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**REPORT FROM THE COMMISSION**

**ANNUAL REPORT OF THE INSTRUMENT FOR STRUCTURAL POLICY FOR  
PRE-ACCESSION (ISPA) 2008**

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## **Introduction**

Following the Brussels European Council in June 2004, which awarded *candidate country* status to Croatia, the country benefited from ISPA as of 1st January 2005. Croatia thus followed the previous ISPA beneficiary countries which received ISPA assistance from when the instrument was launched in 2000. On January 1st 2007 Bulgaria and Romania became members of the European Union and ceased being beneficiaries of pre-accession funding including ISPA. The accession of these two countries left Croatia as the only remaining recipient of ISPA funding. This report therefore only covers the ISPA activities carried out by Croatia.

The year 2008 witnessed a significant improvement in the pace of project implementation in Croatia with several major contracts being signed, physical implementation commencing and the first interim payments being made. Tendering and contracting is still slower than desirable, reflects continuing poor management and coordination, as well as a shortage of suitable staff. Despite the problems however, steady progress was made during the year. At the start of 2008 11 out of a total of 24 tenders foreseen for all projects had been either commenced or concluded with 3 works contracts having been signed and under implementation. By the end of 2008 however, the number of tenders either launched or concluded had risen to 18 with a total of 13 contracts having been signed and implementation ongoing. Furthermore it needs to be noted that tendering and contracting was completed for 3 out of the 6 ISPA projects.

The transformation of the Implementing Agency from the Central Finance and Contracting Unit (CFCU - a body established within the structures of the Ministry of Finance) to the Central Finance and Contracting Agency (CFCA - a government agency) does not seem to have had the immediate effect that was anticipated. Despite the fact that salary levels in the new agency are higher than in other government institutions the CFCA has still had trouble both recruiting suitable staff and retaining them. In an attempt to improve the situation additional recruitment efforts were intensified and further training of staff took place with the assistance of the European Commission (EC) Delegation.

Another contributory factor affecting the progress of ISPA project implementation has been the preparations for the introduction of the Instrument for Pre-Accession Assistance (IPA). It has to be acknowledged that these preparations to some extent diverted the attention of some of the key bodies involved in implementing the ISPA projects due to the necessity to reorganise their staff and to obtain accreditation for the management of IPA funds.

## **ISPA budget**

In accordance with the Commission's activity based accounting system, the budget for the ISPA instrument was provided for by two budget lines: the functional budget line B13.01.04.02 and the operational budget line B13.05.01.01. The first line contains the means for covering Technical Assistance (TA) administrative expenses mainly for reinforcing EC Delegations. This ended in 2006. The second budget line encompasses payment appropriations made available for the effective implementation and operation of ISPA for Croatia.

Budget line B13.05.01.01, amounting to €7,888,041.30 in 2008, covers all expenses for co-financing infrastructure projects (measures).

*Table 1: ISPA budget in 2008 – in Euro*

<b>Budget line</b>	<b>Payments implemented</b>
<b>Functional budget line B13.01.04.02 (closed in 2006)</b>	<b>0</b>
<b>Operational budget line B13.05.01.01</b>	<b>7,888,041.30</b>
<b>Total</b>	<b>7,888,041.30</b>

## Project funding

### 1. NEW ISPA PROJECTS

No new ISPA projects were adopted in 2008.

### 2. NEW COMMITMENTS

No new commitments were made in 2008 for projects either in the environment or transport sectors since the ISPA instrument ended in 2006.

### 3. PROJECTS FUNDED BETWEEN 2005-2008

Between 2005 and 2006, the Commission approved a total of 6 projects on the basis of proposals submitted by Croatia. Of these projects, 3 concern the environment sector, 2 the transport sector, and 1 horizontal TA measure (for the organisation of the statutory monitoring committees and supporting ISPA implementing agencies). The total eligible investment cost of these projects is €123.052 million, with a total of €59 million, or 47.9%, being allocated as ISPA grants. By the end of 2006, the Commission had committed 100% of the ISPA funds set aside for Croatia covering the period 2005 to 2006 with the commitments distributed in a balanced manner between the environment and transport sectors.

**Table 2: Projects approved in Croatia in 2005-2006<sup>1</sup> – in Euro**

Sector	Project decisions n°	Eligible cost	ISPA contribution	Average grant rate %	Commitments
Environment	3	46,287,701	29,466,355	63.65	29,466,355
Transport	2	76,502,738	29,271,310	38.26	29,271,310
Horizontal TA	1	262,335	262,335	100	262,335
<b>Total</b>	<b>6</b>	<b>123,052,774</b>	<b>59,000,000</b>	<b>47.94</b>	<b>59,000,000</b>

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<sup>1</sup> No projects have been approved since 2006 due to the ending in that year of the ISPA programme.

#### 4. PAYMENTS

Generally, payments for each investment project consist of two advance payments totalling 20% of the ISPA contribution, as well of intermediate payments (i.e. reimbursements) of up to 80% (and in exceptional cases up to 90%) of the contribution, as well as payment of the final balance after closure. A total of €7.88 million in payments were made in 2008 for the ISPA projects approved in Croatia, representing 13.3% of the corresponding ISPA grants. This contrasts starkly with the equivalent figure the previous year of just €124,629.

Thus, better progress was made in 2008 in implementing ISPA measures. This is reflected by the increase in the number of requests received for second advance and intermediate payments. Intermediate payments are of particular significance as they result from actual project implementation (i.e. the payment of invoices) rather than the transfer of advance payments, which had mostly been the case up until 2008. By the end of the period 2005-2008, a total of €14,083,747.30 had been paid out to Croatia, representing 28.87% of the budgetary commitments implemented in that period (€59 million) and over double the amount paid out up until the end of 2007.

**Table 3: Payments – in Euro**

<b>Sector</b>	<b>2005-2007</b>	<b>2008</b>	<b>Total 2005-2008</b>
Environment	3,043,266	2,443,261.00	5,486,527.00
Transport	2,975,344	5,412,008.30	8,387,352.30
TA	177,096	32,772.00	209,868.00
<b>Total</b>	<b>6,195,706</b>	<b>7,888,041.30</b>	<b>14,083,747.30</b>

## 5. SUMMARY TABLES

Table 4 presented below provides an overview of the ISPA interventions for both the year 2008 and for the period 2005-2008.

**Table 4: Projects decided in Croatia in 2005-2008 – in Euro**

Sub-sector	N° of projects	Eligible cost	ISPA contribution	2008		2005 – 2008	
				Commitment	Payments	Commitment	Payments
<b>Environment</b>							
Water	0	0	0	0	0	0	0
Water & wastewater	1	36,000,000	22,500,000	0	2,250,000	22,500,000	4,500,000
Wastewater	0	0	0	0	0	0	
Solid waste	1	8,823,601	6,000,049	0	0	6,000,049	600,005
Air quality	0	0	0	0	0	0	
Horizontal	1	1,464,100	966,306	0	193,261	966,306	386,522
<b>Sector total</b>	<b>3</b>	<b>46,287,701</b>	<b>29,466,355</b>	<b>0</b>	<b>2,443,261.0</b>	<b>29,466,355</b>	<b>5,486,527</b>
<b>Transport</b>							
Road	0	0	0	0	0	0	
Rail	1	75,761,000	28,789,180	0	5,412,008.3	28,789,180	8,290,926.3
Road and rail	0	0	0	0	0	0	
Inland waterways	0	0	0	0	0	0	
Airports	0	0	0	0	0	0	
Horizontal	1	741,738	482,130	0	0	482,130	96,426,00
<b>Sector total</b>	<b>2</b>	<b>76,502,738</b>	<b>29,271,310</b>	<b>0</b>	<b>5,412,008.3</b>	<b>29,271,310</b>	<b>8,387,352.3</b>
<b>Horizontal</b>							
TA	<b>1</b>	262,335	262,335	0	32,772	262,335	209,868
<b>TOTAL</b>	<b>6</b>	<b>123,052,774</b>	<b>59,000,000</b>	<b>0</b>	<b>7,888,041.3</b>	<b>59,000,000</b>	<b>14,083,747.3</b>

## Technical assistance

### 6. FORMS AND METHODS OF PROVIDING TECHNICAL ASSISTANCE

The recourse to technical assistance measures constitutes an essential element for ensuring the successful programming and implementation of ISPA projects. These measures focus on project preparation and project implementation alongside the close involvement of the beneficiary thereby applying the "learning by doing" principle. In addition, by accompanying institutional strengthening and the enhancement of administrative capacity, ISPA contributes to the preparation of the beneficiary countries for implementing the instruments of cohesion policy, in particular in this case, the Cohesion Fund.

Two types of technical assistance measures are utilised

- technical assistance which is carried out on the initiative of the beneficiary country and which is directly related to project funding, e.g. project preparation/development, technical assistance for implementation, and technical assistance for enhancing administrative capacity;
- technical assistance which is carried out on the initiative of the Commission and which mostly relates to activities performed by the EC Delegation, including project appraisal;

### 7. TECHNICAL ASSISTANCE ON THE INITIATIVE OF THE BENEFICIARY COUNTRY

#### *Project preparation and institutional strengthening*

TA measures for project preparation have to ensure that, in terms of project concept, management and operation, beneficiary countries present technically and financially sound projects to the Commission for ISPA funding. Where required, these measures can include the elaboration of strategic studies concerning the (sub-) sectors eligible for ISPA funding. Moreover, they are usually aimed at developing a pipeline of quality projects by providing a sufficient number of suitable projects in time in order to enable the beneficiary country to fully commit and absorb the available funds. The disposing of a strong project pipeline is also essential for the successful implementation of IPA. In this respect two of the three technical assistance measures being currently implemented are aimed at preparing IPA project pipelines in the environment and transportation sectors. The third measure is aimed at developing the institutional capacity of the CFCA to manage and implement the ISPA projects.

The total number of TA measures for project preparation approved between 2005 and 2006 stands at 2, representing a total eligible cost of €2,205,838 of which €1,448,436 (65.6%) is being financed by ISPA. One technical assistance measure for institutional capacity building was approved between 2005 and 2006, representing a total eligible cost of €262,335 which is 100% financed by ISPA.



**Table 5: Technical assistance measures on the initiative of Croatia  
2005-2008 – in Euro**

Sub-sector	No of projects	Eligible cost	ISPA contribution	Commitments 2008	Payments 2008	Commitments 2005-8	Payments 2005-8
<b>Environment</b>							
Sector total	1	1,464,100	966,306	0	193,262.00	966,306	386,522.00
<b>Transport</b>							
Sector total	1	741,738	482,130	0	0	482,130	96,426.00
<b>Horizontal TA</b>							
Sector Total	1	262,335	262,335	0	32,772.00	262,335	209,868.00
<b>TOTAL</b>	<b>3</b>	<b>2,468,173</b>	<b>1,710,771</b>	<b>0</b>	<b>226,034.00</b>	<b>1,710,771</b>	<b>692,816.00</b>

**8. TECHNICAL ASSISTANCE ON THE INITIATIVE OF THE COMMISSION**

Since the beginning of ISPA, technical assistance activities carried out on the initiative, or on behalf of the Commission, have been concentrated on enabling the EC Delegation to perform its *ex-ante* control procedures (including project appraisal) in accordance with the standards required for the management of Community funds. No such technical assistance measures have been funded by ISPA since 2006. All such technical assistance measures since that time have been financed from IPA.

## Management and implementation

### 9. IMPLEMENTATION

The first two projects in Croatia were approved in December 2005 with a final four being approved in July and September 2006. By the end of 2008 physical implementation had commenced on 4 out of the 6 ISPA projects including 2 out of the 3 infrastructure projects. In addition tenders were in progress for a further 5 contracts including the final 2 projects which as yet have no contracts concluded.

The speed of tendering out individual contracts remained erratic. In one instance the signature of the main works contract for a project had to be put back due to delays in concluding the corresponding supervision contract. With other tenders there have been delays due to the necessity to resubmit evaluation reports and to issue corrigenda to the tender documents. On another instance a tender was severely delayed due to a lack of suitable bids. These latter problems however, are typical for any tendering processes and reflect the still relative inexperience of the CFCA in project implementation and therefore too much significance should not be attributed to them. Clearly the most significant fact to note is that now most of the projects have entered the implementation stage which represents a significant milestone in the implementation of ISPA in Croatia.

From the start of 2008 the ISPA implementing agency in Croatia continued to suffer from a lack of suitably experienced staff and poor management. Problems also continue to be experienced as a result of the lack of experience of the final beneficiaries in preparing and running international tenders. To their credit the Croatian authorities have tried to address these problems by replacing staff as necessary and intensifying training activities for final beneficiaries.

### 10. PROJECT MONITORING

Overall monitoring and evaluation of the progress and effectiveness of implementation is supported by regular meetings in the EC Delegation offices, monitoring reports submitted by the implementing bodies, site visits by Commission staff and formal monitoring through the twice yearly ISPA Monitoring Committee meetings in Croatia, as well as the receipt of Annual ISPA Reports for each project from the implementing authority.

Until the management of ISPA funds is fully decentralised (using the Extended Decentralised management Implementation System – EDIS with only *ex-post* control by the Commission), the staff of the EC Delegation in Croatia will continue to play an important role in supervising the daily management, implementation and monitoring of ISPA measures. Due to the inconsistent and continuing unreliable management of ISPA measures by the Croatian authorities it is felt that the continuation of *ex-ante* controls for tendering and contracting will be necessary for the immediate future. The preparations for the move to EDIS will be dependent on an improvement in the functioning of the current Decentralised management Implementation System (DIS) structure with *ex-ante* controls by the EC Delegation. In this context it is not anticipated that EDIS will be achieved for Croatia before the second half of 2010.

Two ISPA Monitoring Committees were held in Croatia in 2008; in June and November respectively. The main points to emerge from the meetings were: a significant improvement in contracting out the projects and in the amount of payments being made; the necessity to extend the N+2 rule for one project due to complications in the tendering process which were outside the control of the Contracting Authority; the fact that all the Article 8 conditions contained in the Financing Memoranda for all ISPA projects had been fulfilled; the necessity to submit modification requests for two Financing Memoranda; the necessity to improve the quality of the data contained in the ISPA monitoring reports, as well as their presentation; the necessity to tender out the remaining infrastructure contracts in order to ensure all the works are carried out within the eligibility periods of the respective financing memoranda. It has to be noted that a number of unexpected setbacks were experienced during the tendering process creating particular difficulties with two of the infrastructure projects. However, in contrast the largest ISPA project is now fully contracted out and implementation of the works is steadily advancing.

## **11. FINANCIAL MANAGEMENT AND CONTROL, INCLUDING *EDIS***

The principal requirements for both the financial management and control and the treatment of irregularities are governed by the provisions of the ISPA Regulation and of Annex III of the Financing Memorandum, as applicable under the regime of *ex-ante* control by the Commission. These requirements are close to those applicable to the Cohesion Fund and the Structural Funds. The key elements relate to the establishment of internal financial control systems and procedures that can ensure transparent and non-discriminatory procurement procedures, the accuracy of declared expenditure, adequate internal audit capability, sufficient audit trail and appropriate treatment of irregularities.

Due to the slow progress in ISPA project implementation it was decided that no ISPA audits would be carried out in Croatia during 2008. The main emphasis for the audit unit in the Directorate General for Regional Policy for 2008 related to the preparations for the introduction of IPA in Croatia. Nevertheless, an internal audit of the EC Delegation in Zagreb did take place. The main conclusion of this audit was that ISPA projects were being managed effectively by the Delegation. Furthermore it was recommended that the EC Delegation apply more pressure to the Croatian authorities to speed up project implementation, as well as provide additional training to the implementing body in relation to quality control. One other observation related to the difficulty the EC Delegation had experienced in securing suitable staff. This resulted from the lengthy, inflexible and restrictive recruitment procedures that the EC Delegation is obliged to use.

### **DIS**

The requirement for the DIS accreditation of the implementing agency in Croatia, the CFCA, follows the stipulations of Article 164 of the Financial Regulation. DIS accreditation was awarded by the Commission on 13<sup>th</sup> February 2006.

## **12. RISK ASSESSMENT**

The audit strategy planned for 2008 and subsequent years has been based on the results of an analysis of the state of ISPA implementation and the related objectives

of the Audit Directorate of DG Regional Policy. The audit strategy sets out the objectives which are defined by the senior management of DG Regional Policy. These objectives are defined on the basis of detailed discussions with the operational directorates during which information on potential risk is shared. The audit strategy then sets out the actions to achieve the objectives, taking account of the risks identified. In general, risk is minimized by implementing this strategy. No audits were carried out in 2008 due to the limited progress in implementation.

Under the system of *ex-ante* approval, priority is given to ensuring that sufficient control procedures are put in place regarding project implementation and payments. However, the management of pre-accession funds carries an inherent risk since the funds are delivered by a variety of organisations and systems. Eligibility of expenditure is determined by compliance with rules and conditions fixed at Community and national level which can lead to complexity and risk of misinterpretation. Currently the Croatian authorities plan to submit an application for the waiving of *ex-ante* controls during the second half of 2010 for ISPA projects in accordance with the provisions of Regulation 1266/1999.

### **13. EUROPEAN COURT OF AUDITORS FINDINGS**

No missions or audits were carried out in Croatia during 2008.

### **14. CO-FINANCING PARTNERS – EIB, EBRD AND KfW**

Given their expertise in project preparation and implementation, the Commission has maintained regular contact with these lending institutions, both at a horizontal level to co-ordinate policy and methodological issues related to programming and implementation, and at country level. The specialist skills of these Banks in structuring grant/loan combinations of funding, including public-private partnership arrangements, is highly useful for improving the quality of projects funded from ISPA. Nevertheless the EIB is not involved in any ISPA project in Croatia.

The EBRD is the only IFI which is actively involved in an ISPA project in Croatia with the provision of a €10 mln. loan for an environmental project approved in 2005 – the Karlovac Water and Wastewater Treatment Programme.

## Contribution to Community policies

### 15. PUBLIC PROCUREMENT

From the start of ISPA, the fulfilment of legal requirements for sound, fair and transparent public procurement as enshrined in the PRAG has proved to be a major challenge. In many cases, ensuring compliance with EU procurement principles has led to delays in the implementation of ISPA projects. The Commission services - especially the EC Delegation in Zagreb - had to intervene frequently, not only to check that procedures were correctly applied but also to rectify errors, to liaise with dissatisfied bidders, and to explain to the implementing agency how the procedures concerned should be implemented. Regularly, the quality of the tender documents needed to be improved resulting in the very late announcement or completion of tenders. The cumulative effect of these interventions has been additional delays to the implementation process.

The *ex-ante* approval by the Commission which governs the tendering and contracting of ISPA projects is therefore entirely justified until the conditions exist for EDIS to be granted (see above). Under the *ex-ante* system of approval and in line with the DIS decision for the conferral of management, only the CFCA plays the role of the contracting authority responsible for project implementation, whereas the Commission endorses each step of the procurement process. It follows that, although the Commission is not a contracting partner, it bears shared responsibility for the procedural correctness of the procurement process (without the Commission's approval, contracts concluded between beneficiaries and contractors are not valid).

### 16. COMPETITION POLICY

As the ISPA assistance is directed primarily to cover public expenditure - or equivalent - concerning utility projects, this does not generally raise problems of incompatibility with the Community rules on competition. Unless the rules on public procurement are infringed, and provided free access to such infrastructure is guaranteed for all operators meeting the necessary technical and legal conditions, such assistance does not confer any special advantage to specific firms.

### 17. ENVIRONMENT POLICY

By providing direct assistance to priority projects for the environment, ISPA also contributes to the implementation of environmental policy and to the compliance with EU standards in Croatia. Experience gained through project development and implementation develops administrative capacity and accelerates sector reform in the environment sector. In particular, administrative capacity is being strengthened with regard to environmental investment planning and prioritisation. Steady progress has also been made in the correct implementation of the EIA directive (Council Directive 85/337/EEC of 27<sup>th</sup> June 1985 on the assessment of the effects of certain public and private projects on the environment), particularly the aspects related to public consultation. It is hoped that ISPA will in these ways contribute towards progress in environmental protection in Croatia.

It is important to emphasise that, as far as Croatia is concerned, the introduction of IPA, with its greater number of bodies and a stream of additional projects, the provision of sufficient financial and human resources for implementation (including monitoring, inspection, the provision of permits and reporting) needs to be ensured.

## **18. TRANSPORT POLICY**

The transport networks in Croatia, agreed in accordance with TINA (Transport Infrastructure Needs Assessment) and REBIS (Regional Balkans Infrastructure Study) were constructed around the framework of pan-European corridors. Several of them run across the territory of Croatia including Corridors VII (the Danube river), X (Salzburg-Ljubljana-Zagreb-Beograd-Nis-Skopje-Veles-Thessaloniki, including branch Xa) as well as Corridor V, which has two branches in Croatia (Vb - Budapest, Zagreb Rijeka, and Vc - Budapest, Sarajevo, Ploče). These networks were used as the planning basis for the national transport strategy for ISPA purposes. As a consequence the single ISPA transport project forms part of the TINA and REBIS networks, i.e. it concerns the construction or rehabilitation of a section, nodal point or access relating to the networks. The TEN-T networks for Croatia are based on SEETO (South East Europe Transport Observatory) recommendations.

## **Co-ordination among pre-accession instruments**

As required by the Coordination Regulation<sup>2</sup>, the Commission ensures close co-ordination among the three pre-accession instruments, PHARE, SAPARD and ISPA. In line with the provisions of this Regulation, the PHARE Management Committee plays a special role in general co-ordination of the three pre-accession instruments.

### *Co-ordination with the (PHARE) Joint Monitoring Committee*

The Joint Monitoring Committee is responsible for co-ordinating the monitoring of each pre-accession instrument and for assessing the overall progress of EU-funded assistance in the beneficiary countries. The Committee issues recommendations to the ISPA Committee or to the Commission when relevant.

### *Co-ordination with EC Delegations*

Periodic meetings were organised by the Commission services (DGs Enlargement, External Relations and Regional Policy) with the experts in the Delegations responsible for PHARE and ISPA to discuss programming and implementation issues, in particular those related to tendering and contracting.

### *Co-ordination with the IPA instrument*

In order to ensure the efficient coordination of activities and the prevention of duplication the two ISPA Monitoring Committees held in Croatia in 2008 were organised alongside the IPA Sectoral Monitoring Committees for the Regional Development component. In addition it should be noted that 2 of the technical assistance measures being funded through ISPA relate to the preparation of project pipelines for implementation using IPA co-finance. In this way it is hoped that there will be a smooth transition from the ISPA to the IPA instruments and the uninterrupted implementation of measures in the respective sectors.

## **19. PUBLICITY ACTIONS**

One publicity action took place in 2008 with regard to the ISPA projects. A ceremony was held at the Deletovci railway station in Eastern Croatia marking the commencement of construction works on the Vinkovci to Tovarnik to State Border Railway Rehabilitation project, being the first ISPA project to start in Croatia. The Croatian Ministers for Finance and Transport and the Head of the EC Delegation in Croatia addressed the assembled guests and media representatives. A presentation of the project was also made by the works Supervising Engineer. The event was highly successful and was widely covered in the Croatian media.

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<sup>2</sup> Council Regulation (EC) N° 1266/1999 of 21 June 1999 on co-ordinating aid to the applicant countries in the framework of the pre-accession strategy.