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Annex to the

Report on the follow-up to 2003 Discharge Decisions - Council's Recommendations

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INTRODUCTION

This Working Document completes the Report from the Commission to the Council on the Follow-up to 2003 Discharge decisions {COM(2005)...final}. It presents in detail the answers to the 66 specific recommendations made by the Council in the comments accompanying its Recommendations on the 2003 Discharges.[1]

[1] For each specific recommendation a reference is given to the relevant Council document. The references for recommendations 1 to 42 are all for Council document 5665/05 "Discharge to be given to the Commission in respect of the implementation of the budget for the financial year 2003".

Annex to the report on the follow-up to 2003 Discharge Decisions - Council's Recommendations

Introduction

1. Progress rapidly in fully implementing the actions contained in the White Paper on "Audit, management and financial control", including the control standards, the production of adequate indicators for activity-based management, financial management and the quality and extent of the reservations contained in the declarations of the Directors General *(§ 2, 2nd paragraph, page 5)*

Commission's response:

Most of the actions in the White Paper have been completed and the corresponding procedures put in place: this is the case in particular for the internal control standards which were introduced in 2000. The Commission is nonetheless continuing its efforts to put in place effective internal control systems. The Commission's reform requires ongoing monitoring to ensure that the initiatives taken are timely and are effectively applied by the departments. Such monitoring is carried out annually by the Commission, in the framework of the summary of annual activity reports.

The quality of the reservations entered by the Directors-General has improved greatly over the years, which demonstrates that the control systems introduced work well and can detect existing shortcomings - the first step towards formulating and implementing action plans. The fact that certain reservations have not yet been lifted is not in itself surprising, as corrective action does not always have an immediate effect.

As regards the lack of consistency highlighted by the Court between the scope of certain reservations and the formulation of a reasonable overall assurance, improvements are beginning to be made in the 2004 annual activity reports. However, further progress is still possible to allow the Court to rely more fully on the annual reports and declarations made by the Directors-General to support its statement of assurance.

2. In the context of shared management, step up efforts to apply the supervisory systems and controls in an effective manner, in close co-operation with the Member States *(§ 2, 3rd paragraph, page 5)*

Commission's response:

The recommended action is taken. The Commission will work with Member States to improve controls over funds in shared management. It will identify the gaps which, in its view, lie between the control framework in place for each area of all budgetary expenditure and the general principles defined by the Court in its opinion no 2/2004 on the 'single audit' model, with particular emphasis on the controls which limit the risks concerning legality and regularity in the underlying transactions. It will propose the action required to address each gap, and the timetable for implementing this action, and discuss this with the Court, the Council and Parliament.

3. As regards annual activity reports, complete actions which are not yet finalized, in particular by increasing the accuracy of the assessments, and clarify formulation of reservations made by the Directors-General. *(§ 2, 4th paragraph, page 6)*

Commission's response:

The recommended action has been taken and, for the 2004 annual activity reports, the reservations are often more precise and coherent and their impact on the services' reasonable assurance on the use of resources and legality and regularity of operations is often supported by an explicit reasoning.

During the peer review of potential reservations of the 2004 services annual activity reports and its aftermath, three groups of services' 'families' have started working towards a more coherent approach to assess the seriousness (materiality) of detected weaknesses for their budgetary area and to determine the potential financial impact of systemic weaknesses.

Actions stemming from reservations in the Annual Activity Reports and from Synthesis actions are closely followed up by services and regularly reported upon.

4. Further improvements are needed to the Annual Activity Reports to make them a reliable indicator of the Commission's performance in order to enable the Court to use them as a basis for its statement of assurance. *(§ 2, 6th paragraph, page 6)*

Commission's response:

The recommended action has partially been taken; the Commission observes that the annual activity reports and declarations already provide a basis for the Court's judgement. Improvements have already been brought out for the 2004 exercise and further improvements will be dealt within the initiatives formulated in the Synthesis Reports.

5. Endeavour, with Member States' assistance, to give budget estimates closer to capacity for use of appropriations and corresponding to real needs. *(§ 3, 2nd paragraph, page 6)*

Commission's response:

The recommended action has been taken. The budget estimates have improved overall and in particular for the Structural operations. In 2004, the implementation rate of commitments was 98% and of payments 96% (compared to 99% resp. 92% in 2003). For Structural operations, the implementation rate of payment was 99% in 2004, compared to 90% in 2003 (the latter after cancellation of €5 billion of payment appropriations).

6. All stakeholders to continue their work by improving the supervisory and control systems' ability to manage the associated risk in order to obtain as soon as possible the necessary conditions for obtaining reasonable assurance on the legality and regularity of the underlying transactions in each area of the budget and thus allowing the Court to give a DAS, and the Commission to update the Council on a regular basis starting by October 2005 on progress achieved on setting out the Commission's roadmap to achieve a DAS. *(§ 2, 3rd paragraph, page 8)*

Commission's response:

The recommended action is taken by the Commission. On 15 June 2005, the Commission adopted a communication on a roadmap to an integrated control framework which lays down some guidelines as to actions to be done by the Commission and Member States so as to complete the control framework on which the ECA could base the assurance it seeks. Before detailing a complete action plan, Commission services need to conduct a gap assessment with regard to the general principles defined by the Court in its opinion n° 2/2004 for each area of budget expenditure. DG BUDG will provide a synthesis of these assessments by early July. The Commission will undertake discussions with the appropriate Council Committees and present in October an initial report proposing a basis for a common understanding with Member States on an integrated control framework. Commission services should also verify the regulatory framework proposed for 2007-2013 and if necessary propose adaptations to include the provisions which, in the light of the gap assessment, are required to complete an integrated control framework.

A common understanding should be reached by November with the Parliament (as discharge authority) and Council on how the current internal control framework can be improved in order to give additional comfort to the Court of Auditors for its reasonable assurance as to the legality and regularity of transactions.

7. Continue efforts to further develop a clear and comprehensive audit and control strategy, in the context of a "Community internal control framework". *(§ 3, 1st paragraph, page 8)*

Commission's response:

As Vice-President Kallas announced at the Ecofin Council in March, the Commission adopted a communication in June 2005 aimed at establishing an integrated control framework; this communication will be the subject of an interinstitutional agreement in the autumn.

8. Take, where appropriate, the relevant initiatives so that no sector should be excluded from the approach of the Community Internal Control Framework. *(§ 3, 2nd paragraph, page 8)*

Commission's response:

The Commission is taking the recommended action. The integrated control framework referred to above will cover all Community policies, whatever the management method.

9. Apply and, where appropriate, develop common standards for financial control and internal audit in the context of a Community internal control framework. *(§ 3, 3rd paragraph, page 8)*

Commission's response:

The integrated control framework referred to above will lay down management and control guidelines on proper use of Community funds, including ex-post checks. Implementation of the framework as regards funds under shared management, which account for 80% of the Community budget, will depend on the co-operation of the Member States.

10. Achieve the remaining objectives of the modernisation of the accounting system, in particular full inter-operability, the integration of accounting records and the provision of financial information on multi-annual projects, and ensure the continuing comparability from one year to another. *(§ 4, 3rd and 4th paragraph, page 9)*

Commission's response:

The Commission is taking the recommended action - the new accounting system became operational in January 2005, on schedule, and is currently being used by all Directorates-General. As had been foreseen, work is ongoing to meet the remaining objectives and to date there are no significant delays or problems noted in meeting these objectives.

11. As regards the Annual Activity Reports, include in an annex to the Synthesis report all reservations made by Directors-General on a two year basis *(§ 5, 2nd paragraph, page 9)*

Commission's response:

The recommended action has already been taken and Annex 3 of the 2004 Summary Report already contains the information requested.

Budgetary management

12. Provide more information on the consequence of the level of outstanding commitments (RAL) both on demand on future payments and on the respect of the Financial Perspective ceiling. *(4th paragraph, page 11)*

Commission's response:

The Commission is taking the recommended action. In 2004, the RAL was stable for the EU-15 and increased - as must be expected - for the EU-10. The n+2 rule for the Structural Funds for the current programming period implies that there will not be a concentration of payments at the end of the programming period, as was the case in the past.

The Commission provides an annual reporting on the evolution of the RAL, as well as the Commission's successful management endeavours to eliminate 'abnormal RAL', as defined in the Joint Declarations of 2002 and 2003. The 2004 report on Budgetary and Financial Management provides analyses on cumulative state of implementation of the main multi-annual Community programmes.

13. Improve information on budgetary implementation, in particular by providing clear information on the cumulative state of implementation of the most important Community programmes, as well as the use of commitments and payments at different levels *(5th paragraph, page 11)*

Commission's response:

The recommended action has been taken. The Commission has systematically improved the information on budgetary implementation provided to the Budgetary Authority, i.e., by including an analysis of the cumulative state of the most important Community programmes in the 2004 report on Budgetary and Financial Management.

Own resources

14. Make further progress concerning the management of agricultural tariff quotas with a view to further streamlining and harmonisation of the procedural framework related to quotas. *(§ 1, 4th paragraph, page 12)*

Commission's response:

The recommended action is being taken. The Commission continues to work on proposals to simplify the procedural framework.

The AMIS Quota project foresees a central, integrated IT system that will help to manage agricultural import tariff quotas other than those managed by the "first come, first served" system." Data concerning the quantities covered by import licences can be fed into this new centralised system.

The project has entered the parallel run or pre-production phase, the aim of which is to manage the information on certain quotas via AMIS Quota in parallel with the current management method, to check whether the system produces the expected results. The parallel run comprises two phases. The first (ongoing) only involves the Commission services. The second, which would probably start after Summer 2005, will also involve a limited number of pilot Member States.

15. Go on with the work initiated in the Green Paper on preferential origin rules in order to review the rules concerning preferential trade arrangements. *(§ 1, 5th paragraph, page 12)*

Commission's response:

The recommended action has been taken. Following the consultation initiated by the Green paper, the Commission adopted on 16 March a Communication to the Council, the EP and the EESC on 'the rules of origin in preferential arrangements – orientations for the future' - COM(2005)100 final. It provides general orientations, which the Commission intends to follow and promote in the context of all preferential arrangements the Community is involved in, based on a coherent package of three pillars: simpler and more development friendly rules for the determination of origin and the use of cumulation of origin; more efficient procedures based on a better balance of responsibilities between trade and customs; secured environment for legitimate trade through enforced rules.

The common agricultural policy

16. Work more actively with Member States in order to improve the control systems, especially for those categories of CAP spending with higher risk (animal premium schemes and subsidies paid on the basis of quantity produced) or those subject to recurrent errors. *(§ 1, 3rd paragraph, page 14)*

Commission's response:

The Commission has taken the recommended action. The clearance of accounts process continues to play a key role in promoting control improvements. For example, the Commission will follow up instances where information supplied by Member States appears to be erroneous. This may lead to revision of the data, or, in cases where a monetary risk to the Fund is evident, financial corrections as appropriate. Audit activity on ex-post controls has been reinforced in 2005.

17. Review certain control procedures, identify subsidies that are particularly subject to fraud and error, improve the supervisory checks, use these checks as a tool for comparison and have their results included in the annual activity report of the Director-General for Agriculture and if relevant in the Synthesis report. *(§ 1, 1st paragraph, page 15)*

Commission's response:

The Commission has taken the recommended action, in that it effectively addresses these issues by performing detailed analyses when establishing the annual work plan. It believes that the current system of statistical reporting is sufficient.

The results of the IACS checks made by Member States have been included in the 2004 Annual Activity Report of the Director General for Agriculture, as recommended by the Council and the Court.

18. Investigate the reason why, for IACS checks on area aid schemes (arable crops), tests performed on a random basis showed a higher rate of error than those based on a risk analysis. *(§ 1, 1st paragraph, page 15)*

Commission's response:

The recommended action has been taken. The Commission amended the IACS Commission Regulation in January 2004 as regards risk analysis, especially in introducing an obligation for Member States to review annually the efficiency of the risk factors used.

19. As regards the financial clearance of paying agencies, insist on the need to ensure that both limited audit evidence and supervision receive sufficient attention by certifying bodies *(§ 2, 2nd paragraph, page 15)*

Commission's response:

The recommended action has been taken. During 2004, the Commission provided further guidance (via note AGRI/63916/2004 presented at an Expert Group Meeting in October 2004), and by arranging bilateral meetings with several MS (Certifying bodies and Paying agencies) in which the issues of supervision and audit evidence were discussed. Consequently, the Certifying Bodies paid much more attention to these issues in the 2004 certification exercise. As a result, for the

financial year 2004, the accounts of only 5 paying agencies were disjoined, compared to 29 accounts in the 2003 financial year.

20. Make further efforts to lessen the risk of fraud involved in the area of export refunds. *(§ 3 a), 2nd paragraph, page 15)*

Commission's response:

The recommended action has been taken. In response to the ECA Special Report No. 7/2001 ("export refunds – destination and placing on the market"), the Commission drew up an action plan and implemented it. It believes that the management of the risks involved has significantly improved.

Regarding the one Court recommendation considered still to be partially "open" (proofs of arrival), the Commission committed itself to provide Member States' authorities with a new catalogue of customs documents and stamps of the main 50 third countries. A call for tender was made in 2002 to have this done. However, the company which obtained the contract proved unable to deliver the product and the contract was cancelled. A second call for tender has been launched in 2004 and a one year contract with the successful bidder was signed on 16th December 2004.

21. Take into consideration all the Court's recommendations as regards the support scheme for olive oil and continue to verify that checks are made correctly and uniformly. *(§ 3 b), 1st paragraph, page 16)*

Commission's response:

The Commission is taking the recommended action. Nine enquiries concerning olive oil are currently ongoing; all should result in final clearance decisions by mid-2006.

Structural measures

22. Fully take on responsibility for budgetary implementation and take all measures necessary to remedy the weaknesses identified by the Court. *(§ 1, 2nd paragraph, page 17)*

Commission's response:

The Commission is taking the recommended action. The Commission is pursuing its efforts to remedy the weaknesses in the supervisory and control system for structural expenditure. The action includes, on the one hand, further improvements in the Commission's internal control system and in the annual declarations of directors general to increase the assurance they provide and, on the other, the correction of weaknesses in the systems through which the Member States manage the bulk of these funds on a day-to-day basis "in cooperation" with the Commission (Article 274 of the EU Treaty). In relation to the Member States the Commission is continuing its own audits and following up its recommendations for improvements in systems, and is strengthening its cooperation with national audit bodies and providing guidance and disseminating good practice to them. The Commission applies financial corrections for irregular expenditure or non-compliant systems it finds in its audits, and suspends payments when weaknesses remain uncorrected. The Commission is currently examining possible gaps in the control framework and how they can be filled, in an exercise that seeks to establish a "roadmap to an integrated Community control framework" complying with the recommendations made by the Court of Auditors in its "single audit" opinion. The legislation proposed for the 2007-13 period consolidates the necessary improvements in the control framework.

23. In the context of enlargement and strategy for the next programming period, improve, in co-operation with Member States, on the basis of the principle of proportionality the effectiveness of the financial control framework for structural measures. *(§ 1, 3rd paragraph, page 17)*

Commission's response:

The Commission is taking the recommended action. Before accession the Commission did considerable work to prepare the new Member States to fulfil their financial control obligations in managing the Structural and Cohesion funds. After accession the new Member States were required to submit descriptions of their management and control systems. The Commission is completing its assessment of these descriptions - for the Cohesion Fund it has already done so - and is beginning systems audits. The management and control framework for the 2007-13 period proposed by the Commission in July 2004 which is now being negotiated with the Council builds on the experience of the past by further reinforcing and clarifying the control responsibilities of the Member States whilst respecting the requirements of proportionality. The improvements proposed include an ex ante compliance assessment of the set up of systems to be conducted by Member States, the designation of an audit authority with overall responsibility for the audit activity for each programme, the presentation by the audit authority of an audit strategy and the submission each year of a detailed control report with a formal opinion by the audit authority on the functioning of the systems. The Commission also refers to the "roadmap" exercise currently being undertaken to improve the effectiveness of the control framework.

24. Add to the annual activity report some tables summarising the main findings including reservations, in order to provide a quick overview of the state of affairs and to measure progress from year to year. *(§ 1, 4th paragraph, page 17)*

Commission's response:

The recommended action has been taken. Tables containing the information referred to by the Council have been included in the Directors'-General Annual Activity Reports for 2004 and will appear in these reports in future.

25. As regards 2000-2006 programming period, Commission and Member States to implement all the necessary improvements to the control systems, in order to avoid the repetition of the problems encountered at the closure of the 1994-1999 period. *(§ 1, paragraph 3, page 18)*

Commission's response:

The Commission is taking the recommended action. The Commission is continuing its audits of the systems in 2000-06 programmes. It makes recommendations to the Member State to remedy any weaknesses found, follows up the action taken and will suspend payments if the problems represent a serious risk to Community funds. At the same time the Commission is increasing its cooperation with national control bodies and is able to monitor the progress of their work through the annual financial control reports which are discussed each year at coordination meetings. The Commission anticipates fewer problems with closure of the current generation of programmes than with those of the 1994-99 period because the legal requirements are now familiar and both the Member States and the Commission are better prepared. Closure guidance has already been drafted and will be published in 2005.

26. As regards results of substantive testing, continue checks in Member States and apply, where appropriate, the regulatory provisions in case of serious weaknesses or irregularities. *(§ 1, 4th paragraph, page 18)*

Commission's response:

The Commission is taking the recommended action. As already stated, the Commission is continuing its audits in Member States and stepping up its cooperation with Member States' audit bodies. It plans to issue shortly guidance on best practices in day-to-day management checks under Article 4 of Regulation (EC) No 438/2001. These are the basis of an effective control system but have been found to be deficient in some Member States. The Commission already applies the regulatory provisions for suspension of payments and financial corrections where it finds serious weaknesses or irregularities.

Internal policies, including research

27. Reinforce financial information regarding payment delays and to improve monitoring of budgetary implementation. *(§ 1, paragraph 2, page 20)*

Commission's response:

The recommended action has been taken. Financial scoreboards are regularly produced. They include information regarding payment delays and budgetary implementation. In addition to these scoreboards, the budgetary implementation is monitored on a more regular basis by the end of the year (reports/recommendations are send to operational directorates on a daily basis in December).

28. Continue efforts to ensure the effective deployments of the common IT system for FP6 proposal, contract and project management, and provide direction to contractors and external auditors as regards the preparation of audit certificates. *(§ 2, paragraph 3, page 20)*

Commission's response:

The recommended action continues to be taken. FP6 IT tools are being deployed and upgraded to provide the full range of support for proposal evaluations through to Contract payment and project monitoring.

An interdepartmental working group has been set up in the last quarter 2004 in order to monitor the efficient functioning of audit certificates. This group is in the process to provide special working papers for contractors and external auditors in addition to the already existing guidelines. These Working Notes have been drafted with the following intentions:

- to present all important aspects regarding certification in a summarised, concentrated and easy to use form;

- to incorporate the suggestions and proposals which were obtained from discussions with professional auditors

29. Remedy the internal control weaknesses as regards the European Refugee Fund and provide direction to Member States on how to achieve a harmonised control environment at national level. *(§ 3, paragraph 1, page 21)*

Commission's response:

The Court observations have already led to corrective action being taken. Strengthening the control environment at national level remains, however, an ongoing concern for the Commission.

The Commission would emphasise that the European Refugee Fund is a "young" instrument as it was adopted at the end of 2000 and its management structure was modelled on that of the Structural Funds. As the national representatives were not those who manage the Structural Funds, some adaptation was necessary. The Commission has made various monitoring visits to the Member States, giving rise to several recommendations. Visits were also made to the new Member States at the end of 2004 and beginning of 2005.

The experience gained during Phase I of the ERF was used to review and strengthen the management systems to be put in place by the Member States in

Phase II of the ERF which was adopted at the end of 2004. The detailed rules for implementing this new instrument have already been presented to the Member States.

The strengthening of the control and certification functions, independently of management structures, will help to create a more harmonised and higher-level system of control for ERF II.

30. As regards late payments by the Commission and over-declarations of costs by beneficiaries of indirect RDT actions, follow-up findings of the ex-post financial audits more rigorously and ensure a more adequate and rapid recovery procedure for undue payments. *(§ 4, 1st paragraph, page 21)*

Commission's response:

The recommended action has been taken. To assist the financial services in monitoring their recoveries, the Commission's services dealing with External Audits has put in place a reporting system.

On a regular basis the Commission's service dealing with External Audits issues a report on all audits closed identifying the actions to be taken by the Directorates (Financial conclusion of the audit : "no change", "amount in favour of E.U", "amount in favour of contractor", date of action taken and reference to documents). The Commission's service dealing with External Audits consolidates the various reports for all related RTD contracts. Periodic reports are then issued for the higher management on the state of the play of the financial adjustments following the audits.

It is worth noting that audit databases for the audit follow up will be in place.

31. Take further corrective action to establish a coherent audit approach (stating measurable objectives and targets) for internal control framework, which takes the specificities of the different areas into account. *(§ 4, 2nd paragraph, page 21)*

Commission's response:

The recommended action has been taken. The developments of FP6 (audit certificates, new instruments and increased importance of the consortium agreement) required a re-consideration of the external audit policy. In the 6th FP audit certificates are appended to financial statements and a third signature of an independent auditor is added on the certificate. "A common audit policy of the Research DGs for FP6" was defined and agreed by the DGs operating Research.

32. Step up audit activity of indirect RDT actions in order to achieve target. *(§ 5, 1st paragraph, page 21)*

Commission's response:

The recommended action continues to be taken. The Commission has set an overall audit target of 10% of contractors of FP5 to be audited.

The Commission has confirmed that it will continue its audits on FP5 contractors, as multi-annual projects are ongoing and a new framework contract with an external audit firm has been set up for that purpose. The Commission expects the overall audit target for FP5 can be reached at the end of corresponding activities.

The Directorates-General operating RTD framework programmes have indicated their intentions in the context of the launch of the procurement procedures for the framework contracts with external auditors.

The drafting of a Call for tenders for external audit services in the field of research contracts under 6th Framework Programme and the related Tender Specifications (batch sizes, duration of the batch indicative audit report model) is almost finalised and will quickly result in the signature of a framework contract.

33. Assure an adequate and timely follow-up of audit results. *(§ 5, 2nd paragraph, page 21)*

Commission's response:

The recommended action has been taken, see also Commission reply to point 30: To assist the financial services in monitoring their recoveries, the Commission's services dealing with External Audits has put in place a reporting system.

On a regular basis the Commission's service dealing with External Audits issues a report on all audits closed identifying the actions to be taken by the Directorates (Financial conclusion of the audit : "no change", "amount in favour of E.U", "amount in favour of contractor", date of action taken and reference to documents). The Commission's service dealing with External Audits consolidates the various reports for all related RTD contracts. Periodic reports are then issued for the higher management on the state of the play of the financial adjustments following the audits.

It is worth noting that audit databases for the audit follow up will be in place.

External actions

34. As regards the fact that control activities carried out in the field of external actions varied markedly between the different delegations and directorates in the Europe-Aid Co-operation Office due to the gradual implementation of the devolution of management tasks to delegations, continue to work in a way that is consistent with the reform process. *(§ 1, paragraph 1, page 22)*

Commission's response:

The requested action has been taken. Since its creation EuropeAid has worked towards achieving the objectives of the reform of external aid management, notably as regards the quality, timeliness and responsiveness of EC assistance, on the basis of sound management procedures. It will continue to work along that line. Its role has progressively evolved towards supervision, coordination and support to devolved management. The recent reorganisation of EuropeAid services aims at further strengthening this role, notably ensuring a harmonised approach across the World with a strong drive on quality support to the Delegations.

35. As regards the relatively high number of irregularities detected in the transactions of implementing organisations, adopt a comprehensive approach to the supervision, controls and audit of these organisations. *(§ 1, 2nd paragraph, page 22)*

Commission's response:

The recommended action has been taken. The Commission's monitoring and control systems aim at ensuring the compliance of contract partners (NGOs, public 'project management units', etc.) with the contractual requirements. Checks and audits on the contract partners' internal control systems are carried out on the basis of risk assessments since in many cases a detailed examination of their overall internal control systems would be disproportionate on top of normal checks concerning legality and regularity of payments.

36. Further develop the management information system in order to facilitate the supervision and control by means of improving the flow of information on audit results. *(§ 3, 2nd paragraph, page 23)*

Commission's response:

The Commission is taking the recommended action. The introduction of new tools (such as CRIS Audit) will contribute to further improve the flow of information on audit results on central level.

Pre-accession aid

37. As regards Phare, ISPA and Sapard, where expenditure was materially affected by errors, further efforts have to be made to address the weaknesses detected and to limit the risk of affecting the legality and regularity of the underlying transactions. *(1st paragraph, page 24)*

Commission's response:

The Commission is taking the recommended action, but wishes to stress that a number of the errors reported are only of formal nature.

With regard to tendering and contracting procedures, the Commission agrees that the regulatory provisions must be complied with and is committed to a transparent evaluation of bids and proper documentation.

The Commission accepts the errors concerning ineligible expenditure and has taken steps to correct the declarations concerned.

38. As regards Phare, pursue action to fully implement the Extended Decentralised Implementation System (EDIS). *(2nd paragraph, page 24)*

Commission's response:

The Commission is taking the recommended action. For the acceding countries, EDIS verification audits have been conducted but difficulties have still been noticed. Moreover, in some cases PHARE transition teams in the Commission Representations are still finding problems in files submitted even though the EDIS preparations of the countries should have been largely complete. The authorities have been challenged to restart the work to confirm whether further strengthening of the systems is required.

For the candidate countries, EDIS seminars have been given, and enhanced action is scheduled in order to ensure that Romania and Bulgaria have appropriately staffed Phare fund management systems in place by end of 2005

39. As regards ISPA, continue to reinforce audit strategy to make sure that the main objectives are met. *(3rd paragraph, page 24)*

Commission's response:

The Commission is taking the recommended action. Between September 2004 and March 2005 the Commission carried out desk reviews of the set-up of the management and control systems for the Cohesion Fund in all new Member States. By mid July 2005, it will have completed the first round of verification audits of the systems on the spot in all new Member States to ensure that the system work as described. The second round of audits will start in September 2005 and continue in 2006. For the other Funds desk reviews of the systems set up are nearing completion and verification audits will follow, starting in 2005. As well as the desk reviews, the Commission in 2004 audited 23% (by value) of the ISPA/Cohesion Fund projects for which interim payment claims had been submitted The new Member States' own audit services are also carrying out audits and inform the Commission of the results.

The Commission is also continuing to carry out a large number of system and project audits in the remaining ISPA beneficiary countries Bulgaria and Romania.

In 2004 it carried out five audits in these two countries and a further eight are being carried out in 2005. It will carry out similar audits of ISPA projects in Croatia. This country became eligible for ISPA on 1 January 2005.

40. As regards ISPA, take the necessary measures to prevent risks regarding tendering and contracting procedures. *(3rd paragraph, page 24)*

Commission's response:

The Commission is taking the recommended action. The Commission pays special attention to this risk in its audit work both in the new Member States and in the two countries that are still ISPA beneficiaries, Bulgaria and Romania. Inadequate checks of public procurement procedures at management level have been one of the main findings in the audits. In 2005 the Commission will therefore launch a separate preventive enquiry with the aim of verifying the correct application of public procurement procedures based on a sample of contracts concluded after accession. By March 2006 all new Member States will have been subject to this audit with the exception of Cyprus and Malta. In Bulgaria and Romania (and since 1 January 2005 Croatia), the continuing ex ante controls of tendering and contracting procedures by the EC delegations pending accreditation for EDIS mitigate the risk. Nevertheless, the rejection rate by the EC delegations is systematically assessed by Commission auditors and recommendations are made to the national authorities in this regard.

Administrative expenditure

41. As regards administrative expenditure, improve the effective implementation of internal control standards, the introduction of ex-post controls, and the carrying out of the internal audit function, to meet all the requirements set out in the new Financial Regulation. *(§ 2, 2nd paragraph, page 25)*

Commission's response:

The Commission accepts the recommendation and corrective action is being taken.

For administrative expenditure, the Court of Auditors was able to give a positive statement of assurance. The Commission intends to continue to implement the reform effectively, with internal control standards, development of a common risk analysis methodology, ex-post controls and internal audit.

Financial instruments and banking activities

42. As regards the financial instruments in favour of small and medium-sized enterprises, the importance of applying consistent rules in respect of calls on guarantees and State Aid, as well as in respect of the data used for valuation of European participation in the Funds, is stressed. *(2nd paragraph, page 26)*

Commission's response:

The recommended course of action was followed by the Commission already prior to the recommendation. The Commission is generally satisfied with the quality of the reports received from the EIF. Consistent rules are already applied in respect of guarantee calls as well as state aid. The recognised industry standard for valuation of venture capital participations, i.e. the EVCA guidelines are generally applied.

Requests to the Commission concerning the agencies

43. As regards the European Agency for Reconstruction, undertake the appropriate actions to ensure a satisfactory implementation and control of EU funds in case of joint management with UNMIK and other international organisations. *(Doc 5679/05 ADD 1, page 4)*

Commission's response:

The Commission is taking the recommended action.

As recommended by Council, the Commission will undertake all appropriate actions possible within its limited remit as one of the 26 members (the other 25 being the Member States) of the Governing Board of the European Agency for Reconstruction (EAR). The Commission has already provided advice, guidance and assistance to the EAR so that it may follow-up closely on all the recommendations of the Court of Auditors. The EAR is a unique and legally distinct (from the Commission) Community institution, established on the initiative of the Budgetary Authorities. Under law it is the legally distinct EAR which is responsible for management and control of the funds allocated to it, supervised by the Governing Board and subject to external audit by the Court of Auditors. In this context, it must also be clarified that the Commission does not have "joint management" with UNMIK, which does however, have contractual relations with the EAR with respect to funds from the CARDS National Programme for Kosovo. The Commission will reiterate the views of Council to the other supervising members on the Governing Board

Conclusions on the follow-up of the 2002 discharge

44. As regards the Commission's report on the action taken in response to the Council's comments on the 2002-discharge procedure, include cross-references and useful links between the report itself and the related working document. *(Doc 5680/05, § 1, page 2)*

Commission's response:

The recommended action has been taken. In the Commission's report on the follow-up of the 2003 discharges references to the related working document have been in included.

45. As regards the Common agricultural policy, strengthen control systems in areas that are not checked through IACS, where serious problems such as high risks and recurrent errors still occur. *(Doc 5680/05, § 5, page 3)*

Commission's response:

The Commission has taken the recommended action. Audit activity on ex-post controls has been reinforced in 2005.

The clearance of accounts process continues to play a key role in promoting control improvements.

46. As regards Structural measures, pursue efforts to sign "contracts of confidence" with Member States. *(Doc 5680/05, § 5, page 4)*

Commission's response:

The Commission is taking the recommended action. The Directorate General for Regional Policy re-launched efforts to conclude "contracts of confidence" with a number of Member States in May 2005.

47. As regards the management of the structural funds, carry on ensuring consistent interpretation of legislation or guidance by all parties concerned. *(Doc 5680/05, § 5, page 4)*

Commission's response:

The Commission is taking the recommended action. As noted in point 267 of the Commission's working document on the follow-up of the 2002 discharge, the directorates general responsible for the Structural Funds co-ordinate their interpretation of legislation and the guidance they provide to Member States. The Commission's Legal Service is involved where appropriate. The guidance given is as precise as possible, having regard to the varying legal environments and administrative systems in the Member States. The Commission also organises seminars and technical meetings with Member States to disseminate best practices. Consistency of interpretation and guidance is being given increased attention in the internal risk assessments of the directorates general responsible for the Structural Funds and a number of new common guidance notes are currently in preparation or under consideration as part of the "roadmap" exercise.

48. As regards structural funds, prepare more accurate and updated budget forecasts, in close cooperation with Member States. *(Doc 5680/05, § 5, page 4)*

Commission's response:

The Commission is taking the recommended action. At the beginning of the 2000-06 period the difficulties of forecasting were increased by unfamiliarity with the reimbursement-based payments system introduced in 2000. Since then the Commission has already taken steps to improve Member States' forecasts. It refers to the Follow-up Report to Parliament's resolution and the Council's recommendation for the 2001 discharge (COM(2003) 691 final, points 40 and 13 respectively). The Commission has also gone over to relying for assessment of payment needs more on its own estimates based on the pattern of implementation and foreseeable trends rather than on the Member States' forecasts. Within the limits of the Financial Regulation, it also revises its budget proposals, before the budget is approved, in order to shorten the time-span between the payment forecast, budget decisions and implementation. Finally, during the financial year it uses an "early warning" system in the monitoring of the annual Budget Implementation Plan in order to anticipate surpluses or shortfalls in payment appropriations in time to propose an amending budget.

49. As regards TEN-T, take all necessary measures to increase the effectiveness of controls prior to payments. *(Doc 5680/05, § 5, page 4)*

Commission's response:

DG TREN checks requests for payment on receipt. In the case of final payments, these checks are regularly followed up by on-the-spot checks on technical and financial aspects before payment. To improve the efficiency of these checks, DG TREN is planning to adopt a "desk-control" methodology to make checks by financial managers more structured, systematic and formal. This method should be introduced by the second half of 2005.

50. As regards external actions, keep improving control over the selection of auditors by beneficiaries and implementing organisations *(Doc 5680/05, § 5, page 4)*

Commission's response:

The Commission is taking the recommended action. It is currently in the process of clarifying and improving the criteria for the selection of auditors and providing appropriate guidance. Moreover, it intends to introduce appropriate conditions concerning basic criteria for the selection of auditors in standardised terms of reference for audits that beneficiaries and implementing organisations have to comply with when they select and contract auditors.

51. As regards pre-accession aid, remedy the remaining weaknesses of the supervisory and controls systems. *(Doc 5680/05, § 5, page 4)*

Commission's response:

The recommended action has been taken. The new Members States have all set up audit services to fulfil the financial control requirements laid down by Regulation No 438/2001 and the Commission will monitor their work in the period ahead and will itself test the systems.

52. As regards pre-accession aid, improve management in particular through technical assistance and audits. *(Doc 5680/05, § 5, page 5)*

Commission's response:

The recommended action has been taken. As far as the implementation of internal controls responding to the new Commission standards and the financial regulation is concerned, DG Elarg has made significant strides towards formally complying with and effectively living up to these standards. Hence, two new units were set up, including an operational audit unit separate from the Internal Audit Capacity, aimed at strengthening the follow-up of the EDIS processes in candidate countries and consolidating the strategy on clearance of accounts audits.

53. As regards old and new agencies, closely monitor the mandate and work programmes in order to promote possible synergies and to avoid any overlapping of tasks. *(Doc 5680/05, § 5, page 5)*

Commission's response:

The recommended action has been taken. This close monitoring happens already, and has lead to memoranda of understanding between Agencies being active in a neighbouring fields of activity (eg Eurofound/EU-OSHA, CEDEFOP/ETS…) and will certainly continue in the future.

54. As regards banking operations under the direct responsibility of the Commission, implement the recommendations issued by the internal audit, especially those regarding the ex-post controls. *(Doc 5680, § 5, page 6)*

Commission's response:

The Commission is taking the recommended action.

In 2004, the "Internal Audit Capability" (IAC) carried out an audit of banking operations and related treasury activities.

All 10 recommendations were accepted and have already been implemented except for two : the authorisation harmonisation process (a Commission decision is under preparation) and the SWIFT recovery site. Concerning the latter, the implementation of an agreement between ECFIN and OIL on the provision of a suitable room for the SWIFT recovery site and installation of appropriate equipment is under way.

Court of Auditors' special reports

55. As regards Special report 5/2003 concerning Phare and ISPA funding of environmental projects in the Candidate Countries, the Commission is invited to further draw upon the report to maximise the future impact of Phare and ISPA funding on the environmental sector during the continuing enlargement process. *(Doc 5665/05 ADD 2, § 2, page 2)*

Commission's response:

The recommended action has been taken. The Commission agreed with the conclusions and recommendations of this special report and already stated it in its 2002 Strategy Paper. Among other things, the following objectives will be further pursued :

- Scarce grant financing will be targeted more effectively

- Absorption capacity will be increased by strengthening project preparation and tendering capabilities

56. As regards special report 14/2003 concerning the measurement of farm incomes, the Commission is encouraged to continue efforts to improve the harmonisation and validation of the Farm Accountancy Data Network (FADN) through the active involvement of the relevant Management Committee. Further studies, including a feasibility study, should be carried out to identify what statistical tools might be used to generate appropriate data on the income situation of the agricultural population. All new proposals should undergo a cost-benefit analysis and priorities should be set between competing demands for statistics on the agricultural sector. *(Doc 5665/05 ADD 2, §§ 5-7, page 4-5)*

Commission's response:

The recommended action has been taken. A feasibility study for the development and cost of statistics that measure the standard of living of the farming population across all the Member States of the Union is being launched by the Commission (Eurostat is finalising a call for tender to be published soon). The financial situation and income levels of farming undertakings and in the agricultural sector generally continue to be the subject of regular monitoring on the basis of FADN and EAA data, the harmonisation and consistency of which is being strengthened through increased collaboration among the various services concerned.

57. As regards special report 15/2003 concerning microproject programmes (MPP) financed by the EDF, the Commission should improve the organisation of its central services so as to exploit this form of cooperation more fully. *(Doc 5665/05 ADD 2, § 3, page 7)*

Commission's response:

With the reorganisation of EuropeAid Co-operation Office, a new thematic unit "Governance, human rights, democracy, gender" has been created to enhance the quality in the implementation of the EU's cooperation programmes through thematic support mainly to EC Delegations, AIDCO Geographic Directorate and other units. In that unit a focal point person has being put in place and will follow the microproject programmes (MPP). The linkages between MPP, capacity building of non state actors and local authorities will be enhanced.

58. As regards special report 15/2003 concerning microproject programmes (MPP) financed by the EDF, the Commission should examine more closely the conditions for ensuring the sustainability of microprojects and in particular the role to be given, for this purpose, to local administrations at the various stages of the project cycle. *(Doc 5665/05 ADD 2, § 4, page 7)*

Commission's response:

The Commission agrees that the involvement of local authorities can contribute to better development results and increase sustainability. The provisions set out under Cotonou allow a greater role for Non State Actors in the development process.

In that context, local development necessitates the cooperation of all development actors: microprojects should allow community base organisations and non governmental organisations (NGOs) to fully participate to development planning, implementation and monitoring in cooperation with local authorities.

59. As regards special report 15/2003 concerning microproject programmes (MPP)financed by the EDF, the Commission should adopt, for each country, realistic methods for measuring results, in order to derive greater benefit from the experience gained. *(Doc 5665/05 ADD 2, § 5, page 7)*

Commission's response:

EuropeAid Co-operation Office will promote together with EC Delegations the development of appropriate indicators to monitor MPP at country level.

60. As regards special report 15/2003 concerning microproject programmes (MPP) financed by the EDF, the Commission should carry out evaluations covering more than one country, in order to identify best practice to be disseminated to delegations. *(Doc 5665/05 ADD 2, § 6, page 7)*

Commission's response:

The Commission is taking the recommended action. A systematic evaluation on a cross-cutting basis of Micro Project Programmes (MPPs) has been launched in 2004 and the final report should be available by September 2005. The evaluation targets the MPPs supported over the period 1998-2003 within the 8th and 9th EDF. It covers now 78 micro-projects programmes implemented in 34 countries (25 countries in Africa, 5 in the Caribbean and 4 in the Pacific region). 59 out of the 78 programmes were still ongoing in 2003.

The evaluation's aim is to provide lessons and recommendations on the MPP support provided in the ACP countries. Indeed, the results of this evaluation should assist in the decision-making on possible further use or development of MPP facilities within the Country Strategy Papers (CSPs).

In addition, the evaluation should provide an analysis of the value added of the MPPs compared with other components of the Commission's strategies as well as with other "horizontal" programmes and budget lines.

61. As regards special report 15/2003 concerning microproject programmes (MPP) financed by the EDF, the Commission should provide delegations with a common microproject management guide which takes account of the specific characteristics of the instruments and the experience acquired in this area. *(Doc 5665/05 ADD 2, § 7, page 7)*

Commission's response:

The Commission is taking the recommended action. Guidelines for the management of the MPPs financed by the EDF are being finalised and should be sent in 2005 to all EC delegations in ACP countries. They will provide guidance for current MPP (lessons to be learned) with basic information as to what activities have been funded, implementation models used in different scenarios and drawing on past experiences. The guidelines aim to contribute to an effective preparation and implementation of MPP presenting basic ground rules and acceptable practice drawing on past experiences, while stressing flexibility as regards implementation modalities.

62. As regards special report 1/2004 on the management of indirect RDT actions under the 5th Framework Programme for Research and Technological Development (1998 to 2002), the Commission should continue its efforts to improve its organisational and management approaches to the implementation of the Sixth Framework Programme and report on this before the end of 2004, based wherever possible on quantitative indicators and on the practical input of participants. *(Doc 5665/05 ADD 2, § 6, page 9)*

Commission's response:

The recommended action has been taken and is continuing. The simplification of FP6 implementation in compliance with the legal and financial framework has been a main objective. An Action Plan on Rationalisation and Acceleration has addressed many of the issues identified as problematic or needing improvement under FP6; the Commission has informed the Council and the Programme Committees of progress achieved. For the future, the efforts on simplification will also address any potential changes that may be necessary to the legal and financial framework and further improvements in delivery of the framework programme. To that end, a working paper on simplification was part of the Commission's proposal for FP7 adopted on 6.04.05. Work has begun on the implementation of the proposals made in that paper.

63. As regards special report 6/2004 concerning the organisation of the system for the identification and registration of bovine animals in the European Union (SIRB), it is important that greater harmonisation between the databases in the Member States should not be achieved through additional rules, but through further guidance from the Commission. *(Doc 5665/05 ADD 2, § 2, page 13)*

Commission's response:

The Commission has already, under the existing legal situation, provided advice and assistance to the Member States setting up and managing databases for bovine animals. A working document for benchmarking of the national databases has been developed to assist the Member States in further improving their databases.

European Development Funds

64. The readability of the EDF financial management report could still be improved, and the report should in future provide an overview of EDF management costs charged to the Union's general budget. *(Doc 6632/05, § 2, page 3)*

Commission's response:

The Commission has further improved the readability and precision of the report. However, with regard to administrative costs linked to the implementation of development aid in ACP countries (EDF and budget lines), these are mostly included under policy area 21 "Development and Relations with the ACP countries" of the general EU budget. The total costs under this policy area amounted to 238.9 million Euro in 2004. This figure includes the expenditure related to staff at headquarters, in delegations, as well as external staff, plus expenditure on buildings and related expenditure.

It is not possible to quantify how much of this expenditure relates specifically to the ACP or the EDF, as part of policy area 21 relates to development policy in all parts of the world (ex.: food aid, grants to NGOs, support for the environment, eradication of poverty diseases, etc, as well as policy definition) which is not financed by the EDF, although it concerns ACP countries as well as other developing countries.

To have a full picture of administrative costs related to the implementation of aid in ACP countries, one would have to add the administrative expenditure linked to funding from other policy areas of the budget (11 "Fisheries", 23 "Humanitarian aid", 19 "External relations", etc.) This would be an extremely difficult exercise.

Moreover, it should be noted that the 9th EDF made it possible to fund some administrative costs directly from the EDF. These costs amount to a total of 233 million Euro covering the whole 5-year period of the 9th EDF.

To sum up, as activities related to the EDF are integrated into the Commission's other activities concerning development aid and political relations with developing countries, the total administrative costs charged to the general budget cannot be divided between EDF activities and other activities in a meaningful way.

65. The granting of EDF budgetary assistance must be accompanied by a strengthening of the administrative structures in partner countries, not only in the programme implementation phase, but also as regards controls on the use of funds. In particular, the Commission should support the supreme audit institutions in the ACP countries more than in the past. Budgetary assistance should also be better coordinated with national budgetary procedures in partner countries and strictly tied to PRSP processes. Moreover, the evaluation of budgetary managements systems needs to be improved. Finally, the Commission should take into account the possibility of coordinating with other donors present on the ground, particularly with those which provided budgetary assistance. *(Doc 6632/05, §§ 2-6, page 4)*

Commission's response:

The Commission is taking the recommended action. The agreements on budgetary assistance must now include a substantial section on institutional support with the specific aim of strengthening the administrative structures in beneficiary countries. At the end of 2004, the Commission drew up an outline strategy for

strengthening support to SAIs, which was sent to the Delegations for implementation of beginning of 2005. Harmonisation of analysis and payment of budgetary assistance with national procedures, particularly the reviews of implementation of the Poverty Reduction Strategies (PRS) is an ongoing concern for the Commission. It is actively working with other lenders on the ground, particularly under coordination protocols, which are being used more and more frequently to formalise efforts at coordination.

66. As regards Stabex funds, it is crucial that the Commission adopt a general strategy with its partners to clear unused funds once and for all. The Commission would need to ensure that similar operations provided for under the Cotonou agreements (FLEX) were correctly managed and monitored in such a way that it could prove within a reasonable period of time that the funds in question had been put to appropriate use. *(Doc 6632/05, §§ 1-2, page 5)*

Commission's response:

The Commission is taking the recommended action. The Commission has issued instructions, with deadlines, to the Commission delegations to ensure closer financial monitoring and the rapid approval of all outstanding Frameworks of Mutual Obligations.

The new instructions, implementation of which is being closely followed by the Commission services, will have the desired effect.