

Committee of Independent Experts

SECOND REPORT

on

Reform of the Commission

**Analysis of current practice and proposals for tackling
mismanagement, irregularities and fraud**

VOLUME I

(10 September 1999)

The Committee of Independent Experts

Membership

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Recommendations of the Committee of Independent Experts

Chapter 2

A genuine contracting philosophy, a remodelled legislative, regulatory, and budgetary frame of reference, and greater responsibility entrusted to authorising officers should help to restore order to the Commission's management, in which the most disturbing anomalies have been brought to light by the TAO phenomenon.

Recommendation 1

The Commission should treat contracts as a whole as a priority in their own right in order to make for the utmost transparency. Instructions should be laid down and proper training provided. Community public procurement law is marred by a jumble of disparate source texts. Its codification is a matter to be studied, without seeking to overregulate, but rather to achieve rationalisation to facilitate the work of practitioners (see 2.1.17).

Recommendation 2

Given that it is not suited to the requirements of modern management and effective supervision, the Financial Regulation is in need of fundamental revision. In any event, it should form part of a clear-cut hierarchy of Community acts and be confined to the essential principles which all institutions must observe. As regards the details, it should make reference to specific rules applying to each institution (see Chapter 2 as a whole).

Recommendation 3

Conclusion of a contract – following an invitation to tender or by a negotiated procedure – funding of a project under the heading of external aid, or award of a subsidy are different forms of disbursement of Community moneys. The Financial Regulation should accordingly lay down the basic rules to be observed by all institutions, namely transparent decision-making, non-discrimination, and *ex post* assessment of use, and dispel the fundamental confusion as regards contracts. The concept of a contract and the different types of contracts should be spelled out (see 2.1.21 ff.).

Recommendation 4

The present budget nomenclature, based on the distinction necessitated by the Financial Regulation between Part A (administrative expenditure) and Part B (operating expenditure) is impracticable. It is frequently circumvented when appropriations are earmarked under the budget. A nomenclature based on policies whereby the aggregate cost of the latter would be specified and the various expenditure assigned for a given purpose would be identified according to its nature must be established in order to facilitate assessment and enable the budgetary authority to exercise complete supervision (see 2.1.15 to 2.1.19).

Recommendation 5

Expenditure under the heading of cooperation with non-member countries is at present a self-contained, chaotic area, given the numerous and diverse legal rules by which it is governed. The principles deriving from Community Directives must apply not only to the public contracts awarded by the Commission itself, but also to those it awards as the agent of external recipients of Community funds (see 2.1.33 to 2.1.35).

Recommendation 6

Rules must be laid down to govern subsidies. Since they entail a quid pro quo, and are awarded for that reason, they should be treated in the same way as contracts as regards the award procedure (putting up for tender), supervision (consideration by the CCAM), and administration (monitoring by means of databases) (see 2.1.40).

Recommendation 7

The serious gap in terms of the membership of the assessment committee has to be remedied (see 2.1.28).

Recommendation 8

Intellectual service contracts must be systematically planned. Human and financial resources should not be scattered over a myriad of contracts too small to be overseen, the different procedures must be properly understood, accurate definition of the subject of the contract should be treated as a matter of crucial importance, and the Commission must have the means to monitor the proper execution of contracts (see 2.2.17 to 2.2.48).

Recommendation 9

The Commission should ask its contractors and special interest groups, where applicable, to specify the membership of their board of directors and the identity of their shareholders. Both to educate them and to treat them absolutely equally, it must allow unsuccessful bidders to consult the documents relating to a tender procedure (see 2.2.36 to 2.2.38 and 2.2.60 to 2.2.63).

Recommendation 10

Authorising officers must be responsible, consider themselves responsible, and held responsible. Their role should be enhanced, for instance by offering them the necessary guarantees of independence, or indeed certain career advantages, and all the requisite training and information. Their disciplinary and financial liability must not remain a purely theoretical possibility. The fact that a decision to commit expenditure is separate from the signing of the commitment proposal runs counter to a sense of responsibility. The authorising officer and the signatory to a contract (the only instrument legally binding on the Commission in relation to third parties, whereas commitment is merely an internal decision) must be, if not one and the same person, at any rate close associates (see 2.2.49 to 2.2.59).

Recommendation 11

The Commission, or a Member whom it has empowered to act, must be debarred from acting as authorising officers (see 2.2.58).

Recommendation 12

Authorising officers should be advised more extensively where contracts are concerned. The Central Contracts Unit, recently set up by the Commission, should accordingly be equipped with increased human resources in order to provide the necessary prior assistance to authorising officers to help them compile the requisite documents and thereafter monitor the execution of the main contracts and draw the appropriate conclusions to enable constant adjustments to be made to the rules. The unit thus needs to be acquainted, through the Advisory Committee on Procurements and Contracts (CCAM), with the most important or typical contracts. Its representatives should therefore serve on the committee and constitute the principal technical element (see 2.2.75 to 2.2.77).

Recommendation 13

The CCAM, which at present does no more than carry out near-routine implementation checks and is slowing down what is already an excessively cumbersome procedure, has to be reformed. Very strict limits should be imposed on the number of matters considered. Draft contracts should be selected under the personal responsibility of the chairman of the CCAM, assisted by the secretariats of the committee and the Central Contracts Unit, working in synergy. Contracts not selected must be abandoned immediately, and, instead, those few matters deemed to serve as example should be studied in depth. In hierarchical terms, CCAM meetings should take place at a sufficiently high level, but not so high that full members would more often than not be prevented from attending. The CCAM must be constituted as a joint body in order to provide a forum for dialogue between administrative and operating DGs. Opinion thresholds should be raised substantially, broadly according to the types of contracts (see 2.2.78 to 2.2.98).

Recommendation 14

The Commission must finally equip itself with a central database for contracts and contractors. If this cannot be done under the SINCOM system, the central departments should consider the alternatives (expansion of the CCAM database) in collaboration with the authorising officers (see 2.2.64. to 2.2.73).

Recommendation 15

Since the Commission's management tasks are increasing in both number and range and the complement of officials cannot be expanded continuously to tackle them, a policy of outsourcing should be pursued. The use of private sector resources should be regulated so as to meet the requirements of public service. In addition, the committee believes that implementing agencies under the exclusive control of the Commission is an option deserving thorough consideration (see the entire section 2.3).

Chapter 3

The extreme complexity of the legislation renders the EAGGF Guarantee section vulnerable to fraud and makes its control very difficult. The control of EAGGF Guarantee expenditure remains an important current issue despite the gradual reduction in the EAGGF Guarantee section's percentage share of the total Community budget. Sensitive sectors such as export refunds and direct income support are also key sectors which merit the Commission's particular attention. The recent clarification of the respective responsibilities of the Commission and the Member States for payments and control may have a positive impact if given the correct follow-up. The clearance of the accounts with the Member States is the final, overall management act by the Commission in its exercise of control over expenditure by the Member States under the Commission's responsibility. The findings of the Court of Auditors annual Statements of Assurance suggest that there should be an increase in the amounts recovered through the Clearance of Accounts.

Recommendation 16

All decisions taken by the Commission in the EAGGF Guarantee area, either as an administration or as a college, must be taken in conditions of complete independence. The Commission must ensure that the Clearance of Accounts unit can work independently and without being subject to any inappropriate external or internal pressure or influence (3.12.3.-4).

Recommendation 17

The Commission should ensure a more stringent application of the provisions of Regulations 1287/95 and 1663/95 which deal with the accreditation of paying agencies and the certification of their accounts (3.9.8.-3.9.10).

Recommendation 18

The Commission should make full use of its right of on-the-spot controls in the Member States for accounting and compliance clearance and exclude from the certified accounts those amounts relating to accounting errors and underlying transactions which are irregular (3.10.6.).

Recommendation 19

Where systematic weaknesses are found higher rates of flat rate correction for the amounts to be recovered should be applied (3.8.6., 3.12.2.)

Recommendation 20

There remains scope to recover greater amounts through a reinforced clearance effort. To this end the Clearance of Accounts unit needs a further increase in staff to allow a wider coverage each year and checks through to the level of the final beneficiary. It should set a target for amounts recovered linked to the error rates found by the Court of Auditors in its annual Statements of Assurance ((3.12.2.)).

Recommendation 21

Interest should be charged by the Commission from the date of payment by the paying agency on those amounts recovered which have been subject to the conciliation procedure (3.11.1-3.11.5-6).

Recommendation 22

The threshold for amounts in dispute which can be presented to the Conciliation body should be increased if need be by expressing it as a fraction of the value of the average transaction in each Member State (3.11.3.).

Recommendation 23

The Commission should seek to reduce the length of time taken in the clearance procedure by reducing the number of steps and in particular the number of distinct occasions which Member States have to comment on proposed recoveries and the Commission's observations leading to them (3.10.9.).

Recommendation 24

The Commission should ensure that the cycle of Clearance of Accounts' inspection of market and direct payment regimes is short enough to guarantee that all major areas are covered in a 24 month period in view of article 1 of Regulation 1663/95 (3.10.7.).

Recommendation 25

In the new system the compliance clearance decisions can refer to transactions in different years. The Commission should therefore ensure that in the interests of transparency its records and reporting show how much is recovered through compliance clearance for payments made for each accounting year (3.10.5.-8).

Recommendation 26

The Commission should pay particular attention to the area of export refunds differentiated by destination and ensure that guarantees are recovered in full when frauds are uncovered (3.13.2-5).

Recommendation 27

The Commission should give priority to ensuring the proper implementation and correct application of the Integrated administrative and control system (IACS) (3.13.6-7).

The size of the Structural Funds means that day-to-day control of expenditure must be exercised by the Member States. The fact that the division of responsibilities between the Commission and the Member States has recently been clarified in legislation does not mean that the right balance in the division of responsibilities has been struck. A certain number of factors tend to divest the Member States of responsibility. The Commission must ensure that the Member States have put in place effective control systems.

Recommendation 28

There has to be a strengthening of control within the Commission through reinforced internal control units in the Directorates General. This is necessary to avoid the Commission being almost entirely dependent on the Member States for information on implementation and irregularities and the subsequent possibilities of pursuing these. This recommendation accords with proposals made in Chapter 4 of this report concerning decentralised financial control and modern internal and professional auditing (3.17.2-9).

Recommendation 29

Checks by the Commission in the Member States must be reinforced both in number and in quality, that is to say they should go beyond checks which lead simply to the provision of advice by the Commission and an exchange of views. Checks should be designed to result in the detection of irregularities and consequently in financial corrections. They should be most frequent in countries and regions with relatively weak administrative structures. This implies more Commission resources devoted to control in the Member States. This implies stronger and more effective control by the Commission of such structures in all the Member States (3.17.2-9).

Recommendation 30

The number of administrative units involved in the management of the Structural Funds should be decreased and not increased. To this end the EAGGF Guarantee Directorates in DG 6 should have no role in rural development measures which should be left to the Guidance Directorates. The Committee's view is that only one Directorate General should have responsibility for the new objectives 1 and 2 (3.21.1.-2).

Recommendation 31

The use of diverse national rules to determine project eligibility if compatible with the provisions of the Treaties, should be carefully monitored by the Commission to ensure equality of treatment in respect of Structural Fund assistance for all citizens of the Union. Where the national rules cannot ensure this then the Commission should come forward with one or more additional eligibility datasheets to function as guidance notes (3.18.5.).

Recommendation 32

The Commission should refuse to accept over-declarations for reimbursement from Member States and return them for proper presentation (over-declaration occurs where Member States in claiming submit more expenditure than their entitlement leaving to the Commission the task of selecting eligible expenditure from within this larger sum). It is the Member State's responsibility to present its claims for payment in a transparent and detailed way so that all parties can be satisfied that the expenditure concerned was eligible and its effects can be evaluated (3.18.1.-4).

Recommendation 33

Member States should inform the Commission of all project substitutions and their value. The Commission should systematically retain this information to form an overview of the integrity and coherence of the programmes. Member States should prepare for comparison the initial proposal without substitutions with the final outcome with substitutions. This would allow the Commission to intervene to assess certain instances of re-use and to ensure it may recover sums unduly paid from the Community budget(3.18.1-4).

Recommendation 34

If the reforms referred above at paragraphs 3.24.1. and 3.24.6. were not to be implemented, the Commission should take the initiative by preparing a distinct legislative proposal.

Chapter 4

The existence of a procedure whereby all transactions must receive the explicit prior approval of a separate financial control service has been a major factor in relieving Commission managers of a sense of personal responsibility for the operations they authorise while at the same time doing little or nothing to prevent serious irregularities of the sort analysed in the Committee's First Report. Moreover, the combination of this function with a (weak) internal audit function in a single directorate-general gives rise to potential conflicts of interest on the part of the Financial Controller. Thus a serious rethink of both internal control and internal audit is necessary.

Recommendation 35

A professional and independent Internal Audit Service, the competences and activities of which should be based upon the relevant international standards (Institute of Internal Auditors), should be established, reporting directly to the President of the Commission. The centralised pre-audit function in DG XX should be dispensed with and internal control - as an integrated part of line responsibility - decentralised to the directorates-general. One of the principal tasks of the proposed Internal Audit Service should be to audit the efficiency and effectiveness of these decentralised control systems. (c.f. Recommendation 49 below) (4.7.1-2, 4.9.8, 4.13.3, 7)

Recommendation 36

Chains of delegation should be made clear and explicit: every subordinate manager is responsible and accountable for internal control in his/her field of responsibility. It is for the director-general (and heads of independent services) to assume (overall) responsibility for all operational matters in her/his directorate-general or service, including for internal control. The chain of delegation begins at the level of the Commission through the commissioner. She or he thus holds ultimate managerial responsibility for all financial matters, including for financial control, and political responsibility as a member of the College. (4.9.5-9)

Recommendation 37

Each directorate-general should have at its disposal two basic prerequisites for effective financial management: (i) a specialised internal control function, exercised under the responsibility of a senior official reporting directly to the director-general; (ii) an accounting function, exercised under the responsibility of a delegated accounting officer. The latter would work under the functional supervision of the Commission's accounting officer, but be responsible for keeping the accounts and processing the financial operations exclusively of the directorate-general in which it is located.

Recommendation 38

Each directorate-general should produce its own annual financial report and accounts, audited by the Commission's internal auditor, including both financial information and a wider review of the directorate-general's activities. These reports should be examined first by the Commission, which should then submit them to the competent institutions as part of the discharge procedure. (4.9.13-17)

Recommendation 39

The Internal Audit Service should act under the responsibility and authority of the President of the Commission, independently of any other Commission service. It should above all be a diagnostic tool in the hands of the President, enabling him/her to identify structural and organisational weaknesses in the Commission. The competences, objectives, powers and status of this Service should be set out in a basic founding document (a "charter") The work programme of the Internal Audit Service should ensure periodic coverage of all Commission activities. It should however leave headroom for additional *ad hoc* audit tasks to be carried out at the request of the President and/or on the basis of needs arising. (4.13.3, 7, 9)

Recommendation 40

The Head of the Internal Audit Service should be a highly qualified and experienced member of the auditing profession, recruited specifically for this task. S/he should hold an administrative grade equivalent to that of a director general. The Head of the Internal Audit Service, though reporting to the President, should enjoy full independence as to the conduct of audits, the maintenance of professional standards, the contents of reports, etc. (4.13.8)

Recommendation 41

The internal contradictory procedure between the Internal Audit Service and its auditees should last at most one month, whereafter publication of the audit report should take place at the discretion of the Head of the Internal Audit Service. (4.13.11-12)

Recommendation 42

The President of the Commission should present to the Commission each year an annual report of the Internal Audit Service, outlining its activities, principal findings and the action taken, or to be taken, by the President as a result. This report should be made public. (4.13.13-14)

Recommendation 43

All audit reports of the Internal Audit Service should be sent to the Court of Auditors. Additionally, all data collected by the Service, all preparatory work and audit findings should be available to the Court and be of sufficient professional quality to be used by it. (4.13.15)

Recommendation 44

The present General Inspectorate of Services (IGS) should be integrated into the new Internal Audit Service.

Recommendation 45

A central specialised unit, responsible for the formulation and oversight of financial procedures and internal control mechanisms should be constituted within DG XIX. This body should have no role in individual transactions (though it could, in difficult cases, offer advice), but should establish Commission-wide procedures and ground rules for financial management and monitor their application. (4.9.1-3)

Recommendation 46

All officials involved in financial procedures should undergo compulsory and regular training in the rules and techniques applying to financial management as a precondition of being allocated such work. (4.9.1-2, 4, 11)

Recommendation 47

The formal aspects of financial transactions should be verified by the delegated accounting officer. Any objections should be referred back to the authorising officer, who should decide, on his/her own responsibility, whether to overrule the objections and proceed with the operation. (4.9.12)

Recommendation 48

A new and specific administrative procedure should be established, governed by (an amended) Title V of the Financial Regulation, designed formally to establish the individual responsibilities and/or liabilities of authorising officers in respect of financial errors and irregularities. To this end, a new Financial Irregularities Committee would deliberate on the basis of reports from the Commission's internal auditor. Disciplinary or other action could follow if necessary. (4.9.18-28)

Recommendation 49

In the light of the foregoing recommendations, the existing DG XX no longer has any reason to exist. DG XX staff qualified for audit work should be redeployed to the new Internal Audit Service, while other staff should be redeployed, as needed, to other Commission services, notably those requiring expertise in financial procedures. (4.15.1-2)

Recommendation 50

The Court of Auditors could seek to obtain a more constructive reaction on the part of the Commission to its audit observations through greater recourse to department-based auditing, presenting its observations in a more analytical style, giving an overview of the situation it encountered and placing greater emphasis on the management needs of the Commission. (4.16.4)

Recommendation 51

It would be helpful if the Court were able in its Statement of Assurance (“DAS”) to indicate with greater precision which sectors, systems and procedures, and, in the case of shared management, which Member States, are mainly affected by errors, and the nature of the errors concerned. (4.16.5)

Recommendation 52

The duration of the contradictory procedure between the Court of Auditors and the Commission (and other auditees) should be considerably shortened. The process should not assume the nature of a negotiation on the severity or otherwise of the Court’s observations but seek only to establish the facts. The underlying purpose of the Court’s audits should be to identify the remedial management action required in the Commission to address the issues identified by the Court (4.16.7).

Chapter 5

The Committee found that the current legal framework for combating fraud against the financial interests of the European Communities is as yet incoherent and incomplete, largely because the Commission (i.e. UCLAF/OLAF) possesses only administrative law powers and competences, which however have important implications in the area of criminal law. Thus the existing framework (i) fails to recognise and accommodate the true nature of UCLAF/OLAF, (ii) leaves the legal instruments for the investigation, prosecution and punishment of fraud ineffective and (iii) fails to provide sufficient guarantees of individual liberties.

Recommendation 53

The independence of OLAF vis-à-vis the Commission in particular must be and remain a fundamental point of principle if the organisation is to play its role, which is substantially of criminal investigation, fairly and effectively. (5.11.4-8)

Recommendation 54

OLAF must earn the respect, and thus wholehearted cooperation, both of EU institutions and personnel and of Member States' investigative and judicial authorities through ensuring that its inquiries are – and are seen to be – independent, rigorous, objective, procedurally correct, reasonably rapid and ultimately productive of results. (5.9.4-7)

Recommendation 55

OLAF's activities must be subject to the supervision of a judicial authority in order to guarantee due legal process in the course of investigations and the protection of the civil rights of persons affected, directly or indirectly, by inquiries. In this context, the existing Supervisory Committee of OLAF, though fulfilling a useful transitional role, cannot be considered adequate and should be replaced by a special chamber of the Court of First Instance created for this purpose (and, on appeal, also by a chamber of the Court of Justice). (5.12.5-5.12.9)

Recommendation 56

With a view to its role as a central data and criminal intelligence collation point, OLAF must take action to overcome the failings of UCLAF (identified by the Court of Auditors in particular) in the exploitation of information technology. While respecting the data protection requirements of Community and Member State legislation, it should also do the utmost to maximise the potential synergies with national authorities and with Europol in this area (5.9.5, 5.11.10)

Recommendation 57

OLAF must possess adequate human resources to deal with its case-load at least as effectively as an equivalent Member State service. It should also ensure that certain lacunae in the staffing of UCLAF are remedied, notably through the recruitment of adequate specialist expertise, beyond its core investigative personnel, in the fields of (a) auditing, especially “forensic accountancy”, (b) information technology, (c) prosecution and (d) judicial procedures in Member States. All OLAF staff should moreover be selected strictly on the basis of their suitability for OLAF’s purposes, which should preclude any “automatic” transfer of UCLAF staff to the new organisation. (5.11.9-13)

Recommendation 58

In preparation for the introduction of the new legal framework described hereafter, the Member States should (i) ratify the Convention on the protection of the financial interests of the European Communities (ii) further develop common definitions of relevant criminal offences and procedures, and (iii) formally agree common standards of criminal investigation within the context of the European Convention on Human Rights (5.13.2)

Recommendation 59

With the foregoing principles in mind, the Committee recommends a three-stage introduction of a new legal framework for the prosecution and punishment of criminal offences affecting the financial interests of the European Communities in accordance with the proposal set out in this report (section 5.13), summarised as follows:

- *Stage 1: Appointment of an independent European Public Prosecutor (EPP).* The EPP would hold unrestricted jurisdiction (i.e. without the obstacle of official immunity or confidentiality) for offences committed by members and officials of EU institutions and bodies. S/he would work closely with the Director of OLAF and prepare prosecutions as appropriate. Prosecutions would be referred to the appropriate national court. The legality of OLAF investigations and of EPP decisions would be supervised by a special chamber of the Court of First Instance (5.13.4)

- Stage 2: Creation in each Member State of a national *Prosecution Office for European Offences* (POEO) which would be competent for its entire territory. A POEO would be established within each national prosecution service specifically to deal with cases wholly or partially affecting the financial interests of the European Communities. POEOs would act through national police forces and before national criminal courts in conformity with national criminal procedure. The legality of the POEO's activities would be supervised in each Member State by a single court, the same court at which it is located. (5.13.5, 7) The EPP would receive from OLAF all information liable to give rise to criminal proceedings and be responsible for referring it, with appropriate advice, to the appropriate POEO. The EPP would moreover act as liaison between the POEOs of different Member States, notably advising them on possible conflicts of jurisdiction on cases involving more than one Member State and making recommendations for their resolution. The EPP would report annually to the EU institutions on its activities and on the action taken by the POEOs as a result of its recommendations. (5.13.6)
- Stage 3: Creation, on the basis of the EPP and POEOs, of a single, indivisible European Prosecution Office (EPO) with delegated public prosecutors in the Member States holding jurisdiction for all offences affecting the financial interests of the European Communities. The EPO would operate through OLAF and national investigation units. In terms of EU fraud, this stage of the reform would create the single "area of freedom, security and justice" foreseen by the Treaty (TEU Art. 29) (5.13.7)

Recommendation 60

Preparation of the three-stage introduction of a new legal framework should begin immediately and implementation achieved within the following timescale:

First stage: within one year

Second stage: as soon as possible thereafter,

Third stage: to be agreed at the next Intergovernmental Conference (IGC), or at an *ad hoc* IGC shortly thereafter. (5.13.9-10)

Chapter 6

An in-depth reform of Staff policy is required. Practices and procedures must be changed in order to ensure that the Commission can operate effectively and retain its traditional role as the driving force behind European integration. What is really required is not an overhaul of the Staff Regulations themselves, but simply correct application of the rules and principles set out therein.

The Commission should vigorously enforce the principle of the recognition of merit. This will improve standards throughout the organisation, which will in turn serve as an example to all and lead to a positive atmosphere at all levels of the hierarchy.

With this in mind the Commission should formulate a dynamic careers policy so as to foster greater commitment and ambition in its staff and head off all risk of stagnation.

Recommendation 61

Proper social and trade union relations within the Commission are essential. The Administration must recognise the role played by the trade unions, but the latter must in turn avoid any temptation to set up a kind of alternative hierarchy and must focus on the responsibilities they exercise which are crucial to the success of the plan to change and modernise the European civil services (62.34-38).

Recommendation 62

The significance of national balances within the Commission should be reduced by: designing professional training courses in such a way as to strengthen the 'European' nature of the civil service in the institutions; encouraging the genuine 'multinationalisation' of Commissioners' cabinets; reconsidering the number of tasks and their distribution among the Directorates-General, according to real needs, rather than national balances; making 'national quotas' more flexible; and rotating staff more frequently (6.2.18-33).

Recommendation 63

Training and professional conversion should be seen as an ongoing process, starting with the probationary period and forming a regular, compulsory element throughout an official's career. The Commission should step up the financial resources allocated to training measures (6.3.6.-14).

Recommendation 64

Mobility should be encouraged and no exceptions should be made. It should be made compulsory to change posts at the end of a given period of time. This means that flexibility is a quality which is valued and rewarded in terms of promotion. Furthermore, mobility should be an essential precondition for duties involving leadership or management of staff (6.3.15-18).

Recommendation 65

Empowerment of staff requires that everyone's duties should be clearly defined and that the efforts made and the results obtained by each official in carrying out the duties allocated to him are recognised, encouraged and rewarded (6.3.19-22)

Recommendation 66

Decentralisation plays an important role in enhancing the sense of responsibility felt by staff. However, the tasks that are decentralised must be clearly defined and effective. Thus the practice of creating or maintaining posts with no real responsibilities (or corresponding workload) should be regarded as contrary not only to the rationality and effectiveness of the system but also to the principle of empowerment. Decentralisation should not become synonymous with confusion. The process of decentralisation must be accompanied by a reinforcement of programming and internal coordination and genuine leadership must be exercised (6.3.23-25).

Recommendation 67

The practice under which 'other servants' of the Commission – in particular, temporary staff – have 'permanent temporary status' should be brought to an end. Temporary staff should be appointed to permanent posts, which would oblige them under the Staff Regulations to leave within three years. At the same time, the list of temporary posts should be gradually reduced.(6.4.22-27).

Recommendation 68

The use of external help should be reduced so as to decrease the institution's dependence on external staff, who should be used only in exceptional circumstances, on the basis of better-regulated conditions and procedures.(6.4.28-41).

Recommendation 69

The system of open competitions for the recruitment of Commission staff should be thoroughly reviewed, since the number of candidates has increased considerably over time and the procedures followed have proved inadequate. One might consider decentralising pre-selection tests in each Member State, and extending the practice of holding specialist competitions with more precise job descriptions, and holding competitions for each language.

In order to eliminate the lack of transparency in practice which occurs between drawing up the reserve list and recruitment, a list of candidates who have passed a competition should be published in order of merit reflecting the results of the competition. Any divergence from the order on the list when the actual recruitment takes place should be justified and made public.

Internal competitions for the establishment of temporary staff should be abolished. On the other hand, internal competitions to enable officials to move from one category to another should be retained. (6.5.4-25)

Recommendation 70

A reform of the staff reports and promotions system is necessary in order to restore the credibility of the selection process and the career structure. To that end there is a need to strengthen the assessment culture, review the form of the reports and simplify their headings, draw more specific and balanced assessment criteria, award more clearly differentiated marks and provide more detailed comments with better justifications, and encourage more active and responsible participation by the officials concerned.

One might even consider a system of internal competitions for a limited number of available posts, particularly for professional and managerial staff, whose appointments are decided upon by a flexible procedure which is thus open to dangers of favouritism. This competition, based on qualifications and examinations, and carried out by external selection boards or chaired by an external examiner, would be the most ambitious and motivated officials an alternative means of trying their chances other than promotion under the Staff regulations. (6.5.28-42.)

Recommendation 71

Over the years rather serious shortcomings have been revealed in the appointment of senior officials (A1 and A2). It is essential to establish rules, or at least a code of conduct, for their recruitment. As for national balances, one might consider gradually increasing the flexibility of quotas, placing a time-limit on the term of office, or banning the appointment of a successor of the same nationality. As for the recruitment arrangements, more rigorous selection criteria and more transparent procedures should be introduced within these quotas.

Although improvements will have to be made later, as regards the procedure to be followed, and the criteria and arrangements for selection, the Committee considers that the reforms envisaged by the new Commission are a step in the right direction (6.5.43-58).

Recommendation 72

Professional incompetence should be the subject of a more clear and precise system of rules. A procedure distinct from the one for disciplinary hearings should be introduced (6.5.61-66).

Recommendation 73

Practice in the field of disciplinary responsibility should be amended. It has shown severe limitations in terms of effectiveness and speed, with negative consequences for the European civil service and its image.

In particular:

- the rules on the formal conditions and procedural arrangements, as well as the protection of individual rights, should be specified;
- the membership of the disciplinary board should be much more stable and less internal to the Commission, particularly its chairman. An inter-institutional disciplinary board might also be a possibility. The idea of entrusting the part of the procedure which currently takes place before the disciplinary board to an external body should also be considered, particularly as regards the higher grades ;
- a member of the Appointing Authority should be involved in the work of the disciplinary board, at least for all the stages of the procedure at which the official and/or his representative are present;
- disciplinary scales setting out a relatively standard correspondence between errors and penalties should be set to prevent widely diverging penalties from being imposed for identical failings (6.6.11-34).

Chapter 7

The Committee considered that the codes of conduct elaborated by the Commission remain insufficient and are not yet backed up by the necessary legal framework. The attribution of responsibilities and chain of delegation between the Commission, single commissioners and the departments are ill-defined and ill-understood by those concerned. Finally, the concepts of political responsibility and accountability remain unclear and the mechanisms for their practical application inadequate.

Recommendation 74

The code of conduct for commissioners should redefine the concept of collective responsibility to encompass not only a prohibition on calling into question decisions adopted by the college, but also the right and the obligation of each commissioner to keep him/herself fully apprised of the activities of every other commissioner and to take action in this respect as necessary, for example by having frank and open discussions with other commissioners both inside and outside the college. (7.5.1-4, 7.10.1-2)

Recommendation 75

Commissioners' *cabinets* should be limited to a maximum of six category-A officials. The commissioner must ensure that the *cabinet* is multi-national in character and rules must be introduced to exclude any unduly favourable treatment of *cabinet* members at the end of their service. (7.5.7-8)

Recommendation 76

Clear rules should be established as to the applicable criteria to the appointment of individuals to commissioners' *cabinets*, with a particular view to eliminating the possibility of favouritism based on personal relationships. Full transparency as to any personal relationship between a commissioner and a member of his/her *cabinet* must be ensured. (7.5.9-10)

Recommendation 77

Commissioners who use undue influence to favour fellow nationals or wider national interests in any sector for which they are competent are in serious breach of their obligation of independence, and should be subject to an appropriate sanction. (7.5.9-10)

Recommendation 78

Commissioners must carry out their duties with complete political neutrality. They should not be permitted to hold office in any political organisation during their term of office. (7.5.11-12)

Recommendation 79

The Commission must establish clear internal guidelines – to be made public – designed to ensure maximum openness and transparency as to acts and decisions of the Commission once taken and the processes by which they were arrived at. (7.6.3-7)

Recommendation 80

The rights and obligations of officials to report instances of suspected criminal acts and other reprehensible behaviour to the appropriate authorities outside the Commission should be established in the Staff Regulations and the necessary mechanisms put in place. The Staff Regulations should also protect whistleblowers who respect their obligations in this regard from undue adverse consequences of their action. (7.6.8-11)

Recommendation 81

An independent standing “Committee on Standards in Public Life” should be created by interinstitutional agreement to formulate, supervise and, where necessary, provide advice on ethics and standards of conduct in the European institutions. This Committee on Standards should approve the specific codes of conduct established by each institution. (7.7.1-5)

Recommendation 82

All Commission staff should undergo professional training aimed at raising awareness of ethical issues and providing guidance, from both a personal and management perspective, on how to deal with practical situations as they arise. (7.7.6-9)

Recommendation 82(7)
The code of conduct on commissioners and their departments should establish that each commissioner is responsible both for policy formulation and the implementation of policy by his/her department(s). The commissioner shall therefore be answerable to the Commission as a whole for the actions of the department(s), and accountable to the European Parliament. Officials in departments shall answer to their director-generals, which shall in turn be accountable to the competent commissioner. (7.9.1-9)

Recommendation 83

The Secretary General should be considered as the prime interface between the political and administrative levels of the Commission. He/she should above all ensure that decisions of the Commission are effectively followed up by the administration. (7.11.1)

Recommendation 84

Members of *cabinets* should not be permitted to speak on behalf of their commissioners. The primary function of *cabinets* is to provide information and to facilitate communication vertically (between the commissioner and the services) and horizontally (between commissioners). In neither case should the *cabinet* prevent direct communication with the commissioner, but rather stimulate such communication. (7.12.1-6)

Recommendation 85

The Commission is accountable to the European Parliament. To this end, it is under a constitutional duty to be fully open with Parliament, providing it with the complete, accurate and truthful information and documentation necessary for Parliament to carry out its institutional role, notably in the context of the discharge procedure and in connection with committees of inquiry. Access to information and documentation should only be refused in exceptional, duly motivated circumstances and in accordance with procedures agreed between the institutions. (7.14.1-13)

Recommendation 86

The enforcement of the individual political responsibility of commissioners should be a matter for the President of the Commission. The President should be empowered to dismiss individual commissioners, modify the attribution of responsibilities between them or take any other measure in respect of the composition or organisation of the Commission he/she deems necessary to enforce political responsibility. The President of the Commission shall be accountable to the European Parliament for any action (or inaction) in this context. These powers of the President should be made explicit in the Treaties, but, until this is possible, all commissioners should agree to abide by these principles. (7.14.16-22)

Recommendation 87

Any commissioner who knowingly misleads Parliament, or omits to correct at the earliest opportunity inadvertently erroneous information provided to Parliament should be expected to offer his/her resignation from the Commission. In the absence of an offer of resignation, the president of the Commission should take appropriate action. (7.14.14)

Recommendation 88

The Council should give greater political priority to the preparation of its annual recommendation to the European Parliament on discharge, as this would reinforce the political status of the prime institutional mechanism whereby the Commission is held accountable for financial management. (7.15.8-9)

Recommendation 89

Council and Parliament should be bound by the principle of budgetary discipline to take into account the resource requirements attached to any policy initiative they request from the Commission. The Commission should be able to refuse to assume any new tasks for which administrative resources are not available and cannot be provided through redeployment. (7.15.10)

Recommendation 90

The management of Community programmes, and in particular all questions of financial management are the sole responsibility of the Commission. Committees composed of Member State representatives should not therefore be empowered to take any decision relating to the ongoing financial management of programmes. Any risk that national considerations might affect financial management at the expense of sound financial management criteria should be excluded. (7.15.11-14)

1. INTRODUCTION

1.1. The Mandate

1.1.1. In its First Report, and in accordance with the mandate it was given for the first phase of its work¹, the Committee of Independent Experts (henceforth ‘the Committee’), addressed the issue of individual responsibilities of members of the Commission relating to certain allegations of fraud, mismanagement and nepotism.

1.1.2 Following publication of the First Report of the Committee on 15 March 1999 and successive events, at its meeting of 22 March 1999 the Conference of Presidents of the European Parliament considered and approved a note on the terms of reference for the Committee’s second report. Specifically, it mandated the Committee as follows:

"In the light of the findings of the first report (...), it is proposed to mandate the Committee to produce its second report, concentrating on formulating recommendations for improving:

- *procedures for the awarding of financial contracts, and of contracts for interim or temporary staff, to implement programmes;*
- *the coordination of Commission services responsible for detecting, and dealing with fraud, irregularities and financial mismanagement (and, particularly, internal auditing departments, and financial control);*
- *the application and, possible, the adaptation of the Staff Regulations, to facilitate the holding of officials to account in cases of fraud and mismanagement."*

1.1.3. The following day the European Parliament adopted a resolution confirming the mandate of the Committee in the following terms:

*"Looks forward to the second report by the Committee of Independent Experts containing a more wide-ranging review of the Commission’s culture, practices and procedures and in particular its concrete recommendations for strengthening these procedures and any other appropriate reforms to be considered by Commission and Parliament; this report should deal amongst other issues with procedures in existence for the awarding of financial contracts and of contracts for interim or temporary staff to implement programmes, with procedures for following up allegations of fraud, mismanagement and nepotism (detection and treatment), and with the treatment by the Commission of cases of fraud, mismanagement and nepotism, involving staff; this report must be finished by the beginning of September 1999;"*²

1.1.4. In preparing its Second Report the Committee has adhered to the terms of this mandate. The report therefore deals the “culture, practices and procedures” of the Commission, with an eye to formulating recommendations for reforms in the areas encompassed by its mandate, namely financial procedures, control mechanisms, personnel

¹ See First Report, section 1.1

² Resolution B4-0327, 0328, 0329, 0330, 0331, 0332 and 0333/99 of 23.3.99, paragraph 4

management, measures aimed at combating fraud, etc. By the same token, the Second Report does not seek - by contrast with its First Report - to attribute individual responsibilities. Cases cited in the present report serve simply as illustrations of the wider points the Committee wishes to make.

1.1.5. The approach taken by the Committee was formally communicated to the President of the European Parliament by its Chair by letter on 3 August 1999:

“Everything relating to the individual or collective responsibilities of the Commissioners was said in the first report submitted on 15 March 1999. The second report will not in any way go back over this type of question...Nothing it contains will be of a kind to call into question past responsibilities. It will be devoted to analysing the procedures and systems set up by all those involved in the European Union – Institutions and Member States – to combat fraud, and will endeavour simply to present analyses and recommendations in order to increase their effectiveness.”

1.1.6. In keeping with this approach, the Committee does not in the present report pursue, re-examine or update any of the cases analysed in its First Report.

1.2. Structure of Second Report

1.2.1. The subjects covered by the Second Report are determined by the mandate outlined above. The Report comprises a brief introduction, six substantive chapters, each containing specific recommendations, and some brief concluding remarks. For ease of reference, the Committee’s recommendations are also presented together at the beginning of the report. It should be stated at the outset, however, that the recommendations can only fully be understood in the light of the substantive arguments contained within the body of the text. For this reason the reader is invited to refer, for explanation and elucidation of the recommendations, to the paragraphs cited after each of them.

1.2.2. The chapters of the Second Report are as follows:

Chapter 1:	Introduction
Chapter 2:	Direct Management
Chapter 3:	Shared Management
Chapter 4:	The Control Environment
Chapter 5:	Fighting Fraud and Corruption
Chapter 6:	Personnel Matters
Chapter 7:	Integrity, Responsibility and Accountability in European Political and Administrative Life
Chapter 8:	Final Remarks

1.3. Working methods and language

1.3.1. As in the first phase of its work, the Committee worked independently of both the European Parliament and of the Commission. It therefore adopted its own working methods and procedures. It has continued to operate on the basis of the agreements already in place concerning the availability of Commission officials to appear before the Committee and the provision of documentary information on request. The Committee thanks all those who have contributed through the statements they gave and the information they provided to the

formulation of the ideas set out in this report.

1.3.2. The constituent parts of this report were drafted and adopted in one or the other of the Committee's two working languages: English and French. The Committee declines any responsibility for language versions other than the originals, translation of the text being a matter for the European Parliament. The reader is therefore informed that the original languages of the chapters are as follows:

English: Chapters 1, 3, 4, 5, 7

French: Chapters 2, 6, 8

2. DIRECT MANAGEMENT

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2. DIRECT MANAGEMENT

2.0. Introduction

- 2.0.1. This chapter considers certain expenditure incurred under the direct management of the Commission which has come in for a good deal of criticism in recent years. In order to cope with ever more numerous and specific management responsibilities, for which it did not always have the appropriate staff, the Commission has had to contract out part of its work. The contracts concluded to this end with organisations commonly referred to as TAOs have been at the heart of the difficulties which have arisen. On the other hand, many subsidies have been criticised. Most of the contracts concerned have related to the provision of complex services: project management, technical assistance, consultancy work and research, the importance of which has increased in the past ten years.
- 2.0.2. Expenditure whose management is shared between the Commission and Member States (particularly EAGGF-Guarantee and Structural Funds) is dealt with in Chapter 3.
- 2.0.3. Initially, the Committee thought that it would perform a traditional audit of the contracts and subsidies directly managed by the Commission. In order to do so, it would have been necessary to start with a risk analysis to identify the highest-risk types of contract and subsidy, then compile a representative sample of cases, study them and draw general conclusions from them. This proved impossible, due to a lack of data classified under the appropriate headings from which selections could have been made.
- 2.0.4. This observation is indicative of the poor quality of the Commission's management tools for contracts and subsidies.
- 2.0.5. Generally, there are grounds for believing that the Commission's current difficulties are due not only to a lack of human resources but also to a lack of management tools and the inadequacy of the contracting system, which have made it difficult to contract work out to reliable partners. However, in the case of contracts the largest possible number of specific cases has been examined by way of example. The Committee has based its work on a knowledge of existing practices and rules gained from a number of interviews and from the available documentation in order nevertheless to perform a study of the system and formulate general conclusions concerning it.
- 2.0.6. To the Commission, 'contract' and 'subsidy' are poorly defined and largely overlapping concepts. Most subsidies are the subject of quasicontractual documents signed by the two parties concerned and designated as agreements, or sometimes even as contracts. What is a subsidy? How does it differ from a contract? The answer is not clear. At all events, virtually no rules exist concerning the awarding of subsidies: there is no reference to this category of expenditure in the Financial Regulation.
- 2.0.7. The rules on awarding contracts are rather confused: the general legal provisions in the Financial Regulation occupy only a minor position among them, particularly in comparison with the Directives on public contracts. Moreover, apart from the two major fields which the Financial Regulation recognises as enjoying

exceptional status, namely research and external action programmes, each Community programme has its own procedures.

- 2.0.8. The aid granted to certain third countries (or to other parties under agreements concluded with States) itself gives rise to contracts awarded by these recipients rather than by the Commission. However, in most cases the Commission retains a responsibility as an agent entrusted with drafting calls for tenders and selecting candidates. In addition, it is responsible to the Community's budgetary authority for checking that this aid is put to good use.
- 2.0.9. The Financial Regulation applies to all institutions of the European Union. For this reason it is inevitably poorly adapted to the size and diversity of the tasks which the Commission is now required to perform, and which are out of all proportion to those of the other institutions. Moreover, the Regulation has not changed much since it was first adopted. The procedure for amending it is long and complicated.
- 2.0.10. The Commission tends to resort to internal instructions which mingle advice, wishes expressed in the conditional, and prohibitions of various degrees of severity. This miscellany of documents – instructions, procedural manuals and vade mecums – is applied according to need and circumstances to such fields as the ACPC, external procedures, subsidies and TAOs, and sometimes lacks coherence.
- 2.0.11. As regards management procedures, the shortcomings are likewise extreme. Decision-making procedures are often of an artificial character. The extreme centralisation of many of them dilutes responsibilities. When the Commission itself takes decisions – which is by no means unusual – the documents supplied to each member of the Commission contain a whole series of favourable opinions delivered at various stages by departments which have only ever been marginally involved in the matter concerned. These opinions are regarded as sufficiently reassuring to secure a positive final decision. There is hardly any monitoring of contracts or subsidies already awarded.
- 2.0.12. The following observations deal firstly with the legal and budgetary framework in which operations are performed relating to contracts for the provision of complex services and subsidies and the management of these contracts and subsidies. Secondly, the problem of contracting work out will be discussed in general terms.

2.1. The framework

- 2.1.1. The appropriations³ for direct-management operations amount to around EUR 14 billion⁴ per annum, or one sixth of the Community budget.
- 2.1.2. The annual number of contracts approved by the ACPC⁵ is approximately 1200 and their value is EUR 2 billion, to which must be added some 10 000 contracts representing a total of EUR 2 billion awarded in the context of external aid (including

³ After consideration by the ACPC. The figures quoted in paragraphs 2.1.1 to 2.1.3 are taken from estimates by DG XIX.

⁴ EUR 12 billion if one excludes administrative expenditure, particularly on staff.

⁵ Advisory Committee on Procurements and Contracts. See 2.2.81 et seq.

8000 which are additional agreements further to existing contracts and 2000 contracts concluded after a call for tenders). These figures include technical assistance contracts.

- 2.1.3. Of these subsidies, those awarded by virtue of a legal basis (a programme based on a directive, regulation or decision) have a total value of EUR 7 billion, while those which do not have a legal basis other than the budget (also referred to as ‘unregulated subsidies’)⁶ number about 7000 and have an approximate value of EUR 1 billion.
- 2.1.4. The distinction between contracts and subsidies is extremely debatable, both in theory and in practice.

The structure of the budget: administrative and operating appropriations

- 2.1.5. It was not until the Preliminary Draft Budget for 1982 that the Commission proposed distinguishing, apparently in the interests of ‘political transparency’, between two parts: administrative appropriations – expenditure on staff and buildings and other administrative expenditure (Part A) – and operating appropriations (Part B). However, from the outset some Part B appropriations, classified according to purpose, were assigned to staff, particularly for research (performance budgeting).
- 2.1.6. In order for the distinction to improve transparency, precise criteria would have been required, to make it possible to determine the exact dividing line between administration and operations, which proved impossible. The manual on budgetary procedures merely states: ‘Administrative appropriations are appropriations intended to ensure the operation of the whole administrative machinery represented by the Institutions, to enable them to carry out their tasks’; ‘operating appropriations are directly intended for the implementation of the various Community measures or policies: they are funds for carrying out operations’.
- 2.1.7. It is often suggested that the Part A/Part B nomenclature gives Parliament the advantage that it separates operating appropriations off into Part B, enabling Parliament to exert visible political influence, while facilitating its control over the administrative expenditure in Part A. As budgetary authority, Parliament has the last word on all non-compulsory expenditure, whether in Part A or in Part B. Thus this distinction does not affect the classification of expenditure. The distinction between CE (compulsory expenditure) and NCE (non-compulsory expenditure) could be expressed perfectly satisfactorily if the budget were structured in a way which did not involve the Part A/Part B nomenclature.
- 2.1.8. With regard to subsidies, the Part A/Part B nomenclature, far from leading to clarity, adds to the confusion. As will be seen below, a large proportion of subsidies are in fact disguised contracts which the Commission refuses to treat as such, for a whole series of reasons, the main one being that transparency is even less fully assured for subsidies than for contracts.

⁶ The figure of 1 billion is based on the Inspectorate-General’s inquiry concerning the 1996 financial year, but does not take account of changes in this field which have made it possible to give several budget lines a legal basis, which has obvious implications for the relationship between regulated and unregulated subsidies – see Annexes I and II.

- 2.1.9. Many subsidies contribute directly to the attainment of one or other of the objectives of the European Union. They are only assigned to ‘beneficiaries’, who are in effect contractors, because in doing this the Commission asks them in return to help achieve these objectives. If the Part A/Part B nomenclature were adhered to, all of them would have to be financed from Part B (operating appropriations), which is far from being the case. It should also be the case for all the subsidies allocated to external organisations to which a specific task is assigned, such as the European Institute in Florence. Conversely, all subsidies which do not help to attain a given objective of the European Union, or which help only indirectly to do so, ought to be classified as Part A expenditure (operating appropriations), which they are not. By way of example, EUR 325 000 is allocated for the Yehudi Menuhin Foundation, classified under heading B3-2005, and EUR 100 000 is allocated as a subsidy to the European Forum for the Arts and Heritage, classified under heading A-3021.
- 2.1.10. This confusion has been further aggravated since the Court of Justice gave its judgment of 12 May 1998⁷ condemning the Commission for having executed appropriations on lines which lacked a legal basis (directive, regulation or decision). Since then the Commission and, to an even greater extent, Parliament have sought to ‘protect’ subsidies which lacked a legal basis by entering them in Part A of the budget. As no legal basis is regarded as necessary to justify entering appropriations in Part A, *which is intended to ensure the operation of the Institutions*, this part has become a refuge for the financing of subsidies which have no legal basis, no matter what their purpose.

Mini-budgets and TAOs

- 2.1.11. A decade ago, the concept of operating appropriations (Part B) favoured the creation of ‘mini-budgets’, the Commission’s first attempt to meet the need for specific and temporary staff arising from the launching of new Community measures which were directly managed.
- 2.1.12. Mini-budgets comprised administrative appropriations which, despite their character, were entered in Part B because they were closely associated with the implementation of a measure which was itself financed by means of operating appropriations. In 1991, all the mini-budgets together were valued at ECU 153 m. From 1993 and until 1998, these appropriations were repatriated to Part A. They were converted into 1830 new budgetary posts spread over five years. An equivalent number of staff were recruited (temporary, auxiliary and local staff and service-providers), using internal competition procedures which lacked transparency.
- 2.1.13. In parallel, at the beginning of the present decade the practice developed of awarding contracts to what it was agreed should be dubbed ‘technical assistance offices’ (TAOs), to which the third part of this chapter relates. In November 1998 it appears that these contracts were responsible for the employment of 800 staff carrying out administrative duties at about a hundred TAOs⁸. Far from being charged to Part A of the budget, as required by the Financial Regulation, they were financed from Part B, the concept of ‘operating expenditure’ making it possible to camouflage them, while

⁷ CJEC 12.05.98, Case 106/96, United Kingdom of Great Britain and Northern Ireland v. Commission of the European Communities, ECR I-2729

⁸ The Commission has been unable to confirm these data with any exactitude.

the ceilings imposed by the multiannual Financial Perspective did not allow these appropriations to be entered as administrative expenditure (Part A).

2.1.14. In an attempt to escape from this disorder, a bizarre distinction subsequently appeared among the various activities entrusted to TAOs, the view being taken that those which operated 'for the benefit of the Commission' should be funded from Part A while those which operated solely for the benefit of the partner States could be funded from Part B, as could those operating for the 'mutual interest' (to remedy the deficiencies of the beneficiary States while increasing the Commission's workload). These acrobatics further aggravated the disorder.

A new budget structure

2.1.15. It is therefore necessary to establish a budget structure favourable to transparent management and effective monitoring. The distinction between administrative and operating expenditure should be abandoned. It could be replaced by a twofold budgetary nomenclature whose headings would cross to form a matrix.

2.1.16. The first nomenclature, in columns, would identify the activities to which each Directorate-General was devoted, so that its cost and benefit could be assessed and expenditure could be optimally divided between staff and procurement of goods or external services, including technical assistance contracts. The real cost of each measure could be ascertained and compared with the results achieved. In future, the budget should be presented along these lines for each policy separately, the number of Directorates-General being brought into line with the number of policies.

2.1.17. The second nomenclature, in lines, would present the authorisations granted by the budgetary authority according to type of expenditure for each Directorate-General or activity, identified in columns. This expenditure of various types would be broken down in such a way as, in particular, to highlight appropriations for staffing, procurement of goods, payments for ordinary services, purchases of complex services, and subsidies.

2.1.18. Thus the budgetary authority would have all the information necessary to exercise its power of decision and control over the overall cost of policies.

2.1.19. The management of Community programmes would gain in coherence and transparency from this presentation of the budget, showing both the administrative and the operational cost of each measure simultaneously. As a result, the Commission would have an incentive to redeploy its human and administrative resources more effectively in accordance with priority programmes. The budgetary authority would retain the guarantee that it could exercise its power of decision over the allocation of the resources intended for any given measure. The possibility of reducing or increasing administrative expenditure items would remain its responsibility.

1.1. The rules applicable to contracts

2.1.20. The Financial Regulation, while not providing any general principle other than that of non-discrimination between the nationals of the Member States on grounds of nationality (Article 62):

- purely and simply ignores measures relating to the granting of subsidies⁹;
- contains a number of provisions concerning the award of contracts: contracts for the supply of goods or services or the performance of construction work, and contracts for purchase, lease and hire awarded by the Communities (Title IV), broadly distinguishing certain major categories (supply, construction work, services, lease and hire, etc.), none of which corresponds to the particularly sensitive contracts which have given rise to major difficulties in recent years, namely those pertaining to complex services, technical assistance or project management;
- contains a number of specific provisions concerning research contracts (Title VII) and contracts in the field of external aid (Title IX).

2.1.21. The Financial Regulation has been amended many times. It still does not take due account of the enormous changes in the role of the Commission (cf. 2.0.9). However, it has lost much of its coherence. It now needs to be completely overhauled so as to concentrate on the essential principles while detailed rules should be contained in regulations relating to each institution. The requirement of a unanimous decision by the Council, however minor the issue, is a considerable obstacle to the Commission's efforts to improve its management. The incorrect recourse to 'soft legislation' is one of the consequences.

General law

Although it is the point of departure, the Financial Regulation is by no means the sole source of the rules on the award of contracts as a whole. Its provisions directly regulate only contracts below the threshold of applicability (Article 56) of the public contracts directives¹⁰. Moreover, Regulation 3418/93 laying down detailed rules for implementation¹¹ contains essential details concerning the application of the Directives (Title XIX), calls for tenders (Title XV), the determination of the various thresholds in respect of contracts (Title XVI), the functioning of advisory committees on procurements and contracts (Title XVII) and guarantees and preliminary deposit (Title XVIII).

2.1.22. Far more than the Financial Regulation and the implementation rules, it is the public contracts Directives¹² that finally constitute the real body of rules on the award of contracts. They are far more detailed, from the point of view of the choice of award

⁹ Except, that is, for stipulating that wherever Community funds are granted to beneficiaries outside the institutions, the recipients must agree in writing that the Court of Auditors may audit the utilisation of the amounts granted (Article 88).

¹⁰ Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts (OJ L 209, 24.7.1992, p. 1), Directive 93/36/EEC of 14 June 1993 coordinating procedures for the award of public supply contracts (OJ L 199, 9.8.1993, p. 1), Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts (OJ L 199, 9.8.1993, p. 54)

¹¹ Commission Regulation of 9 December 1993 laying down detailed rules for the implementation of certain provisions of the Financial Regulation (OJ L 315, 16.12.1993, p. 1)

¹² Directive 92/50/EEC of 18 June 1992 relating to the coordination of procedures for the award of public service contracts (OJ L 209, 24.7.1992, p. 1), Directive 93/36/EEC of 14 June 1993 coordinating procedures for the award of public supply contracts (OJ L 199, 9.8.1993, p. 1), Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts (OJ L 199, 9.8.1993, p. 54)

procedures, rules on publicity, rules on the participation of candidates allowed to tender, selection criteria and criteria for awarding contracts. The very fact that they are Directives presupposes that, in order to make them applicable to the institutions, there will be reference provisions whose purpose is to coordinate national procedural provisions: Articles 126 et seq. of the implementing rules.

2.1.23. These rules were conceived more for the use of the Member States than of the Community's own institutions, with the aim of ensuring equality of treatment between candidates and compliance with competition rules. The Directives made no attempt to lay down all the technical provisions which might ensure the proper use of Community funds, but each Member State did so itself.

2.1.24. Irrespective of the contracts Directives and the provisions implementing the Regulation to which the Regulation refers, authorising officers are required to take account of:

- the international agreement on public contracts of 1994¹³, to which the Community became a party in the framework of the WTO;
- various instruments which, while they do not directly concern public contracts, contain provisions which must be taken into account when awarding them, for example the Code of Conduct of October 1994 containing general provisions governing relations between the Commission and certain categories of staff;
- the case law of the Court;
- the practices of the ACPC as codified in its vade mecum and, where appropriate, financial control practices;
- any specific provisions laid down in connection with a particular programme.

2.1.25. This proliferation is clearly excessive, as authorising officers are required to be familiar with the details of the various provisions, their development, how they are linked to one another, and the practices adhered to by other departments.

2.1.26. It is not surprising, therefore, that when it comes to implementation, problems of consistency arise. This applies to the procedure for evaluating bids: some DGs assign priority to assessing the technical aspects of a bid and only start to consider the financial aspects once they have done that. Most DGs assess both aspects simultaneously. The same applies to the selection method: the criterion of the lowest bidder, the criterion of the most economically advantageous bid, various conceptions are acceptable provided that the bidder knows in advance on what basis he will be judged, which is not always the case. To tell the truth, no matter how good the rules are, it is impossible to regulate everything in advance: at this level of detail – which is, however, essential – the observations of the ACPC ought, on an ad hoc basis, to have helped to gradually develop a doctrine common to all Commission departments.

¹³ Council Decision 94/800/EC of 22 December 1994 (OJ L 336, 23.12.94, p. 1, 2, 10 and 273-289), entered into force on 1 January 1996: WTO Agreement on government procurement of 15 April 1994, Uruguay Round

2.1.27. In all the sets of rules, which are currently very disparate, the Committee noted a gap regarding the assessment of bids, which is, however, an absolutely crucial point. The provisions implementing the Financial Regulation do not include a single provision on this subject¹⁴. In its opinions, the ACPC simply expresses the wish that at least one member of the assessment committee should be external to the authorising department. This vague, non-binding clause is not sufficient.

Research contracts

2.1.28. Research grants are contracts governed by autonomous and clear legislation (framework programme of research, Annex IV). The framework programme is implemented in three ways: firstly, in the case of grants, ‘calls for proposals’ are published and the resulting proposals assessed by a panel of experts before the contract is negotiated. Procurement of supplies and ordinary services is subject to a standard procedure, albeit with different thresholds. Lastly, a specific procedure of calls for candidates applies to the recruitment of independent experts to assess projects.

Contracts arising from cooperation with third countries

2.1.29. Each year, around 10 000 contracts are concluded in the context of the Community’s cooperation with third countries – awarded either by the Community or by a public authority of the recipient State, but funded by the Community – and some 2000 of these involve the publication of a call for tenders.

2.1.30. Title IX of the Financial Regulation contains a set of ‘provisions applicable to external aid’, covering (Articles 112-119) the award of contracts. However, the situation is even more complex, as some of the Community programmes concerned themselves have specific rules attached to them, applicable only under the particular programme, and these rules in turn may be replaced by provisions laid down in the financing agreements negotiated with the States or public bodies receiving the aid.

2.1.31. Such aid, which in most cases results in contracts awarded for external beneficiaries, but under the control of the Commission, nonetheless constitutes Community expenditure, for the execution of which the Commission bears a twofold responsibility. On the one hand it must be able to satisfy the authorities of the Union that its financial management is sound and the expenditure effective. On the other hand, whether acting on its own behalf or as an agent in its role of executing contracts arising from the aid granted, it must comply with the basic principles adhered to by the Union in the field of public contracts, particularly for the Directives adopted in this field.

2.1.32. The fact that external contracts are governed by as many special sets of rules as there are different legal bases for the various external operations (EDF, various cooperation agreements, Phare, Tacis, Meda, etc.) needs to be stressed. Whatever the particular character of a given activity in relation to the direct management work of the

¹⁴ Whereas they do incorporate some quite precise provisions concerning the *opening* of tenders: Article 104 of the detailed rules for the implementation of the Financial Regulation.

Commission within the territory of the Union, such diversity – not to say disorder – cannot be justified. The Commission has recently realised this and has instructed its new service for the management of cooperation with third countries (Relex joint service) to draw up an overview of these various contrasting rules and to make proposals for codifying the procedural rules applicable to all contracts for services, supplies and public works concluded by the Commission in connection with its operations in third countries and contracts concluded by the beneficiary States themselves under cooperation agreements.

- 2.1.33. However, this codification is constrained by the limited nature of the Commission's autonomous regulatory powers. As, under some programmes, the basic act itself goes so far as to lay down contract procedures, the codified manual¹⁵ proposed by the Commission cannot replace these unless it assumes the form of a legislative act itself, down to its minutest details: the Commission's management powers are effectively subject to a kind of supervision which does nothing to enhance its responsibility. It would be better to start by reviewing the institutional arrangements governing the management powers of the various parties concerned so as to prepare the Commission to adopt rules in this field.
- 2.1.34. Meanwhile, and while awaiting a Council Regulation, in order to ensure that Community action is coherent and transparent the Commission could impose on itself the provisions of the aforementioned manual. In addition, whenever possible, these provisions would be incorporated into contracts with the bidders concerned. But this approach would certainly not absolve the institutions of the duty to engage in the thinking referred to above.

Subsidies

- 2.1.35. In 1998, more than 7000 commitments related to subsidies. Nevertheless, the rules concerning them are weak. The only binding provisions are of a general nature, such as Articles 2, 24 and 87 of the Financial Regulation and the Commission's implementing provisions (Regulation 3418/93) of 9 November 1993. The specific provisions concerning subsidies are not binding. Moreover, they are scattered. They are to be found not only in the vade mecum on subsidies published in 1988 but also in the budgetary procedures manual and Annex 17/2 to the vade mecum of the ACPC.
- 2.1.36. The vade mecum on subsidies published in November 1988 incorporated only part of the recommendations from the report presented by the Inspectorate-General in 1997¹⁶. Moreover, in some cases it did so only in vague or excessively brief terms. In any case it is not legally binding. DGs V, VI, VIII, X and XIII and the Secretariat-General interpret it restrictively, on the pretext that they have their own vade mecums.
- 2.1.37. The fact that the vade mecum contains two types of provisions, some of which are supposedly compulsory while others are optional, too often results in equivocal statements which invite recourse to exceptions: *'ought preferably'*, *'should have'*, *'departments should ensure that'*, *'it is recommended that you ask'*, *'cannot be excluded a priori'*, *'it may be worthwhile'*, *'it may be asked to provide'*, *'the normal*

¹⁵ Relex joint service – procedural rules (final version – 25.5.99)

¹⁶ Report by the Inspectorate-General: Inspection sur 'l'attribution des subventions par les services de la Commission' (inspection of the award of subsidies by the Commission), IGS, 16 May 1997

rule is that', etc. However, it is worth asking what means the Commission had at its disposal: either it could go down the authoritarian road of binding rules by proposing amendments to the Financial Regulation, which would require unanimity among the Member States (a cumbersome and lengthy procedure), or it could opt for persuasion by means of 'soft legislation' in the form of a standard text, intended to educate both authorising departments and outsiders, thereby highlighting the contractual character of the award (the *vade mecum* is incidentally intended for requesters and beneficiaries). The main weaknesses of this publication lie in the risks of multiple award to a particular beneficiary (no requirement for authorising DGs to consult the SINCOM third-party database before selecting their projects in order to check whether the potential beneficiary has already received commitments or payments), the fact that there is no requirement to lay down in advance and in writing the rules governing *ex ante* assessment in order to limit the discretion of the authorising department, and the lack of rigour in the composition of the assessment committees.

- 2.1.38. But the most serious gap in the existing rules concerns the lack of any definition of the concept of the 'subsidy'. This gives authorising departments too much latitude in selecting either the procedure for awarding contracts or that for subsidies. The *vade mecum* on subsidies does not provide any clear indication on the subject. The ACPC *vade mecum* tries to base the selection of the procedure to be adhered to on excessively complex criteria: the subject of the contract, the existence or otherwise of a readily identifiable *quid pro quo*, who holds the power of initiative and management of the operation, who owns the ultimate result of the operation, the extent of the financial participation, and the arrangements for selecting the contractor. Finally, the internal procedures manual proposes a definition based mainly on the criterion of property. Where the Commission acquires the ownership of goods or services, there is a contract. Where this is not the case, even if the Community's interests are at stake, there is a subsidy. Although this definition may appear logical, it is in reality far too reductive.
- 2.1.39. The concept of *quid pro quo*, which in most cases is the very essence of a contract, arises in connection with most subsidies, justifying their award. Indeed, in many cases it is explicitly formalised in the legal act (agreement) linking the Commission to the beneficiary. The commitment and active participation of the beneficiary are indispensable with a view to attaining the objectives set, using the means provided. A contractual relationship exists even where it is not completely formalised. In principle therefore, subsidies ought to be treated as contracts.
- 2.1.40. In cases where there is no element of reciprocity – and only in these cases – there is a subsidy. Subsidies, therefore, include, for example, financial grants designed to provide material or moral support. In this case, after all, no immediate and direct *quid pro quo* is expected of the beneficiary of the Community funding.
- 2.1.41. Situations will arise in which there are grounds for hesitation as to how contracts/subsidies should be classified. It will be up to the authorising department to decide (cf. 2.2.60 *et seq.*) which management system should apply to the expenditure in question. In doing so it will be guided by the decisions of the budgetary authority as expressed in accordance with a nomenclature (cf. 2.1.15) which, within the resources allocated to a particular DG, distinguishes between appropriations to be used in awarding subsidies and those to be used to finance contracts.

2.2. Management

- 2.2.1. Agreements relating to subsidies and contracts pertaining to the provision of complex services (consultancy, research, technical assistance or project management) constitute legal acts which create financial obligations by means of which Community policies are implemented. Responsibility for them rests with the authorising departments. Contracts and subsidies are sometimes awarded too repetitively to organisations gravitating around the Commission, thereby helping to keep them alive artificially.
- 2.2.2. In order to identify the causes and mechanisms of this situation, the following observations are intended to describe the life cycle of a contract, first providing two concrete examples and then analysing the process whereby contracts and subsidies are awarded.

The life cycle of a contract: specific examples

- 2.2.3. When the budgetary authority enters in the Commission budget the necessary appropriations to carry out a Community project, the authorising department and the departments managing the operation initiate the procedures which will result in the conclusion of a contract or the award of a subsidy, in return for which the institution will receive the required quid pro quo.

The main steps are as follows:

- the decision to contract the operation out
- selection of the procedure: call for tenders and/or negotiation
- selection of contractor
- financing and monitoring of contracts

Each of these steps is attended by dangers of irregularities or even fraud, which the Committee has identified by studying a limited number of cases; it does not claim that these constitute a genuinely representative sample but nonetheless believes that certain conclusions and warnings may be drawn from them.

A made-to-measure contract for complex services

- 2.2.4. Ten years ago, the Commission awarded a contract pertaining to publicity work in the field of agriculture which was worth a little over ECU 4 m. Formally, the decision was taken at the highest level, by the Commissioners, and accompanied by every imaginable guarantee: a call for tenders, a large number of candidates, favourable opinions from the ACPC, the legal service and the financial controller, and a proposal submitted by the appropriate Commissioner in the form of a file several centimetres thick. The decision by the Commissioners could not fail to be positive, as it duly was.
- 2.2.5. Yet this whole procedure, although formally regular, was actually biased, as the Commission gradually came to realise due to the absence of any effective quid pro quo from its partner.
- 2.2.6. Firstly, the call for tenders published in the OJ was couched in extremely vague terms. The purpose of the contract, i.e. what the contractor was to do in exchange for the payment by the Community, was poorly defined. More seriously still, the criteria for

assessing the various bids were not stated in the call for tenders. It is not unlikely that they were decided only after the bids had been received. They were weighted in such a way as to give a decisive advantage to just one bidder, which could not in any way have been foreseen from the call for tenders published. The Committee has questioned the officials who were involved at the time, and they confirmed that there was no assessment committee to speak of. No minutes of its meetings exist.

- 2.2.7. The ACPC was required to consider the project in writing, on grounds of alleged urgency. The records do not contain any hint of a justification for this urgency. The ACPC delivered a favourable opinion without comment. The same applies to the legal service. The Commission took a favourable decision, under the circumstances described above, without discussion, the matter being entered as an A item.
- 2.2.8. The contract itself contained grave anomalies. Firstly, 40% of the total sum for which it provided was to be paid immediately after signature, whereas the guarantee provided by the firm was minimal. Secondly, as already noted, the subject of the contract was ill-defined. No binding financial commitment was given by the contractor. Thirdly, there was no way of monitoring subcontracting. This enabled the contractor, within a very short time, to subcontract 90% of the value of the contract to a company registered in a Member State but located far away from the Brussels seat of the Community institutions, contrary to the very heavily weighted criterion which had resulted in the contractor being preferred to its competitors. What is more, after a time the subcontractor vanished. An audit by the Commission, whose conclusions were very negative, finally resulted in the contractor's receiving only about 75% of the amount originally provided for by the contract. It was stated that a steering committee consisting of experts appointed by the Commission would monitor the implementation of the operations provided for by the contract. The Committee has been unable to find any evidence either that the members of the committee were appointed or that they held any meetings.

A technical assistance contract for the performance of pilot projects

- 2.2.9. The case just described is an old one. The Directives on public contracts had not yet been published. Even so, it must be said that although these now apply, the practical progress made is not obvious. The history of a technical assistance contract concluded recently for the performance of pilot projects bears witness to this.
- 2.2.10. The authorising department issued a call for tenders, published in the OJ. Seven bids were registered, all admissible, and five of them met the selection criteria published in the call for tenders. By and large, the prices offered by the competitors lay between ECU 1.1 m and 2 m. The authorising department ranked the lowest bid second in terms of quality of service, immediately behind one of the highest bids, costing ECU 700 000 more and ranked first. The bid ranked first in terms of quality had been submitted by a non-profit-making association in which another non-profit-making association occupied a dominant position, and the latter already had a contract with the Commission and was being liquidated following litigation with the latter.
- 2.2.11. Rather than awarding the contract to the lowest bidder, the authorising department wished to declare this bid unsuccessful on the basis of Article 11 of the Directive on public contracts; with this in view it consulted the ACPC, arguing that, given the

configuration of the bids, it was impossible to establish a quality/price ratio. The ACPC delivered a favourable opinion. The authorising department then asked the five bidders to submit bids amended as to price, while retaining all other aspects unchanged. The previous lowest bidder raised its bid by ECU 400 000, while the bidder behind which the association which had already worked with the Commission had been ranked reduced its bid by ECU 80 000. The difference between the two was now only around ECU 200 000.

- 2.2.12. The authorising department now submitted to the ACPC a draft contract relating to the bid which it had from the start regarded as offering the best services. The ACPC suspected a possible conflict of interests because of the composition of the contractor's board (cf. 2.2.10); the authorising department replied in writing, supplying reassuring but inaccurate information, particularly regarding the contractual relations of the association in question with the Commission and the possibility of conflicts of interest. The replies were quoted verbatim from a document drawn up the previous day by the president of the association submitting the bid, who was also president of the association which already held a contract.
- 2.2.13. An amount representing half of the contract was paid immediately after its signature, whereas the contractor's guarantee corresponded to only 1.25% thereof. A few months later the contracting group subcontracted some services to one of its members. Less than a year afterwards, its president was forced to resign because of the difficulties of the aforementioned association (cf. 2.2.11), of which he was likewise president.
- 2.2.14. Two months before expiry of the contract, Financial Control issued a very critical report on its implementation, particularly concerning partial performance of the contract, subcontracting to members of the group which gave rise to conflicts of interest, inadequate management and monitoring procedures, lack of transparency of accounting transactions, acceptance of travelling and subsistence expenses claims without verification, etc., concluding that the contract ought not to be renewed.

In 1998 it was nonetheless decided to renew the contract for one year.

- 2.2.15. In the light of the observations made while drafting its first report and in view of the cases considered since, particularly the two examples cited here, the Committee believes that it should draw attention to the need for a complete overhaul of the contract and subsidy award system. In the interests of greater transparency, this overhaul should particularly concern the following stages:

- the procedure for awarding contracts and subsidies
- the hierarchy among authorising officers and their relations with officials responsible for negotiating contracts
- relations with interest groups
- management tools
- advice to authorising officers: central contracts unit and ACPC.

These points will each be considered in turn.

The procedure for awarding contracts and subsidies

- 2.2.16. The procedure to be followed depends on whether the expenditure is classified as

relating to a contract or a subsidy. This classification is important, as in the case of the former, the procedure is governed by the rules on public contracts, whereas the award of subsidies depends on more flexible provisions if governed by the provisions authorising them or is even exempt from rules altogether if it is not.

2.2.17. As indicated in paragraph 2.1.40, most expenditure which is currently classified as ‘subsidies’ ought in future to be classified as ‘contracts’. Not only does it entail an element of mutual performance, which determines its contractual nature: above all, this would bring more transparent procedures into play for it.

The budget nomenclature (cf. 2.1.15 et seq.) should be used so as to ensure that appropriations for contracts cannot be used for subsidies, and vice versa.

2.2.18. As regards contracts alone, the first stage should be to define and justify the need to be met. In the instance of technical assistance, in particular, this is a stage which the Commission tends to forget. The quality of bids and the clarity of definition of the subject of the contract necessarily suffer as a result. However, some sectors of the Commission have come to appreciate that needs are mostly enshrined in programmes. This is a trend which should be encouraged. A contract to provide complex services should always form part of a programme. This is the ‘political’ framework on which a decision should be taken by the Commissioner responsible. The programme expresses the need and indicates the period within which it is to be met. Programming is a job in its own right. Contracting is another. But it ought not to be possible to propose entering into contracts which cannot be accommodated within a programme.

2.2.19. Moreover, the Commission should take care not to enter into innumerable small contracts relating to technical assistance, research, consultancy work, etc., even if they have a place in a programme. Too many contracts, often for amounts of less than EUR 1 m, make excessive demands on officials’ time. It would be worth investigating whether this phenomenon might not be one of the reasons for the staff shortages at the Commission. Moreover, all too often, the authorising officer, assuming that he is not incurring any risk in view of the insignificance of the amount involved, signs them without paying sufficient attention. Or – even less creditably – he signs in the knowledge that he is granting an individual or a firm an undeserved advantage, but one which will go unnoticed.

2.2.20. The Committee believes that the Commission should set thresholds below which small contracts would be avoided wherever possible, unless covered by a programme. Otherwise, technical assistance needs should be met by recruiting auxiliary staff in accordance with the rules applicable to other staff (cf. Chapter 6).

Awarding a contract – the choice of procedure

2.2.21. Where the rules on contracts are applied, and where the need is recognised, the authorising officer decides on the procedure to be adopted when awarding a contract. The general rule is that there should be a call for tenders, either open or restricted, while the rules applicable permit only two alternatives to these, by way of exception: private treaty or negotiated procedure.

2.2.22. A contract may be awarded without a call for tenders (1) if the amount concerned is less than EUR 12 000, (2) on grounds of extreme urgency, (3) if a call for tenders is

unsuccessful or has resulted in unacceptable prices being quoted, (4) if, on account of technical necessities or factual or legal circumstances, the service can be rendered only by one supplier or entrepreneur, or (5) in the case of contracts which, for technical reasons, cannot be separated from the main contract.

- 2.2.23. In principle, a call for tenders is preferable, but only if the necessary practical conditions are met and if there is complete transparency. Authorising officers tend to issue calls for tenders in every case, which is the procedure advocated by all internal monitoring bodies. In this way they seek to forestall criticism. This attitude is regrettable, as each type of procedure is appropriate in the right context, outside which there is a high risk of fraud. The only thing worse than a false call for tenders (cf. 2.2.4 et seq.) is false negotiation (cf. 2.2.9 et seq.). Where negotiation occurs, it is important that the administration should have adequate means of analysis (cf. 2.2.27) and the will to use them.
- 2.2.24. Drafting a call for tenders requires effort, first to plan and then to write it: the authorising officer must state his needs and define precisely and exhaustively the subject of the contract as criteria for selection and award which cannot subsequently be modified. The call for tenders is the instrument which provides information for enterprises, the tool for selection among bidders and the first element in the contract which bidders undertake to perform when they submit their bids. The Committee has observed that the Commission finds it difficult to draft calls for tenders in sufficient detail where the object of the contract is concerned.
- 2.2.25. In some calls for tenders, it appears that one beneficiary is wanted or even preselected, and that the call for tenders has been organised without any desire to accept the outcome of the procedure. The procedure is biased. Insofar as it is possible to determine on the basis of the cases examined, this bias operates at two points, not necessarily in a cumulative manner: when the call for tenders is drafted and when a decision is taken on the conclusions to be drawn from the bids (cf. below).
- 2.2.26. If the Commission's interests are at stake or if the monopolistic or quasi-monopolistic situation on the market makes a call for tenders unrealistic, the authorising officer should not hesitate to recognise this formally (cf. 2.2.23) and conclude the contract after negotiation with the firm as permitted by Article 59 of the Financial Regulation and Article 11 of the Directive on public contracts. In fact, in monopolistic situations, calls for tenders encourage agreements between firms and result in higher prices than could be obtained through negotiation.
- 2.2.27. It is essential that those responsible for advising authorising officers should be able to provide them with negotiating expertise. When faced with monopolies or quasi-monopolies, the public authorities, be they a State or the Commission, are relatively defenceless. However, the duration of the contract is for it to decide. It should make the most of this trump card and make a practice of asking the would-be contractor for an estimate structured in accordance with its own accounting categories, certified by an accountant approved by the two parties. Negotiations should be based on the estimate, and the contract should contain a verification clause making it possible to ascertain upon its expiry that there has not been any deception. This method depends for its success on the assumption that the contractor will realise that his reputation is at stake, as is the possibility of securing future contracts from the public authorities.

Prior information

2.2.28. The rules on publicity are precise, detailed and binding, as regards both the information to be supplied and the time limits for candidacies or submission of bids. Authorising officers abide by them scrupulously, except, until 1998, for the requirement to provide prior information, which is, however, compulsory if a contract for services to be rendered in the next 12 months is equal to or exceeds EUR 750 000. This provision, which is intended to facilitate access to public contracts for small and medium-sized enterprises and to improve the transparency of policy on contracting, requires programming of contracts, which authorising officers have some difficulty in carrying out. Until 1998, no penalties were imposed for failure to comply.

Opening of bids

2.2.29. Bids are opened by a committee appointed for the purpose, which checks whether they comply with the formal requirements stated in the call for tenders. All bids are opened, and their opening entered in a written record. This part of the procedure is well established and does not call for any comments from the Committee.

Consideration of candidacies

2.2.30. Bidders are required to produce declarations and documentary evidence concerning their legal, economic and financial capacity.

2.2.31. At present, the first step when considering bids is to check whether a bidder ought not to be excluded from the procedure on account of bankruptcy, liquidation, judicial settlement or because of a conviction of serious professional misconduct or an offence with implications for the bidder's professional morality, that the bidder's situation as regards payment of taxes and duties is regular, that it is entered in professional registers, etc. The second operation is to check its economic and financial capacity by studying the bank declarations, balance sheets and references which it is required to produce. The Committee recommends that the strictest precautions be taken.

2.2.32. But familiarity with the above information is not enough to guarantee that the bidder possesses the requisite capacity, as it does not include adequate particulars concerning the bidder's true identity. Certainly, the Commission has its early warning system – cf. 2.2.73 below. It should also check the true identity of its potential partners, requiring them to state the composition of their board and to provide information about holders of their capital. In addition the Commission should keep a file on contractors (cf. 2.2.69 et seq. below).

Comparison of bids

2.2.33. Bids are compared on the basis of the award criteria stated in the call for tenders. It is prohibited to add new criteria, or to alter or delete any of those which have been stated. Each bid must be analysed, without discrimination, by an assessment committee whose composition is not regulated by any binding provisions. Failings have occurred at the assessment stage and when deciding what conclusions should be drawn from it. The stated criteria are applied to establish an order of merit, generally in the form of figures, but they may be too vague, permitting discrimination in favour of the beneficiary desired, or the results of the assessment may not accord with the

findings based on the criteria.

- 2.2.34. It may be necessary to declare a call for tenders unsuccessful if the analysis of the bids shows that competition has not operated or has operated only imperfectly. In this situation, it is not desirable to accept without debate the price offered by the front-runner. An attempt should be made to negotiate over it, either with this firm alone, if it proves to enjoy a monopoly, or with all the bidders. For this purpose the Commission should not hesitate to declare the call for tenders unsuccessful with a view to opening the negotiated procedure (Article 59 of the Financial Regulation). But, as has been seen above (2.2.27), this measure will be productive only if the Commission has the requisite means of analysis to provide the negotiating department with the expertise it needs.
- 2.2.35. This procedure may be used in a way which runs counter to the Commission's financial interests – whether or not the intention is fraudulent – if, before the tender procedure even begins, the authorising officer intends to conclude a contract with a particular partner (cf. 2.2.9 et seq. above). In the event of such collusion, if the desired firm submits a bid which is too high, the negotiated procedure makes it possible to give that firm a second chance, which opens the way to fraud. This enables the firm to submit a financially more acceptable bid in a situation where it already offers the best quality and is possibly aware how much its competitors have bid.

Conclusion of the contract and provision of information to bidders

- 2.2.36. The department concerned concludes the contract with the successful bidder and informs the other bidders of their rejection. If the contract is subject to the Directives on public contracts, the results of the procedure are published within 48 hours of the award in a notice of award. This states the procedure used to award the contract in the event of a negotiated procedure without prior publication of a call for tenders, the justification for the use of this procedure, the date of award of the contract, the award criteria, the number of bids received, the name and address of the successful bidder, the price paid or the range of prices, indicating the minimum and maximum, and the value of the part of the contract which may be subcontracted, if any.

In addition, the authorising officer is required to communicate to each unsuccessful bidder within 15 days of receiving a request to this effect, the grounds for rejection of its bid and the name of the successful bidder. If the authorising officer decides not to award a contract after a tender procedure or if he recommences the procedure, he must likewise inform any bidder who so wishes of the grounds for his decision.

In the case of contracts which fall short of the threshold for application of the Directives, bidders are informed that their bid has been rejected. If they request additional information, this is provided in writing.

- 2.2.37. It is vital that all businesses should receive clear and complete explanations of the reasons why their bids have been rejected, which in practice does not by any means always happen. However, if the rejection is justified, the authorising officer ought not to have any difficulty in informing the bidder of the reasons. The bidder should be informed of its own scores and those of the successful bidder for each of the selection criteria announced. An explanation for 'educational' purposes ought to be regarded as obligatory, because it is not in the Commission's interests to discourage bidders: rather

it needs to enlighten them as to their weaknesses in order ultimately to receive more worthwhile bids.

- 2.2.38. Because of the transparency requirement, the records concerning the procedure must be made available to those bidders who so request, including competitors' bids, subject to the legitimate protection of business secrets.

Implementation and monitoring of the contract

- 2.2.39. The Commission generally pays a large percentage of the value of the contract as soon as the contract is concluded; this is equivalent to actual prefinancing. The two examples given in paragraphs 2.2.4 et seq. demonstrate how hazardous this practice can be. The guarantee paid by the contractor becomes valueless, and termination of the contract virtually impossible: it is hard to imagine an authorising officer pursuing this option when 40% or 50% of the value of the contract has already been paid at the outset without any quid pro quo. Any call for tenders and, in general, before any contract is concluded, the call for tenders pertaining to it, should contain a realistic schedule for payment by instalments linked to performance, to ensure that bidders are placed on an equal footing with their competitors. A competitor who is totally dependent on the Commission for the execution of his contract and who moreover guarantees only 1.25% of the value of the contract constitutes a real risk to public funds if the Commission has to bring proceedings against him.

- 2.2.40. Effective monitoring is imperative to ensure the proper performance of a contract or a subsidy agreement and, if necessary, terminate it prematurely, taking the necessary measures to ensure continuity of service in good time. The Commission's monitoring of contracts or subsidies is inadequate. Lack of monitoring by authorising officers is a direct cause of non-performance and poor performance, particularly in the case of TAOs: reduction of the contractor's obligations without any compensation for the Commission, unauthorised subcontracting with members of the bidding group who cannot simultaneously carry out their duties and monitor the way in which that is done, inadequate management, etc.

Renewal and termination of contracts

- 2.2.41. When a contractor fails to give satisfaction, its contract should not be renewed, although situations can be so complex that this is not always possible. However, the reasons ought to be explained in great detail when a contract is to be renewed without compelling need to do so or other contracts are to be awarded to a firm which has not performed satisfactorily. That said, the reality is often quite different. When no justification has been provided, any decision to award or renew a contract under the circumstances described above must be regarded as professional misconduct constituting grounds for disciplinary action.

- 2.2.42. The cases considered by the committee when it drew up its first report, and the examples mentioned above, reveal a number of culpable shortcomings. These failings occur at every stage at which assessment may be brought to bear and are not always detected by the persons called upon to exercise supervision. Because of the failure to supply proper or complete information, those responsible for the system cannot take decisions with full knowledge of the facts, and bidders whose interests have been damaged are likewise not in a position to seek explanations and assert their rights.

Award of subsidies

2.2.43. Until the guide to subsidies entered into force on 1 January 1999, there were no Commission-wide guidelines as regards the rules to follow when making awards. However, the amounts paid out under that heading are extremely substantial. In 1996, for example, according to the IGS report of 16 May 1997, the amounts of subsidies falling outside regulated award procedures were of the same order of magnitude as the value of contracts submitted to the CCAM (ECU 1 bn and ECU 1.4 bn respectively).

2.2.44. One distinct category of subsidies are those for which the award conditions are determined by the legal basis. These subsidies are allocated in accordance with criteria laid down by the legislative and budgetary authority, more often than not when a programme is launched, and generally granted after committees including representatives of the Member States have had their say. Subsidies not in the above category are awarded on the basis of specific criteria under the particular procedure followed by the Directorate-General administering the relevant chapter of the budget. The arrangements for allocating subsidies of this latter type are discussed below.

2.2.45. Prior information is provided in the form of a call for proposals published in the Official Journal or sent to an up-to-date list of potential recipients or, indeed, may be channelled via contacts with recipients and bodies known to departments which have taken the initiative of applying for a subsidy. Publication in the Official Journal imposes constraints, and managing authorities are consequently obliged to supply more detailed information. Unless the same information is likewise published in the Press, the other two channels of contact open the way to all kinds of abuses.

In retrospect it can be said that lists of recipients have been published only occasionally and the media used have frequently proved inappropriate for their purpose.

2.2.46. There is no well-established practice regarding the arrangements for submitting applications, assessment criteria, or the substance of agreements. The only form of check made on subsidies before they are awarded is carried out by the Financial Controller. Monitoring of subsidies and assessment of their aims are the responsibility of the authorising Directorate-General.

2.2.47. The SINCOM system (see 2.2.70 ff. below) records data relating to subsidies under the SUB code. However, because the computer codes used in SINCOM are based on vague definitions, some subsidies are excluded from the list. The data therefore cannot be assumed to be reliable. With the possible exception of DG XIX, no department or committee has an overall picture of the subsidies allocated. Owing to the fact that the details are not properly publicised, the same bodies and organisations may receive subsidies from several DGs at once. Subsidies may be administered openly, and recipients treated equally, but this does not happen as a rule. Some authorising officers take decisions on their own, and their staff are not even asked to compile background documents.

2.2.48. In the light of the proposal referred to in 2.1.40, true subsidies, that is to say, those for which no immediate or direct quid pro quo is expected from the recipients, ought not to be left to the discretion of the Directorates-General, but instead should be centrally managed, for instance by the Secretariat-General, in a transparent way on the basis of an internal

Commission Directive. The recommendations set out in the recent guide are totally insufficient.

Authorising officers

2.2.49. Authorising officers are empowered to enter into contractual obligations on the Commission's behalf in relation to third parties. Article 73 of the Financial Regulation stipulates that when they do so, but fail to comply with the proper rules, they may incur disciplinary and possibly financial penalties, subject to the conditions set out in Articles 22 and 86 to 89 of the Staff Regulations of officials.

Under Article 22 of the Staff Regulations, for example, an official may be required to make good the whole or part of any damage sustained by the Community as a result of serious personal misconduct of which he may have been guilty while performing his duties. In practice, as will be made clear in Chapter 4 of this report, the above provision is hardly ever enforced.

It is legitimate to ask whether the failure to invoke Article 22 and, moreover, the fact that disciplinary action against authorising officers is an extremely rare occurrence do not stem from the workings of the complex delegation and subdelegation system, which, by confusing the powers of authorising officers, political accountability, and the authority of superiors, negates the concept of the authorising officer as a party having liability and diffuses responsibilities.

System in force

2.2.50. The system in force is exceedingly complicated. The Commission may delegate its powers to implement the budget (Article 22(4) of the Financial Regulation) subject to the conditions laid down in its internal rules adopted on 20 December 1974¹⁷. Under those provisions, the following are entitled to enter into obligations on the Commission's behalf:

- the Commission itself;
- delegated authorising officers;
- subdelegated authorising officers, provided that they have been empowered to commit expenditure;
- as regards administrative appropriations, the official to whom a delegated or subdelegated authorising officer has given formal permission to sign contracts or purchase orders. In that event, the authorising officer commits the appropriations, and the official signs the contract under the responsibility of the authorising officer and, in so doing, renders himself personally liable with respect to the terms of the contract.

2.2.51. The instrument of delegation sets out clear limits which delegates may not overstep.

The list of authorising officers (650 in 1999) is compiled and updated by DG XIX.

¹⁷ Internal rules on the implementation of the general budget of the European Communities (Commission section).

2.2.52. When, in order to deal with particular budget headings considered politically sensitive (see the example above, points 2.2.4 ff.), the Commission retains the powers normally devolved upon authorising officers, it takes its decision at a meeting, by a written procedure, or by conferring the necessary entitlement on one of its Members. The proposal to be dealt with by one of these three procedures is assessed in an opinion by the Directorates-General or departments concerned and submitted to the Financial Controller for approval. The final decision is taken by the Commission or the Member entitled to act. (If a Member of the Commission has been empowered to act for this purpose, he will decide, and the Commission, having been duly informed, takes note of what is deemed to be its decision. To that extent, the above procedure is different from the procedure of delegating powers to a Member of the Commission). Once the decision has been taken, the expenditure commitment proposal is signed by the head of the managing administrative unit, who may delegate that power. Consequently, when the Commission itself exercises the powers of an authorising officer, it takes the decisions but does not sign the expenditure commitment or the contract, even though the latter is the only instrument establishing rights and obligations.

The Commission may also delegate its powers to one of its Members. In that event, the rules applicable are those governing delegations (see 2.2.53 below).

In the cases referred to above, legal commitment falls under the heading of both political and administrative responsibility. Officials initiate the procedures, examine the documents, and sign the expenditure commitments and contracts. The fundamental decisions are taken by the Commission.

2.2.53. When the Commission delegates responsibility for revenue and expenditure operations as a whole, the only person to whom such powers may be delegated is a Member of the Commission and not a Director-General or head of department, in other words a senior official in charge of the main administrative unit (the Directorate-General) or an independent administrative unit. The person to whom the necessary responsibility has been delegated is empowered to implement the appropriations entered under the budget headings concerned.

2.2.54. Delegates may themselves subdelegate powers to officials in category A or grade B 1 under their authority or to another delegated authorising officer, who may likewise subdelegate the powers to A and B 1 officials under his authority. Irrespective of this possibility, which applies only to Directors-General and heads of department, a person to whom powers have been subdelegated may not transfer those powers in turn.

2.2.55.. At all events, a delegated authorising officer who subdelegates his powers may at any time, even when the instrument of delegation has not been altered, continue to exercise the subdelegated power either on his own initiative or at the request of the subdelegate. A person who has subdelegated powers is consequently not debarred for that reason from exercising his responsibilities.

The above provision enables the powers of authorising officers to be reconciled with the duty of obedience to superiors deriving from Article 21 of the Staff Regulations. When a subdelegate cannot render himself liable in disciplinary and financial terms for an operation ordered by his superiors, he may request the delegated authorising officer to commit the appropriations and conclude the contract in his place. In practice, the delegated authorising officer refrains from assuming liability in such a case, and the matter is shelved.

2.2.56. When he elects to subdelegate his powers, an authorising officer is free to choose any

person in his department in whom he has sufficient confidence. However, because the authority of superiors is exercised in parallel to the powers of authorising officers, subdelegations in practice follow the departmental order of ranking so as to avert conflicts between superiors and subdelegated authorising officers. Many Directors-General deplore a situation that leads them, *de facto*, to subdelegate authorising officer's powers to persons not of their own choosing. Subdelegated authorising officers often regret the fact that their career may depend on a refusal to sign at variance with the wishes of their superiors.

2.2.57. The delegation system should be reorganised and simplified.

Extricating the Commission as a body and its individual Members from the responsibilities of authorising officers

2.2.58. When the Commission exercises the powers of an authorising officer, it releases the administrative hierarchy from all or part of its responsibility, and that state of affairs is unhealthy. It would be preferable in the future if not just the Commission, but also each one of its Members were to refrain from directly exercising an authorising officer's powers. If delegation of powers were to become the standard practice, the Commission and its Members would have no cause to strip officials of their responsibilities, and officials, who are obliged under the Staff Regulations to observe the law, would accordingly take sole responsibility for the matters entrusted to them. Of course, individual Members and the Commission collectively, by virtue of the status attaching to their position, would still be empowered to issue instructions to authorising officers without prejudice to the rights and responsibilities of the appointing authority and would naturally remain politically responsible.

2.2.59. If an authorising officer were to consider that an order was irregular or contrary to the principles of sound financial management, he should state the position in writing. If the Member concerned or, where applicable, the Commission as a whole were to confirm the order in writing, the Commission would plainly assume political responsibility for the matter. By the same token, the official would be released from his responsibility in that connection.

How officials can be led to shoulder responsibility

2.2.60. The subdelegation system should be decentralised to a far greater extent so as to ensure that the party negotiating a contract is the authorising officer or an official ranked closely to him who can communicate directly with him as soon as it becomes necessary to do so.

2.2.61. It should likewise no longer be the case that an authorising officer, by signing an expenditure commitment, renders himself liable in respect of the amount and the identity of the recipient, whereas a more junior official signs the contract and is consequently liable for the instrument constituting the grounds for a compliant.

2.2.62. Once he has formally accepted the powers conferred on him, every delegate should be deemed to have a specific status whereby he would be financially liable in relation to the Community if he were to be guilty of an error or negligence (see Chapter 4), without prejudice to any disciplinary proceedings that might be instituted. Furthermore, the list of authorising officers should be updated in real time, which does not happen at the moment, and circulated widely throughout the Commission.

2.2.63. Authorising officers in the lower grades (A 6, A 7, A 8, and B 1) could perhaps be covered by provisions to protect their independence more effectively or indeed, as far as their career progression was concerned, to offset the responsibilities they exercise and the risks to which they are exposed, not least compared to officials in the same grades who are not authorising officers.

Special interest groups

2.2.64. Although they take the decisions and bear responsibility for the operations, authorising officers and administrators are not the only prime movers in direct management, since they have to contend with the activities of pressure groups. Special interest groups are very strongly represented in Brussels. In addition, some national representatives attempt to exert influence. Furthermore, Members of the European Parliament may approach departments directly, for instance at the request of national pressure groups, with a view to obtaining subsidies. They may also enter remarks in the budget in order to specify the recipient of a subsidy or indeed the amount to be allocated.

There is no cause to challenge the principle of special interest groups. It is their task to influence the legislative activity of the institutions and obtain subsidies. The Commission needs them in order fully to understand the factors to be taken into consideration when dealing with a particular matter.

The Commission's approach to date has been to maintain open relations with special interest groups, without treating any one group differently from the rest. A compulsory accreditation system or registration and codes of conduct have been ruled out. It has been assumed that the sectors concerned are capable of drawing up and ensuring compliance with their own codes of conduct based on the minimum criteria laid down in the communication of 5 March 1993¹⁸.

The Commission has also elected to disseminate information without restrictions. A computer site given over to its relations with special interest groups thus contains all the working tools that officials can use to involve socio-economic circles and representatives of civil society in the legislative procedure. The aim is to encourage officials to consult the circles concerned as a matter of course. The site also includes the codes of conduct of trade unions and professional organisations brought to the Commission's notice.

2.2.66. Experience shows that the above arrangements are not enough. The Commission does not have to regulate special interest groups as such, but should take more binding steps to guarantee transparency. Groups should be required to make a declaration specifying their legal status and financial situation in order to be eligible to attend meetings at which the Commission wishes to consult them on a particular subject. It goes without saying that all groups without exception should invariably be involved in such consultations if they have completed the declaration formalities. Undeclared groups, however, should not be invited to take part. The Commission has to proceed openly when consulting lobbies, and special interest groups must do likewise when dealing with the Commission and consequently make no secret of their legal and financial position. Notice of meetings should be published, and the proceedings recorded in minutes.

¹⁸ OJ C 63, 5.3.1993.

2.2.67. Certain precautions should be taken before permitting undeclared special interest groups to approach Commission departments. Officials should be required to observe an internal Directive governing their contacts with such groups and, within 24 hours, submit a written record of their conversations to their immediate superior. Officials in most departments do so as a matter of routine when they meet politicians or senior officials from Member States. It would make little sense if they were to elude that obligation when dealing with relatively obscure pressure groups.

Management tools

2.2.68. If appropriations are to be managed efficiently, an authorising officer, before awarding a contract or subsidy, must ascertain whether the bidder has had any previous dealings with the Commission, that is to say contracts, whether concluded directly with the bidder or through the intermediary of other companies or organisations, subsidies granted, difficulties encountered, or disputes.

2.2.69. A central database for contracts and contractors should be compiled first and foremost for authorising officers and also for supervisory, auditing, and advisory bodies, which need to have a complete picture. No such database exists at the present time. Whether they are dealing with contracts or subsidies, decision-makers have no overall view of the Commission's activities, so much so that 'the right hand does not know what the left hand is doing'.

The Commission became aware of that fact in the mid-1990s as a result both of the growing volume of disputes and pre-litigation procedures relating to the award or execution of contracts and of mounting criticism from Parliament, the Court of Auditors, and for that matter the Ombudsman (50% of complaints addressed to the Ombudsman relate to problems connected with the Commission's contracting activity).

2.2.70. Since it did not go beyond what was required to ensure compliance with the Financial Regulation, the official SINCOM financial and accounting system did not make for very accurate understanding of the statistics (on the question of subsidies, for example, see 2.2.45).

SINCOM does indeed include a 'third-party file' (i.e. listing persons who have received payments from the Commission), but the file, which is designed to be used to make payments, is based on bank accounts and does not indicate how many contracts the Commission has concluded with a recipient of payments or whether a company owes money to the Commission.

Such information as might be available on the administration of contracts can be obtained only via the local systems operated by the Directorates-General, which interface with SINCOM. By making step-by-step inquiries, it is possible to work a way back to these data, which hinge on the information standard of the local system but are not comparable to those which would be provided by a central database for contracts and contractors.

2.2.71. The CCAM operates its own database, ADAM, a record of all public procurement matters considered since 1993. This database makes for exhaustive analyses because all types of sorting are possible. However, once it has delivered its opinion, the CCAM no longer keeps track of a matter (according to one plan, authorising officers were supposed to input the number of the CCAM opinion concerning each expenditure commitment, but, for cost reasons, this has never been done). It records information on the award of a contract but

plays no role in the financial and accounting procedure related to its execution. The ADAM database consequently offers little help to non-CCAM users.

2.2.72. The fact that there is no central database has gradually led to numerous difficulties for the Commission. In the first place, legal proceedings in which the Commission is involved are considerably more complicated to handle. Secondly, the Commission cannot respond quickly or efficiently to problems connected with a contract, as the committee discovered in its various investigations for its first report when it encountered difficulties in identifying the total number of contracts concluded with a given company by the different departments. Finally, the lack of a central database reduces the likelihood of bringing about organised solutions to recurrent problems arising from the award and execution of contracts, since overall assessment becomes more difficult and 'good practice' cannot, therefore, be so readily disseminated.

2.2.73. In 1997 the Commission, mindful of this state of affairs, set up a computerised Early Warning System (EWS), based on the SINCOM third-party file and designed to be consulted at the earliest possible stage of the pre-contract procedure (calls for expression of interest or invitations to tender)¹⁹. The system is intended to identify actual or potential recipients of Community moneys who could legally be excluded under the public procurement Directives either because they have been mentioned in the findings of investigations by UCLAF, the financial control departments, or the Court of Auditors, or because they are parties involved in legal proceedings or liable under recovery orders issued by the Commission.

The fact of being identified by the EWS (at any rate in the three cases referred to above) does not necessarily debar a recipient from having dealings with the Commission. On the other hand, the department intending to enter into a contract with that recipient will be more likely to take precautions, for instance by making enquiries to the Directorate-General which entered the relevant details in the system. The EWS is a useful initiative, but no substitute for the indispensable back-up tool for contract policy that would be provided by a database for contracts/contractors.

2.2.74. Following on from 'SEM 2000' and in conjunction with the new 'Central Contracts Unit', which will be discussed below (2.2.78), the Commission has decided in principle to compile a contract register (a register of standard contracts will be compiled first) and process contractors in great detail (monitoring of company mergers, newly established subsidiaries, changes of name, etc.) by setting up a contractor register, again based on the third-party file but which, as well as being used for payment purposes, as is presently the case, could also be used for the purposes of commitments.

However, more than three years have passed since that decision was taken, and it has proved impossible, on account of the numerous technical difficulties and the huge development costs of the SINCOM II system, for the projected combined third-party/contracts/contractors file to be put into operation.

2.2.75. One alternative to consider, therefore, is expansion of the CCAM's ADAM database. The development project already begun, ADAM module 2, was initially intended purely to ascertain whether the Commission should make use of external studies²⁰. There is no reason

¹⁹ Communication SEC(97)1562 of 30 July 1997.

²⁰ ADAM 2 has replaced CERES, the centralised database run by DG XIX, which has never worked well, because the information it contained depended on the goodwill of the authorising departments. The second

why the same method should not be used to process information about other types of contracts (consultants and subsidies), apart from the difficulty of 'interfacing' such a database with the SINCOM II system²¹. To guarantee success, the discussion must be pursued in cooperation with the authorising officers, the only sources capable of loading the central system.

Advice to authorising officers

2.2.76. Advice to authorising officers is clearly a corner-stone of the direct contract management system, in which the committee includes all subsidies requiring the recipient in return to render services of direct use to the Commission in the performance of its tasks.

2.2.77. The committee believes the above point to be especially important because this report is endeavouring above all to lay emphasis on the concepts of transparency and responsibility. In return for the transparency and responsibility which they have to bring to bear, authorising officers are entitled to a high standard of technical assistance at all times.

Central Contracts Unit

2.2.78. To maintain control over and harmonise its contracting activity and in conjunction with its decision to equip itself with a central database for contracts and contractors, the Commission has set up a new unit within DG XIX, the Central Contracts Unit.

2.2.79. This unit, currently in the process of organisation, will act as a channel of contact between the Legal Service, the financial control departments, and the CCAM. Its task is to identify consistent categories of contracts in order to establish a more accurate typology, standardise contracting practices, and encourage authorising departments to use standard contracts in as systematic a way as possible. The Central Contracts Unit should also provide specific assistance to authorising officers, in particular when they wish to draw up more specialised contracts, and compile a register of standard contracts with a view to developing the contract/contractor database.

2.2.80. The Central Contracts Unit has no supervisory or advisory power and no seat on the CCAM. To perform its role of bringing coherence to contracting activity, it will have to rely on the other departments and wait to be consulted: public procurement matters are not automatically referred to it, and it has no power to deliver opinions on its own initiative. To offset this relative remoteness from the subject with which it is supposed to deal, it should either anticipate departmental needs, and its staff complement would accordingly have to be increased to enable it to do so, or computerise the drafting of contracts so that authorising officers would be obliged to follow the prescribed models or else would have to consult the unit if they wished to depart from them. However, the existing management tools would have

module, grafted on in 1997, enables the ADAM database to record all research contracts, including those which, because their value falls below the mandatory threshold, do not have to be referred to the CCAM, and to pool together all useful references ('local' reference in ADAM 2, CCAM number, number of the CCAM decision) and essential qualitative information.

²¹ It would be essential to provide the interface because there is virtually no prospect that data could be entered into a database of this kind in a systematic and reliable way if the database were separated from the financial flows generated by execution of contracts. Unfortunately, an interface is difficult to achieve on account of the technical problem of defining budget commitment references in SINCOM II.

to afford the opportunities for the unit to proceed in that way. The committee's proposed solutions to this problem are discussed below (2.2.97 and 98).

Advisory Committee on Procurements and Contracts (CCAM)

2.2.81. The CCAM performs a dual supervisory and advisory role. To enable it to exercise the supervision that it is required to provide, it has to deliver an opinion, before the authorising officer takes his decision, on all draft works, supply, or service contracts, including research contracts, worth not less than EUR 46 000. This threshold is extremely low, but a higher value applies where contracts are to be concluded by the Joint Research Centre.

2.2.82. All subsidies, by definition, fall outside its terms of reference, as do contracts worth less than the threshold value necessitating an opinion and those covered by Title IX of the Financial Regulation ('Special provisions applicable to external aid'), with the exception of service contracts 'awarded in the interests of the Commission' (Article 119 of the Financial Regulation). It is legitimate to ask what kind of contracts might not be awarded in the interests of the Commission, since, by nature, every contract implies that the Commission will derive some form of benefit in return for the amount disbursed. This example is indicative of the depths of inanity plumbed by certain definitions which have recently gained currency in the Community.

Even though it is impossible in practice to distinguish between service contracts awarded in the interests of the Commission and those awarded in the interests of a recipient of funds, the Commission nevertheless decided in 1988 that all contracts relating to technical assistance offices²² would be submitted to the CCAM.

2.2.83. The opinions of the CCAM relate to the question whether the procedure followed is in accordance with the provisions applicable, the selection of the proposed successful bidder, and, in general, the conditions specified for the award of contracts.

The CCAM is called upon to ascertain that the projected expenditure is not out of proportion to the aims being sought and that those aims cannot be achieved at less cost. It is therefore entitled, if not to say whether a contract should be awarded, then at least to consider whether the measures proposed are economically the most appropriate to attain the appointed objective. In general terms, it seeks to ensure that the rules for putting projects up for tender are applied in such a way as to make for transparency in the proceedings and treat all bidders equally.

2.2.84. CCAM opinions are of a purely advisory nature: they do not in themselves constitute any form of veto. Even if, in practice, an authorising officer withdraws his project, when he continues the procedure and submits the project to the Financial Controller, the latter quite often adduces the views of the CCAM in support of his refusal of approval. Furthermore, there have been a great many cases in which the Financial Controller has withheld his approval whereas the CCAM has delivered a favourable opinion.

Under the Financial Regulation and the implementing rules, the CCAM is required in addition to play an advisory role. It may thus be called upon to deliver an opinion, at the request of the appropriate authorising officer or one of his staff, on especially important or highly specific projects put up for tender, matters arising from the award or execution of contracts (cancellation of orders, requests for remission of penalties for late fulfilment of obligations,

²² At this point the term 'technical assistance office' accordingly needs to be defined (see section 2.3 below). It would have been preferable if the CCAM had been called upon to consider technical assistance contracts or simply project managership contracts (a contract regrettably unknown to the Commission).

exceptions to the terms and conditions set out in the contract documents), or contracts falling below the opinion threshold that raise questions of principle (Article 68 of the implementing rules). This advisory role is not very extensive in practice and confined mainly to procedural matters.

2.2.85. Although, under Article 112 of the implementing rules, the CCAM may exercise wide-ranging powers in its advisory capacity and, for example, conduct investigations or instruct other parties to do so, its activities tend to be confined to modest proportions. In conjunction with its opinions it makes recommendations on specific points and distributes circulars to authorising officers on matters arising from contracts, for instance to alert them to problems posed by conflicts and delegation of the tasks of public authorities and contractors. It ceased some years ago to put forward recommendations to the Commission, and its annual report, addressed to the Commission, does not refer directly to the Commission's contract policy.

Membership and operation of the CCAM

2.2.86. Article 64 of the Financial Regulation stipulates that the CCAM must include at least one representative of the department responsible for overall administration, a representative of the department responsible for finance, and a representative of the department responsible for legal matters. In addition, a representative of the Financial Controller attends meetings as an observer. Those provisions apart, membership decisions rest with the Commission. At present, the CCAM consists in theory of ten members, mostly in grade A 2, representing the Directorate-General for Personnel and Administration (DG IX), the Legal Service, the Directorate-General for Budgets (DG XIX), the Directorate-General for the Internal Market and Financial Services (DG XV), the Directorate-General for Competition (DG IV), the Directorate-General for Industry (DG III), the Joint Service for the Management of Community Aid to Non-Member Countries (SCR), the Publications Office, and the Statistical Office. The chairmanship is held by the Directorate-General for Budgets, represented by a Deputy Director-General.

Each DG or unit represented on the CCAM also appoints a substitute. With the exception of the chairman, those who serve on the CCAM are in fact substitutes. They occupy much more junior positions than the full members and are sometimes employed under temporary contracts. They change from one year and one meeting to the next. This regrettable practice scarcely fosters a sense of cohesion and responsibility within the committee and detracts from the standard and status to which the committee's opinions should aspire.

2.2.87. The Commission's explanation for the situation is indicative of a decline in the role of the CCAM. The Commission maintains that, because the public procurement Directives have been adopted, it is acceptable to make use of substitutes, or even substitutes for substitutes, since their attendance suffices for the 'routine' implementation, as it were, of now perfect rules. Moreover, because an increasing number of matters are submitted for consideration, the workload of a member of the CCAM is too heavy to be assumed by senior officials.

2.2.88. Each CCAM representative is appointed for a given year to report on matters originating from a DG other than his own. Committee offices rotate every year.

2.2.89. The CCAM is assisted by a secretariat comprising six officials, including two in category A. The Deputy Director-General who chairs it devotes much of his work to

committee activities. Apart from providing assistance, the secretariat advises authorising departments, especially when contract documents are being drawn up, and arranges their training.

2.2.90. Before each full meeting, a preparatory working party examines all the reports tabled and proposes that they be adopted as 'A' items, without debate, or considered at the meeting ('B' items). The working party consists of members and substitutes from the Directorates-General represented on the CCAM.

2.2.91. The CCAM meets about once a month (13 times in 1997). Meeting days are very long (from 9 a.m. to 8 p.m. or indeed 10 p.m. or later). Opinions are delivered by a simple majority, and the chairman has a casting vote in the event of a tie. Individual votes are not recorded in the minutes, and CCAM proceedings are secret.

2.2.92. According to its annual reports, 914 matters were placed on the agenda in 1996, in other words 100 matters per meeting, and 1 014 in 1997, or 78 per meeting. The number of matters treated as A items was 560 in 1996 and 533 in 1997. As a result, 354 contracts in 1996 and 481 in 1997 were, in theory, considered in detail. On average, 39 matters were considered at each meeting in 1996, and 37 in 1987, but the average figure is meaningless because, on account of budget annuality, most matters are dealt with at the end of the year. In 1997, for example, the CCAM dealt with as many as 72 B items at a single meeting, giving a total of five to ten an hour. Under those circumstances, thorough consideration, dialogue with the departments responsible for contracts, and education become complete impossibilities.

2.2.93. Each matter is the subject of an opinion which may give endorsement, sometimes coupled with a recommendation for forthcoming contracts or qualified by reservations, in which case the department concerned is called upon to alter certain points in the draft contract, more often than not in consultation with the Legal Service, suspend judgment until the authorising officer has supplied further information, or advocate rejection. Explanatory statements attached to opinions, which are sometimes not produced, are frequently brief or vaguely worded.

In 1997 the CCAM delivered 912 favourable opinions and 27 unfavourable opinions. In 42 cases the authorising officer withdrew a draft contract while the procedure was in progress, for the most part to avoid an unfavourable opinion.

Out of the 912 favourable opinions, 24% related to studies or consultancy contracts. Consequently, only 23.5% of the matters submitted for consideration were sensitive issues (research and consultants) giving rise to difficulties. A total of 643 contracts were concluded after the project had been put up for tender, and 274 were concluded by the negotiated procedure.

2.2.94. To obtain a favourable opinion, a department has to wait for about three weeks to a month, when the matter poses no problems, and two months if it raises difficulties. The time required is invariably the same, regardless of the classification by the preparatory working party, in spite of the fact A items have virtually no prospect of being considered by the CCAM, which cannot even manage to deal properly with all of the matters classed as B items. Furthermore, as mentioned above, a favourable opinion does not guarantee that the Financial Controller will give his approval, bearing in mind that he observes different criteria from the CCAM.

Should the CCAM be abolished?

2.2.95. The CCAM has gradually confined itself to the role of junior inspector (checking the date and content of publications, compliance with time-limits, proper observance of the criteria for selecting bidders and awarding contracts, and so forth). It endorsed most of the service contracts which have recently been called into question. It is legitimate to ask whether rapporteurs are in a position (in terms of time, expertise, and independence, not least in relation to superiors) to subject the matters under their responsibility to accurate scrutiny.

2.2.96. Given that it slows down contracting procedures and the value added that it generates is not always plain to see, the CCAM could conceivably be abolished.

2.2.97. On the other hand, if the CCAM were to be abolished, Commission authorising officers would no longer be able to seek enlightened advice from colleagues having an overall picture of contract policy which the Contracts Unit in its present form cannot replace.

20. In fact, the Central Contracts Unit needs the CCAM and should use it to resolve its specific problem (see 2.2.71).

2.2.98. The CCAM must therefore be reorganised. Its full members should be Directors or Directors-General, and their substitutes, officials in grades A 3 to A 6, as a minimum, selected on account of their authority, individual skills, and independence in relation to their superiors when performing their duties. The membership should be reduced to one representative of the Legal Service, one or two members of the Contracts Unit (DG XIX), and a representative of the Secretariat-General. Their operational expertise should be matched by an equal number of authorising officers chosen on the basis of their experience and administrative position in DGs very actively involved in public procurement.

2.2.99. Independent rapporteurs should be appointed, where appropriate former officials on a list to be compiled by the chairman of the CCAM. This point is important because the current arrangement does not guarantee the independence of rapporteurs in relation to fellow rapporteurs.

2.2.100. Given that members themselves should attend meetings, the organisation of CCAM business should be changed. Instead of considering about fifty contracts per meeting, at an average speed of ten an hour(!), the CCAM should examine three or four, selected either because they could serve as examples and material for case-studies or because they might be of use for an individually tailored consultation policy. Opinion thresholds should be increased substantially, and distinctions made according to the types of contracts. Intellectual service contracts and in particular project management contracts should be considered with special care. The threshold for normal supply and service contracts could be raised to EUR 3 m, whereas the threshold for intellectual service contracts – apart from project management contracts – could be set at the lower level of EUR 100 000. All project management contracts (TAOs) should continue to be submitted to the CCAM, as is the case at present.

2.2.101. Higher thresholds would not remove the need for selection, since the number of contracts submitted to the CCAM would still be very high. The selection should be made not by the preparatory working party, which should be abolished, but by the chairman of the CCAM, acting under his own responsibility and assisted by a secretariat whose staff complement could to some extent be increased. Projects not selected by the chairman to be considered by the CCAM would instantly be ‘jettisoned’ so as to avoid needless. If

necessary, the CCAM should in addition be split into specialist sections according to the types of contracts. The matters which the CCAM should be called upon to consider for the purpose of delivering an opinion should not exceed a hundred a year.

2.2.102. Any authorising officer who so wished should be permitted to ask the CCAM to consider a draft contract under an accelerated procedure, if the contract has not been selected. Responsible authorising officers ought to understand, however, that they would be given little credit if they were to make such requests too frequently.

2.2.103. To preserve the independence of committee members, the confidentiality of CCAM proceedings should be very carefully protected. Its opinions, on the other hand, should be supported by detailed statements of reasons and distributed as a matter of course to all authorising officers.

2.2.104. The reforms advocated would enable the CCAM to revert to the spirit of the role assigned to it by the legislative authority and, aided by the resulting synergy, combine with the Central Contracts Unit to form a consultative focal point offering practical experience, overall vision, and hence the necessary authority to help authorising officers and guide the Commission's contract policy, not least by refining the typology of contracts to gear them to new needs.

2.3 Contracting-out of Commission tasks

2.3.1. The Commission will in future have a huge number of tasks to perform, the temporary and specialised nature of which requires them to be contracted out - subcontracting being justified on the grounds of efficiency, expediency and cost. It may be noted that recourse to technical assistance on the part of the Commission has never been challenged either by Parliament or by the Council.

2.3.2. In practical terms the concept of technical assistance (or, rather, technical and administrative assistance) covers a very varied range of tasks relating to the running of a Community programme or initiative, all of which are possible candidates for contracting out: for example, the dissemination of information concerning the programme in question, the collection and processing of data, the performance of checks to ensure that work has been paid for, the preparation of payments (administrative assistance tasks), the assessment of the technical soundness of tenders submitted, the provision of an operational interface between the authorities of third countries and the Community, the organisation of conferences and seminars, and the carrying out of checks on, and assessments of, the progress made in the implementation of the programme (technical assistance tasks). This list is by no means exhaustive²³.

2.3.3. The fact that such tasks are carried out in such close proximity to the Commission's activities as a public authority and the major likelihood that conflicts of interest could occur would have justified the performance of very careful checks on the subcontracts concluded. Quite the opposite has occurred, since the way in which those subcontracts have been carried out has highlighted the most disturbing aspects of the Commission's contractual practices: arbitrariness in budget entry, poor understanding of the rules governing the

²³ In accordance with the description contained in the Inspectorate-General's report on the inquiry into the Commission's use of technical assistance offices, 4 February 1998. See Annex III.

conclusion of contracts, a dilution within the hierarchical chain of the responsibility of authorising officers and a poor standard of advice and monitoring from the centre. All of the weaknesses described earlier concerning the Commission's direct management system were graphically illustrated during the 1990s by the TAOs (Technical Assistance Offices), some of which have recently featured in news reports concerning Community affairs²⁴.

What are TAOs?

2.3.4. The first report made the point that 'As may be seen from several of the files discussed in this report, the concept of having European public programmes implemented by private contractors needs to be carefully considered and managed²⁵'. A TAO is in practice nothing more than a Commission contractor. It is not its status vis-à-vis the Commission or its legal form (which may vary: non-profit-making body, university, private company, etc.) which makes it a TAO but, rather, the substance of the contract which it concludes with the Commission: a contract for the contracting out by the Commission of some or all of the tasks involved in the implementation of a programme for which the Commission is responsible.

2.3.5. It would therefore be artificial to seek a generic definition of a TAO as a structure – a point made by the Inspectorate-General (I-G) in the introduction to its 1998 report²⁶: '[at the Commission] there is no single definition of the term Technical Assistance Office'. Many definitions are possible, depending on the conventions within which a definition is sought. Hence the I-G report considers only TAOs taking the form of legal persons providing technical assistance to the Commission itself (and not to the programme's beneficiaries) over a period exceeding one year in duration and by means of outside human resources. However, although the guide to technical assistance offices which is being prepared under the leadership of DG XIX (see above) maintains the concept of outside service provision as a criterion for identifying a TAO, it takes the view that the term covers not only assistance provided solely to the Commission but also assistance provided to the mutual advantage of the Commission and the beneficiaries of Community programmes. (Assistance provided solely for the beneficiaries of Community programmes was deemed to be outside the scope of the guide.)

2.3.6. Presentation of technical assistance from the point of view of TAOs is not only artificial but also deceptive, since the administrative status which is conferred on them tends to divert attention from the essential consideration, namely the legal act (often poorly monitored) represented by the conclusion of a public contract for the provision of services. Furthermore, such a presentation makes it impossible for technical and administrative assistance, which may take a variety of forms, to be managed in a comprehensive fashion.

2.3.7. In the light of the above it is not surprising that caution should be exercised when assessing the extent of such assistance. For 1996 the I-G listed 51 TAOs involved in 45 Community programmes or initiatives, employing 653 persons from outside the Commission at a cost of approximately ECU 80 million and responsible for administering appropriations totalling ECU 270 million. However, a later assessment²⁷ based on a different method estimated that TAOs represented the equivalent of approximately 1000 men per year costing a

²⁴ First report by the CIE: ARTM (MED programmes) – paragraphs 3.1.1. to 3.8.4, AGENOR (Leonardo programme) – paragraphs 5.1.1. to 5.8.7. in particular

²⁵ First report by the CIE, paragraph 5.8.1.

²⁶ *op.cit.*

²⁷ Inquiry into the use of outside technical and administrative assistance by the Commission; memo dated 30 November 1998. This document also details the TAOs by DG; see Annex IV.

total of approximately 190 million euros (although technical and administrative assistance provided from sources other than TAOs represented the equivalent of 710 men per year at a total cost of 64 million euros).

2.3.8. Be that as it may, technical and administrative assistance is extensively used and the increase in such use during the 1990s is due to a combination of factors:

- the application to the EU budget, as part of the convergence process leading to the establishment of a single currency, of a degree of austerity similar to that applied to the Member States' domestic budgets. This austerity has most severely affected administrative expenditure, with the effect that departments have tended to compensate by making increased use of technical assistance financed from operational headings;
- a major increase in the Commission's management tasks, stemming from the implementation of numerous multi-annual programmes relating both to internal policies (Leonardo, Socrates, Media, Raphaël, Kaleidoscope, Ariane) and to external activities (Phare, Tacis, Meda), an increase which the Commission has been unable to cope with adequately by means of measures to redeploy the available resources;
- emphasis on the objective of implementing the various programmes, particularly in the case of the European Parliament which has sought to link the allocation of further appropriations to the satisfactory implementation (in quantitative terms) of the appropriations relating to previous years.

2.3.9. Irrespective of the extent of the assistance provided, analysis reveals in particular significant differences between TAOs as regards the DGs which use their services, the source of their budget funding (either Part A or Part B), the average cost of a job in a TAO (ranging from ECU 14 420 to 214 000), the nature of the services provided (see below), the checks carried out by the Commission on the activities of its fellow contractors, the share of the appropriations allocated to a Community programme which passes through the hands of the TAO (between 6% and 90%), etc.

Difficulties associated with using TAOs

2.3.10 Using TAOs first of all raises the question of where to draw the dividing line between Commission tasks which can be subcontracted without any risk to the public service (and even with certain benefits in terms of efficiency) and those in respect of which the Commission would be abandoning its responsibilities if it were to delegate them to private companies. Within the Commission it is customary for the latter category of tasks to be described as 'public-authority tasks'²⁸ and it is agreed that they should not be entrusted to outside staff. This at least is what was 'recommended' in a 1997 staff memo from the Secretary-General²⁹ which, under the pretext of laying down minimal rules (vague and non-binding into the bargain), surreptitiously legitimised TAOs. In the absence of any other directive³⁰, of bodies to advise and assist Commission staff and of any system for disseminating sound practices (shortcomings which were openly condemned in the I-G

²⁸ In other words, public-service tasks which cannot be entrusted to the providers of technical assistance.

²⁹ SEC(97) 1542 of 30 July 1997

³⁰ Other than a single vague definition in the 1994 Code of Conduct relating to the use of outside personnel: 'These tasks include in particular duties relating to the representation, the negotiation, the monitoring and the observance of Community law'.

report), TAOs were entrusted with tasks such as checking and paying for work, managing contracts concluded with the final beneficiaries of Community initiatives and assessing tenders.

2.3.11 The development of the TAOs has brought to light the frequent failings and the extremely diverse nature of the Commission's contractual practices, as illustrated by the care taken with the drawing up of tender specifications, the introduction of schemes for checking on the resources used by TAOs in implementing their contracts, the concern to avoid the repeated use of certain TAOs so as to prevent them from becoming privileged partners of the Commission, the selection of the procedure for the conclusion of service contracts, and the criteria for the awarding of such contracts and the role of the CCAM (a body which was aware that things were going awry but which had no real power to intervene).

2.3.12. Furthermore, the use of TAOs has highlighted the unsuitability of the budgetary framework (see section 2.1.5 above). The restrictions on the appropriations allocated to administrative expenditure had led from a very early stage to the financing of such expenditure from operational headings in the form of 'mini-budgets', in blatant contravention of the rules laid down in the Financial Regulation concerning the entry of resources into the budget. Following criticism of the matter by the budgetary authority the mini-budgets were progressively absorbed from the 1993 budget onwards, the corresponding appropriations were 'repatriated' to Part A and at the same time 'converted into jobs' (1830 jobs created) and new rules on the entry of resources into the budget were issued. However, those rules, which were based on vague definitions and were accompanied by numerous exceptions, did nothing to ensure transparency and by their very wording they laid themselves open to circumvention: in particular they allowed the appropriations intended to cover the cost of technical assistance to be entered in different parts of the budget according to the identity of the 'beneficiaries' of that assistance (Commission or third countries). Hence the rules in no way prevented further operating appropriations from being entered in Part B: back in 1996 the Commission indicated that it needed extra staff on account of the Phare and Tacis programmes and the funding was drawn once again from both Part A and Part B (the 'Liikanen facility'). At no point did the Council, Parliament or the Commission take the extent of the problem seriously.

The Commission's response

2.3.13 Although as early as 1993 an I-G report condemned the risks inherent in subcontracting the running of Community programmes to private bodies³¹, although (apart from the abolition of mini budgets) the Financial Regulation continued to be constantly infringed and although spectacular reforms relating to structures (SEM 2000) and the staff (MAP 2000) were announced, the TAOs continued to develop with impunity, the Commission reacting only belatedly and half-heartedly.

2.3.14 A guide is currently being drawn up, the principles of which were adopted by the resigning Commission at its meeting of 22 June 1999. The guidelines it contains are certainly an improvement over the vacuum which they have replaced. As a response to the problems described above they are, however, incomplete and insufficient. In the first place the very idea of issuing a guide to TAOs is based on an error of analysis. It has already been pointed out

³¹ IG report on private bodies, 11 March 1993: risks to the Commission's image; financial risks; risk of conflict of interest for officials (in the event of service provision which is not in accordance with the requirements of contracts); risk of deviation from financial procedures; risks relating to the establishment of special permanent links with certain service providers; risk of unfair competition.

that TAOs do not constitute a legal category which can be defined other than by means of the contractual relationship between them and the Commission. It is therefore this contractual relationship which needs to be analysed and firmly regulated, as stated above. Behind every TAO there is a contract. Why has the Commission failed for so long to recognise this fact, thereby losing control over technical assistance? Because the Financial Regulation has never adequately spelt out the law on contracts and in particular it does not allow for the special nature of contracts covering intellectual services and especially, within such contracts, the concepts of technical assistance and project management.

2.3.15 Furthermore, the proposed guidelines are not sufficiently firm as regards the essential issue of the tasks which TAOs may not carry out on the grounds that they are constituent parts of the 'hard core' of public service duties which should not be delegated under any contract. If, for example, a contract delegates the examination of files to a TAO, the Commission's power to approve applications for funding is merely a token one.

2.3.16. Doubt may be expressed regarding the wisdom of setting up a TAO monitoring agency within DG XIX, as mentioned in the guide. Central monitoring is certainly essential but responsibility for the task could surely be given to the Central Contracts Unit which works closely with the CCAM secretariat (see paragraph 2.2.78 et seq). The Commission tends to set up one unit after another in order to create a good impression, but in so doing it runs the risk of making them redundant or of creating rivalry between them.

2.3.17. The guide perpetuates the questionable distinction between TAOs based on the kind of beneficiary they serve in order to justify the entry of the appropriations relating to some of them in Part B of the budget. This constitutes an infringement of the Financial Regulation which once again demonstrates the obsolescence thereof (see section 2.1). At least the guide takes note of the three conditions laid down by the budgetary authority which have to be met if the funding for TAOs which 'provide assistance in the mutual interest of the Commission and the beneficiaries of Community programmes or actions' is to be entered in Part B: appropriate authorisation of the legal basis, a reference in the budget remark relating to the programme concerned and an indication of an annual ceiling on TAO-related expenditure.

Better contracting-out

2.3.18. Any planned new action or programme adopted by the legislative and budgetary authority should be assessed in advance from the point of view of the resources needed for it to be implemented.

Stricter contracts

2.3.19. To start with there must be improved monitoring of the conclusion and implementation of contracts in accordance with the following principles: public service responsibilities must never be entrusted to TAOs; TAOs must be used only if they represent the most economic way of having specific tasks carried out; an appropriate system based in particular on an internal audit department, the establishment of which is recommended in Chapter 5 of this report, must be devised for the purpose of overseeing and monitoring all their activities; conflicts of interest must be avoided; the cost of TAOs may be funded from Part B of the budget only if the agreement of the budgetary authority is secured. The difficulty lies entirely in determining what constitutes public service responsibilities and in this respect there is a considerable gap between principle and reality.

2.3.20. A case in point is one in which a contractor, on behalf of the Commission and on the basis of a number of separate contracts concluded with different Directorates-General, performs a range of precise tasks which can be clearly specified. In such a case, no objection can be raised if each of the DGs concerned deals individually with the TAO, which acts as a multiple service provider.

2.3.21. Things are very different when it comes to contracting out an integrated set of indissociable tasks (or, at least, a set of measures) with a view to implementing a programme on a permanent basis. In such a case a contractual arrangement comes up against three limitations:

- It presumes that the substance of a contract can be perfectly defined in the contract specifications whereas, in practice, although a thorough analysis may be sufficient in many cases, there will still be others in which neither the precise result to be expected from the technical assistance nor the actual resources needed for that assistance to be provided can be known in advance.
- It supposes that the distinction between public-authority tasks and other, non-public-authority tasks can always be translated into organisational terms, so that the former can be reserved for the Commission and the latter delegated to the providers of technical assistance. Simple clerical tasks such as, for example, information dissemination or data processing, may fall within the public authority domain if they cannot be separated from the exercise of powers of assessment. On the other hand, high-level tasks may call for specific skills which are more likely to be found in the private sector than within the Commission (implementation of a tourism promotion programme, for example).
- Subjecting TAOs to the tighter discipline of a more binding contract is no substitute for the daily monitoring which may in certain cases be necessary, particularly where the management of major projects relating to the implementation of an entire large-scale Community programme is concerned.

2.3.22. In the above case, improved monitoring of contracts may not be sufficient to ensure that the Commission has satisfactory control over the tasks which are contracted out. Consideration should therefore be given to the various ways which could enable the Commission, acting under its own responsibility, to entrust them to external bodies (existing or to be created) which it could monitor effectively.

Recourse to private bodies

2.3.23. Recourse to non-profit-making bodies is not a generally acceptable arrangement since conflicts of interest would be inevitable if such bodies were to be set up by Commission officials acting in an individual capacity or by persons close to such officials. Furthermore, those officials could be accused of using a non-profit-making body to circumvent the provisions of the Financial Regulation and the requirements imposed by the principle of transparency.

2.3.24. This does not of course apply in cases where the non-profit-making body, rather than being an artificial construction, is a credible entity capable of existing independently and having a large number of members, genuinely active social sections and a humanitarian (or at least disinterested) social purpose. In such a situation, either the body in question has a range

of perfectly acceptable contractual links with the Commission (see 2.3.20 above), or the service provision is restricted to a single supply and is not subject to contract (see 2.3.21 above), and the non-profit-making formula is inappropriate.

2.3.25. The involvement of the Commission in private companies which it would monitor in its capacity as majority (even sole) shareholder is an alternative to be considered. It has certain attractive features such as a definite legal framework and well-structured management bodies, but also the flexibility characteristic of the private sector, particularly as regards staff recruitment.

2.3.26. However, setting up such companies would be cumbersome since the Commission would be unable to secure the funds needed for the requisite capital to be constituted without obtaining the budgetary authority's consent. Furthermore, its decision-making and supervisory powers within the company would be subject to the provisions of national company law (as regards the secondment of officials, the powers of the internal audit department referred to in chapter 5 of this report, the removal of the chairman and managing director, etc.). Successful contracting out of certain Commission tasks by this means calls for a skilful balancing act. On the one hand, if the company concerned is dependent on the Commission for its survival, this could distort competition in the sector and give rise to conflicts of interest. On the other hand, if the company has a range of customers the Commission would be required, as a shareholder, to assume commercial responsibilities which lie outside its field and which would be a distraction from its desired objective, namely to concentrate on its public service tasks.

Implementing agencies

2.3.27. As has already been done in certain Commission departments³², consideration should therefore be given to securing access to technical assistance through the development of new Community legal structures which could be described as 'Commission executive agencies'. In putting forward this suggestion the Committee would straight away point out the need to avoid various stumbling blocks which have already been encountered in the past:

- The Commission should not be surrounded by the type of agencies which currently exist: these, far from providing a means of more flexible management enabling the Commission to tap skills which it lacks internally but which are present in the private sector, represent permanent structures within which the Commission's management powers are undermined by the Member States (which sit on the governing bodies). In addition they are very cumbersome to set up on account of the requirement for a unanimous Council decision and they are often monitored less stringently as regards the setting and the implementation of their budget.
- Any risk of creating permanent bodies should be avoided by insisting that Commission executive agencies should be set up only if specific, temporary needs (relating to the implementation of a programme) have been identified.

³² Contradictory response from DG IX to the IG inspection report on TAOs, memo 0367 of 3 February 1998 from Director-General IX; memo 0200 of 25 January 1999 from Director-General IX on European Programme Implementation Offices, etc. A reference to these considerations may be found in paragraph 7.2.3.2 of the DECODE report.

2.3.28. An appropriate solution could therefore be to use implementing agencies having a distinct legal personality and financial autonomy. A framework regulation based on Article 308 (ex Article 235) of the Treaty and adopted by the legislative authority would establish the conditions and the arrangements for the setting up of such agencies, to which the Commission would resort on a case-by-case basis.

2.3.29. The implementing agencies would make it possible for officials seconded in order to perform certain strategic tasks (general running, book-keeping, legal services) within the agency to be combined in a pragmatic fashion with staff from the private sector who would carry out clerical duties or specialist tasks directly related to the nature of the agency and the programme. Under no circumstances should temporary or auxiliary staff recruited under the Community rules relating to other servants be on the staff of an agency. The risk of creating a permanent body would be avoided if the agency were established, and the private staff recruited, solely for the duration of the programme for which it had been set up.

2.3.30. The establishment of agencies should not lead to any increase in the size of the Commission's permanent staff, i.e. in the number of officials. The on-going nature of the Commission's tasks requires it to have officials who have received a generalist training (in the legal, economic and financial spheres), whilst in order to meet specific, temporary needs it may have to call on the skills of specialist workers, the permanent recruitment of whom is not desirable. Certain TAO employees who are replaced by agencies could of course obtain an employment contract with those agencies on an individual basis.

2.3.31. In the light of the above comments the Committee therefore encourages the Commission to give greater consideration to the establishment of a 'new category of bodies based on Community law'. In so doing it must insist on issuing the following warning: although using executive agencies would make Commission management more flexible and would obviate the need for idle discussions concerning what falls into the public authority category and what does not, a distinction would still have to be made between political missions and management tasks: there can be no question of delegating the **political** aspects of Community action to agencies.

2.4. Recommendations

A genuine contracting philosophy, a remodelled legislative, regulatory, and budgetary frame of reference, and greater responsibility entrusted to authorising officers should help to restore order to the Commission's management, in which the most disturbing anomalies have been brought to light by the TAO phenomenon.

2.4.1 The Commission should treat contracts as a whole as a priority in their own right in order to make for the utmost transparency. Instructions should be laid down and proper training provided. Community public procurement law is marred by a jumble of disparate source texts. Its codification is a matter to be studied, without seeking to overregulate, but rather to achieve rationalisation to facilitate the work of practitioners (see 2.1.17).

2.4.2. Given that it is not suited to the requirements of modern management and effective supervision, the Financial Regulation is in need of fundamental revision. In any event, it should form part of a clear-cut hierarchy of Community acts and be confined to the essential principles which all institutions must observe. As regards the details, it should make reference to specific rules applying to each institution (see Chapter 2 as a whole).

2.4.3. Conclusion of a contract – following an invitation to tender or by a negotiated procedure – funding of a project under the heading of external aid, or award of a subsidy are different forms of disbursement of Community moneys. The Financial Regulation should accordingly lay down the basic rules to be observed by all institutions, namely transparent decision-making, non-discrimination, and *ex post* assessment of use, and dispel the fundamental confusion as regards contracts. The concept of a contract and the different types of contracts should be spelled out (see 2.1.21 ff.).

2.4.4 The present budget nomenclature, based on the distinction necessitated by the Financial Regulation between Part A (administrative expenditure) and Part B (operating expenditure) is impracticable. It is frequently circumvented when appropriations are earmarked under the budget. A nomenclature based on policies whereby the aggregate cost of the latter would be specified and the various expenditure assigned for a given purpose would be identified according to its nature must be established in order to facilitate assessment and enable the budgetary authority to exercise complete supervision (see 2.1.15 to 2.1.19).

2.4.5 Expenditure under the heading of cooperation with non-member countries is at present a self-contained, chaotic area, given the numerous and diverse legal rules by which it is governed. The principles deriving from Community Directives must apply not only to the public contracts awarded by the Commission itself, but also to those it awards as the agent of external recipients of Community funds (see 2.1.33 to 2.1.35).

2.4.6. Rules must be laid down to govern subsidies. Since they entail a *quid pro quo*, and are awarded for that reason, they should be treated in the same way as contracts as regards the award procedure (putting up for tender), supervision (consideration by the CCAM), and administration (monitoring by means of databases) (see 2.1.40).

2.4.7. The serious gap in terms of the membership of the assessment committee has to be remedied (see 2.1.28).

2.4.8 Intellectual service contracts must be systematically planned. Human and financial resources should not be scattered over a myriad of contracts too small to be overseen, the different procedures must be properly understood, accurate definition of the subject of the contract should be treated as a matter of crucial importance, and the Commission must have the means to monitor the proper execution of contracts (see 2.2.17 to 2.2.48).

2.4.9 The Commission should ask its contractors and special interest groups, where applicable, to specify the membership of their board of directors and the identity of their shareholders. Both to educate them and to treat them absolutely equally, it must allow unsuccessful bidders to consult the documents relating to a tender procedure (see 2.2.36 to 2.2.38 and 2.2.60 to 2.2.63).

2.4.10 Authorising officers must be responsible, consider themselves responsible, and held responsible. Their role should be enhanced, for instance by offering them the necessary guarantees of independence, or indeed certain career advantages, and all the requisite training and information. Their disciplinary and financial liability must not remain a purely theoretical possibility. The fact that a decision to commit expenditure is separate from the signing of the commitment proposal runs counter to a sense of responsibility. The authorising officer and the signatory to a contract (the only instrument legally binding on the Commission in relation to third parties, whereas commitment is merely an internal decision) must be, if not one and the

same person, at any rate close associates (see 2.2.49 to 2.2.59).

2.4.11. The Commission, or a Member whom it has empowered to act, must be debarred from acting as authorising officers (see 2.2.58).

2.4.12. Authorising officers should be advised more extensively where contracts are concerned. The Central Contracts Unit, recently set up by the Commission, should accordingly be equipped with increased human resources in order to provide the necessary prior assistance to authorising officers to help them compile the requisite documents and thereafter monitor the execution of the main contracts and draw the appropriate conclusions to enable constant adjustments to be made to the rules. The unit thus needs to be acquainted, through the Advisory Committee on Procurements and Contracts (CCAM), with the most important or typical contracts. Its representatives should therefore serve on the committee and constitute the principal technical element (see 2.2.75 to 2.2.77).

2.4.13 The CCAM, which at present does no more than carry out near-routine implementation checks and is slowing down what is already an excessively cumbersome procedure, has to be reformed. Very strict limits should be imposed on the number of matters considered. Draft contracts should be selected under the personal responsibility of the chairman of the CCAM, assisted by the secretariats of the committee and the Central Contracts Unit, working in synergy. Contracts not selected must be abandoned immediately, and, instead, those few matters deemed to serve as example should be studied in depth. In hierarchical terms, CCAM meetings should take place at a sufficiently high level, but not so high that full members would more often than not be prevented from attending. The CCAM must be constituted as a joint body in order to provide a forum for dialogue between administrative and operating DGs. Opinion thresholds should be raised substantially, broadly according to the types of contracts (see 2.2.78 to 2.2.98).

2.4.14 The Commission must finally equip itself with a central database for contracts and contractors. If this cannot be done under the SINCOM system, the central departments should consider the alternatives (expansion of the CCAM database) in collaboration with the authorising officers (see 2.2.64. to 2.2.73).

2.4.15. Since the Commission's management tasks are increasing in both number and range and the complement of officials cannot be expanded continuously to tackle them, a policy of outsourcing should be pursued. The use of private sector resources should be regulated so as to meet the requirements of public service. In addition, the committee believes that implementing agencies under the exclusive control of the Commission is an option deserving thorough consideration (see the entire section 2.3).

1.2. Annexes

- I. Subsidies: number and value of commitments by year and by DG**
- II. Subsidies: breakdown of the amounts allocated; cost of subsidy management in terms of human resources**
- III. TAOs: description of the tasks which TAOs were asked to perform**
- IV. TAOs : breakdown by DG**

SUBSIDIES
Number and value of
commitments by year
and by DG

DG	Number of commitments	Value of commitments
V	2 074	125 121 959 .38
VIII	867	321 267 932 .00
X	833	38 565 327 .59
XXIII	739	31 576 579 .30
XXII	395	16 792 928 .26
XI	366	25 526 499 .93
I B	255	119 247 115 .00
I A	222	57 088 036 .46
XXIV	205	17 378 498 .00
Secr.	121	31 003 406 .00
VII	120	18 326 444 .00
III	109	14 517 171 .59
XVII	106	16 494 207 .87
XII	104	3 405 455 .19
XIII	66	4 414 064 .49
I	60	5 588 711 .00
XVI	60	168 886 202 .00
XIV	57	40 149 074 .00
VI	50	5 550 434 .00
SOEC	30	4 668 844 .87
XX	18	136 200 .00
II	13	387 000 .00
XXI	11	1 074 248 .00
XV	6	69 069 .38
IX	2	40 000 .00
JICS	1	155 550 .00
TOTAL	6 890	1 067 430 958 .31

Source :I-G report(May1997)

ANNEX II

SUBSIDIES

Breakdown of the amounts allocated

Bands (in euros)	Amounts	Number of commitments
0-10 000	5 153 223	964
10 000-20 000	13 132 395	947
20 000-30 000	25 921 598	1 167
30 000-40 000	16 402 266	486
40 000-50 000	18 227 930	420
50 000-60 000	20 322 270	383
60 000-70 000	16 945 653	266
70 000-80 000	17 183 048	230
80 000-90 000	14 789 794	176
90 000-100 000	15 129 427	160
100 000-110 000	19 107 976	187
110 000-120 000	10 937 540	96
120 000-130 000	11 902 068	96
130 000-140 000	7 942 146	59
140 000-150 000	8 410 694	58
+ de 150 000	745 922 925	1 194
Total value of commitments	967 430 952	6 889

Cost of subsidy management in terms of human resources

Tasks	Total	%
- operational	366.37	72.8
- assessment	36.38	7.2
- financial	100.75	20.0
Total	503.5	100.0

The staff engaged in subsidy management tasks may be estimated at 503.4 men/year
Source : I-G report on the Commission's use of TAOs (4 February 1998)

ANNEX III

TAOs

Description of the tasks which TAOs were asked to perform

	Number of TAOs performing the task
A. – ADMINISTRATIVE ASSISTANCE TASKS:	
A1. Management of administrative contracts concluded with the beneficiaries of Community action	15
A2. Dissemination of information concerning the programme	21
A3. Secretarial work in connection with the programme	14
A4. Collection and processing of data, creation and/or management of databases	19
A5. Checks on payments for work	14
A6. Preparation of payments	9
A7. Other	5
T. – TECHNICAL ASSISTANCE TASKS:	
T1. Recruitment of experts to assist in projects	3
T2. Analysis of the soundness of tenders submitted	9
<u>T3.</u> Assessment of the technical soundness of tenders	12
T4. Checks on and assessment of the progress made in the programme	9
T5. Attendance at technical and information meetings concerning the programme	18
T6. Participation in the assessment of tenders	8
T7. Participation in discussions on project financing, drawing up of annual activity reports	14
T8. Drawing up of programme action plans	7
T9. Operational interface between the authorities of third countries and the EEC	6
T10. Organisation of conferences and/or seminars	13
T11. Establishment of terms of reference for a project/definition of the tasks to be performed	2
T12. Other	16

I-G report on the Commission's use of TAOs (4 February 1998)

TAOs
Breakdown by DG

(Euros)

DG	Parts A and B	
	M/yr*	Appropriations
1	0	0
<i>IA</i>	191	40 608 010
1B	324	44 379 000
2	0	0
2FOS	19	2 968 350
3	0	300 000
4	0	0
5	83	20 010 499
6	21	5 574 248
7	0	0
8	67	19 328 891
9	0	0
10	56	5 273 230
11	0	0
12	0	0
13	0	964 165
14	0	0
15	0	476 224
16	0	12 432 695
17	0	0
19	0	0
20	0	0
21	0	171 000
22	86	8 604 000
23	51	6 789 759
24	0	0
ESA	0	0
SO	0	0
JRC	0	0
SC	0	0
ID	0	0
ECHO	0	0
I-G	0	0
OOPEC	0	0
SOEC	52	4 693 000
JICS	0	0
RSC	24	14 597 082
TS	0	0
Secr	0	0
LS	0	0
SS	0	0
ANTF	0	0
TOTAL	974	187 170 153

*Men/year (indicative data for 1998)

Source : Inquiry into the outside technical and administrative assistance used by the Commission in implementing Community programmes or actions (Memo of 30 November 1998)

3. SHARED MANAGEMENT

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3. SHARED MANAGEMENT IN GENERAL

3.1. Introduction

3.1.1. The first report of the Committee dealt with subjects related to direct management by the Commission. The preceding chapter of this report also deals with such matters. Although during the last ten years problems have become manifest in that field this should not divert attention from longer established difficulties in other sectors such as agriculture and the Structural Funds³³ where management is shared between the Commission and the Member States.

3.1.2. In both sectors management of policy has been inadequate for many years. The European Court of Auditors in its annual reports, special reports and opinions repeatedly criticised weaknesses, in particular those leading to a high incidence of irregularity ranging from simple errors to serious frauds and a lack of effectiveness. The problem of a high level of irregularities was recognised at the time of the adoption of the Maastricht Treaty. The Treaty required the Court of Auditors to publish an annual Statement of Assurance as to the reliability of the Community's accounts and the legality and regularity of the underlying transactions³⁴.

3.1.3. The insertion of a new article 280 (formerly 209a) in the same Treaty (effective from 1993) which states that "*Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests*" was a breakthrough in approach. Member States themselves had by this time become aware of the need to take a more committed approach to protecting Community funds even when they had no immediate financial interest in so doing. The new article in the Maastricht Treaty reflected this change in attitude which led, although with too long a delay for the Structural Funds, to amendments to the Regulations in these fields (agriculture from 1995, Structural Funds from 1999).

3.1.4. It is important to bear in mind that although Member States are the principal disbursers of Community monies in their own territories, where a fraud or irregularity goes undetected or unreported it is the Community budget, and not the Member State, which pays (see below at 3.7.3. and ff.).

3.1.5. The history of shared management demonstrates the difficulties the Commission has had as a manager of money, policy and programmes vis a vis the Member States. Strengthening financial management, tighter controls, reducing the number of irregularities and better fraud detection were long overdue. Recognition of this also gave rise to the creation of UCLAF (see chapter 5 of this report).

3.1.6. The Treaties have given wide –ranging powers, and a considerable area of discretion in their deployment to the Commission. The everyday relationship between the Commission and the Member States is sometimes delicately balanced and this can lead to the Commission

³³ The Structural Funds are the European Regional Development Fund, the European Social Fund, the European Agricultural Guidance and Guarantee Fund, Guidance Section, and the Financial Instrument for Fisheries Guidance.

³⁴ Article 248 (ex article 188c)

showing a lack of courage and exhibiting laxity in order supposedly to preserve this balance. The Commission has even been prepared to negotiate when faced with improper pressure from Member States. But a compliant Commission is not in the interests of sound management nor in the longer-term interests of the Member States as a whole. It is the Commission which implements the budget on its own responsibility, a responsibility not shared with the other Institutions or the Member States (see paragraph 3.3.4 below). Community legislation in the fields of agriculture and the Structural Funds must respect this Treaty provision by giving the Commission the powers to exercise this responsibility and to fulfil its obligation of accountability to the discharge authority.

3.1.7. The question is whether the right balance has been found between the Commission's responsibilities and the legal and material means of which it disposes to exercise its responsibilities. This point also merits careful attention not least because of the enlargement of the Union now being prepared. The realisation of the 'acquis communautaire' in this field should not be limited to legal texts. It should also be understood to include the requirements of control in executing Community policies.

3.1.8. This chapter will examine shared management as it is applied in practice to the implementation of Community policies and not as an abstract concept. In budgetary terms shared management characterises most of the Commission's and the Member States' activity to implement Community policies. Some of the issues raised will be discussed from different perspectives in other chapters of this report. Shared management and the areas to which it applies are considered separately and distinctly here because of its prevalence, history and financial importance. The field of its application is so wide that it will not be possible to consider every area to which it does apply nor to examine its application in all its diverse ways and circumstances. The focus of this chapter will be on certain aspects of the shared management of the European Agricultural Guidance and Guarantee Fund (EAGGF) Guarantee section and the Structural Funds.

3.2. Definitions

3.2.1. Shared management is nowhere specifically defined in Community legislation. The key regulations governing the EAGGF and the Structural Funds simply set down the respective roles and tasks of the Commission and the administrative authorities of the Member States in such a way as to make it clear that the legislator's intention is that the management of the EAGGF and the Structural Funds should be shared. These Regulations will be considered in greater detail below where the operation of shared management in these areas is discussed.

3.2.2. For the purposes of this chapter shared management will be understood to refer to the management of those Community programmes where the Commission and the Member States have distinct administrative tasks which are inter-dependent and set down in legislation and where both the Commission and the national administrations need to discharge their respective tasks for the Community policy to be implemented successfully. Direct management in contrast is where the Commission directly manages programmes without the necessary involvement of Member State administrations, for example the PHARE programme.

3.2.3. Shared management is a long established practice and is a feature of the Common Agricultural Policy, the biggest common policy in terms of budgetary expenditure. The Guarantee section of the EAGGF accounts for 48 % of the European Union's 1998 annual budget and comprises direct income support, price support payments, export refunds, set aside premiums and other financial aid to agricultural production. Shared management is also used to

implement the Communities' Regional and Social Funds as well as the structural element of the EAGGF, the Guidance section. In total these Structural Funds and the Cohesion Fund³⁵ account for 36 % of the European Union's annual budget. Only a very limited part of the Structural Funds, for example pilot studies to help direct policy development and research contracts within the EAGGF Guarantee section are directly managed by the Commission. **For ease of understanding the reader will find at annexe 1 a table showing the distribution of Community expenditure by broad category.**

3.2.4. Shared management varies in its operation from one area to another but its defining financial characteristic is that payments to beneficiaries made in respect of Community policies are made by national authorities designated by the Member States within the framework of the Regulations governing those policies. Although there are different legal arrangements specific to each policy area, the disbursement of funds by Member States and their subsequent reimbursement subject to financial corrections by the Commission is a constant.

3.3. Shared Management and the Commission's Responsibilities

3.3.1. Shared management implies shared responsibility between the Commission and national administrations for the efficient administration of Community policies and for the ensuring that the law as expressed in the Regulations as well as in the Treaties is respected. Nevertheless the Commission has a particular and over-arching responsibility for Community policies which cannot be shared even where day to day management is. Article 211 (ex-155) of the Treaty establishing the European Community states that the Commission shall "*ensure that the provisions of this treaty and the measures taken by the institutions pursuant thereto are applied.*" The Commission shall also *exercise the power conferred on it by the Council for the implementation of the rules laid down by the latter.*"

3.3.2. The Commission's ultimate responsibility for ensuring the application of Community policies is clear. Shared management although a long standing and clearly necessary arrangement is a contingency whose legal basis is in secondary legislation, mainly the various Regulations concerning the EAGGF Guarantee section and the Structural Funds. Ultimate responsibility for implementation rests with the Commission by virtue of the Treaty itself. This responsibility cannot be delegated even to a national administration and shared management is therefore not a form of a delegated responsibility.

3.3.3. This point is eloquently expressed in the European Parliament's resolution postponing the 1997 Discharge decision³⁶ which says: "*la Commission est la responsable ultime au niveau communautaire de l'action des administrations nationales coresponsables de l'exécution des politiques nationales gérées en partenariat.*"

3.3.4. On the financial side the matter is if anything clearer. Article 274 (ex-205) of the Treaty states that "*the Commission shall implement the budget ...on its own responsibility ... having regard to the principles of sound financial management.*" The key phrase in the context of this chapter is "on its own responsibility". The distinction between responsibility which is established in the Treaties and management which is shared by virtue of secondary legislation is crucial to what follows. Management may be shared but financial responsibility is not.

³⁵ The Cohesion Fund contributes to the strengthening of economic and social cohesion in the Community in Member States where GNP per capital is less than 90 % of the Community average.

³⁶ PE 230650, page 7, point 0

3.4. Shared Management and the Member States' Responsibilities

3.4.1. Notwithstanding the above the Member States do have Treaty derived responsibilities which are relevant in this area. In particular, and this is important for parts of the discussion which follow, Article 280 (ex-209a) of the Treaty as amended by the "Amsterdam Treaty" reads:

"1. The Community and the Member States shall counter fraud and other illegal activities affecting the financial interests of the Community through measures to be taken in accordance with this Article which shall act as a deterrent and be such as to afford effective protection in the Member States.

2. Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests." (The full text of article is quoted at paragraph 5.5.1).

The Amsterdam Treaty also amended article 274 (ex 205) cited at paragraph 3.3.4 above by further adding the words *"Member States shall cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management."*

3.4.2. In addition Council Regulation 2988/95³⁷. of the 18 December 1995 requires Member States to take measures to ensure the regularity and reality of transactions involving the Community's financial interests including by carrying out checks and inspections Other specific requirements are set down in sectoral legislation.

3.4.3. Given the foregoing, two questions arise. Do the Council regulations which establish the various shared management arrangements take sufficient account of the Commission's indivisible responsibility for implementing the budget and ultimate executive responsibility? In the areas of shared management do the practices of the Commission and the Member States reflect the respective Treaty articles? These and other questions are best answered through an examination of aspects of the EAGGF and the Structural Funds' implementation.

3.5. Other Considerations Relevant to Shared Management in General

3.5.1. The Statements of Assurance published by the Court of Auditors to the accounts from 1994 onwards have confirmed the high level of errors in underlying transactions, especially in relation to payments made by the Member States in the fields of shared management. On the basis of information, both quantitative and qualitative, in the successive statements, it is believed that the rate_of substantive errors for payment for the budget as a whole is a good 5 % (substantive errors are those legality and regularity errors which have direct, measurable effects on the amount of the underlying transactions financed by the Community budget). This has prevented the Court giving a positive Statement of Assurance on the payments made. For EAGGF, Guarantee the percentage seems to be somewhat lower and for the Structural Funds much higher.

3.5.2. The partial or complete separation of the financing of a Community policy from its implementation, as is the case in the area of shared management, is a point which merits particular attention. In general in the Member States such structures are avoided. In the Community they cover 85 % of its budget.

³⁷ OJ L 312 of 23 December 1995

3.5.3. The Member States have a conflict of interest. On the one hand as members of the Council it is their duty in adopting regulations to create conditions for their implementation that are readily implemented and controlled by the Commission. On the other hand as nation states they favour their own systems of management and control. This hybrid arrangement leads to a lack of clarity on mutual responsibilities and obligations and fails to give any guarantee that the right balance has been struck in the interests of good management of Community monies.

3.5.4. The occurrence of irregularities and frauds is an extremely important element in the consideration of the advantages and disadvantages of partnership with Member States and decisions on the modalities of shared management. In any case, the Commission must be always in the position to exercise its own responsibilities via monitoring, control and evaluation of the effectiveness of its partners and make financial corrections when necessary.

SHARED MANAGEMENT OF THE EAGGF GUARANTEE SECTION

3.6. The Agricultural System and its Evolution

3.6.1. In European Community terms the Guarantee section of the EAGGF has a very long history. The original six Member States set up a single agricultural fund as far back as 1962 (Reg. 25/62-OJ 30/1962). In 1964 two distinct sections were established (Reg.17/64-OJ 34/1964). The Guidance section covered Community expenditure incurred under the policy relating to agricultural structures while the Guarantee section covered Community expenditure incurred under the policy relating to agricultural markets. In the period to 1970 expenditure under the Common Agricultural Policy was gradually taken over by the Community budget. The key regulation governing the EAGGF adopted in 1970, although amended since, is Council Regulation 729/70 of 21 April 1970.³⁸

3.6.2. This Regulation confirmed the existence of two sections of the Fund: the Guidance section to finance the structural adaptations necessary for the proper working of the market and the Guarantee section which is discussed here. The Guarantee section was to finance refunds on exports to third countries and intervention intended to stabilise the agricultural markets. Broadly put the Guarantee section operated through a system of price support to ensure a fair income for producers and price and supply stability for consumers. Export restitution payments compensated producers when world market prices, estimated for each product and for all destinations on the basis of mercurial factors such as the price of wheat on the Chicago Exchange, were below Community reference prices. Furthermore, a system of storage at the same level of support was implemented in order to regulate the internal markets.

3.6.3. Community prices have been constantly maintained at a level very much higher than market prices and storage has become a quasi-permanent phenomenon. The system led, especially from the end of the seventies, to massive agricultural surpluses and costs which placed an enormous burden on the Community budget. From the eighties onwards the mechanisms for supporting producers' incomes have been progressively modified. Community prices have been somewhat lower, especially for cereals. Nevertheless, overall they have remained clearly above world prices and considerable surpluses are still in place. The system of subventions for export has been diversified to take account of destinations. It has thus become, not only a technical arrangement for the management of agricultural markets, but also a tool of commercial and humanitarian policy. At the same time a complex system of direct aid for agricultural production has been developed.

³⁸ OJ L 94 of 28 April 1970

3.6.4. For the period 1988-1992 and then for the period 1993-1999 an "agricultural guideline" within the context of an overall financial perspective agreed by the Parliament and the Council succeeded in slowing growth in agricultural expenditure and reducing its share of the Community's budget. The "MacSharry" reforms introduced from 1992 onwards began a move away from price support to direct support to producers usually on an acreage or stock basis. In the Agenda 2000 document³⁹ the Commission proposed deepening and extending the 1992 reforms through further shifts from price support to direct payments from the Community budget. Forms of direct payment now account for 70 % of Guarantee section expenditure and will increase to 80 %.

3.7. The Basic Control Regulation

3.7.1. Regulation 729/70 established that from 1970 onwards management of the EAGGF Guarantee section should be shared. Article 4 reads :

*"Member States shall designate the authorities and bodies which they shall empower to effect, from the date of application of this Regulation the expenditure referred to in articles 2 and 3. They shall communicate to the Commission, as soon as possible after the entry into force of this regulation, the following particulars concerning those authorities and bodies: - their name and, where appropriate, their statutes;
... the Commission shall make available to the Member States the necessary credits so that the designated authorities and bodies may, in accordance with Community rules and national legislation, make the payments referred to in paragraph 1."*

These payments by the Commission to the Member States were on a monthly basis originally by way of an advance followed by a declaration after the month end and are now by way of reimbursement on the basis of a monthly declaration by the Member State. In fact those agencies which had made payments under the previous national agricultural regimes by and large became the paying agencies for the Guarantee fund.

3.7.2. Article 5 of Regulation 729/70 required Member States to pass to the Commission the annual accounts and documents for making up the balance sheets of these bodies and to *"Satisfy themselves that transactions financed by the Fund are actually carried out and executed correctly; to prevent irregularities; recover sums lost as a result of irregularities or negligence."* This article provided the basis for a clearance of the annual accounts by the Commission resting on information supplied by the Member States. Initially and in implementing legislation the term "making up of accounts" was used.

3.7.3. The same Regulation made Member States responsible for preventing and detecting irregularities and recovering sums lost because of them. At Article 8 it states

"In the absence of total recovery the financial consequences of irregularities or negligence shall be borne by the Community, with the exception of the consequences of irregularities or negligence attributable to administrative authorities or other bodies of the Member States."

3.7.4. It is this article which gives rise to the situation referred to at paragraph 3.1.4. If a fraud or irregularity is undetected the cost is borne by the Community. Only in the event of detection can the consequences of irregularities or negligence be attributed to the administrative authorities of a Member State. At this point it is worthwhile recalling the sometimes extreme

³⁹ Bulletin of the European Union, Supplement 5/97

complexity of the market regulations and that it is the Member States themselves in Council who have adopted a corpus of complex legislation with all the “loophole” possibilities this entails.

3.7.5. It is difficult to believe that the administrative authorities or other bodies in the Member States are always inclined to highlight for the Commission instances of irregularity or negligence on their part which would result in them bearing the resulting financial consequences. It is also difficult to believe that they are never negligent. In other words the arrangements which this basic Regulation established and which still pertain do not provide the immediate disbursers of 48 % (at one time this figure was as high as 70 %) of the Community's budget, the EAGGF paying agencies in the Member States, with any immediate incentive for rigour and tight control of what is in effect someone else's, that is the Community's, money.

3.7.6. This observation will be revisited below but it does strongly suggest that the Commission must at all times be able legally and in terms of its resources to act decisively and independently to protect the Community's financial interests in accordance with Article 274 of the Treaty.

3.8. The History of the Clearance of Accounts

3.8.1. Since 1970 the Clearance of Accounts procedure has been crucial to the protection of the Community's financial interests and while not the Community budget's first operational line of defence in the EAGGF Guarantee section it is its most important. The Clearance of the accounts by the Commission leads directly to closing the accounts. In doing that the Commission accepts what may be charged definitively to the Community budget. It should therefore have full responsibility for checking and evaluating the systems in operation and the documents it receives both in Brussels and on the spot in order to clear and then close the accounts. All other acts including audit by Member States are no more than technical preparations for this final management act which the Commission undertakes on its own responsibility.

3.8.2. The complexity of the various systems has always made Clearance difficult. The recurring temptation is to stray from the strict application of the legislation to something more akin to bargaining between the Commission and each Member State. These difficulties led, at the end of the seventies and beginning of the eighties, to delays in clearance often of more than five years. Finally, the Clearance of Accounts procedure underwent a major change in 1995 after the adoption of two new regulations, Council Regulation 1287/95 of 22 May 1995⁴⁰ and Commission Regulation 1663/95 of 7 July 1995⁴¹ both applicable from the 15 October 1995 and considered below (at 3.9.1 ff.). To examine the significance of that change and to place it in its context it is necessary briefly to describe the previous procedure, the difficulties it gave rise to and the reasons for its reform. It is important to recall that both before and after the adoption of the new regulations the Commission made and makes monthly payments to the paying agencies in the Member States and thereafter seeks to make recoveries where it believes undue payments have been made.

3.8.3. Under the pre-1995 arrangement the Commission was required to clear the EAGGF Guarantee accounts by the 31 December of the year following the financial year concerned, that is by the 31 December of year n+1. Member States submitted the accounts of paying agencies

⁴⁰ OJ L 125 of 8 June 1995

⁴¹ OJ L 158 of 8 July 1995

by the 31 March of year n+1. Thereafter the Commission opened an enquiry phase based on the information submitted and its own checks. There followed a contradictory procedure during which the Member States had an opportunity to contest the Commission's proposed corrections and which brought in informal but substantial elements of political pressure and negotiation which invariably reduced the amounts recovered through clearance. The accounts were rarely closed on time. More usual was for the accounts to be closed at the 31 December of year n+ 2. The delay began with the Member States who very largely failed to respect the deadline for the submission of the paying agencies' accounts. The delays meant that the accounts were not closed by the time the Court of Auditors drafted its Annual Report and its Statement of Assurance and even on occasion had not been closed before the Parliament had begun the discharge procedure for the year concerned. After the Commission's formal decision Member States also enjoyed the right to take a case to the Court of Justice.

3.8.4. In addition the whole procedure was seen in some quarters as too conflictual. When interviewed in connection with this report one senior Commission official expressed the view that the Member States had lacked confidence in the Commission's judgement when it came to determining corrections. This led to an initial reform to the procedure that took place in 1994 when a Conciliation body of five "wise" persons was set up by the Commission to consider disputed corrections. A further observation on conciliation will be made below (paragraph 3.11.1 and ff.). Notwithstanding any effect this may have had on Member States' perceptions of the outcomes, it had the effect of adding a further six months to the clearance procedure.

The amounts involved in the annual clearance decisions were substantial. The total disallowed in respect of 1992 was 788 million ECU. The amount for 1993 was 755 million ECU. These sums represent respectively 2.6 % and 2.3 % of the yearly total of Guarantee expenditure but are above average because of exceptional corrections related to the implementation of milk quotas. The amounts so far for 1994 and 1995 are 307.6 million and 430 million ECU or about 1% of yearly Guarantee expenditure.

3.8.5. There were and are two types of correction dealt with in the context of clearance. The first type of correction is made when a particular irregularity or mistaken payment is uncovered. The second type is more important. Flat rate corrections are made where the Commission on inspection has identified a systematic weakness in a paying agency's procedures which it is reasonable to suppose has led to a series of irregular payments over time. The underlying principle is that the rate of correction must be clearly related to the probable loss. From 1990 the Commission applied flat rates of 2 %, 5 % and 10 % depending on the extent of the systematic weakness and the estimated loss to the Community. At the Parliament's insistence a 25 % rate was added from 1998. The Court of Justice has upheld the Commission's prerogative to apply flat rate corrections of up to 100 %⁴².

3.8.6. For the period from 1989 to 1993, some 3200 million ECU were recovered from Italy and Spain after those Member States' failure properly to implement the milk quota regime. The Commission had originally favoured allowing all of this expenditure but had been obliged to reconsider following observations from the Court of Auditors supported by the Parliament. The Council subsequently decided that the states involved could repay in four separate tranches. This case clearly showed the Commission's weakness in the face of the political pressure that was brought to bear, although it was clear that the amounts should be recovered. Political pressure eventually obtained the "compromise" of staggered repayment. The case also illustrated the

⁴²

Case C-50/94, Greece v. Commission - 4/7/96 - European Court Reports 1996, page 1 -3331

weakness of the then clearance procedure the outcome of which the Commission was prepared to disregard on this occasion despite, or perhaps even because of, the very large sums involved.

3.8.7. The 1993 clearance procedure was particularly contentious. In fact for that year two distinct clearance decisions had to be made in April and July 1997 because at the time of the earlier decision an amount was still eligible for or subject to the conciliation procedure. Even so, and despite the amount of 755 million ECU disallowed, of which 27% concerned milk products in Italy, 1566 million ECU or 4.8 % of the total expenditure declared was excluded from the clearance decision and carried forward to future clearance years⁴³.

3.9. The New Clearance of Accounts: Accreditation and Certification

3.9.1. The impetus for reform, set in the context of a more general concern about frauds and irregularities, was now well established. As mentioned above it led to the 1995 reforms laid down in Council Regulation 1287/95 which amended the provisions of the basic Regulation 729/70 dealing with the Clearance of Accounts.

3.9.2. This Regulation refers in its preamble to the difficulties created by a single annual decision and the need to shorten the time limit for the clearance decision. Crucially it established two distinct types of clearance decision, one accounting and the other relating to compliance. Commission Regulation 1663/95 of 7 July 1995 lays down the detailed rules which reform the clearance procedure.

3.9.3. In summary these two regulations introduced three new substantial features

- paying agencies must now be formally **accredited** by the Member State. Only these agencies may make payments. The annex to Regulation 1663/95 gives the criteria which paying agencies must meet. These include the existence of an internal audit service and a structure which separates the authorisation, execution, and the accounting for payment⁴⁴
- **certification** of the annual accounts of the paying agency before their transmission to the Commission by “*a department or body which is operationally independent of the paying agency*”⁴⁵ (only the correctness of the accounts from an accounting point of view and not as regards the legality and regularity of the underlying transaction is concerned here)
- a distinct **accounting** clearance decision based on the annual accounts submitted with a definite decisional timetable; and a distinct **compliance** clearance decision based on the Commission’s checks⁴⁶ on the legality and regularity of the underlying transaction. Each of these new features is discussed below: accreditation and certification at 3.9.4 ff., and the separation of accounting and compliance clearance at 3.10.1 ff.

3.9.4. The accreditation of paying agencies and the certification of accounts really concern the operation of shared management at Member State level. The Court of Auditors Special Report

⁴³ Court of Auditors Special Report 2/98 - OJ C 121/1988

⁴⁴ Article 1 of Regulation 1287/95 and article 1 of Regulation 1663/95

⁴⁵ Article 3 of Regulation 1663/95

⁴⁶ Article 1 of Regulation 1287/95

21/98 examined in detail the accreditation of paying agencies and the certification of accounts by the Member States as well as the accounting clearance of accounts for the first year of the new system. Although it found shortcomings and delays leading ultimately to two accounting clearance decisions for 1996 (5 May and 30 July 1997, both after the deadline date of 30 April given in Regulation 1663/95) it concluded that *"both the Member States and the Commission made significant efforts to comply with the new Regulation"* (paragraph 5.1, page 10)⁴⁷. The Court did point out however that no decision had been made at the time of writing of its report in regard to compliance either for transactions in 1996 or 1997.

3.9.5. Accreditation is new. It is a central feature of the new regulations. Council Regulation 1287/95 requires the Member States to *"limit the number of accredited paying agencies to the minimum necessary in order to effect the expenditure under satisfactory administrative and accounting conditions."*

3.9.6. Before 1996 there were hundreds of unnotified, small de facto agencies making EAGGF Guarantee payments in the Member States without any structured procedures for checking on their activities or accounts in terms of EC Regulations. This was clearly illegal but tolerated by the Commission and practised by the Member States. Given that officially they did not exist for the purposes of making payments any payments they were making must have been legally questionable. The original Regulation 729/70 was quite clear. There were no exceptions. It required the Member States to communicate to the Commission the names and statutes of all authorities and bodies making payments as well as their annual reports and accounts (article 4.2). This certainly did not happen. Shared management here amounted to not much more than shared acceptance that the Regulation could be flouted. The Commission is most at fault. In this situation it is difficult to see how it could be sure that bodies about which it officially knew nothing (although of course it was fully aware of their existence) were properly disbursing funds for decades for which the Commission was ultimately responsible.

3.9.7. The number of de facto paying agencies has decreased since 1996 largely because of Commission pressure. In consequence the number of properly notified agencies which keep accounts of EAGGF Guarantee expenditure has increased from 55 in 1995 to 90 now as Member States have been finally obliged, after 26 years, to respect the law which they adopted.

3.9.8. Criteria for accreditation are laid down in the Annex to Regulation 1663/95. Nevertheless the Commission has in practice decided that these need not apply to smaller paying agencies for which it has allowed the Member States to use less stringent criteria. In view of this and in the event of irregularities or a future legal challenge will the Commission be able to insist that accreditation be withdrawn or withheld in respect of a particular agency?

3.9.9. Certification of the accounts is new. It too is a central feature of the new Regulations. Certifying bodies must be operationally independent of the paying agency (Regulation 1663/95, article 3). Notwithstanding this in Denmark and more often than not in Germany they are the internal audit departments of the paying agency as the Court of Auditors confirms in its Special Report 21/98. In effect the paying agencies certify their own accounts in these Member States which is in direct contradiction to the requirements of the Regulation and negates the idea of an external audit.

3.9.10. In fact the overall situation is neither transparent nor reassuring. The leeway which the Commission has allowed the Member States on accreditation and certification amounts to a lax

⁴⁷ OJ C 389 of 14 December 1998

implementation of the Regulation. In these circumstances there is a real risk that the number of paying agencies will again increase. The Committee is of the opinion that the Commission should ensure conformity with the letter and spirit of the Regulation in the interests of transparency and efficiency.

3.10. The New Clearance of Accounts : Accounting and Compliance separated

3.10.1. The third strand of reform was the separation of the accounting (based largely on accreditation and certification) from the compliance clearance of accounts. The objective here was to speed up the clearance procedure. The Community's overriding interest remains the recovery through clearance of amounts unduly paid within a reasonable period of time

3.10.2. It is difficult to see how the separation of the clearance into accounting clearance and compliance clearance has in practice contributed to attaining this objective.

3.10.3. The timetable set down in Regulations 1287/95 and 1663/95 for **accounting** clearance is straightforward. Member States must provide the certified accounts to the Commission by 31 January of year n+1. The Commission must clear these accounts by 30 April of year n+1. This accounting clearance decision covers the integrity, exactitude and veracity of the accounts submitted (Article 1 of Reg.1287/95). In other words this decision is limited to an examination of the accounting documents but does not require an examination of the acceptability of the underlying transactions.

3.10.4. Nevertheless the Commission has not made one single accounting clearance decision by the date fixed in the Regulation for any of the years 1996,1997 or 1998. It continues to 'disjoin' expenditure (in effect postpone consideration of it) and make two accounting clearance decisions for each year. This is largely because not all Member States respect the timetable for presentation of the certified accounts of paying agencies to the Commission.

3.10.5. The timetable for the **compliance** clearance decision is not straightforward. There is no overall deadline given in the Regulations for the completion of this exercise. It is true that the Commission may only refuse to finance expenditure incurred in the 24 month period preceding its formal communication to a Member State on a given matter. For example formal letters sent by the Commission on 1 June 1999 cannot result in the recovery of expenditure effected by paying agencies before 1 June 1997 (although this does not apply to specific instances where an irregularity has been uncovered). When, as is usually the case, the amount to be recovered is disputed the Commission and the Member State are enjoined to resolve the matter bilaterally. Thereafter the Member State can call for mediation by the Conciliation body which gives an opinion. The matter could go to the Court of Justice if the Member State is still not satisfied with the definitive decision of the Commission which is taken in cognisance of the Conciliation body's opinion.

3.10.6. Compliance clearance is based on the Commission's checks on transactions themselves and on systems of transaction and not on a reading of the accounts, as with accounting clearance. The Commission's clearance of accounts unit carries out about 120 on-the-spot compliance check missions in an average year. Given that the certificate for the accounts obtained by the Member States does not concern the validity of the underlying transactions there is no reason to weaken compliance, in fact it will be argued below that this should be strengthened.

3.10.7. There are two problems here. Obviously the Commission must be quick off its mark in sending out formal communications to Member States given the 24 month limit. In view of this the Commission is urged to adopt a conscious policy of making these formal communications within as short a period as possible after the transaction to which they refer. The second problem is the absence of a deadline date for compliance clearance. Unless the Commission is energetic and the Member States co-operative corrections identified through checks could be in abeyance for very long periods of time. It is hard to see how from the Community's perspective this represents an improvement on the previous situation.

3.10.8. In fact there are good grounds for concern. The first compliance clearance decision for the first year to which the reformed procedure was applied, 1996, was taken in March 1999. To date under compliance clearance 111.2 million ECU has been recovered for 1996 and 1997 together; nothing for 1998. In total 276 formal communications have been sent for a total estimated recoverable expenditure of 1214 million ECU. The overall situation as at the 25 June 1999 looks like this:

	No. of letters in the year	Est. Sum to be recovered for year	Sum recovered For year	Amount in abeyance
		Mio ECU		
1996	20	415	77.3	337.7
1997	66	406	33.9	372.1
1998	139	393	0	393.0
1999 (to date)	51	?	?	?
Totals	276	1214	111.2	1102.8

(source: Commission's services)

3.10.9. Interest cannot be charged on these sums owed to the Community. It is believed that the total amount in abeyance for 1996 will not be completely recovered until 2000. As far as the Committee can determine this is because of the slowness of the procedures in general including within the Commission. Time scales of this duration are not an improvement on the previous clearance arrangements that were in place before 1996. In this regard it is important to point out that the Member States have five distinct opportunities in the procedure, before the Commission's collegiate decision, to influence or contest the amount the Commission seeks to recover.⁴⁸

3.10.10. Seen from this optic the reform represents no improvement. The total amounts so far recovered through accounting clearance are small (77.33 million ECU for 1996; 33.9 million ECU for 1997). This, it has been argued, is because of the introduction of accreditation, effective internal control and certification. These three new requirements have resulted, so the argument goes, in better control of payments in the Member States with as a consequence less to be recovered. But equally the small amounts being recovered through accounting clearance could be because large sums are being held over for compliance clearance. Moreover the time taken to close the dossiers and recover the amounts involved is still being measured in years rather than months after the market year concerned.

3.10.11. It is important to recall that corrections need not await the final compliance clearance decision. The monthly reimbursement payment system referred to at paragraph 3.7.1. above allows for a minimum of monitoring during the year. Individual cases can be examined urgently

⁴⁸ Reply to formal letter (article 8), bilateral meeting; reply following bilateral meeting; conciliation; Fund Committee.

where there is a suspicion of serious irregularity or fraud and settled after examination one way or another. Sound management depends on everyday actions in the implementation of the EAGGF Guarantee Fund.

3.11. The Conciliation Procedure

3.11.1. Conciliation is a win-win procedure for the Member States as things stand. From the Community's standpoint conciliation at best leads to a delayed recovery of undue payments in cases won by the Commission or at worst to a delay and reduction in repayment in cases won by the Member State. Nor do Member States have to accept the Conciliation body's opinion. They retain the right to appeal to the Court of Justice after the Commission's final decision. Since 1995 115 conciliation recommendations have been made and the Commission has accepted reductions totalling of 275 million ECU in recovery payments or 17 % of the total value of all cases submitted to the Conciliation body. Of course no decision has resulted in an increase in recovery. 54 Commission decisions following conciliation have nevertheless been subject to further appeal to the Court of Justice. So far the Commission has won 14 of these and 40 are still before the Court.

3.11.2. A number of senior officials and the Commissioner responsible when interviewed by the Committee suggested that conciliation helps to deflect improper pressure from the Member States who are simply referred to the Conciliation body. The overall adjustment proposed by the Conciliation body over the years of its operation does not seem enormous. If however it is used to provide additional assurance to Member States there can be no case, in normal circumstances, for the Commission's final collegiate decision on clearance being anything other than as proposed by its services after conciliation. It seems however that notwithstanding conciliation the Commission does not always adhere to the proposal put before it by its services and sometimes makes a further adjustment in favour of a Member State or States.

3.11.3. Conciliation takes time and, although the examination by the body is rigorous and professional, the procedure is open to abuse. Almost half of the cases submitted to the Conciliation body by the Member States have subsequently been brought before the Court of Justice by the same Member States. One Member State, Italy, seems to send cases to conciliation as a matter of course (it accounts for 30 % of all cases). Some Member States use conciliation to retain for as long as possible sums they know in all probability will eventually have to be returned to the Community. The Conciliation body itself reports that *"the risk is clearly apparent that certain member States (and more particularly Italy) refer systematically any correction notified by the Commission to the Conciliation Body, and not only those likely to be genuinely debatable"*.⁴⁹

3.11.4. Member States also introduce new evidence and arguments to the Conciliation body which could just as well have been presented to the Commission during the preceding bilateral phase. The Evaluation Report states that *"it is not rare that an important obstacle to the smooth operation of the conciliation procedure (and the clearance in general) is created by the Member States when they produce at the conciliation stage new explanations and/or evidence, not*

⁴⁹ Evaluation Report concerning the Conciliation Proceedings opened by Commission Decision (94/442/EC of 1/7/94) paragraph 23.

provided to the Commission departments at the time of the audit or at the time of the earlier bilateral discussions".⁵⁰

3.11.5. One option is for a provision that interest be paid to the Community on sums held for months and years by the Member States and subject to conciliation, calculated from the date of the expenditure concerned by the paying agency until the formal clearance decision for Commission proposed corrections brought before the Conciliation body. This would discourage the over-ready appeal by Member States to the conciliation procedure. The legislation in force is on this point weighted in the Member States favour. When corrections are contested the onus of proof and recovery lies with the Commission even though paying agencies are ultimately acting on the Commission's behalf in a common policy area.

3.11.6. An alternative to charging interest on the Community's behalf on sums eventually recovered after the formal clearance decision as suggested above would be to grant the Commission the right to recover immediately and fully pending resolution of the dossiers with the Commission paying interest on any reduction in recovery. An immediate incentive for Member States to expedite files would be created. The option described at paragraph 3.11.5 above is preferred by the Committee.

3.12. The Resources of, and Pressures on, the Clearance of Accounts Unit

3.12.1. Given the amounts involved and the complexity of the market regulations, the personnel resources devoted to Clearance of Accounts in the Commission are still not adequate. Although the unit has doubled in size since 1990 the total number of professional staff is 55. Set against the average annual amount cleared in recent years, 40 billion ECU, and the average amount recovered or expected to be recovered of 400 million ECU, this does not represent an enormous staff input. It is 6 % of the total Agriculture Directorate General staff of 1100. The Commission should consider to what degree an increase in expert staff working on clearance could result in increased recoveries and strengthen this unit accordingly by reallocating resources to it. This would also help authorising officers the better to discharge their duties.

3.12.2. In this context the Committee observes that the amount recovered through clearance is lower than the error rate for agriculture in the Court of Auditor's Statement of Assurance would suggest. The Statement of Assurance's error rate is between 3 % and 4 % implying an additional amount over clearance corrections of about 1000 million Euros. In the Committee's view the reasons for this difference should be examined in detail by the two Institutions concerned. The Committee has found a number of factors which may largely (or even wholly) explain the situation.

*The Court uses the whole of the Guarantee section as its sampling frame to draw a sample from which it extrapolates to an overall error rate. Clearance checks focus on particular sectors in particular years.

*The Court systematically examines transactions to the level of the final beneficiary. The Commission does not.

*It may well be that the flat rate corrections applied by the Commission are too low to ensure adequate recovery.

*The number of occasions where Member States can state their case and enjoy "the benefit of the doubt" tends to a lower than desirable recovery rate.

⁵⁰ op. cit. - paragraph 22

These considerations confirm the Committee in its view that there is significant scope for an increase in the amounts recovered through clearance if the clearance unit is reinforced.

3.12.3. In preparing this report the Committee heard from sources within the Commission and elsewhere but not connected to the Clearance of Accounts unit, of frequent pressure brought to bear in the past on the unit from national governments, sometimes in conjunction with trade lobbies, from Commissioners' cabinets and senior officials to adjust corrected amounts in Member States' favour for reasons which had no legal basis or technical justification.

3.12.4. It is important to emphasise however that since structural and other changes were made in the Directorate General for Agriculture which roughly coincided with the arrival of the new procedures such practices have become less common. Officials who resist these kinds of pressures are to be encouraged in their endeavours and although some of the criticisms above are trenchant they should not be read as damning. Nevertheless it has been confirmed to the Committee that the Commission as a college still adjusts recoveries when its final position is established in the light of factors which are subjective and sometimes connected to national considerations. The Commission must not reduce the amounts recovered after a long and detailed process in conformity with the Regulations has established how much should be recovered for the Community taxpayer for reasons such as these.

3.13. Other Observations on the Control of Expenditure

3.13.1. The Clearance of the accounts as described in the previous paragraphs is the final management act by the Commission in that field. The Committee would not want to leave this subject however without emphasising that the volume of work in this field very much depends on control in general over policy and the systems implemented. In the past systems of export refund in particular gave rise to irregularities and fraud. The scale of export refunds has diminished (see paras. 3.6.3. and 3.6.4.) because of the gradual change from market assistance to direct support to farmers. Nevertheless the export refund policy still exists and will exist in the near future as long as EU prices are higher than world market prices. The "new" policy of direct support also poses its own problems from a control viewpoint. Direct support to farmers raises a number of issues which need attention. Both export refunds and direct support are dealt with hereafter at paragraphs 3.12.2 to 3.12.5. and 3.12.6 to 3.12.7 respectively.

Export Refunds

3.13.2. Export refund payments are intended to bridge the gap between Community prices for agricultural produce and world market prices. The Community's practice has been to differentiate these payments as a function of the produce type, sometimes very finely defined, and the export destination. Experience has shown that this system of differentiation is vulnerable to fraud. It necessitates careful verification that the product really is of the type which attracts the export refund claimed and that the final destination is the country stated and not another where prices are higher, and for which a lower refund would have been paid. Experience has also shown that it is very difficult to police this export refund policy, even when traders are obliged to lodge guarantees to be forfeited in the event of fraud by, for example, changing the destination of the produce. A system without differentiation would have been more readily controlled. The problem is even more serious and control more difficult in cases of export to countries in the context of special food aid when lower prices and higher refunds are in play.

3.13.3. The following example may serve as an illustration of how the system of differentiation described above is very much open to fraud, especially when the Commission's services fail to apply sound management and to treat fraud adequately. This example which occurred in the early nineties is certainly not a unique case, but is an obvious one for two reasons. Firstly because it constitutes a case of poor management on the part of the Commission under the pressure of commercial interests which was transmitted by a Member State, as well as a fraud by an exporter and secondly it shows how a system of export restitution payments differentiated by destination encourages trade distortions prejudicial to the Community budget when they result from frauds as in the example below. Actually such distortions may also arise when export refunds are undertaken, completely legally, since there is nothing to prevent an exporter, after clearing customs at the point of arrival and while remaining within the law, organising re-export in conjunction with a local partner.

3.13.4. It appears from information in the file to which the Committee had access, but which it could not check, that the trader concerned imported the goods to a country other than the country of destination and presented forged proof of import to the intended destination in order to liberate his guarantee. When this became known to the Commission's services, they asked the national authorities of the country from where the goods in storage were exported to block the release of the trader's security. From then on matters went wrong. After the authorities of the trader's Member State (which was another than the one from which the goods were exported) had intervened on the trader's behalf, the national authorities of the exporting country were informed, to their surprise, that the Commission would not press for recovery of the guarantee. In fact, the Commission's services produced a draft amendment to the Regulation which would have the effect of retroactively reducing the amount of the guarantee the trader would lose. In addition there is no indication that the Commission's services asked the national authorities to pursue the fraudulent aspects of the case indicated by the forgery of import documents.

The aforementioned draft Regulation was strongly opposed by the Legal Service and the Financial Controller of the Commission. As a result a new amendment to the Regulation was prepared but was finally adopted on the basis of no retroactive effect thanks to the resistance of the national authorities of the Member State of export and the Commission's Financial Controller.

That was not the end of the story. The Commission's services now drafted a decision with the effect of applying the adopted amendment regulation nonetheless with retroactive effect. Notwithstanding objections from the Financial Controller and initially also from the Legal Service (which later on changed its attitude) and after a new intervention of the authorities of the trader's Member State with the Commission's senior hierarchy a letter was finally sent to the national authorities of the exporting Member State informing them of the Commission's decision to apply the amended Regulation retroactively anyway. In the end, it was decided that the trader should forfeit less than 20% of the guarantee.

3.13.5. As indicated (at 3.12.2.) the example shows how the systems of export refunds differentiated as a function of the destination of export is extremely difficult to police. Even more importantly, and most regrettably, it also shows how the senior hierarchy of the Commission has been influenced by national authorities of the Member State of the beneficiary of the refund and has chosen, notwithstanding opposition from its own administration and from the national administration of the exporting Member State, to take a decision of doubtful legality at the expense of the Community's finances which it has a duty to preserve. On a more general level the example shows that a possibility of an a posteriori reduction of a guarantee, which aims to be dissuasive and proportionate to the risk involved to assure a proper execution of

export transactions, undermines the purpose of the guarantee as well as legal continuity and equality of treatment.

Direct support

3.13.6. The move from price support to direct support to farmers, and thus to income aids entailed the establishment of an Integrated administrative and control system (IACS) which has been operational in most Member States since January 1997. For plant products the system reposes on aid applications by farmers indicating all their agricultural parcels; a computerised data base recording this information; an alphanumeric identification system for agricultural parcels and an integrated control system for administrative control and field inspections. For animals the IACS necessitated the establishment of an alphanumeric system for their identification and registration. The system is governed by Council Regulation 3508/92 of 27/11/92⁵¹

3.13.7. It is probably too early to say with confidence that the new system has been successfully established but it is clearly vital to the future control of EAGGF Guarantee expenditure and depends to a large extent for its implementation and execution on the Member States. A two - year delay in its full implementation was largely due to tardy preparation of the relevant systems in the Member States. As for the partial implementation which did take place, the Court of Auditors in its Annual Report for 1996 found for plant products that “*the result of on-the-spot checks was that on average 20% of the applications checked on the spot were found to be incorrect*”⁵². The successful establishment and use of the IACS system is probably one of the most important tasks for shared management in the EAGGF Guarantee section in the immediate future.

3.14. Conclusions

3.14.1. The error rate in EAGGF transactions is still too high. An error rate of about 3.5% as reported by the Court of Auditors (error not fraud rate) amounts to about 1400 million Euros. Recovery through clearance is running at 400 millions Euros per annum.

3.14.2. Member States complain that when their own controls, Commission controls, and Court of Auditors controls are taken into account there are too many on-the-spot controls. The Commission's Clearance of Accounts Unit makes 150 control visits (compliance and accounting) in a year to cover 40 000 million Euros of annual expenditure. Can this really be too many or even enough in order for the Commission to exercise its responsibilities as authorising officer?

3.14.3. One of the questions posed at 3.4.3 was whether the Council Regulations which establish the various shared management arrangements take sufficient account of the Commission's financial and executive responsibilities. Regulation 729/70 generally, and the more recent Regulations on Clearance of Accounts in clearly spelling out the Member States obligations in respect of the provisions concerning the accreditation of paying agencies and certification of accounts certainly do. The second question was whether practices on the ground respect the Commission's responsibilities. Not as far as the long term acceptance of undeclared paying

⁵¹ OJ L 355 5/12/92, para. 3.6.8.

⁵² OJ C 348 18/11/97.

agencies is concerned. In the same way there is a clear danger that with the passage of time the Commission's responsibility to ensure that agencies are properly accredited and accounts certified will be eroded, especially if, as is the case, the Commission itself fails rigorously to implement the provisions of the new regulations from the start.

3.14.4. There existed up to 1995 a climate in the EAGGF area whereby Member States were allowed unduly to influence Commission clearance decisions against a background of a set of complex market regulations. This has prevented a proper equilibrium being established in the shared management of the EAGGF Guarantee section by the Commission and the Member States. Responsibility for this is shared between Member States who fail to respect the Commission's role and the Commission which is too ready to accommodate the Member States. The ultimate loser here is the Community taxpayer.

3.14.5. A more promising regulatory framework has been established since 1995 for the Clearance of Accounts with some improvements in practice in the Member States under Commission pressure.

3.14.6. However a failure to take the broad view means that this activity is still under-resourced. A target for amounts recovered linked to the error rates found by the Court of Auditors, together with an unbending application of the regulation and real efforts to reduce the timescales, would result in more and speedier recoveries.

3.14.7. In general for clearance it can be said that the overall situation has been improved when compared to the laxity which reigned before 1995 but that further improvements are clearly still required.

3.14.8. The work in connection with clearance would be lightened if Member States were obliged to exercise more stringent controls in implementing the different market regulations. Equally the error rate would be lower.

3.14.9. Generally beyond clearance the key is an independent Commission with the capacity to act, even when opposed by the Member States, to protect the Community's financial interests.

SHARED MANAGEMENT IN THE STRUCTURAL FUNDS

3.15. History and Background

3.15.1. The Structural Funds, which include the EAGGF Guidance section, is the other main area of joint management between the Commission and the Member States. They differ from the EAGGF Guarantee in that expenditure to meet their objectives always comes from both the Community and the Member States' national budgets, although to varying degrees. Whereas the Guarantee section of the EAGGF is a common policy area in which the Community has exclusive competence, the Structural Funds concern a Community policy where political and funding responsibility is shared between the Community and the Member States. The historical development of the Structural Funds is also different from that of EAGGF Guarantee section. It will be briefly outlined below to allow a better understanding of the current situation.

3.15.2. The EAGGF Guidance section is contemporaneous with the Guarantee section and the legislation which established it is discussed above at paragraph 3.6.1. The Guidance section is

concerned with agricultural structures and measures to assist producers in the processing and marketing of agricultural produce and it also provides a system of aid for investments in agricultural holdings. The European Social Fund was established by Regulation 9/1960⁵³ and has been substantially adjusted and modified since that date. The European Regional Development Fund was established by Regulation 724/75 in March 1975⁵⁴ and has also been adjusted and amended since its inception. There has been a pattern of change and development in the area of the Structural Funds, which in summary has had three inter-related features. Firstly the share of the Community budget devoted to the Structural Funds has increased in absolute and in percentage terms over time. Secondly greater efforts have been made to co-ordinate the activities of the different funds to meet a set of common objectives. Thirdly there has been an accelerating devolution of decision making on project selection and management to the Member States. This part of the report will focus in the main on problems connected to the shared management of the Social and Regional Funds which together account for almost two-thirds of all structural measures.

3.15.3. Council Regulation 2396/71 of 8 November 1971⁵⁵ allowed the Social Fund already foreseen in the Treaty of Rome to assist operations aimed at solving problems arising in areas suffering "*a serious and prolonged imbalance in employment.*" 60 % of appropriations were reserved for tackling long term structural unemployment. The Council on a Commission proposal drew up a list of qualifying aid measures and Member States submitted particular projects. The Commission would assess their eligibility on the basis of the Council's decision. Reimbursement was on the basis of project costs actually incurred. The operation of the Social Fund was refined by Council Regulation 2950/83⁵⁶ which implemented the Council decision 83/516/EEC of 17/10/83⁵⁷. Fund assistance was directed to vocational training and recruitment and wage subsidies for young workers, the long term unemployed, women and others deemed particularly vulnerable on the employment market. Fund assistance was granted at the rate of 50 % of eligible expenditure. For the first time some detailed control provisions and a clear delineation of the Member States' and the Commission's respective tasks was established. Member States were to certify the accuracy of the facts and accounts in payment claims. The Commission was to carry out on the spot checks on the basis of representative sampling.

3.15.4. Following adoption of the Single Act in 1986 the European Regional Development Fund became the main Community instrument for the correction of regional imbalances. Its history goes back further. The Council Regulation 724/75 of 18 March 1975 which established the Regional Fund set as its principal objective the correction of regional imbalances particularly those resulting from the preponderance of agriculture and industrial change and structural unemployment. Assistance was not however to lead to Member States reducing their own regional development effort. Up to 50 % of public authority aid could be met from the Fund. The decision to support lay with the Commission except in instances where a Fund Committee decided effectively to refer the matter to Council. Individual investment proposals were considered by the Commission with a view to the regional development programmes also prepared and submitted by the Member States. Project and programme submissions had to include detailed information on, inter alia, their anticipated effect on economic activity and employment. Payment was made on the provision of statements certifying expenditure and detailed supporting documentation. The Commission having consulted the Fund Committee could reduce or cancel payments. Sums paid in error were to be repaid. Member States were to

⁵³ OJ O 12 of 31st August 1960

⁵⁴ OJ L 149 of 10 July 1975

⁵⁵ OJ L 249 of 10 November 1971

⁵⁶ OJ L 289 of 22 October 1983

⁵⁷ OJ L 289 of 22 October 1983

provide the Commission with all information necessary for the effective operation of the Fund and the Commission could conduct on-the-spot checks.

3.15.5. The clear intention of the legislator at this point for both the Social and Regional Funds was that individual projects should have clear objectives which accorded with the provisions of the Regulations and that payment should be conditional on progress to those objectives, for the Regional Fund within the framework of a wider programme. The Commission under these arrangements had a much more “hands on” role in project selection, monitoring and control in the Structural Funds. Later, as will become clear, there was a shift in the management balance between the Commission and the Member States.

3.15.6. The first major reform of these arrangements was in 1988 with Council Regulation 2052/88 of 24 June 1988⁵⁸. This was aimed at concentrating expenditure and moving to co-ordinated programmes rather than individual projects. Five common objectives for all of the then Structural Funds were set down. These were the promotion of development and structural adjustment in regions “lagging behind”; the redevelopment of regions suffering industrial decline; combating long term unemployment and facilitating young people’s entry to the labour market; facilitating workers’ adaptation to industrial change; facilitating agricultural structural adjustment and promoting rural development (objectives 3 and 4 were the exclusive domain of the Social Fund and 5a of the EAGGF Guidance section). Regulation 2052/88 also established arrangements to set overall Structural Fund expenditure over a number of years and distribute it by Member State. This is a recurring and important feature in the Structural Funds. Levels of Community expenditure by Member State are set down in the Regulations or by the Commission on the basis of the provisions of the Regulations using “transparent procedures”. Member States thereby negotiate target levels of expenditure before any scientific information on needs or absorption capacities is brought to bear on resource decisions. In short for the Structural Funds the ceiling of expenditure in each Member State is also a target and this is bound to have a knock-on effect in the areas of project selection, evaluation and control. There is pressure on the national administrations to find and on the Commission to accept sufficient projects to attain the predetermined levels of expenditure in each Member State. An inter-institutional accord of 29 June 1988 provided that the total amount available under the Structural Funds should be doubled in the period 1987 to 1993. Fund specific regulations were also adopted to dovetail each fund with the new horizontal regulations discussed here and below.

3.15.7. The implementing Council Regulation 4253/88 provided for co-ordination between the Funds based on a system of multi-annual planning. Member States were to submit integrated plans for specified regions upon which Community Support Frameworks detailing the forms of intervention and its financial volume over a three to five year period would be prepared by the Commission in conjunction with the Member State and followed up by operational programmes. Projects would be proposed within these frameworks by Member States and the Commission’s decision would cover an operational programme “package”.

3.15.8. Member States were supposed to prevent and pursue irregularities, recover amounts lost or themselves meet the cost except if they could show they had not been negligent and inform the Commission accordingly (article 23 of Regulation 4253/88). As well as conducting on the spot checks the Commission could reduce or suspend financial assistance from the Funds post facto (article 24 of Regulation 4253/88) if it was not satisfied with project implementation. Monitoring Committees of Member State and Commission representatives were established to verify progress towards programmes’ stated objectives.

⁵⁸

OJ L 185 of 15 July 1988

3.15.9. Changes were introduced in revised regulations in 1993 that had the effect of maintaining or consolidating the main principles adopted in 1988. New regions were incorporated, planning procedures were adjusted and provision made for Community funding of new types of measures. Five new regulations modified those of 1988, in addition to the adjustment of a Regulation on the financial instrument for fisheries guidance. Once again the financial volume of the Funds was almost doubled over a six year period and a new fund, the Cohesion Fund, set up to further economic and social cohesion by providing additional support in Spain, Italy, Ireland, Portugal and Greece.

3.16. The New Regulations and their Implications

3.16.1. The Structural Funds again stand on the threshold of a major reform. The Council has recently adopted a series of proposals encapsulated in five new regulations⁵⁹ based on the Commission proposal, COM(1998) 131 final, of which the key Regulation is again the “horizontal” one, Regulation 1260/99 of 21 June 1999. On the policy side these bring the number of common objectives down to three. These are to promote the development and structural adjustment of less developed regions; support economic and social development in regions with structural difficulties and support the adaptation and modernisation of education and training systems and employment. The first objective is assisted by four Funds (Regional, Social, EAGGF Guidance and the Financial Instrument for Fisheries Guidance), the second by the Regional and Social Funds as well as EAGGF Guarantee for rural development and the third by the Social Fund alone. A second major intention is to concentrate resources on a smaller overall population. By 2006 the percentage of the 15 Member States’ population eligible under objectives 1 and 2 will be reduced from 51 % to between 35 % and 40 %. Funding will be maintained at 1999 levels (286.4 billion for the period 2000 to 2006). One important aim of the reform is to clarify the respective roles of the Commission and the Member States.

3.16.2. On the management and administration side significant changes discussed in greater detail below are envisaged which impact on the roles of both the Commission and the Member States and which again pose questions about ultimate responsibility and the distribution of tasks. These will be considered from four standpoints, financial control and irregularity; project eligibility; additionality; and evaluation, ex ante, current and ex post. They will be examined in turn below and the new Regulations will be considered in the light of current and previous arrangements where this is appropriate. General remarks on organisation will also be made.

3.17. Financial Control and Irregularity

3.17.1. There has been a history of legislative change and development in this area. Articles 23 and 24 of Regulation 4253/88 dealt with financial control and the reduction, suspension or cancellation of assistance respectively. Article 23 required Member States to verify that Community financed operations had been carried out properly, prevent irregularities and recover any amounts lost. The Commission was to be informed of the measures taken and in particular of the progress of administrative and judicial proceedings. It was also permitted to carry out its own on the spot checks. Article 24 empowered the Commission to reduce, suspend or cancel the Community’s financial assistance, if the operation did not appear to justify the assistance, having asked the Member State for its comments. On paper control was further reinforced by the adoption of Commission Regulation 2064/97⁶⁰ which came into force in November 1997. This

⁵⁹ OJ L 161 of 26 June 1999 and OJ L 160 of 26 June 1999

⁶⁰ OJ L 290 of 23 October 1997

laid down in some detail what was required of Member States' control systems. The certification of payment claims was introduced. A sufficient audit trail was to be provided. Sampling controls of systems and expenditure declarations were to be introduced on the basis of risk analysis. The requirement already established in existing legislation to report irregularities to the Commission was reiterated and not later than final payment Member States were to submit to the Commission a statement summarising the conclusions of their control examinations in previous years. This provision has in effect not been implemented because for the current programme period no final declarations of expenditure have been submitted.

3.17.2. Under the new Regulation 1260/99 Member States are again to be the Community's first line of defence against irregularity and fraud in the Structural Funds. They are to ensure that management and control systems are in place, vouch for the expenditure declarations presented to the Commission (this time prepared by someone independent of project management) and recover sums lost through irregularity. Many of its provisions restate in other terms the requirements established in Regulations 4253/88 and 2064/97. For example the requirement to verify management and control arrangements (article 38 (1)(a) of Regulation 1260/99 and article 4 of Regulation 2064/97). What is new in article 38 of Regulation 1260/99 is a clear statement that the Commission "*shall ensure that Member States have smoothly functioning management and control systems so that Community funds are efficiently and correctly used.*" To this end the Commission's on the spot checks to be conducted with a minimum of one day's notice are to cover not just transactions but Member States' management and control systems. Thereafter the Commission may make observations including on the management shortcomings found and after observations from the Member State suspend all or part of any interim payment made. Article 39 of the same Regulation deals with recoveries and allows the Commission to effect recoveries after verifications where there are serious failures in management and control systems. Corrections are to be proportional and are to follow a structured attempt to come to an agreement with the Member State. This provision could be read as an embryonic clearance of accounts arrangement or the basis for developing such an arrangement.

3.17.3. The Committee's view is that the new Regulation does clarify responsibilities but whether or not in practice it leads to better control will be determined by how it is implemented. Experience to date of the implementation of current control provisions does not permit an optimistic forecast of this. It is also evident that resources devoted to control in the operational Directorates General with responsibilities for the Structural Funds are woefully inadequate to ensure proper implementation of the current legislation, never mind ensure implementation of the new Regulation. The Commission must also find the will and courage to implement the Regulation even if this means a Member State does not attain its expenditure target. It is also the Committee's view that although Regulation 1260/99 brings clarity in certain areas it also strikes the wrong balance between Member State and Commission responsibilities and powers in others. For example, if national rules are to be the primary criteria for determining eligibility (article 30 of Regulation 1260/99), then the Commission must at least be in position to monitor their application and be able to assess if the differences between national rules are giving rise to serious distortions between Member States in the pursuit of Community policy objectives.

3.17.4. It is important to recall the observation made at paragraph 3.1.4 above. For the Structural Funds as for the EAGGF Guarantee section it is the Member States who are almost always the disbursers of Community monies on their territories. However where an irregularity or fraud involving Community resources goes undetected or unreported it is the Community budget and not the Member State that pays. It is sometimes argued that because programmes and projects in the Structural Fund's sector are co-financed with Member States that there is an identity of interest in recovering undue payments and that Member States have an immediate incentive so

to do. The Committee is surprised, if this is the case, that for 1997 during which about 500,000 projects were current and total Regional Fund expenditure was 13 billion ECU only 79 irregularities for a total value of 27.5 million ECU were communicated to the Commission by national authorities under the terms of Council Regulation 1681/94⁶¹ which requires them to inform the Commission of judicial and administrative action taken in the event of irregularities.

3.17.5. The new and former regulations allow the Commission to conduct on-the-spot checks which may be followed by a suitable reduction in the amounts paid from the Community budget in accordance with article 24 of Regulation 4253/88 or article 39 of Regulation 1260/99 when it enters into force. In 1998 the Commission undertook 37 on the spot missions for the Regional Fund. Since July 1996 to date the Commission has made formal recovery decisions for 8 Regional fund cases covering 14 million ECU for the programme period 1989 to 1993. This is not credible as an indication of the sums lost to the Community to Regional Fund irregularities. During 1998 the Commission cancelled two interventions worth 2.8 million ECU on evidence of irregularity. However when asked the Commission was unable to provide information on the number of instances, and the value of these, where it had refused to pay the full amount requested by Member States at the closure of an intervention during the period 1989 to 1993. This was because the Commission's routine record keeping did not allow it to distinguish these instances from those where Member States requested a final payment which was less than the sum initially committed. In these circumstances the Commission can have no overview of the effect, financial and other, of its checking of final payment requests from Member States.

3.17.6. When asked by the Committee for information on the number of instances of formal application of article 24 of Regulation 4253/88 and their outcomes the Commission's services were unable initially to provide an elementary breakdown of the number of cases or their financial consequences. It emerged that information in this form was not routinely maintained by the Directorate General for Regional Affairs although assurances were given that it would be henceforth. This failure by the Commission to monitor the application of an important article on financial control in a basic Regulation confirms the Committee in its view that the article has been a dead letter and that it is the implementation of Regulations' provisions which is lacking rather than inadequate legislation per se. In part this situation arises because of Member States' aversion to the application of the Regulation.

3.17.7. For the Social Fund in 1997 123 irregularities were reported by the Member States and 21.2 million ECU were recovered. In 1998 86 control missions were undertaken by the Commission to cover a budget of 7,600 million ECU. If anything the Social Fund is more exposed to irregularities and even frauds because it deals in intangibles such as training courses and the like. Recent reports in one Member State indicate widespread Social Fund irregularity and fraud in two regions and there are indications from a larger Member State of irregularity rates in the Social Fund of up to 50 %. Notwithstanding this and subsequent investigations by the national authorities in the smaller Member State, as at 15 June 1999, these same authorities had not communicated to the Commission in respect of 1998 one single Social Fund irregularity which had been the subject of initial administrative or judicial investigations, as they are required to do by article 3 of Commission Regulation 1681/94 of 11 July 1994.

3.17.8. The new Regulation 1260/99 does provide for more co-ordination between the Commission and the Member States in the area of on the spot checks but its basic provisions as set down at its article 38 are not very different from the analogous provisions in the preceding

⁶¹ OJ L 178 of 12 July 1994

Regulation 4253/88⁶² at its article 23. The same is true for these articles' provisions on Member States reporting of irregularities to the Commission. If the Member States failed to respect the provisions of the old Regulation in these areas and the Commission was lax in enforcing the Regulation why should the adoption of a new regulation, of itself, necessarily change these practices? In the Committee's view the problem is more one of attitudes and a lack of respect for the rules rather than the rules themselves. Nevertheless the clarifications included in the new Regulation 1260/99 give the Commission more opportunity to insist on their application.

3.17.9. The Court of Auditors' annual Statements of Assurance indicate a material payment error rate in Structural Fund transactions present in the accounts of perhaps as much as 10 %, representing between 2 to 3 billion Euros. This must not be read as an indication of levels of fraud. The point is that there is an enormous gap between what the Commission is appraised of as irregularities as described at paragraphs 3.17.4 and 3.17.7 above and error levels determined by neutral and scientific auditing. There are two possibilities. The Commission and Member States have no idea of what is going on or the Member States know but the Commission does not. In either case the extent of the Commission's ignorance is culpable. This situation is at least in part the result of widespread project substitution and over-declaration (see paragraph 3.18 and ff.). More will be said on material error rates and the attitude of the Commission and Member States representatives on this question at 3.22.5.

3.18. Eligibility

3.18.1. The original arrangements for both the Regional Fund and the Social Fund allowed project eligibility to be considered by the Commission on a case by case basis within the framework of agreed programmes. By 1988 the volume of projects and the imminent expansion of Structural Fund activity made separate Commission decisions on individual projects an impracticable option. Regulations 2052/88 and 4253/88⁶³ in instituting a system of programming based on Community support frameworks and operational programmes allowed Member States to determine the projects that made up these programmes and moved the key decision about eligibility to that level. The Commission was to make one single decision for each operational programme as an entity (Article 14 of Reg. 4253/88). The real opportunity the Commission enjoyed to assess project eligibility was in effect transferred to the point where Member States submit expenditure declarations on programme completion. It became clear over time that the lack of clear definitions in the area of project eligibility was causing difficulties for both the Commission and the Member States. The practice of project substitution was used from the outset and became ever more frequent. If a project is declared ineligible by the Commission Member States simply submit a replacement project introduced to the operational programme post facto for just this purpose and often at a point where the new project is underway or even completed. The new Regulation 1260/99 now specifically permits this. Its article 39.2 reads “*the corrections made by the Member State shall consist in cancelling all or part of the Community contribution. The Community funds released in this way may be reused by the Member State for the assistance concerned.*”

3.18.2. The basic objective is that come what may, Member States be permitted to spend up to their financial targets. The real concern is to identify enough on- going projects to achieve that. In this respect and to provide a kind of “cover” against the possibility of a decision that a project is ineligible certain Member States routinely over-declare expenditure. This is clear from the

⁶² OJ L 374 of 31st December 1988

⁶³ OJ L 144 of 27 May 1989

report prepared under the auspices of the Commission entitled SEM 2000-etape III: 5eme rapport d'avancement.^{64.}

“In the case of the structural funds, an irregularity in terms of eligibility does not necessarily mean a loss of resources, since the Member States’ requests for pyament often contain more eligible items of expenditure than necessary so as to justify the Commission’s payment.”
(paragraph 2.2.3)

In essence the Member State has a programme and submits a total of, for example, 80 million ECU’s worth of expenditure and expects the Commission to identify say 50 million ECU of expenditure from that total, being the sum already earmarked for the Member State from the Structural Fund budget. If a project within the 50 million is found to be ineligible it will be replaced by another project identified by the Commission from within the additional 30 million.

3.18.3. The Commission has in any case always accepted project substitution and from 1988 onwards came to accept over-declaration. In a recent letter to the President of the European Council (19/5 /99) the Court of Auditors concludes that *“in many cases the over-declaration of eligible expenditure is insufficient to ensure that those errors do not have a definitive impact on the total of the Commission’s payments in respect of the programs concerned.”* The errors to which the Court of Auditors makes reference here are those uncovered in the preparation of its annual Statement of Assurance on the accounts. The substantial point is that over-declaration does not of itself remove the risk that errors are present in expenditure accepted by the Commission. A further comment on error rates, the Court of Auditors concerns and the reaction of the Commission and senior civil servants from the Member States will follow at paragraph 3.22.5.

3.18.4. A related difficulty which arises here is that equal treatment between Member States and between programmes within a Member State cannot be assured. If a Member State includes the whole field of action in the operational programme then there will be no possibility for it to substitute one project for another or to over-declare.

3.18.5. Following a process of consultation in the context of phase 3 of the SEM 2000 exercise the Commission prepared a package of 20 fact sheets or guidance notes dealing in detail with aspects of eligibility judgements to guide Member states and its own services in this area. The consultation was with the Group of Personal Representatives composed of senior civil servants in the main from Finance ministries in the Member States. The legislation now adopted, so the Commission argues, incorporates elements of these fact sheets that are consequently being revised. However the same legislation states in Article 30 of new Regulation 1260/99 dealing with eligibility that the *“relevant national rules shall apply to eligible expenditure except where, as necessary, the Commission lays down common rules on the eligibility of expenditure”*. Moreover in proposing the new Regulation the Commission stated that *“le contenu plus détaillé de la programmation, ainsi que la gestion des interventions, seront par contre de la responsabilité pleine et entière des Etats membres”*.⁶⁵ Revised fact sheets will continue to be available as points of reference but the basic eligibility decision will move substantially into the domain of the Member States. The Commission argues that because of co-financing the interests of the Member States and the Community run in parallel as far as project eligibility is concerned. However in many instances the Community’s share of a programme cost is much greater than the Member State’s.

⁶⁴ O/99/142-7/5/99

⁶⁵ COM(1988) 131 final, page 20

3.19. Additionality

3.19.1. Clearly if Community expenditure merely substitutes for national expenditure then it has no added value. The preamble to the Regional Fund's initial regulation (Reg. 724/75) insists that *"the fund's assistance should not lead Member States to reduce their own development efforts but should complement these."* Article 4 of Regulation 2052/88 covering all of the funds says that *"the Commission shall take the steps and measures necessary to ensure that Community operations ...impart to national initiatives an added value"*.

3.19.2. Additionality has never been easy to verify. It is difficult to determine its presence either in the context of specific projects or programmes or more globally. The move from individual project approval by the Commission to programme approval which occurred with the introduction of the 1988 reform effectively removed the possibility for the Commission of verifying additionality at this level at least ex ante. The 1993 regulations began to consider additionality at a global level only. Article 9 of Reg. 2082/93⁶⁶ states that *"the Commission and the Member State concerned shall ensure that the Member State maintains, in the whole of the territory concerned, its public structural or comparable expenditure at least at the same level as in the previous programming period, taking into account however the macroeconomic circumstances in which the funding takes placeand business cycles in the national economy."* This is already a very generalised and highly qualified interpretation of additionality. The new Regulation 1260/99 attempts to work with this broad interpretation and proposes a verification by the Commission of its application at the ex- ante, mid-point and ex-post stages of the programming period. For new objectives 2 and 3 the Commission and the Member State will establish the reference level of national expenditure for the programme period. It is clear however that this new definition of additionality merely reflect the fact that the Commission has no longer any effective means to ensure additionality below the macro-economic level. It is also difficult to believe that it disposes of any effective means to ensure additionality at the macro-economic level. What could the Commission do at the mid point or ex post stage if after its verifications it concluded that a Member State had reduced its level of public spending because of the availability of Structural Fund monies? The Regulation does not provide for a sanction of any kind. At no level, macro-economic or other can the Commission act independently of the Member States to observe, confirm or ensure additionality.

3.20. Evaluation

3.20.1. Evaluating and monitoring are different activities. Evaluation involves assessing the impact of the assistance while monitoring entails having an overview of implementation. The two activities have been linked in this field by the role established in successive regulations for the Monitoring Committees composed of Member State Representatives and chaired by the Commission. A key component in the matter of evaluation was the monitoring Committees set up in accordance with article 17 of Regulation 2052/88 which also provided for ex ante and ex post evaluation against the five objectives set at that time for the Funds. Their role was significantly reinforced in this area by the provisions of Regulation 2082/93 and the new Regulation further formalises this by providing for ex ante, mid point and ex post evaluation. In the case of ex ante evaluation especially a more systematic approach is introduced to allow a reference point for subsequent mid point and ex post evaluation. Monitoring is to be against both physical and financial indicators and is to be used to measure the impact of measures

⁶⁶ OJ L 193 of 31st July 1993

overall, at Community Support Framework level and at programme level. This being the case the monitoring Committees might better have been styled monitoring and evaluation Committees. While acknowledging the Commission's role in persuading Member States of the importance of evaluation the Court of Auditors made remarks in its Special Report 15/98 that the Committee finds disquieting. Despite the Commission's best endeavours on evaluation the Court reports that *"according to information gleaned orally during the (Court's) audits, only some of the results and recommendations are of any real use in terms of assisting decision-making, managing projects, re-programming or preparing the next generation of interventions"* (paragraph 6.7)⁶⁷. Other reports of the Court of Auditors have been critical of the relative passivity of the Monitoring Committees for whom progress has been measured almost exclusively in terms of the amount of expenditure effected.

3.20.2. Notwithstanding this the new Regulation will limit the Commission's role in the monitoring Committees to a purely advisory one. Article 40 of Regulation 1260/99 speaks of evaluation being a joint responsibility. The structure of these arrangements however leaves the Commission with little opportunity to conduct an independent evaluation the results of which may not accord with an evaluation entirely dependent on information from the Member State.

3.20.3. A further consideration is the overall impact on the objectives set out. Evaluation at this level is difficult not least because a major increase in levels of expenditure in a given limited area resulting from fund activity would have a "keynesian" effect whether or not the resources used were deployed in the interests of long-term structural development.

3.21. Organisational Aspects

3.21.1. At an administrative level the Committee noted a recent development in parallel with the introduction of the new Regulation. As the Community moves from 6 to 3 objectives the number of instruments involved increases yet again with the introduction of the "contribution" of the EAGGF Guarantee (as opposed to Guidance) section to objective 2. The argument advanced, that objective 2 sometimes entails rural development is hardly convincing. Does objective 1 not also entail rural development? A consequence of the new arrangement is that there will be different programme methods for rural development between objective 1 and objective 2. If the rural development element for objective 1 can safely be left to the Guidance section which has years of Structural Fund experience then why is the intervention of the Guarantee section necessary in respect of objective 2. The argument that the expenditure would be subject to clearance of the accounts has some merit. However if a clearance procedure is to be recommended for some objective 2 expenditure then why not all, indeed why not all Structural Fund expenditure. The Committee's view is that this hybrid administrative arrangement now reflected in the Regulation results from pressure from the agricultural lobby and internal bureaucratic considerations within the Commission related to the probable continuing decrease in agricultural price support expenditure.

3.21.2. The first objective (promoting the development and structural adjustment of regions lagging behind) and the second objective (supporting the economic and social conversion of areas facing structural difficulties) could be better attained, in the Committee's view, if both were covered by one unified fund managed by one Directorate General. This would allow easier co-ordination and control and achieve economies of effort and personnel resources for the Commission. It has been suggested to the Committee that such an arrangement would be

⁶⁷ OJ C 347 of 16 April 1998

opposed by the Member States because they prefer the structure of the Commission's services to mirror that of national administrations with a "corresponding" Directorate General for each national ministry. The Committee also believes that bureaucratic opposition within the Commission has so far precluded a rationalisation of this kind.

3.22. Conclusions

3.22.1. The legislative and administrative development of the Structural Funds tends to the conclusion that the balance of decision-making power and effective control of direction and expenditure has passed decisively to the Member States. The Commission has not acted energetically to protect the resources involved from irregularity and the gap between the irregularities uncovered and the rate of material errors revealed by audit is startling. As ultimately responsible for the implementation of the budget the Commission has no right to complacently suppose that irregularities are routinely uncovered and corrected in sufficient numbers in the structural fund area by the Member States. This point is linked in particular to the question of eligibility. The loss of the possibility of systematically verifying the eligibility of individual projects and substitution of projects has not been compensated on the Commission's side by a mechanism which would allow it to take an independent, informed decision to exclude expenditure and protect the integrity of operational programmes. Experience has shown that the Commission has great difficulty in ensuring the application of the key control articles of Regulation 4253/88, 23 and 24. Despite their greater clarity there is no reason to believe that the key control articles of the new Regulation 1260/99, 38 and 39, will of themselves be any easier to apply. Effective control in and of the Member States requires more staff resources.

3.22.2. Additionality is now almost impossible to verify and verification at the level of Member States national expenditure by region and policy is so problematic as to be pointless. The Commission has made serious attempts to promote evaluation but it is difficult to see why its role here should not be reinforced while that of the monitoring Committees is. In general it is difficult not to conclude that there has been a gradual erosion of the Commission's position in shared management of the Structural Funds. In this the Commission, if it has not lost sight of its primary Treaty derived responsibility to implement the budget, has at least allowed its vision of it to be obscured. This erosion of the Commission's position should not be confused with a clearer delineation of responsibilities. A clearer delineation of responsibilities is worthwhile in itself but it does not guarantee that the right balance has been struck between the powers and responsibilities of the Commission on the one hand and those of the Member States on the other.

3.22.3. Although control has passed to the Member States, six factors tend to divest them of responsibility.

- the separation of responsibility for financing and executing, where the Commission co-finances a policy for which the day to day management is the responsibility of the Member States.
- expenditure ceilings are also targets.
- Community support can be as high as 70 %
- project substitution which undermines project selection from the outset
- over-declaration which undermines project selection and control in general.
- the procedures for control and recovery by the Commission are difficult to apply under the old and probably under the new Regulations (4253/88 and 1260/99)

3.22.4. Other provisions of the new horizontal Council Regulation 1260/99 do have the benefit of making some matters clearer, for example how, by whom and when evaluation should be conducted. However its provisions on the reporting of irregularities and Commission on-the-spot missions are not very different from the previous provisions which have had very little practical impact. They have been more or less dead letters, in part because of project substitution and over-declaration by Member States, both tending to undermine their responsibility from the outset to take due care in selecting projects. What really matters is whether the Commission is energetic in implementing the new Regulation and in pushing for further reform while adjusting its administrative structures. It is the Committee's view that if this does not happen there will be no further reform of the Structural Funds but that under the strain of enlargement and the administrative difficulties faced by new Member States from central and eastern Europe the Community policy approach will give way to a simple redistribution mechanism, for which for the moment there is insufficient political support.

3.22.5. Part of this Committee's remit is to consider the Commission's administrative culture. The Personal Representative's Group of senior finance Ministry officials was constituted on the Commission's initiative to consider the whole area of shared management in the context of the SEM 2000 initiative. In this group's most recent document cited at paragraph 3.16.2 and prepared in conjunction with the Commission discussion turned to the Court of Auditor's Statements of Assurance. Remarks made here are illustrative of a joint reluctance on the part of the Commission and the national administrations to accept the existence of problems when their resolution might be difficult for Member States. On the Court's decision not to give a positive Statement of Assurance on payments in successive years following its scientific audit the document reads *"la situation n'est guère encourageante pour la Commission: pour la quatrième année consécutive, la Cour des Comptes n'a pas été en mesure d'établir une DAS positive sur les paiements."* The context of this remark, wherein the Court's methods are compared with a national Court of Auditors and its definition of error tendentiously questioned, would lead the reader to believe that the problem is the Court's unwillingness to give a positive Statement of Assurance rather than the underlying error rate which gives rise to that unwillingness. This is the world on its head. The Court is supposed to produce a positive statement, irrespective of the facts, to aid the Commission's morale at the behest of national civil servants. This is illustrative of an administrative culture that has difficulty with objectivity. The Court's reply in its letter of 19 May 1999 to the Council advises *"caution before any decision is taken which would involve a commitment to the achievements of a positive DAS on the transactions underlying the Commission's payments within a given timetable. Of course, where expenditure directly managed by the Commissioners concerned, it should be within the Commission's powers to make the necessary improvements within such a time scale. But the Member States will also have to ensure that their own monitoring and control procedures are strengthened – for example, implementing correctly the new higher structural fund's regulations and that their financial reporting to the Commission is improved, if the Commission is to be able to deliver reliable financial statements whose underlying transactions are legal and regular."* The Committee shares this view.

RECOMMENDATIONS

3.23. Shared Management in the EAGGF

The extreme complexity of the legislation renders the EAGGF Guarantee section vulnerable to fraud and makes its control very difficult. The control of EAGGF Guarantee expenditure remains an important current issue despite the gradual reduction in the EAGGF Guarantee section's percentage share of the total Community budget. Sensitive sectors such as export

refunds and direct income support are also key sectors which merit the Commission's particular attention. The recent clarification of the respective responsibilities of the Commission and the Member States for payments and control may have a positive impact if given the correct follow-up. The clearance of the accounts with the Member States is the final, overall management act by the Commission in its exercise of control over expenditure by the Member States under the Commission's responsibility. The findings of the Court of Auditors annual Statements of Assurance suggest that there should be an increase in the amounts recovered through the Clearance of Accounts.

3.23.1. All decisions taken by the Commission in the EAGGF Guarantee area, either as an administration or as a college, must be taken in conditions of complete independence. The Commission must ensure that the Clearance of Accounts unit can work independently and without being subject to any inappropriate external or internal pressure or influence (3.12.3.-4).

3.23.2. The Commission should ensure a more stringent application of the provisions of Regulations 1287/95 and 1663/95 which deal with the accreditation of paying agencies and the certification of their accounts (3.9.8.-3.9.10).

3.23.3. The Commission should make full use of its right of on-the-spot controls in the Member States for accounting and compliance clearance and exclude from the certified accounts those amounts relating to accounting errors and underlying transactions which are irregular (3.10.6.).

3.23.4. Where systematic weaknesses are found higher rates of flat rate correction for the amounts to be recovered should be applied (3.8.6., 3.12.2.)

3.23.5. There remains scope to recover greater amounts through a reinforced clearance effort. To this end the Clearance of Accounts unit needs a further increase in staff to allow a wider coverage each year and checks through to the level of the final beneficiary. It should set a target for amounts recovered linked to the error rates found by the Court of Auditors in its annual Statements of Assurance ((3.12.2.).

3.23.6. Interest should be charged by the Commission from the date of payment by the paying agency on those amounts recovered which have been subject to the conciliation procedure (3.11.1-3.11.5-6).

3.23.7. The threshold for amounts in dispute which can be presented to the Conciliation body should be increased if need be by expressing it as a fraction of the value of the average transaction in each Member State (3.11.3.).

3.23.8. The Commission should seek to reduce the length of time taken in the clearance procedure by reducing the number of steps and in particular the number of distinct occasions which Member States have to comment on proposed recoveries and the Commission's observations leading to them (3.10.9.).

3.23.9. The Commission should ensure that the cycle of Clearance of Accounts' inspection of market and direct payment regimes is short enough to guarantee that all major areas are covered in a 24 month period in view of article 1 of Regulation 1663/95 (3.10.7.).

3.23.10. In the new system the compliance clearance decisions can refer to transactions in different years. The Commission should therefore ensure that in the interests of transparency its

records and reporting show how much is recovered through compliance clearance for payments made for each accounting year (3.10.5.-8).

3.23.11. The Commission should pay particular attention to the area of export refunds differentiated by destination and ensure that guarantees are recovered in full when frauds are uncovered (3.13.2-5).

3.23.12. The Commission should give priority to ensuring the proper implementation and correct application of the Integrated administrative and control system (IACS) (3.13.6-7).

3.24. Shared Management of the Structural Funds

The size of the Structural Funds means that day-to-day control of expenditure must be exercised by the Member States. The fact that the division of responsibilities between the Commission and the Member States has recently been clarified in legislation does not mean that the right balance in the division of responsibilities has been struck. A certain number of factors tend to divest the Member States of responsibility. The Commission must ensure that the Member States have put in place effective control systems.

3.24.1. There has to be a strengthening of control within the Commission through reinforced internal control units in the Directorates General. This is necessary to avoid the Commission being almost entirely dependent on the Member States for information on implementation and irregularities and the subsequent possibilities of pursuing these. This recommendation accords with proposals made in Chapter 4 of this report concerning decentralised financial control and modern internal and professional auditing (3.17.2-9).

3.24.2. Checks by the Commission in the Member States must be reinforced both in number and in quality, that is to say they should go beyond checks which lead simply to the provision of advice by the Commission and an exchange of views. Checks should be designed to result in the detection of irregularities and consequently in financial corrections. They should be most frequent in countries and regions with relatively weak administrative structures. This implies more Commission resources devoted to control in the Member States This implies stronger and more effective control by the Commission of such structures in all the Member States (3.17.2-9).

3.24.3. The number of administrative units involved in the management of the Structural Funds should be decreased and not increased. To this end the EAGGF Guarantee Directorates in DG 6 should have no role in rural development measures which should be left to the Guidance Directorates. The Committee's view is that only one Directorate General should have responsibility for the new objectives 1 and 2 (3.21.1.-2).

3.24.4. The use of diverse national rules to determine project eligibility if compatible with the provisions of the Treaties, should be carefully monitored by the Commission to ensure equality of treatment in respect of Structural Fund assistance for all citizens of the Union. Where the national rules cannot ensure this then the Commission should come forward with one or more additional eligibility datasheets to function as guidance notes (3.18.5.).

3.24.5. The Commission should refuse to accept over-declarations for reimbursement from Member States and return them for proper presentation (over-declaration occurs where Member States in claiming submit more expenditure than their entitlement leaving to the Commission the task of selecting eligible expenditure from within this larger sum). It is the Member State's

responsibility to present its claims for payment in a transparent and detailed way so that all parties can be satisfied that the expenditure concerned was eligible and its effects can be evaluated (3.18.1.-4).

3.24.6. Member States should inform the Commission of all project substitutions and their value. The Commission should systematically retain this information to form an overview of the integrity and coherence of the programmes. Member States should prepare for comparison the initial proposal without substitutions with the final outcome with substitutions. This would allow the Commission to intervene to assess certain instances of re-use and to ensure it may recover sums unduly paid from the Community budget(3.18.1-4).

3.24.7. If the reforms referred above at paragraphs 3.24.1. and 3.24.6. were not to be implemented, the Commission should take the initiative by preparing a distinct legislative proposal.

*CHAPTER 3 : SHARED MANAGEMENT***European Union Budget 1999****Expenditure by broad category (1999 payment appropriations)**

	mio EUROS	in % of total budget
EAGGF – Guarantee	40735	48.5
EAGGF – Guidance	3774	4.5
Regional Fund	12702	15.1
Social Fund	7246	8.5
Other Structural Funds	3846	4.7
TOTAL Structural Funds	27568	32.8
Cohesion Fund	2887	3.4
TOTAL Structural & Cohesion Fund	30455	36.2
Other expenditure	12798	15.3
TOTAL budget	83978	100.0

Source: OJ L 39 - Final Adoption of the General Budget of the European Union for the Financial Year 1999.

4. THE CONTROL ENVIRONMENT

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- 4.15. Organisational consequences**
- 4.16. The use made by the Commission of the audit findings of the Court of Auditors**
 - Audit coverage*
 - Nature of audit observations*
 - DAS*
 - Timing of reports*
 - The Contradictory Procedure*
- 4.17. Parliamentary budgetary control**
- 4.18. Recommendations**

Annex 1: SEM 2000 Recommendations

Annex 2: DG XX – Facts and Figures

INTRODUCTION

4.1. The basics

4.1.1. The present chapter will examine the mechanisms in place within the Commission for the control of revenue and expenditure⁶⁸. Such mechanisms include the measures taken to verify the legality and regularity of expenditure *before* it is made - *ex ante* control - and those which occur *after* or *during* expenditure - *ex post* control.

4.1.2. These functions, currently grouped under the responsibility of the Directorate-General for Financial Control (DG XX), are in fact substantially different in nature. The former category is essentially an administrative process whereby proposals for expenditure (both commitments and payments) are checked for conformity with the appropriate rules and procedures and validated by the Financial Control service. Approval for an operation must explicitly be given before it can take place. This procedure is known in Community jargon as the granting of a "visa". The second category of control takes the form of *audits*, which may be of specific services, programmes, projects, etc., carried out by a specialised service within DG XX, the conclusions of which ultimately take the form of reports by the Commission's Financial Controller. For the purposes of this chapter, the two functions will be referred to as **internal control** and **internal audit**.

4.1.3. Both functions, though different in nature, include verification of conformity with the financial rule-book of the European Union, the *Financial Regulation*.⁶⁹ This document, the application of which is further elucidated in *Implementing Rules* adopted by each institution, is the basic text of financial control. It lays down the ground rules for the basic budgetary procedures: the establishment, structure and presentation of the budget, the implementation and management of the budget, the presentation of the accounts, the external audit of the accounts and the discharge to be granted to the Commission for its implementation of the budget. It also contains a number of special provisions for specific areas of expenditure. For present purposes, the key provisions are those concerning implementation of the budget by the Commission and the oversight exercised over them by DG XX.

4.1.4. One key provision of the Financial Regulation is that each institution shall appoint a *Financial Controller* with two principal tasks: monitoring (i) the commitment and authorization of all expenditure, and (ii) the establishment and collection of all revenue.⁷⁰ The Financial Regulation is also concerned with the status of the Financial Controller. Each institution shall make its own provisions in its implementing rules, but in all cases these "*shall be such as to*

⁶⁸ For those familiar with audit terminology, the title of this chapter, "control environment", is used here with this restricted meaning. It will not concern itself with the wider connotations of the term (e.g. corporate ethos, disciplinary regime, etc.) as these are covered abundantly elsewhere in the report.

⁶⁹ The "Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities" (OJ L356 of 32.12.77), amended on eleven occasions.

⁷⁰ Article 24, first and third indents

guarantee that they are independent in the performance of their duties".⁷¹ In the case of the Commission, the Financial Controller is the Director-General of DG XX.

4.1.5. Another fundamental of the financial control system, also contained in the Financial Regulation, is the *separation of functions* between the person authorising expenditure and the person actually carrying out the financial operation concerned, or, as the text has it, *the authorizing officers and accounting officers are different individuals*"⁷². Consequently, any commitment or payment order requires the agreement of three individuals: the authorizing officer, who enters into financial commitments and issues payment orders, the Financial Controller, who gives his/her visa for the operation, and the accounting officer, who carries out the operation in question. These duties, in the words of the Financial Regulation, are "*mutually incompatible*".⁷³

4.2. Ongoing reforms

4.2.1. In some respects, the Committee is dealing with a moving target in this field, notably because of the processes underway as part of the "SEM 2000"⁷⁴ initiative. The purpose of this initiative is to address failings in the Commission's financial management identified by the Santer Commission at the beginning of its mandate. SEM 2000 was billed as a wide-ranging reform not only of formal structures and procedures, but also of the entire financial management "culture" of the Commission. (The eleven "recommendations" of SEM 2000 are reproduced in Annex 1 to this chapter.)

4.2.2. Latterly linked with the SEM 2000 process, several batches of amendments to the Financial Regulation (picturesquely known as "trains") have been put forward by the Commission in response to the changing circumstances of financial management. While each "train" has been proposed for good reason, the overall result, inevitably, has been to complicate the Financial Regulation to the point that it is becoming unworkable. Under pressure not least from the Court of Auditors, the Commission has therefore stopped the process of partial revision and launched a complete review of the Financial Regulation under the banner "the Recasting of the Financial Regulation"⁷⁵. Its reflections have not yet, nor will for some time, taken concrete form. However in its introductory document, the Commission, after acknowledging that the repeated amendments of recent years have "*robbed the 1977 text of some of its coherence and readability*"⁷⁶, outlines the nature of the modifications it intends to propose. These relate both to

⁷¹ *Idem.* eighth indent

⁷² Financial Regulation, Article 21 (first indent)

⁷³ *Idem.* (fourth indent)

⁷⁴ "Sound and Efficient Management 2000"

⁷⁵ Title of Commission Working Document - SEC(1998)1228 of 22.7.1998

⁷⁶ *Idem.* Introduction, paragraph 2 (see also the Court of Auditors: "As a result of the successive proposals for revising the Financial Regulation, a good many "facilities" have been arranged, or allowed to emerge; these discretionary arrangements are regarded as useful for managers ... but tend to run counter to a disciplined approach and hugely complicate the accounting and financial management" - Court of Auditors opinion 4/97 (10.7.97) para. 14 - Quoted by Commission in introduction)

form (clarity of text and consistency with other legislation) and to the substance of the provisions laid down in the Regulation. The task is a vast one, which will potentially take considerable time to complete. It is also subject to complex legislative procedures and involves a substantial input notably from the European Parliament, the Council and the Court of Auditors. As such, it would be inappropriate (not to say impractical) for the Committee to attempt to "second guess" these procedures by indulging in its own systematic review of the Financial Regulation. It will therefore restrict itself to indicating its ideas on specific reforms, as they arise in its analysis, and assumes that, insofar as the Committee's recommendations are considered useful, they will be "built-in" to the new Financial Regulation as necessary.

4.3. Other control mechanisms

4.3.1. Though this chapter is predominantly concerned with the internal control functions currently carried out by DG XX, it will also deal more briefly with other aspects of control.

4.3.2. It will thus comment briefly on the *external audit* function, carried out by the Court of Auditors, and in this context at the *political budgetary control* exercised by Parliament (though this subject is more correctly the subject of Chapter 7 and is covered more deeply there). It must also make mention of the *internal inspection* carried out by a specialised service of the Commission⁷⁷.

4.4. Approach taken

4.4.1. The recommendations to be made in this chapter will concern the key matters of principle according to which the Committee believes the Commission's audit and control environment should be designed and do not to enter into the small print of the reforms it identifies as desirable. It is for those directly concerned to build a system which will work on the foundations of these principles.

4.4.2. Furthermore, although SEM 2000 in many respects addresses a similar range of problems to those arising in this chapter, the Committee has preferred, for the purposes of this report, to base its analysis on the situation currently prevailing in the Commission, rather than take its lead from the Commission's own project for the reform of financial management. Although conscious of SEM 2000 plans, and though mention will be made on the occasions where there is a clear coincidence of thinking between SEM 2000 and the Committee's own reflections, on the whole the Committee prefers to follow its own path in reaching its recommendations.

⁷⁷ Referred to in this chapter by the commonly used French acronym, IGS - "Inspektorat Général des Services"

4.5. The First Report: Identifying problem areas

4.5.1. In its first report, the Committee made a range of criticisms relating to the role of the directorate-general for Financial Control. Two observations in particular point to problems which the Committee would identify as fundamental.

4.5.2. The first, in paragraph 9.4.14, is a simple but telling statement of fact:

“Most of the irregularities highlighted by the Committee stemmed from decisions to which Financial Control gave its approval”

4.5.3. Behind this fact lies a substantial question mark as to the effectiveness, indeed usefulness, of *ex ante* financial control as currently organised in the Commission.⁷⁸ It is a question posed not only by this Committee, but one exercising the collective mind of the Financial Control service of the Commission itself. This is hardly surprising: according to DG XX's figures, in 1998 it processed over half-a-million financial transactions. (This could be one factor in the unfortunate reputation the Commission has required for late payment of creditors) The bulk of DG XX's staff is dedicated, directly or indirectly, to *ex-ante* control.⁷⁹ In spite of this, the volume of operations has already led to a system whereby proposals are only studied on a sample basis (30% in 1998, descending to 10% in 1999), with the great majority of operations therefore receiving approval automatically. On this basis, and notwithstanding the application of some effort to target controls on the basis of risk analysis, the supposed “quality guarantee” provided by the *visa* is a myth, and the sense in which authorising officers feel correspondingly relieved of responsibility for the financial regularity of the operation unjustified in either fact or principle.

4.5.4. The second observation relates to the other function of DG XX, internal audit. In this case, the problem arises as a common thread throughout the report. It frequently occurred that irregularities were identified in the course of audits by DG XX, and that these irregularities were such as to indicate at least the necessity for swift remedial action. The prime example of this phenomenon was the Leonardo case, where observations (subsequently proven to be accurate) in early drafts disappeared in final texts.⁸⁰ Moreover, the finalisation of texts can take an inordinately long time, as the arguments under the so-called “contradictory procedure” between auditor and auditee, especially on difficult cases, become protracted.

⁷⁸ Notably in the context of SEM 2000 (see especially "recommendation 11" - Annex 1)

⁷⁹ For detailed figures see from "Financial Controller's 1998 Annual Report" - SEC(1999) 446/2A/4,6,8 (summarised in Annex 2). It should be said that these figures are presented for reference purposes only, as the classification of work and staff (particularly in the category "ex-post" audit) is questionable.

⁸⁰ See First Report, Chapter 5

4.5.5. The Committee supports the basic principle of the right of reply: there is no question that the auditee should have the possibility to reply to audit findings *before* the report is finalised. The problem identified by the Committee is not that the contradictory procedure exists, but in the way it operates in practice - which is in turn the result of the relative position occupied by DG XX within the Commission. What, in the final analysis, is in question is the very conception of internal audit within a large organisation such as the Commission.

4.5.6. The focus of this chapter will therefore be on two subjects: the redesign of internal control and the transformation of internal audit.

4.5.7. The recommendations made will be based on the premise - also the subject of an observation in the first report⁸¹ - that the two functions, *ex ante* control of regularity of financial operations and *a posteriori* audit, are entirely separate (even conflicting) activities which do not belong in the same department.

INTERNAL CONTROL

4.6. The need for change

4.6.1. There are different possible responses to the observation that the *visa* system of financial control in the Commission does not work. The first (an "ideal world" solution) is to try to make the existing system work in practice as it should in theory, in such a way that all financial proposals are genuinely and thoroughly checked. This would involve posting a *vastly* increased number of officials to the financial control service - a move which is impossible for a variety of reasons. A second response is to accept the impossibility of universal testing, by moving to a sampling system, whereby only relatively few, hopefully "targeted", transactions are thoroughly checked with the rest receiving an "automatic" *visa* (this being the current, SEM 2000-sanctioned situation).

4.6.2. Whatever the (im)practicalities of these options, the Committee continues to have strong reservations about them on two points of principle. First, *ex ante* checking, whether it be universal or on the basis of sampling, is unlikely to be a cost-effective process: the effort put in to checking all transactions is clearly disproportionate, while sampling is unlikely to have sufficient dissuasive effect. The second, and fundamental, principle is that any retention of *ex ante* control runs up against the crucial objection that, *de facto* if not *de jure*, it displaces responsibility for financial regularity from the person actually managing expenditure onto the person approving it. This displacement of responsibility, meaning in effect that *no-one* is ultimately responsible.

4.6.3. Thus we arrive at the third kind of response, namely a complete re-examination of the very concept of *ex ante* control.

4.6.4. In the world of international financial management, the *ex ante* financial control system of the Community institutions has something of an antediluvian feel about it. It corresponds to

⁸¹ Paragraph 9.4.16

an outmoded "belt and braces" vision of control which places little value on the sense of personal responsibility of the "manager", focuses on the formal aspects of operations⁸² and which can in any case only work effectively in an environment where a relatively restricted number of financial proposals pass through the system. Both these points have been identified by the Committee as major problem areas for the Commission, which, as the first report of the Committee pointed out, does not structurally encourage a sense of personal responsibility in its staff and carries out a number and range of financial activities beyond its capacity to manage them. In terms specifically of the European civil service, the problem is further exacerbated by the near-impossibility of applying administrative sanctions of a pecuniary nature against officials who commit irregularities.⁸³

4.6.5. Most modern practice indicates a shift away from rigid *ex ante* control systems, to ones which rely on a combination of high quality financial management at source together with a firm regime of *ex post* audit. DG XX itself in part reflects this development, having created an internal audit service alongside the traditional *visa* departments. In doing so, it has arguably provided itself with the worst of both worlds, in the shape of two services, neither of which stands a serious chance of operating effectively. To make matters worse, the functions of the two services are potentially in conflict, as the audit service will inevitably throw up cases where financial control has granted a *visa* for an irregular operation (cases abound...). The position of the Financial Controller in such cases is not a satisfactory one.

4.6.6. The conclusion to be drawn is clear. First, financial control (i.e. the *ex ante* guarantee of the regularity of financial operations) must be completely rethought with a view to making the managers of expenditure genuinely and concretely responsible for it. Second, this function must be completely separate from the internal audit function.

4.7. The principles of responsibility in financial management

4.7.1. The considerations outlined above point to a series of principles which must be respected in any redesign of financial management:

- the manager of expenditure ("authorising officer") must be and feel responsible for all aspects⁸⁴ of the financial operations she/he carries out;
- the responsibility of authorising officers must be concrete and enforceable: formal and practicable mechanisms must exist to sanction contraventions;
- attribution of competences and the delegation of authority in any financial management structure must consequently be clear and unambiguous, in such a

⁸² Notwithstanding the fact that Art. 38(1)e of the Financial Regulation does allow respect for the "principles of sound financial management" to be taken into account.

⁸³ This statement is made not least on the basis of empirical evidence: no Community official has ever been sanctioned under Article 22 of the Staff Regulations (see Chapter 6)

⁸⁴ Broadly, the "legality, regularity and sound financial management" of expenditure. (c.f. TEC Art. 248(2) - *paraphrase*)

way as to allow responsibility to devolve through the hierarchy in an identifiable fashion;

- authorising officers must be adequately trained and equipped to exercise their financial responsibilities;
- a demanding system of accounting, reporting and audit should reinforce the principle of accountability.

4.7.2. With such a system for authorising officers in place, central financial control as currently conceived essentially becomes redundant. Certainly, the submission by authorising officers of financial proposals for approval to a separate directorate-general of the Commission no longer has a place in the system. The "quality control", which is the ultimate purpose of financial control, should be ensured at the level of the directorate-general responsible for the expenditure. A form of "decentralisation" is thus envisaged, whereby responsibility is repatriated in the operational services. Reasons of efficiency moreover preclude any notion that a *visa* system be reproduced in the directorates-general.⁸⁵

4.8. What is internal control?

4.8.1. Before proceeding, it is worthwhile pausing to consider what exactly is meant by "internal control", if the old-fashioned notion of it as an *ex ante* check on regularity is to be replaced. The convenient shorthand term "quality control" has already been used. To be more specific, internal control consists of all activities, instructions and routines in each directorate-general that ensure proper and secure handling of the DG's assets and financial resources. These can be outlined as follows:

- the provision to all parties to financial processes of adequate, complete and accurate information relative to their tasks;
- measures to monitor and guarantee compliance with all relevant procedures, instructions, regulations and laws;
- measures to protect public property and safeguard the value of public assets;
- measures to ensure the economic, efficient and effective use of resources according to the principles of sound financial management;
- measures to monitor and, as far as possible, guarantee the achievement of policy aims, priorities, targets and objectives.⁸⁶

⁸⁵ Though SEM 2000 does not commit itself to this idea, it visibly moves in the same direction - Recommendation no. 11 (Annex 1)

⁸⁶ The criteria applying to *a priori* internal control neatly match those to be reviewed and assessed by internal audit (c.f.14.12.4)

4.9. A new framework for internal control

Oversight and support

4.9.1. Within its vision of a decentralised internal control system falling under the responsibility of each director-general, the Committee would emphasise that it is not proposing anarchy. SEM 2000 already offers a context within which a harmonised financial culture is taking shape, complete with a system of financial "cells" within each directorate-general. This "spread" of financial competence is a vital component in the future development of the Commission. Moreover, for obvious technical/management reasons, it is important that accounting methods and basic financial management procedures should be the same throughout the Commission.

4.9.2. The preoccupation of the Committee that individual director-generals and their delegates should be personally responsible for the functioning of internal control systems and the regularity of individual financial transactions thus does not imply that they should simply be left to sink or swim. On the contrary, it becomes increasingly important that the appropriate structures be in place and that adequate guidance and support be available to authorising officers. This observation points to two needs which must be met.

4.9.3. First, a central specialised financial unit will continue to be necessary to oversee internal control arrangements, to propose and coordinate amendments to the Financial Regulation and other financial rules and procedures, to provide (when necessary) interpretations of the regulations and other advice to authorising officers, etc. Such a unit, which in the view of the Committee should be based in DG XIX (Budgets), should play no formal role in the processing of individual transactions (though, at the request of a director-general, it could offer advice on specific cases), but should establish the basic procedures and ground rules for financial management and monitor their application.

4.9.4. Second, obligatory and regular training must be available to all participants in financial processes. Current practice, whereby individual officials are simply allocated financial responsibilities and left "to get on with it", has no place in the management of a modern organisation. An essential *quid pro quo* of the personal responsibility to be given to authorising officers is that they, in their own interests as well as those of the Institution, be adequately equipped to exercise financial functions.

Delegation of authority

4.9.5. A further *sine qua non* of making internal control work is that the system of delegation in the Commission, and thus the responsibilities attached to each level of the hierarchy, must be absolutely clear. The font of all authority in the Commission is the college of commissioners itself. Ultimately therefore, responsibility for all actions of the administration must find its way back to individual commissioners and through them to the college. The relationship between the commissioners and the upper level of the Commission's permanent hierarchy is discussed in Chapter 7 and need not detain us here. It suffices to say that the administrative authority vested in director-generals is delegated from the Commission itself through single commissioners, with the actions of each director-general being carried out under the supervision of the commissioner (as part of the latter's duty to supervise the overall functioning of his/her directorate(s)-general)

and under his/her political responsibility (cf. 7.9.6). The global operation of internal financial control falls within the concept of the collective responsibility of the Commission as a whole.

4.9.6. For present purposes, the chain of delegation begins at the level of the Commission through the commissioner. She or he thus holds the ultimate responsibility for all financial matters, including for internal control, and as a member of the College.

4.9.7. It is for the director-general to assume (overall) responsibility for all operational matters in her/his directorate-general, including for internal control. Any subsequent delegation to subordinate managers directly under the director-general should be established by the latter in a specific document covering the order of delegation and the precise competences delegated. In this order of delegation the manager directly under the director-general is answerable to the latter for the management of his/her directorate/unit. This delegation of responsibility and accountability also covers internal control. Every subordinate manager is responsible and accountable for the internal control within his/her field of responsibility.

4.9.8. Accordingly, whatever the delegation of authority, the director-general bears primary managerial responsibility, as delegated to her/him by the relevant commissioner, for setting up and ensuring the smooth functioning of efficient and effective control systems that guarantee that regulations are adhered to and that established strategies, policies and plans are followed.

4.9.9. Notwithstanding the chain of responsibilities outlined here, it is important that consistency in financial rules and procedures be maintained across directorates-general. It would be the overarching role of the central financial unit in DG XIX (see 4.9.2-3) to ensure this.

Financial operations - procedures

4.9.10. Within the system of delegation set up in any given directorate-general, specific individuals will, as at present, have the task of authorising financial operations. Under Title V of the Financial Regulation, these persons, the authorising officers, are already (in theory) personally responsible for the regularity of the operation in question. For this responsibility to operate in practice, there should, as this chapter has already argued, be no formal procedure whereby the financial proposal is "vetted" or approved by a third party as a precondition of it taking place.

4.9.11. None of this is to say that there should not be safeguards in the system. In terms of the quality of the preparation of financial transactions, each authorising officer will have the resources of the directorate-general's specialised financial cell at his/her disposal in accordance with the internal procedures put in place by the director-general. In particularly difficult and/or complex cases, the authorising officer should also be able to call on the expertise of the central financial unit in DG XIX for advice.⁸⁷

4.9.12. Furthermore, the intervention of the accounting officer should remain in place, through the presence of a delegated accounting officer in each directorate-general. The need for all operations to be booked in the Commission's accounts will continue to exist, implying the

⁸⁷ This unit would incorporate the "advisory unit on contracts" referred to in chapter 2.

existence of an individual carrying out this role. Moreover, the formal aspects of a transaction (presentation, presence of requisite signatures, authority of authorising officer to sign for the amount concerned, etc.), together with the availability of appropriations, should be verified by the accounting officer. A refusal on the part of the delegated accounting officer to implement a transaction should be referred back immediately to the authorising officer who should then decide, on his own responsibility, whether to overrule the objection and proceed with the operation. The provision of the Financial Regulation whereby the functions of authorising and accounting officer are separate (see para. 4.1.5) should therefore be maintained. (It should be noted that further proposals made below will affect the exact role of accounting officers - these do not however affect his/her participation in the implementation process)

Accounting and reporting

4.9.13. A further vital component of any system based on the "responsibilisation" of authorising officers is an adequate system of monitoring, accounting and reporting. At present, the accounts of the Commission are maintained for official purposes solely by DG XIX. In the view of the Committee, though it is necessary that consolidated accounts be maintained for the Commission as a whole, a system whereby responsibility for financial management is decentralised to the directorates-general implies that official accounts should also be drawn up at that level.

4.9.14. The Committee therefore recommends that each directorate-general be obliged to prepare an annual report and accounts covering all its activities. In accordance with general public and private sector practice, this document should not only contain information of a financial nature, but should also review the activities of the directorate-general more widely, indicating its activities in pursuit of policy objectives and assessing its success in achieving those objectives. This report should bear the certificate of the internal auditor as to the reliability of the accounts and be submitted, first, to the Commission as a whole by the competent commissioner and, second, by the Commission as a whole to the competent institutions as part of the annual discharge procedure.

4.9.15. This proposal is intended to be more radical in its effects than in the new workload it imposes on the Commission. Most, if not all, the information to be included within the annual report is already published (and thus prepared) by Commission services in an array of separate reports, brochures, accounts, etc. So far however, this has never been done in such a way as to make the clear link between the management structures through which policy and expenditure are implemented and the outcome of policies and expenditure. Under the Committee's proposals, this link, which is one of responsibility, is made explicit in order to reinforce the chain of accountability.

4.9.16. If accounts are to be formalised at the level of directorates-general, there are implications for the function of accounting officer. For this reason too, each directorate-general will require its own delegated accounting officer.

4.9.17. The system proposed is one which, if the accounts are to be meaningful, relies upon a greater degree of logic and homogeneity in the division of financial responsibility between directorates-general than currently exists. (See especially chapter 2)

Enforcement of authorising officers' responsibility

4.9.18. From the outset, this chapter has recognised that responsibility must be more than an abstract concept. If the principle is to be workable in the long run, specific administrative sanctions, possibly including of a monetary nature, *must* be available to back up the notion of responsibility in cases where authorising officers grievously fail in their obligations to the institution.

4.9.19. Theoretically, a general possibility already exists under the Staff Regulations to oblige an official "to make good, in whole or in part, any damage suffered by the Communities as a result of serious misconduct on his part in the course of or in connection with the performance of his duties"⁸⁸ This possibility, which in any case is not limited to financial matters, has, to the best of the Committee's knowledge, never been used to exact monetary compensation from an official. (Chapter 6 further examines the possible disciplinary procedures.)

4.9.20. However, the starting point for fixing the individual *financial* responsibilities of authorising officers lies in the specifically *financial* provisions of the European Union, namely the Financial Regulation.

4.9.21. Title V of the Financial Regulation, entitled "Responsibilities of authorising officers, financial controllers, accounting officers and administrators of advance funds", establishes the principle that individuals bear a personal responsibility for their actions:

*"Authorising officers who, when establishing entitlements to be recovered or issuing recovery orders, entering into a commitment of expenditure or signing a payment order do so without complying with this Financial Regulation and the rules for its implementation, shall render themselves liable to disciplinary action and, where appropriate, to payment of compensation."*⁸⁹

4.9.22. Later in Title V, an indication is given of how this liability might be applied:

*"The liability to payment of compensation and disciplinary action of authorising officers ... may be determined in accordance with the provisions of Articles 22 and 86 to 89 of the Staff Regulations"*⁹⁰ (emphasis added)

4.9.23. The Financial Regulation foresees the possibility therefore (note: *not* the obligation) of "operationalising" the liability of authorising officers through the disciplinary procedures under the terms of the Staff Regulations. The difficulties associated with disciplinary procedures were mentioned in the Committee's First Report, and are discussed in detail in Chapter 6 of the present report, where recommendations are made for improvements. In the case of the highly specific subject of *financial* misconduct, the difficulties are particularly serious as nature of the supposed misconduct in question adds extra complications to the process of establishing the responsibility of an official, insofar as specific accounting/financial methods are necessary.

4.9.24. With these problems in mind, the Committee considers that the formal establishment of the responsibility of authorising officers, and any subsequent liability, should be through a new, separate and specific procedure, limited to strictly financial affairs and governed by the

⁸⁸ Staff Regulations, Article 22

⁸⁹ Financial Regulation, Article 73 (extract)

⁹⁰ Financial Regulation, Article 76 (extract) -121-

Financial Regulation. In this respect, however, Title V of the Financial Regulation, as currently worded, is insufficiently specific concerning the mechanisms by which individual responsibilities (and possible liabilities) can be established.

4.9.25. First, it is necessary that the financial irregularity and the persons concerned be identified. As indicated above, this is a job which requires specific financial/accounting know-how and respect for correct procedure. Moreover, the body performing this function must be independent of the service to which the authorising officer belongs. The Committee therefore believes that the Internal Audit Service (whose creation is proposed later in this chapter) should report, according to its usual procedures, on individual cases of financial irregularity and identify the authorising officers concerned. It should do this either on its own initiative, under the responsibility of its Head, on the basis of facts emerging in the course of its normal work, or on the basis of a (duly justified) request from the President, the competent commissioner or a director-general.

4.9.26. Second, the personal responsibility of the individual must be fixed. This should be the task of a specialised financial irregularities committee, composed of persons with relevant experience and attached directly to the Secretary-general. This committee would deliberate on the basis of the reports described above.

4.9.27. The task of the committee described above would simply be to establish and identify the responsibility of an authorising officer. It could do so in a variety of ways, depending on the seriousness of the case. This process, which is purely administrative in nature, could then be followed up, if necessary, by disciplinary procedures.

4.9.28. To conclude, the Committee recommends that the Title V of the Financial Regulation be amended to provide for the procedure outlined above.

INTERNAL AUDIT

4.10. Internal v. External Audit

4.10.1. Audit in the public sector has - or should have - a dual function, reflected in the existence of two forms of audit, external and internal. The purpose of *external* audit is to provide the taxpayer with assurance that public money is being spent in a manner which respects the principles of legality, regularity and sound financial management⁹¹. It can therefore be seen as “public interest” audit. Such audit is external because it must be completely separate from, and thus independent of, the auditee. Such audit seeks objectively to analyse revenue and expenditure and to identify the problems and issues which should be made public.

4.10.2. By contrast, the *internal* auditor provides a powerful tool by which the “management” of the organisation can achieve its objectives with maximum efficiency and at the same time help instill the sense of responsibility in its line managers necessary for effective internal control. In this respect, internal audit in the public sector is more closely related to the conventional internal audit function in the private sector, whose function is not necessarily to make public the weaknesses and irregularities it detects, but to report them to the management in order that remedial action may be taken. It follows that the internal audit service answers only to “top management” and occupies a position of independence within the structure of the organisation.

4.11. The weakness of the present internal audit function

4.11.1. Two related issues lie at the heart of DG XX's audit problems. First, as already stated, the independence of the Financial Controller *vis-à-vis* the auditee is compromised by the mere fact that, at present, both the *visa* and audit functions fall under her/his responsibility as director-general of DG XX. One branch of the directorate-general therefore potentially audits the actions of the other. Second, and in the light of experience more importantly, the Financial Controller does not enjoy the position of authority with respect to other Commission services which is needed to make her/his independence truly operational. In practice, the position of DG XX as just one directorate-general among others, and the corresponding position of the Financial Controller as just one high-level nominee among others, compromises her/his ability to translate audit findings into management action.

4.11.2. The most telling confirmation of this problem comes in the observation that numerous “sensitive” reports drafted by DG XX auditors have been the subject of lengthy contradictory procedures, often with the effect, and, one suspects, the intention, of delaying the report - and any consequent action - by periods of several months. Leaving aside for the present the need to introduce concrete measures to reduce the time taken for contradictory procedures to a reasonable level, these discussions tend to take on the nature of a negotiation between fellow director-generals. In this process, the purpose of audit - the detection and rectification of

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Cf. TEC Article 248 (*ex 188c*) Para. 2.: “The Court of Auditors shall examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound. In doing so, it shall report in particular on any cases of irregularity.” In the Community context, this activity falls within a duty to assist the discharge authority (Art. 276 (*ex 206*) TEC)

irregularities, the identification of systemic weaknesses and proposal of corrective action - does not necessarily take first place, being potentially overshadowed by the wish of both parties to come out of the process looking as good as possible.

4.11.3. Nor is the situation helped by the fact that the commissioner responsible for financial control/audit matters has a relative position, vis-à-vis fellow commissioners, each with their own interests, which is exactly analogous to that of the Financial Controller with respect to fellow director-generals. Once again internal audit is, as it were, unable to impose itself.

4.11.4. The underlying problem is that the internal audit service is not perceived as a central department at the service of the entire Commission, both as a guarantor of financial regularity and as a mechanism through which the financial management of the Commission can be improved, but as an antagonist and a competing service with its own interests to play for.⁹²

4.11.5. It is a noteworthy irony that, whatever the Commission's weaknesses in the field of internal audit, it demands high standards of others. For example, one of the criteria for the accreditation of national EAGGF paying agencies is that they "normally dispose of ... [an] internal audit service: the objective [of which] ... shall be to ensure that the agency's system of internal control operates effectively; the internal audit service shall be independent of the agency's other departments and shall report directly to the agency's top management".⁹³

4.12. What is internal audit?⁹⁴

Definition

4.12.1. "The Institute of Internal Auditors (IIA)", an international professional organisation for internal auditors, publishes definitions, professional standards, ethical rules, etc. for the exercise of the internal auditing profession. It has recently issued a new draft definition of internal audit:

*"Internal auditing is an independent and objective assurance and consulting activity that is guided by a philosophy of adding value to improve the operations of the organisation. It assists an organisation in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of the organisation's risk management, control and governance processes. Professionalism and a commitment to excellence are facilitated by operating within a framework of professional practice established by The Institute of Internal Auditors."*⁹⁵

⁹² Though the Commission itself has recognised the need to extend and reinforce the internal audit function (SEM 2000, recommendation 6), it has not satisfactorily addressed the issue of its relative position vis-à-vis the rest of the Commission.

⁹³ Commission Regulation (EC) 1663/95 of 7.7.95 (OJ L158 of 8.7.95) – c.f. above, at para. 3.8.3

⁹⁴ This section relies on the definitions on internal audit prepared by the Institute of Internal Auditors (IIA). All quotations are from the IIA's website at www.theiia.org

⁹⁵ Draft "definition of Internal audit" - 11 January 1999 (www.theiia.org/GTF/Iadef.htm)

4.12.2. In the context of the Commission, there are a number of salient points in this definition:

- internal audit is an instrument which "adds value" to the activities of an organisation, it is thus a *tool for management*,
- internal audit is within the organisation, but is independent and objective
- internal audit is a profession

Objective and scope

4.12.3. Again according to the IIA, Internal Audit exists "to assist members of the organization in the effective discharge of their responsibilities". To this end, it "furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed. ... The members of the organization assisted by internal auditing include those in management and the board of directors."

4.12.4. The tasks of the internal auditor range from traditional financial audit to value-for-money or "performance audit" and are summed up by the IIA as follows:

- *[To] review the reliability and integrity of financial and operating information and the means used to identify, measure, classify, and report such information.*
- *[To] review the systems established to ensure compliance with those policies, plans, procedures, laws, regulations, and contracts which could have a significant impact on operations and reports, and should determine whether the organization is in compliance.*
- *[To] review the means of safeguarding assets and, as appropriate, verify the existence of such assets.*
- *[To] appraise the economy and efficiency with which resources are employed.*
- *[To] review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned.*

Responsibility, authority and independence

4.12.5. The IIA describes the position of the internal audit department within an organisation as follows:

"The internal auditing department is an integral part of the organization and functions under the policies established by senior management and the board. The purpose, authority and responsibility of the internal auditing department should be defined in a formal written document (charter). The director of internal auditing should seek approval of the charter by senior management as well as acceptance by the board. The charter should make clear the purposes of the internal auditing department, specify the unrestricted scope of its work, and declare that auditors are to have no authority or responsibility for the activities they audit."

⁹⁶ Cf. para 4.8.1. giving criteria for internal control

4.12.6. Though part of the organisation, it is a fundamental principle that the internal audit service should be independent of the *activities it audits*:

"Internal auditors should be independent of the activities they audit. Internal auditors are independent when they can carry out their work freely and objectively. Independence permits internal auditors to render the impartial and unbiased judgments essential to the proper conduct of audits. It is achieved through organizational status and objectivity."

4.12.7. Finally, the IIA addresses the question of the *internal status* of the audit service:

*"The organizational status of the internal auditing department should be sufficient to permit the accomplishment of its audit responsibilities. The director of the internal auditing department should be responsible to an individual in the organization with sufficient authority to promote independence and to ensure a broad audit coverage, adequate consideration of audit reports, and appropriate action on audit recommendations."*⁹⁷

4.12.8. The Committee makes no apology for quoting at length from the IIA, firstly because its status as the relevant international professional organisation gives it unique authority, but secondly, and perhaps more importantly for present purposes, because its preoccupations concerning the scope, objectives, status and independence of internal auditors reflect so accurately the problems encountered in the Commission's present audit arrangements.

4.13. A framework for internal audit in the Commission

4.13.1. The likely shape of any proposal for the future of audit in the Commission emerges naturally from a combination of the analysis of its present defects (both in this and the Committee's first report) and the *desiderata* for internal audit outlined by the IIA.

Status and position within the organisation

4.13.2. It is by now quite clear that the Internal Audit Service can no longer remain part of one of many directorates-general. This organisational position gives its auditors (up to and including the Financial Controller) neither the authority vis-à-vis their colleagues in the Commission nor the "direct line" to top management required by an effective internal audit service.

4.13.3. The Committee therefore proposes that there be a specialised Internal Audit Service, outside the regular structure of directorates-general, reporting directly to the President of the Commission.⁹⁸ The President of the Commission is the only figure in the Commission who is free of sectoral interests (insofar as he is institutionally competent for *all* the activities of the Commission) and who has the authority to draw the necessary conclusions from the results of audits. In line with the vision of internal audit outlined above, the Committee would envisage

⁹⁷ Series of quotations from the "Statement of Responsibilities of Internal Auditing" (originally issued by the IIA in 1947, most recently revised in 1997).

⁹⁸ The President may wish, for internal organisational reasons, to delegate his competences vis-à-vis the Internal Audit Service to a vice-president of the Commission (though no lower than that), but should in any case retain responsibility for the action taken in respect of its findings.

the Audit Service working as a diagnostic tool in the hands of the President, enabling him to identify structural and organisational weaknesses in the Commission and the specific, even isolated, problems which may arise from them. Clearly therefore, the president should be able to instruct the Audit Service to carry out specific tasks on an ad hoc basis and take the management action indicated by the results.

4.13.4. Though this definition of internal audit is one which applies throughout the world of major public and private sector organisations, one objection - drawn perhaps from experience - is predictable. Whereas in the private sector the head of an organisation has a direct incentive, in the shape of the "bottom line" by which he/she is judged, to maximise its efficiency and to root out all forms of waste, does the head of the Commission share such an incentive? Indeed, might his interest, as a political appointee, be to conceal inefficiencies, waste or even fraud?

4.13.5. The very fact that this question can (reasonably) be asked reveals the extent to which democratic accountability has been undermined in the Commission. The key to the previous paragraph's comparison between the head of a major private corporation and the President of the Commission lies in the word "judged". While it is true that the basis of the judgement exercised may be different, it nevertheless remains a basic point of principle that both are accountable, the former to the shareholders, the latter to the public at large, through the European Parliament. The problem is that the accountability of the latter is a more complicated matter.

4.13.6. Indeed, the availability to the president of an effective internal audit function is part of the broader picture by which the Committee hopes to reinforce accountability and in itself reinforces the sense of responsibility felt by officials.

4.13.7. Nor should the nature of the Internal Audit service itself be forgotten. As this chapter has been at pains to emphasise, internal audit is a *profession*. As such, it has professional standards, practices and ethics. These must be written into a basic document - a "charter"⁹⁹ - which sets out the competences, objectives, powers, status, etc. of the service. The officials of the Internal Audit service must be correspondingly qualified professional auditors, up to and including the Head of the service.

4.13.8. The Head of the Internal Audit Service is clearly an important figure, akin to, though with important distinctions, today's Financial Controller. First, the administrative grade of the individual concerned should be equivalent to that of a director-general: anything less would immediately compromise the status of the service¹⁰⁰. Second, the individual concerned must be a highly qualified and experienced member of the auditing profession, to which end it would probably be necessary, or at least desirable, on most occasions to appoint the person concerned from outside the institution on the basis of a specific recruitment notice.¹⁰¹ Third, notwithstanding the fact that the Internal Audit Service responds to the President, the Head of

⁹⁹ See para. 4.12.5

¹⁰⁰ As UCLAF has learnt to its cost...

¹⁰¹ Though not exactly analogous, one could compare this requirement with the formal stipulations about the qualifications of members of the Court of Auditors (EC Treaty Article 247 (*ex 188b*)) or the requirements for the Director of OLAF and the members of its Supervisory Committee (Regulation (EC)1073/1999). By contrast to these cases however, the Head of the Internal Audit Service should be nominated by the Commission on the proposal of the President.

the service must maintain full independence as to the conduct of the audits, the maintenance of professional standards, the contents of reports, etc. On paper, this independence is less complete than that currently enjoyed by the Financial Controller, but in practice the new status of the Audit Service should provide a more favourable "balance of power" and thus greater independence vis-à-vis operational services of the Commission.

Selection of audits

4.13.9. The "charter" of the audit service should include provisions designed to ensure periodic full coverage of the Commission's activities. To this end, the work programme of the Audit Service should be approved by the President on the basis of a proposal by the Head of the Audit Service which takes into account the need to ensure that the Audit Service meets the objectives set out in its charter. At the same time, the Internal Audit Service must remain responsive to management requirements. Some elasticity or "headroom" should therefore be built into the work programme in order to allow for extra audit work arising at short notice. In particular, the President must have the possibility to order special audits in accordance with needs arising.

Conduct of audits

4.13.10. The basic principles governing the conduct of audits, be they within the Commission or "on-the-spot in Member States, need not be significantly different from those currently applying to DG XX officials, which provide for full and unrestricted access to all relevant documentation. Problems have arisen in the past more in connection with the formulation of audit reports.

4.13.11. The internal "contradictory procedure" (i.e. the right of reply of the auditee) has been the source of substantial difficulties in the past (see first report). Though there must be a right of reply, and the replies of the auditee should, where necessary, be published together with the audit report, the auditee should not be able to either "negotiate" the contents of an audit report or delay its finalisation. This is not to say that the auditee should not have the opportunity to correct material errors of fact in the audit report before it is finalised, but that its intervention should not go beyond this factual level. Where divergences of opinion or interpretation subsist between auditor and auditee, these can be dealt with by way of a parallel publication of observation and reply.

4.13.12. In any case, the contradictory procedure (beginning when the draft report is first forwarded to the auditee and concluding with the finalisation of the report) should not last longer than one month. As a point of principle, after the month has lapsed, the decision on when, and under what conditions, to finalise an audit report must lie exclusively with the Head of the Internal Audit Service.

Follow-up of audits

4.13.13. Under the scheme proposed by the Committee, the action to be taken as the result of audit findings necessarily falls to the President of the Commission within the context of his management competences. No prescriptive approach is therefore possible in terms of follow-up to audit reports.

4.13.14. In a spirit of transparency however, the measures taken by the President, and, as a consequence, by other Commission managers, should be a matter of record. This can be achieved in two ways. Firstly, the Internal Audit Service must publish an annual report outlining its activities, summarising its most important findings and describing the action taken in response by the Commission's services. This annual report should be presented by the President to the Commission and should be made public. Secondly, all reports finalised by the Internal Audit Service should be made available to the Court of Auditors. This will permit the Court to monitor the concrete action taken by the Commission in response to audit observations.

Relations with the Court of Auditors

4.13.15. The professional quality of the work of the Internal Audit Service must be sufficient for the external auditor of the Commission to be able to rely on it. In order to maximise the potential benefits, there should be regular contacts between the Court of Auditors and the Internal Audit Service at both the programming and implementation stages of their work. Full access to the audit data of the Internal Audit Service for the Court must be assured, meaning in practice that, beyond the simple communication of audit reports, all the underlying audit files of the Internal Audit Service (i.e. "raw" audit data, observations, etc.) must be accessible to the Court for use in the course of its audit work.

Resources

4.13.16. It is not for the Committee to decide on staffing levels in the Commission. However, it is legitimate to point out, as it did in its first report, that the number of staff currently dedicated to internal/systems audit in the Commission is derisory (13). To be effective the Internal Audit Service which will replace the DG XX internal audit unit must enjoy an adequate level of resources.

4.14. General Inspectorate of Services (IGS)

4.14.1. The IGS was set up in 1991 to fill a perceived need in the management of the Commission for an internal inspection service. Between 1991 and 1999, it has grown from a staff strength of 20 to 35. The IGS is of guaranteed independence and is attached directly to the President of the Commission, who specifically mandates its inspections. Its tasks are briefly as follows:

- to check and assess the respect by Commission services for regulations and procedures and their consequences,
- to check and assess the use of human and financial resources within the Commission in relation to the tasks of the departments concerned,
- to check and assess the cost-effectiveness of Commission services.

4.14.2. To carry out this job, IGS inspectors have unrestricted access to Commission services. Their reports are subject to a contradictory procedure with the heads of the services concerned, and are communicated on a confidential basis, together with an opinion of the Legal Service and with the agreement of the Secretary-General, to the President of the Commission. Any follow-up action is decided upon by the President as is the question of whether or not to publish the report.

4.14.3. It is the experience of the Committee that IGS reports are frequently of high quality, with perceptive analysis of the operation of Commission services and useful recommendations. The follow-up which is given to them is, by and large, far less impressive. The Committee would therefore be in favour of strengthening the position of the IGS.

4.14.4. The means for doing so is implicit in the preceding paragraphs which show that the underlying rationale of the IGS is extremely close, if not identical, to that of the proposed Internal Audit Service, in that both are essentially analytical tools at the disposal of management for the attainment of maximum value for money. In the light of the competences to be given to the Internal Audit Service, the IGS has no need to continue as a *separate service*. It is thus a short step to envisage a rationalisation whereby the staff and activities of the current IGS be subsumed within the Internal Audit Service. The Committee would recommend this course of action.

4.15. Organisational consequences

4.15.1. The recommendations of this report concerning internal control and internal audit affect all directorates-general carrying out financial operations. Given the structural changes in course under SEM 2000, with its introduction of specific financial services in all directorates-general, the organisational consequences for the administrative structure as a whole are not radical. Two services however are more fundamentally affected. First, DG XX. Staff involved in internal audit should normally find a place in the new Internal Audit Service, subject to verification of their qualifications. On the other hand, the vast majority of the staff - currently occupied, directly or indirectly, with *ex ante* control of financial operations - would have to be redeployed, where needed. It should again be stressed that the two present functions of DG XX are completely separate activities. Staff involved in *ex-ante* control are not auditors and would have no automatic claim on positions in the Audit Service. On the other hand, their technical knowledge of financial procedures and the Financial Regulation, should make them valuable to operational directorates-general throughout the Commission. Second, the IGS. As we have seen above, the IGS would find its place as a department within the new Internal Audit Service.

4.15.2. As far as the Financial Controller is concerned, it is evident that this role, as delineated in the Financial Regulation, ceases to exist.

4.16. The use made by the Commission of the audit findings of the Court of Auditors

4.16.1. The main source of audit information for the Commission will (and should) be its own Internal Audit Service. However, a second important source of useful audit results and valuable comment is provided by the Court of Auditors, both directly, in the form of reports and opinions, and indirectly, in the form of the "political" recommendations and observations formulated by

the European Parliament and the Council on the basis of the Court's findings. The present section looks briefly at how the work of the external auditor is transformed into management action by the Commission and at possible means by which the Commission might be encouraged to draw more fruitfully on the audit work of the Court.

4.16.2. In looking at how the Commission makes use of the Court of Auditors' work, it is necessary to look at two separate processes: first, the translation of the Court's own observations into management action and, second, the action taken on the recommendations of the institutions to whom the Court reports, notably in the context of the discharge procedure.

Audit coverage

4.16.3. The Court's work programme is aimed at, on the one hand, carrying out the compulsory tasks set out for it in the Treaty (e.g. a "Statement of Assurance", an annual report) and, on the other, covering, firstly, an adequate range of themes, firstly in any given year, and, secondly, the near entirety of budgetary activity over a longer cyclical timespan. Audits of the Commission are usually theme-based rather than organisation-based, i.e. they focus on specific activities or policy areas rather than on defined departments or services.¹⁰²

Nature of audit observations

4.16.4. A close reading of the Commission's replies to Court's reports, and the testimony of those involved in the process of auditing the Commission, point towards a defensively antagonistic reaction from the Commission to the Court's observations. The Commission could be persuaded into a more constructive reaction if the Court, working with exactly the same audit techniques and findings, were to present its observations in a more analytical style, giving an overview of the situation encountered by the Court more tailored to the management needs of the Commission. This would probably involve a greater emphasis on department-based auditing (which would incidentally allow management responsibilities to be identified (and felt) more keenly), but would have little substantive effect on the way the Court does its job.

DAS

4.16.5. A similar problem of enabling the Commission to make use of audit results arises in connection with the Statement of Assurance (universally known by its French acronym "DAS"¹⁰³). The findings of the DAS, which by necessity come down to a statistical analysis of "error rates" in financial management, are extremely difficult to relate to the systems and services of the Commission. It would be helpful to the Commission, Member States and other readers of the DAS if the Court could indicate with greater precision which sector, systems and procedures, and, in the case of shared management, which Member States, are mainly affected by errors, and indeed the nature of the errors.

¹⁰² An exception to this rule is UCLAF, which was subject to a departmental audit (Special report 8/97 - see chapter 5)

¹⁰³ "Déclaration d'Assurance" - see EC Treaty article 248(1) (*ex 188c*)

Timing of reports

4.16.6. If the impact on the Commission of external audit findings are to be maximised, there is some scope for the Court to accelerate the production of its reports. The possible measures, in terms of the scope of audits, programming, internal procedures, etc. are an internal matter for the Court. Suffice it to say here that the fewer the pretexts given to the Commission not to take Court audits seriously the better.

The Contradictory Procedure

4.16.7. Draft reports of the Court of Auditors are submitted to the auditee in order for the latter to formulate replies. Within a deadline of two months, representatives of the two institutions meet in order, as far as possible, to agree each other's text with a view to publication of the report. In its initial draft replies, the Commission in particular tends to "bid high" with excessively categorical statements, in the knowledge that language and content will be moderated in the course of the contradictory procedure, which it sees as a procedure to "tone down" the Court's report as much as possible. In other words, the process strongly resembles a negotiation and obscures the real purpose of the exercise, which is ultimately to identify the remedial action required.

4.16.8. Thus, not only is this procedure time-consuming - even when respected deadlines are excessive - but it also reveals the unconstructive attitude of the Commission to the audit process.

4.17. Parliamentary budgetary control

4.17.1. The second source of external audit "findings" for the Commission comes by way of the European Parliament, acting in its capacity as discharge authority (with the Council in a subsidiary role). Chapter 7 of this report discusses the principle and operation of democratic accountability to Parliament in depth, and the reader is thus referred to that part of report for comment on the relationship between Parliament and Commission.

4.17.2. Parliament, upon whose observations the Commission is bound to act, thus translates external audit findings into political recommendations for action.

4.17.3. The changes to the Treaty introduced in Maastricht and Amsterdam have considerably strengthened Parliament's hand in the audit-based exercise of budgetary control over the Commission, both in terms of the ammunition provided by the Court and in the use it can make of it. If the Court and the Parliament work effectively as a team, with the Court's reports being timely and relevant and the Parliament's use of them thorough and incisive, external audit in the European Union takes on a new and fruitful dynamic.

4.17.4. Formal powers are not the whole story, however, and the Commission still has to be obliged in practical terms to react positively to the political recommendations based on external audit findings. At the moment, it is not clear whether the institutions are achieving the desired result. The Committee has already criticised Council for its lack of interest in following up Court reports¹⁰⁴ and though Parliament has been more active, its lack of the necessary

¹⁰⁴ First report: paragraph 9.4.12

institutional powers have until recently hampered serious efforts to "operationalise" Court reports¹⁰⁵. The underlying difficulty however remains the one already identified, that the Commission does not treat the discharge as a constructive process, but as an annual ordeal to be gone through. The remedy is similar to that outlined in respect of the Court of Auditors and largely lies with the Commission itself. This has been the subject of this chapter: internal reform in the Commission.

4.18. Recommendations

4.18.1. The existence of a procedure whereby all transactions must receive the explicit prior approval of a separate financial control service has been a major factor in relieving Commission managers of a sense of personal responsibility for the operations they authorise while at the same time doing little or nothing to prevent serious irregularities of the sort analysed in the Committee's First Report. Moreover, the combination of this function with a (weak) internal audit function in a single directorate-general gives rise to potential conflicts of interest on the part of the Financial Controller. Thus a serious rethink of both internal control and internal audit is necessary.

4.18.2. A professional and independent Internal Audit Service, the competences and activities of which should be based upon the relevant international standards (Institute of Internal Auditors), should be established, reporting directly to the President of the Commission. The centralised pre-audit function in DG XX should be dispensed with and internal control - as an integrated part of line responsibility - decentralised to the directorates-general. One of the principal tasks of the proposed Internal Audit Service should be to audit the efficiency and effectiveness of these decentralised control systems. (c.f. 4.18.16 below) (4.7.1-2, 4.9.8, 4.13.3, 7)

4.18.3. Chains of delegation should be made clear and explicit: every subordinate manager is responsible and accountable for internal control in his/her field of responsibility. It is for the director-general (and heads of independent services) to assume (overall) responsibility for all operational matters in her/his directorate-general or service, including for internal control. The chain of delegation begins at the level of the Commission through the commissioner. She or he thus holds ultimate managerial responsibility for all financial matters, including for financial control, and political responsibility as a member of the College. (4.9.5-9)

4.18.4. Each directorate-general should have at its disposal two basic prerequisites for effective financial management: (i) a specialised internal control function, exercised under the responsibility of a senior official reporting directly to the director-general; (ii) an accounting function, exercised under the responsibility of a delegated accounting officer. The latter would work under the functional supervision of the Commission's accounting officer, but be responsible for keeping the accounts and processing the financial operations exclusively of the directorate-general in which it is located.

4.18.5. Each directorate-general should produce its own annual financial report and accounts, audited by the Commission's internal auditor, including both financial information and a wider review of the directorate-general's activities. These reports should be examined first by the

¹⁰⁵ See chapter 7

Commission, which should then submit them to the competent institutions as part of the discharge procedure. (4.9.13-17)

4.18.6. The Internal Audit Service should act under the responsibility and authority of the President of the Commission, independently of any other Commission service. It should above all be a diagnostic tool in the hands of the President, enabling him/her to identify structural and organisational weaknesses in the Commission. The competences, objectives, powers and status of this Service should be set out in a basic founding document (a “charter”) The work programme of the Internal Audit Service should ensure periodic coverage of all Commission activities. It should however leave headroom for additional *ad hoc* audit tasks to be carried out at the request of the President and/or on the basis of needs arising. (4.13.3, 7, 9)

4.18.7. The Head of the Internal Audit Service should be a highly qualified and experienced member of the auditing profession, recruited specifically for this task. S/he should hold an administrative grade equivalent to that of a director general. The Head of the Internal Audit Service, though reporting to the President, should enjoy full independence as to the conduct of audits, the maintenance of professional standards, the contents of reports, etc. (4.13.8)

4.18.8. The internal contradictory procedure between the Internal Audit Service and its auditees should last at most one month, whereafter publication of the audit report should take place at the discretion of the Head of the Internal Audit Service. (4.13.11-12)

4.18.9. The President of the Commission should present to the Commission each year an annual report of the Internal Audit Service, outlining its activities, principal findings and the action taken, or to be taken, by the President as a result. This report should be made public. (4.13.13-14)

4.18.10. All audit reports of the Internal Audit Service should be sent to the Court of Auditors. Additionally, all data collected by the Service, all preparatory work and audit findings should be available to the Court and be of sufficient professional quality to be used by it. (4.13.15)

4.18.11. The present General Inspectorate of Services (IGS) should be integrated into the new Internal Audit Service.

4.18.12. A central specialised unit, responsible for the formulation and oversight of financial procedures and internal control mechanisms should be constituted within DG XIX. This body should have no role in individual transactions (though it could, in difficult cases, offer advice), but should establish Commission-wide procedures and ground rules for financial management and monitor their application. (4.9.1-3)

4.18.13. All officials involved in financial procedures should undergo compulsory and regular training in the rules and techniques applying to financial management as a precondition of being allocated such work. (4.9.1-2, 4, 11)

4.18.14. The formal aspects of financial transactions should be verified by the delegated accounting officer. Any objections should be referred back to the authorising officer, who should decide, on his/her own responsibility, whether to overrule the objections and proceed with the operation. (4.9.12)

4.18.15. A new and specific administrative procedure should be established, governed by (an amended) Title V of the Financial Regulation, designed formally to establish the individual responsibilities and/or liabilities of authorising officers in respect of financial errors and irregularities. To this end, a new Financial Irregularities Committee would deliberate on the basis of reports from the Commission's internal auditor. Disciplinary or other action could follow if necessary. (4.9.18-28)

4.18.16. In the light of the foregoing recommendations, the existing DG XX no longer has any reason to exist. DG XX staff qualified for audit work should be redeployed to the new Internal Audit Service, while other staff should be redeployed, as needed, to other Commission services, notably those requiring expertise in financial procedures. (4.15.1-2)

4.18.17. The Court of Auditors could seek to obtain a more constructive reaction on the part of the Commission to its audit observations through greater recourse to department-based auditing, presenting its observations in a more analytical style, giving an overview of the situation it encountered and placing greater emphasis on the management needs of the Commission. (4.16.4)

4.18.18. It would be helpful if the Court were able in its Statement of Assurance ("DAS") to indicate with greater precision which sectors, systems and procedures, and, in the case of shared management, which Member States, are mainly affected by errors, and the nature of the errors concerned. (4.16.5)

4.18.19. The duration of the contradictory procedure between the Court of Auditors and the Commission (and other auditees) should be considerably shortened. The process should not assume the nature of a negotiation on the severity or otherwise of the Court's observations but seek only to establish the facts. The underlying purpose of the Court's audits should be to identify the remedial management action required in the Commission to address the issues identified by the Court (4.16.7).

SEM 2000: Recommendations

Recommendation No 1: policy debate, in January, to determine the budget priorities for the following year and highlight the limits on the priorities set.

Recommendation No 2: whenever policy decisions are taken, establish the full cost of any proposal in terms of financial, human and other resources (link between the administrative appropriations and operating appropriations).

Recommendation No 3: introduction of system for making overall allocations to individual DGs covering as many categories of administrative expenditure as possible.

Recommendation No 4: systematic evaluation for all Community programmes and action; DG XIX and XX step up their work on improving cost-effectiveness and evaluation techniques.

Recommendation No 5: rationalisation of ex ante control using techniques based on methods and tools such as statistical sampling and the results of systems audits and the quality of a department's financial management.

Recommendation No 6: DG XX will develop the internal audit function in depth and scope, on the basis of an annual work programme adopted by the Commission itself, covering systems audits, management audits, performance audits and accounting audits.

Recommendation No 7: departments to ensure, when drafting a regulation and at subsequent stages ending with final adoption, that it is clear and amenable to control and contains safeguards against attempted fraud.

Recommendation No 8: separation between the design/management/relations function and the finance/resources function in departments and transformation of the latter function into a 'counterweight' within the DG.

Recommendation No 9: integrated resource management and setting-up of a human resource management system similar to and synchronised with the system already in place for financial resources.

Recommendation No 10: resource management experience should be an increasingly important factor in decisions on appointments and promotions. Staff initialling or signing a financial commitment will make a statement to the effect that no conflict of interests exists.

Recommendation No 11: possible changes to regulations (abolition of prior approval, extension of the concept of 'current expenditure', enshrinement of internal audit system in legal texts, and clarification of authorising officers' liability).

N.B. The Commission has deferred its decision on this point.

DG XX (FINANCIAL CONTROL): FACTS AND FIGURES

(The following information is drawn from the Financial Controller's Annual Report for 1998 and Orientations for 1999)

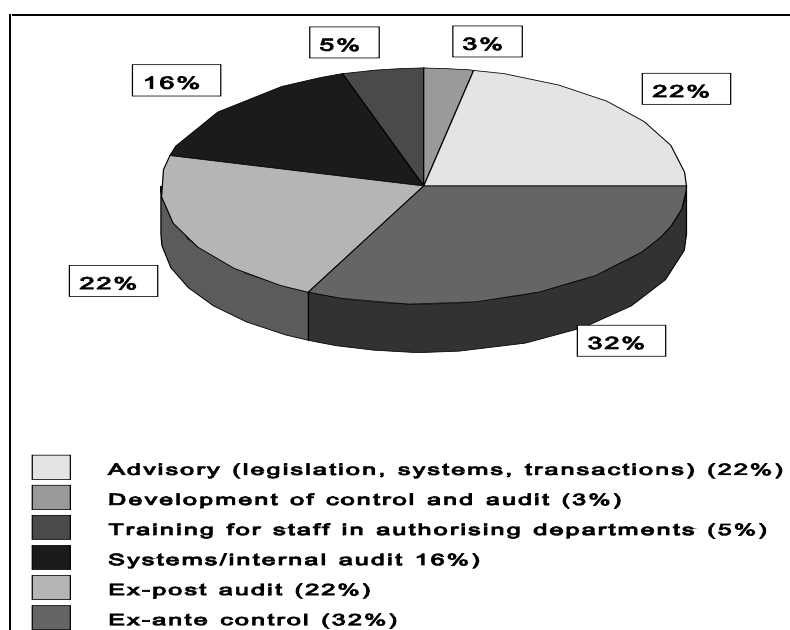
Transactions

The following numbers of financial transactions were processed by the *ex ante* control department of DG XX.

	1994	1995	1996	1997	1998	1999 (est.)
Transactions	275.000	302.000	360.000	461.000	550.000	600.000
Av.days/transaction	6.9	5.9	5.1	4.8	4.4	4.0
Sampling (%)	60%	55%	48%	40%	30%	10%

Use of resources

The chart below shows the proportions of DG XX resources (staff time) dedicated to specific activities in 1998.

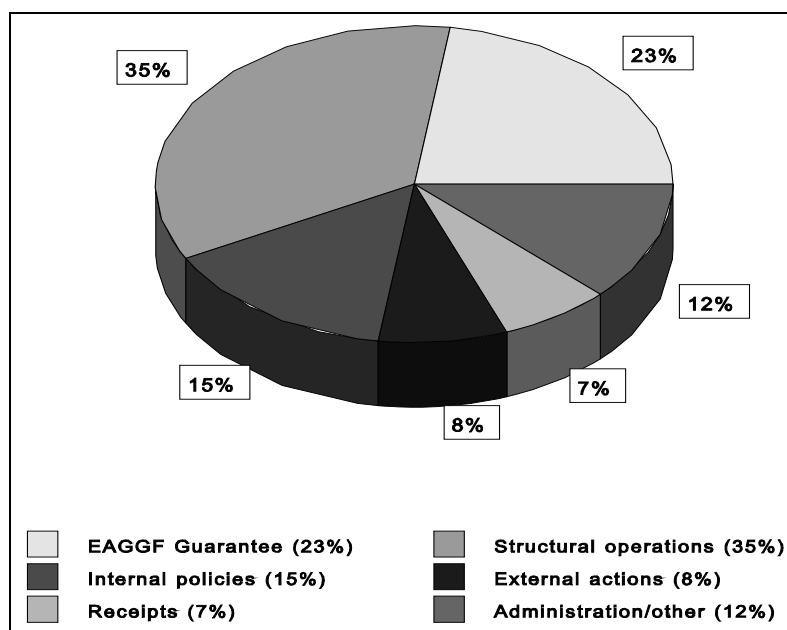


Chapter 4 - ANNEX 2

Audit activity

DG XX carried out 201 ex-post audits in 1998 (against 152 in 1997), plus three special investigations (tourism, Security Office and Leonardo). It plans 284 audits in 1999.

The chart below indicates the coverage of major policy areas (according to the categories of the Financial Perspectives) by ex-post audits:



Staff

DG XX has 230 staff. This figure has been stable since 1995. They are currently deployed as follows:

Advice on proposed legislation, financial systems and proposed transactions	39 staff
Ex ante control	57 staff
Audit	69 staff
Training and technical assistance	9 staff
Development of control and audit instruments	7 staff
Administration and other horizontal activities	49 staff