(2) of the regulation to require further checks to be carried out and has the responsibility to make financial corrections where appropriate and justified.*

*Internal policies*

9.62. The internal policy budgetary area, which represents about 6 % of the budget, is characterised by the great number and the diversity of measures and governing rules. The geographical dispersion of the many beneficiaries adds a further level of complexity to central management and control. The Court has concentrated its audit on the European Community fifth framework programme for research and technological development (fifth FP), which, in financial terms, is the most important management system in the internal policies area.

9.63. In the research framework programmes, financial contributions are granted on the basis of costs actually incurred. The high level of detail and the complexity resulting from contractual arrangements based on a system of cost reimbursement demand a significant administrative effort both from the contractors and the Commission with regard to the proposal, contract and project management for indirect RTD actions. While verifications by the Commission services of costs claimed are mainly limited to plausibility checks, the verification of the reality and accuracy of the cost claims normally requires audits on the spot. The Commission has used private sector audit firms to carry out such audits.

**9.63. THE COMMISSION'S REPLIES**

*The funding system of the research framework programmes has both strengths and limitations. The Commission has progressively addressed the limitations. Even though it is constantly evolving, the participants and the Commission services are quite familiar with the system.*

*For the next framework programme the funding system is again being reviewed to make it simpler for project participants to continue to improve controls within the limits of the Commission's financial and human resources, to make it more focused on results and to improve its capacity to discourage overcharging and fraud.*

*The Commission has significantly increased the number of on-the-spot audits of contractors of the research framework programme, in particular by using external professional auditors who work under the Commission's responsibility. Furthermore, the Commission has launched pilot schemes whereby a limited number of projects are to submit cost claims accompanied by audit certificates.*

## THE COURT'S OBSERVATIONS

9.64. Under the rules of the 5<sup>th</sup> FP the Commission has no means of sanctioning entities which overstate their costs, other than to claim back and charge interest on the amounts overpaid. Therefore there is only a minor risk for beneficiaries when overstating their actual costs.

**9.64. THE COMMISSION'S REPLIES**

*The legal framework for direct expenses and contracts under the 5<sup>th</sup> framework programme of the European Community already includes measures to protect the Community's financial interests. In case of suspected fraud or serious financial irregularity, Article 3.2 and Article 7.6 of Annex II of the contract explicitly allow the Commission not only to reduce its financial contribution but also to recover the contribution in full.*

*Nevertheless, strengthening the provisions on controls is a high priority for the Commission. This is why the OLAF work programme includes incorporation of administrative measures and sanctions in the domain of direct expenditure. In addition to the existing provisions for the reimbursement of the Community's financial contribution, an additional financial penalty clause is under discussion in the event of excessive expenses being claimed deliberately or by negligence in the area of direct expenditure.*

9.65. The Commission did not set out a framework of checks to ensure that policies decided by management are carried out and that necessary actions are implemented to address the identified risks. As a consequence, important steps in the control system were not applied in the same manner or were lacking across the whole or parts of the 5<sup>th</sup> FP. Tests of the operational key controls in each of the subsystems and processes audited have revealed that a number of controls have not been effectively operated by all DGs and all programmes. In particular, the verification of the legal and financial viability of contractors and the prior authorisation of the contract conditions were found to be lacking or not applied coherently. As a consequence, for the whole of the 5<sup>th</sup> FP, only a limited assurance can be derived from the control procedures in place. The weaknesses identified are confirmed by the Court's audit findings on underlying transactions.

**9.65. THE COMMISSION'S REPLIES**

*With the 5<sup>th</sup> framework programme, the Commission has introduced significant improvements to address potential risks, in particular with regard to the selection of proposals, a new strategy to strengthen on-the-spot controls and more effective measures in case of financial irregularities.*

*Internal controls were strengthened, in some DGs along with adapted organisation charts, decentralising financial management, while at the same time formalising the financial circuits and strengthening financial management and internal audit activities.*

*For the a priori verification of the legal and financial viability of participating entities a more elaborate methodology has been developed in order to assure consistent application of standard criteria for determining financial risk. With regard to the contractor's cost systems, once the 'participants' cost reimbursement system is chosen, for research, development and demonstration projects, guidelines for the participants to follow are provided. On-the-spot audits are the only way of checking whether or not the choice is appropriate. The check on a consistent cost reimbursement model for each contractor is undertaken as part of the legal and financial viability certification within each programme. This verification will be extended beyond a specific research programme by setting up a shared database.*

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*The negotiation outcome is subject to authorisation, sometimes implicitly, as it requires the agreement of different scientific and financial departments within the Directorate General in order to launch the Commission's selection decision for each project.*

### External Actions

9.66. The external actions area represents about 6 % of the budget and is characterised by great diversity of measures and worldwide geographical dispersion. The general control framework in this area is being further developed by the EuropeAid cooperation office set up with effect from 1 January 2001.

9.67. For the financial year 2000, the Court undertook an audit, mainly at the level of the Commission, on the Tacis programme (see paragraphs 5.24 to 5.44). This programme is a component of the external action financial perspective area targeted at the new independent States and Mongolia. The European Union assistance under the Tacis programme generally involves grants for technical assistance contracts to promote the transition of the beneficiary countries towards well-functioning market economies. This involves financing the costs of the consultants involved, the majority of which is based on time spent at agreed rates, together with other expenses such as travel and subsistence. The inherent risk in such contracts lies in the reality and quality of the services performed not matching the claims for costs being made by the consultant and supported by time records and performance reports.

9.68. The Commission has a relatively well-developed system covering the process of receipt of invoice from consultant to payment of that invoice. This includes detailed checking of the contents of each invoice to ensure its arithmetical accuracy, compliance with contractual terms (including rates used), receipt of reports or other deliverables and apparent reasonableness. The Court's work found these controls to be generally effective but recommends that the payment procedure include consideration of the reports provided to project managers by monitoring units before payments are authorised. Also, timely on-the-spot inspections should be undertaken on a larger scale.

### 9.66. THE COMMISSION'S REPLIES

*Since January 2001, following the introduction of the practical guide to EC external aid contract procedures, the same procedures, standard publication formats and standard contracts have been applicable throughout the world for all budget expenditure — something that has been greatly appreciated by potential tenderers. A supplementary finance guide to EC external aid is in preparation.*

### 9.67. THE COMMISSION'S REPLIES

*There is a risk that a contractor may make a false claim in any contract. Under the new arrangements, the project manager is responsible for confirming that costs invoiced by the contractor are acceptable. The new service contract incorporates a monthly estimated cash-flow forecast to be used to ensure that deviations from the forecast correspond to known changes in the actual time inputs of experts and incidental expenditure.*

### 9.68. THE COMMISSION'S REPLIES

*Under the new standard arrangements introduced in 2001, a project manager representing the interests of the contracting authority is identified for every contract. The project manager is responsible for monitoring contract progress and the results achieved. In addition, programmes are independently evaluated to address issues of efficiency, effectiveness, impact relevance and sustainability.*

*Project managers have to confirm that invoices reflect the activities actually carried out by the contractors (on the basis*

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of personal knowledge of the project through monitoring reports) before approving them for payment. The removal from the new service contract of the need for supporting documentation to be verified before payment of invoices should allow project managers to monitor the progress of contracts more closely in future.

*Administrative expenditure*

9.69. In planning its audit of administrative expenditure, which represents about 5 % of the overall budget, the Court took into account the generally satisfactory results of the examination of the main systems covering pay and the provision of office space carried out in previous years. This year the Court undertook a detailed examination of the controls over procurement procedures used by the institutions to purchase goods and services, whose results are reported in paragraphs 7.20 to 7.33. The Court concludes that from the standpoint of legality and regularity the administrative expenditure of the Commission — the dominant element in this financial perspective area — and the expenditure of Parliament, the Council and the Court of Justice was satisfactory (see paragraph 7.7). The accounts of the Court of Auditors are the subject of a separate report by independent auditors published separately in the Official Journal (see paragraph 7.7).

## CONCLUSION

*Reliability of the accounts*

9.70. In the Court's opinion, the accounts are reliable, save for the problems mentioned above relating to fixed assets, the lack of information on advances and payments on account, the overstatement of commitments still outstanding and the lack of budgetary commitments, particularly in the Structural Funds, as well as the evaluation of the economic result.

**9.70. THE COMMISSION'S REPLIES**

The Commission would point out the real improvements achieved in terms of reliability of the accounts, especially in fixed assets, debts, economic result and information contained in the annexes to the financial statements (financial perspective, abnormal RAL, pensions, financial intermediaries, etc.). It does not agree with some of the methodological observations made by the Court on the subject of fixed assets and the economic result. It will continue its efforts to improve the reliability of the accounts and to put in place the new accounting framework.

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9.71. Furthermore, as part of the adoption of a new budgetary nomenclature, the commitments still outstanding for the four Structural Funds at the end of 1999 were included in one single article for each objective. For the headings to which substantial amounts of this kind are allocated, the principle of the specificity of the budget loses some of its meaning.

**9.71. THE COMMISSION'S REPLIES**

*The budgetary structure groups together the appropriations intended for any given category of operations. The 'completion' lines mentioned by the Court group together programmes decided on before the current period for a specific objective, this objective constituting the logical link between them. On the other hand, the amounts on these lines are not such a fundamental criterion. Furthermore, the amounts to be entered should decline rapidly over the next few years and frequent changes in the nomenclature should be avoided. Furthermore, implementation can be monitored, if necessary, at a more decentralised level since there are subdivisions in the accounts.*

9.72. The Commission is invited to revise the part of its proposal for amending the Financial Regulation which relates to the accounts and the presentation of the accounts so as to take into consideration the proposals contained in the study made by the experts. Furthermore, it must make a start on carrying out the work to define a new accounting framework based on the principles of accrual accounting, and must at the same time allocate to this the necessary resources. Pending completion of the work to modernise the accounting, the economic result only partially reflects the true economic situation.

**9.72. THE COMMISSION'S REPLIES**

*As far as the project of modernising the accounts is concerned, a working document detailing the various priorities and setting out a plan of action was drawn up. In the amended proposal for the recasting of the Financial Regulation, the Commission included the generally accepted accounting principles, detailed the composition of the annual accounts and took account of the proposals from the experts' study. In order to improve the reliability of the accounts, the Commission is endeavouring to make improvements to the financial statements every year, particularly regarding the economic result.*

*Legality and regularity of the underlying transactions*

9.73. Except for the EU's internal management, the administration and control systems examined suffer from shortcomings, particularly as regards their implementation.

**9.73. to 9.76. THE COMMISSION'S REPLIES**

*The Commission is making considerable efforts to put in place coherent monitoring systems and to ensure effective implementation, especially in the fields of agriculture, structural operations, research and external actions. The reform of the Commission and the recasting of the Financial Regulation are important elements of this action.*

*With the annual review of management policies there is a temptation to continually raise standards such that though there may be a net improvement in the situation compared with the previous year the result could still be viewed negatively as the standard would have been set higher. The institutions should guard against moving the goalposts.*

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*The likelihood of errors occurring, and how serious they are, depends on the complexity of the set of regulations. This should be taken into account when reasonable assurance is to be given.*

Finally, such an assessment would also have to take into account the costs of the corrective measures necessary to achieve an acceptable level of irregularities. If it looks as though new checks will only result in marginal benefit, their cost/benefit could be called into question.

**9.73. THE COMMISSION'S REPLIES**

The Commission has recognised the scope for the further development of its internal control systems, and this action forms a major plank of the current reforms to financial management. The process of improving financial management cannot, however, be completed overnight and the Court will be aware that many of the systems referred to were in fact put in place before the reform process was begun. The actions taken under the reform, notably the development of minimum control standards to be implemented by Commission departments together with greater accountability of the authorising departments and self-assessment of internal control systems, can be expected to result in significant improvements in systems in the future.

Of course, the Commission must also look to its partners who manage indirect expenditure on its behalf to share in the process of improving control. In this context, the Commission is taking measures to improve control of expenditure. The Commission will also continue to take action to improve systems in response to the Court's special reports.

9.74. Thus, the general framework provisions governing checks in the area of Structural Operations (Regulation (EC) No 2064/97) have not succeeded in setting up complete, consistent and effective checks, do not lay down penalties that act as a sufficient deterrent in the event of wrong declaration by beneficiaries, and are far from being applied in full. In the agricultural sector, the implementation of IACS was found to suffer from weaknesses in that in some cases elements had not yet reached an acceptable level of completion to allow effective checks to be made and there were even cases where elements of the system had not yet been put in place (see Special Report No 4/2001, paragraphs 74 to 80,

**9.74. THE COMMISSION'S REPLIES**

The control requirements in relation to structural operations were strengthened and more precisely defined in Regulation (EC) No 2064/97. For the new programming period 2000 to 2006, Regulations (EC) No 438/2001 and (EC) No 448/2001 provide further detailed obligations on the management and control of the Structural Funds by Member States as well as defining the procedures for the application of financial corrections. Sanctions against individual beneficiaries in the case of irregularities are the responsibility of Member States, which are obliged to comply with the provisions of Article 280 of the Treaty. The procedure for closure

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OJ C 214, 31.7.2001). For the part of the common agricultural policy not covered by IACS, the control framework still needs to be further developed. For Internal Policies and External Actions, where the Commission has direct responsibility for the execution of programmes, the control arrangements still need substantial improvement and rigorous implementation, as the Court's audits have demonstrated.

9.75. The checks made by the Court on payment transactions reveal that the control arrangements are not sufficient to prevent irregular uses of Community funds from occurring all too frequently.

9.76. As a consequence, the Commission's insufficient control over the internal control procedures, in particular at decentralised levels, does not make it possible to give a reasonable assurance that the transactions underlying payments are, on the whole, legal and regular. The Commission should further develop the framework regulations and provisions concerning checks, by strengthening existing procedures, ensuring their full application and introducing such mechanisms in cases where they do not yet exist.

of programmes laid down by Article 8 of Regulation (EC) No 2064/97 would help ensure that shortcomings and irregularities previously identified are rectified before the submission of the final declaration of expenditure. The Commission will continue to develop its own audit activities, notably by carrying out further checks on the management and control systems of the Member States to ensure that they conform with the Community requirements and provide an adequate safeguard of Community funds.

As regards agriculture, the Commission agrees that Member States should work towards the integration of their control systems, and encourages this by both legislative and practical means. To this end, special provisions already exist in the current legislation and are being further emphasised in the current IACS review, and on-the-spot audits often give rise to recommendations to Member States. Concerning other CAP expenditure, sectors not covered by the IACS have their own monitoring methods. The Commission has also endeavoured to align its monitoring approach with the IACS, wherever appropriate, by providing for the same land and animal identification systems, cross-checks with the databases and risk analysis and control procedures similar to those used in the IACS. It has made substantial financial corrections where failure to comply with monitoring arrangements has been detected.

As regards internal policies, specifically research, the Commission has introduced significant improvements with the 5<sup>th</sup> framework programme with the aim of addressing potential risks in the monitoring arrangements, in particular with regard to the selection procedure, the negotiation phase and the preparation of contracts. At the same time, internal controls have been strengthened and are improved further in the context of the Commission reform. Additional improvements are anticipated for the next framework programme.

As regards external actions, the Commission is further developing the monitoring framework, notably through the introduction since January 2001 of standard procedures (particularly for the publication of tenders and standard contracts) which are now applicable for all budget expenditure on external development programmes. Moreover, a supplementary finance guide to EC external aid is in preparation.