

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS AND BODIES

COURT OF AUDITORS



In accordance with the provisions of Article 248 (1) and (4) of the EC Treaty and Article 116 of the Financial Regulation of 27 March 2003 applicable to the ninth European Development Fund, the Court of Auditors of the European Communities, at its meeting of 27 September 2007, adopted its

Annual Report on the activities funded by the sixth, seventh, eighth and ninth European Development Funds concerning the financial year 2006

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

(2007/C 259/01)

Annual Report on the activities funded by the sixth, seventh, eighth and ninth European Development Funds (EDFs)

TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	1-5
Chapter I — Implementation of the sixth, seventh, eighth and ninth EDFs	6-11
Financial implementation	6-8
Approval of the tenth EDF	9
The Commission's annual report on the financial management of the EDFs	10-11
Chapter II — Statement of Assurance by the Court of Auditors on the EDFs	12-55
Statement of Assurance by the Court of Auditors on the sixth, seventh, eighth and ninth European Development Funds (EDFs) for the financial year 2006	I-VI
Information in support of the Statement of Assurance	12-55
Scope and nature of the audit	12-13
Reliability of the accounts	14-18
Legality and regularity of the underlying transactions	19-55

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

INTRODUCTION

1. The European Development Funds (EDFs) are the result of international conventions or agreements ⁽¹⁾ between the Member States of the European Union and certain African, Caribbean and Pacific (ACP) States, and of Council Decisions on the association of overseas countries and territories (OCT).

2. The Commission has responsibility for and takes charge of the management of most of the expenditure of the EDFs in association with the ACP States. The EDF's investment facility has been fully managed by the European Investment Bank ⁽²⁾ (EIB) since 1 April 2003. This facility is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure ⁽³⁾ ⁽⁴⁾.

3. The financial allocation for each of the four EDFs being implemented in 2006, with the exception of the instruments now under the EIB's sole management, was mainly assigned to:

- (a) programmable aid ⁽⁵⁾ intended for the implementation of development projects (roughly half of the total allocations);
- (b) programmable aid ⁽⁵⁾ intended to provide budget support for the recipient states (almost a quarter of the total allocations);

⁽¹⁾ The Yaoundé I Convention dates back to 1964. The most recent agreement (Cotonou) dates from 23 June 2000 and was revised in Luxembourg on 25 June 2005.

⁽²⁾ Thus, under the ninth EDF, the initial allocation amounted to EUR 13 800 million, of which the EIB is responsible for EUR 2 200 million.

⁽³⁾ See Articles 96, 103 and 112 of the Financial Regulation of 27 March 2003 applicable to the ninth EDF (OJ L 83, 1.4.2003, p. 1). In its Opinion No 12/2002 on the proposal for this Regulation (OJ C 12, 17.1.2003), the Court stressed that these provisions reduce the scope of the European Parliament's powers of discharge.

⁽⁴⁾ A tripartite agreement between the EIB, the Commission and the Court (Article 112 of the Financial Regulation of 27 March 2003 applicable to the ninth EDF referred to above) sets out rules for the audit of these operations by the Court.

⁽⁵⁾ Programmable aid is defined within the framework of national and regional indicative programmes (NIPs and RIPs) and of intra-ACP funded projects and programmes.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

(c) non-programmable aid intended for specific fields of cooperation such as humanitarian and emergency assistance, support for export earnings (Stabex and Sysmin or, now, FLEX) or financial contributions, such as venture capital ⁽⁶⁾ and aid for debt relief (just over a quarter of the total allocations).

4. Once programming is complete, EDF resources are mobilised in two stages. The Commission, as Chief Authorising Officer, makes the financing decision (shown in the accounts as financial commitments) following receipt of a request from an ACP State, and after a favourable opinion from the EDF Committee ⁽⁷⁾ (composed of representatives of the Member States). The Commission and the ACP State then lay down the rules for the implementation of these decisions by the National Authorising Officer (NAO) ⁽⁸⁾ of the country concerned within the framework of a financing agreement or directly by the Commission. The NAO concludes contracts (shown in the accounts as individual legal commitments) and authorises payments, which will be checked and executed by the Commission in accordance with the procedures for implementing the EDF.

5. Budget support is not subject to this system of management. The Commission remains the sole authorising officer. Financing agreements constitute legal commitments and give rise to payments without any individual legal commitments being entered into. Once the Commission has checked that the conditions of the Cotonou Agreement and the financing agreement have been met, it makes an initial transfer of funds to the budget of the recipient country. Once transferred, these funds merge with the budget of the ACP State, where they are used and audited in accordance with the laws and procedures of the recipient country. The Commission and the other main international donors assess both the improvements made to the management of public finances in these countries and the results in terms of poverty reduction. Before making subsequent disbursements, the Commission checks that the conditions laid down in the financing agreement have been met.

⁽⁶⁾ As regards the sixth, seventh and eighth EDFs, these operations continue to be implemented by the EIB on the Commission's responsibility.

⁽⁷⁾ The EDF Committee's assent is necessary for projects or programmes with a value greater than EUR 8 million or representing more than 25 % of the indicative programme. For projects of less than EUR 8 million, *ex ante* information is given to the EDF committee.

⁽⁸⁾ In general, the NAO's powers are vested in the Finance Minister of the ACP State.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CHAPTER I — IMPLEMENTATION OF THE SIXTH, SEVENTH, EIGHTH AND NINTH EDFS

Financial implementation

6. In 2006, the sixth, seventh, eighth and ninth EDFs were implemented simultaneously. Although the EDFs are committed over a period of five years, there is no time limit for payments. 21 years after the sixth EDF came into force, the Authorising Officer of the EDF decided to close the Fund on 31 July 2006. At closure, EUR 7 339 million had been paid, i.e. 99,3 % of the EUR 7 391 million allocated to projects. The remaining balance of EUR 52 million was transferred to the ninth EDF.

7. **Tables 1 and 2** show the cumulative use of EDF resources and the financial implementation. **Charts I and II** show the cumulative resources and decisions by sector of intervention. In 2006, individual commitments amounted to EUR 3 073 million, after deductions of cancellations, compared with EUR 2 652 million in 2005. Net payments⁽⁹⁾ amounted to EUR 2 762 million, in comparison with EUR 2 489 million the year before. The rate of disbursement, measured as net payments in relation to new financial commitments, was 102 %, compared with 82 % in the previous year, indicating a higher disbursement of funds in 2006. Unspent commitments remained stable at EUR 10 300 million, or 25 % of total funds committed.

8. Payments in the sectors of education, health, water and basic sanitation amounted to EUR 836 million in 2006, i.e. 29 % of the total expenditure. The transport, communication and energy sectors are also significant recipients of EDF funds, with EUR 663 million (23 %) in 2006. Also, direct non-targeted budget aid and sector policy support programmes are two increasingly significant financial instruments, with total expenditure made in 2006 amounting to EUR 638 million (23 %). The Commission has laid down deadlines for the phasing-out of the Stabex instrument, whereby contracting and the subsequent payments are to be completed by the end of 2008 and 2010 respectively.

6.-7. *In line with the Monterrey and Paris agendas the Commission has been making considerable efforts to scale up aid and increase effectiveness. 2006 was a very successful year for the implementation of the EDFs with record levels of contracts and payments made, significant reductions in old and dormant commitments, closure of the sixth EDF and progress towards the eventual closure of the seventh EDF. The objective is to commit all ninth EDF resources by the end of 2007 resulting in EUR 10,5 billion being implemented during 2005-2007, the highest level ever in the history of the EDF.*

On quality, the Commission in 2006 introduced a 100 % coverage by the Quality Support Group of all EDF financing proposals at both identification and appraisal stages. Results oriented monitors monitored over 1 000 EDF projects, finding on average that projects were performing on track or better. 13 evaluations covering aid to ACP States were completed and will feed back results into the programming process and the design of future programmes.

The Commission will continue its efforts to improve even further the implementation of the EDF and will continue to follow up the recommendations made by the Court in that process.

⁽⁹⁾ Net payments equal total payments minus recoveries.

Table 1 — Cumulative use of EDF resources at 31 December 2006

(million euro)

	Situation at end of 2005		Budgetary implementation during the financial year 2006					Situation at end of 2006					
	Global amount	Implementation rate ⁽²⁾	6th EDF	7th EDF	8th EDF	9th EDF	Global amount	6th EDF	7th EDF	8th EDF	9th EDF	Global amount	Implementation rate ⁽²⁾
A — RESOURCES ⁽¹⁾	44 455,0		- 76,1	- 126,7	- 265,3	621,7	153,7	7 338,7	10 654,9	11 050,3	15 564,6	44 608,6	
B — USE													
1. Financial commitments	38 727,3	87,1 %	- 76,1	- 126,7	- 265,3	3 186,7	2 718,7	7 338,7	10 654,9	11 050,3	12 402,0	41 445,9	92,9 %
2. Individual legal commitments	32 965,3	74,2 %	- 38,3	- 6,3	202,5	2 914,8	3 072,6	7 338,7	10 522,7	10 449,6	7 726,9	36 037,9	80,8 %
3. Payments ⁽²⁾	28 402,7	63,9 %	5,0	159,2	736,8	1 860,9	2 761,9	7 338,7	10 244,1	9 122,0	4 459,9	31 164,7	69,9 %
C — OUTSTANDING PAYMENTS (B1–B3)	10 324,5	23,2 %						0,0	410,8	1 928,3	7 942,1	10 281,3	23,0 %
D — AVAILABLE BALANCE (A–B1)	5 727,7	12,9 %						0,0	0,0	0,0	3 162,6	3 162,7	7,1 %

⁽¹⁾ Initial allocations to the 6th, 7th, 8th and 9th EDFs, interest, sundry resources and transfers from previous EDFs.⁽²⁾ As a percentage of resources.

Source: Court of Auditors, based on the EDF Reports on financial implementation and Financial statements at 31 December 2006.

Table 2 — Financial implementation in the financial years 2002-2006 inclusive

(million euro)

	2002	2003	2004	2005	2006
1. Financial commitments	1 768,4	3 395,8	2 375,2	3 035,1	2 718,7
2. Individual legal commitments	2 142,9	2 742,7	2 746,3	2 652,0	3 072,6
3. Payments	1 852,7	2 179,5	2 197,8	2 489,1	2 761,9

Source: Court of Auditors, based on the EDF Reports on financial implementation and Financial statements at 31 December 2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Approval of the 10th EDF

9. The amount of Community aid to the ACP States within the ACP-EC Partnership agreement has been set for the period 2008 to 2013 at EUR 21 966 million. This 10th EDF represents a 62 % increase compared with the financial allocations of the ninth EDF. As the Commission's Annual Report on the Financial Management of the sixth-ninth EDFs in 2006 ⁽¹⁰⁾ indicates, possible delays to the ratification of the tenth EDF and to the adoption of the applicable financial regulation beyond the deadline of 1 January 2008 entail a major risk of late approval of new operations in ACP States, which could affect the continuity of EDF-funded activities ⁽¹¹⁾.

The Commission's annual report on the financial management of the EDFs

10. The Financial Regulation applicable to the ninth EDF ⁽¹²⁾ requires the Commission to report each year on the financial management of the EDFs. The Court carried out a review of this report to assess whether it fairly describes the achievement of objectives, the financial situation and the events that had a significant influence on the year's activities. This review included the verification of the accuracy of the financial data presented and the follow-up of observations made previously by the Court and recommendations made by the discharge authority.

11. The report on the financial management presents an accurate description of the achievement of the objectives for the financial year, the financial situation and the events that had a significant influence on the activities carried out in 2006. The disclosed Stabex information, however, is unreliable mainly due to the complex implementation system of the measure. The EuropeAid Co-operation Office (hereafter called 'EuropeAid') is aware of this and plans an audit of the Stabex funds in 2007.

9. *The Commission has anticipated the risk referred to by the Court. For example, where budget support programmes for countries are due to expire in 2008, they have been extended using funds available from the ninth EDF.*

⁽¹⁰⁾ COM(2007) 240 final of 27.4.2007, p. 3.

⁽¹¹⁾ According to Article 1, paragraphs 3 and 4, of the Internal Agreement on the financing of Community aid under the multiannual financial framework for the period 2008 to 2013 (OJ L 247, 9.9.2006), balances from the ninth EDF or from previous EDFs or funds decommitted from projects under the ninth EDF or from previous EDFs can no longer be committed after 31 December 2007.

⁽¹²⁾ Articles 96 and 102.

CHAPTER II — STATEMENT OF ASSURANCE BY THE COURT OF AUDITORS ON THE EDFs

Statement of Assurance by the Court of Auditors on the sixth, seventh, eighth and ninth European Development Funds (EDFs) for the financial year 2006

I. The European Court of Auditors (the Court) has examined the accounts of the sixth, seventh, eighth and ninth EDFs and the underlying transactions for the financial year ending 31 December 2006. These accounts comprise the financial statements, the reports on financial implementation, and the financial statements and information supplied by the European Investment Bank (EIB) ⁽¹³⁾. Pursuant to the financial regulations the Court is required to provide the European Parliament and the Council with a Statement of Assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions in respect of the part of the EDF resources for whose financial management the Commission is responsible ⁽¹⁴⁾. The Court carried out the audit in accordance with its auditing policies and standards. These are based on generally accepted international audit standards that have been adapted to the context of the EDFs. The Court thus obtained a reasonable basis for the opinions expressed below.

Reliability of the accounts

II. The Court is of the opinion that the reports on financial implementation for the financial year 2006 and the financial statements at 31 December 2006 reliably reflect the revenue and expenditure relating to the sixth, seventh, eighth and ninth EDFs for the financial year and their financial situation at the end of the year.

Without qualifying the above opinion, the Court draws attention to:

- (a) the fact that the validity of the assumptions used for the estimate of the provision for invoices to be received has not been demonstrated by the Commission;
- (b) the overstatement of the amount of guarantees disclosed in the notes to the financial statements.

⁽¹³⁾ Pursuant to the provisions of Articles 96(1), 100, 101 and 125(2) of the Financial Regulation applicable to the ninth EDF; in practice, this refers, firstly, to the balance sheets and associated statements prepared by the Accounting Officer and, secondly, to the management accounts comprising the tables prepared by the principal Authorising Officer in consultation with the accountant. These financial statements are presented for each of the four EDFs and in a comprehensive, consolidated form. The financial statements and information supplied by the EIB are not covered by this Statement (see footnote 14).

⁽¹⁴⁾ Pursuant to Article 103(3) of the abovementioned Financial Regulation; taken together with Article 1 of the same Regulation, this means that the Statement does not extend to the part of the ninth EDF resources that is managed by the EIB and for which it is responsible.

Legality and regularity of the underlying transactions

III. In view of the results of its audit, and except for the matter expressed in paragraph IV, the Court is of the opinion that the transactions underlying the revenue, allocations, commitments and payments for the financial year are, taken as a whole, legal and regular.

IV. The Court's audit revealed a material incidence of errors affecting underlying transactions authorised by Delegations.

V. With regard to budget aid, and without further qualifying the above audit opinion, the Court's audit revealed that Commission's disbursement decisions do not demonstrate in a sufficiently formal and structured manner that there is compliance with the Cotonou Agreement.

VI. Despite the progress made by the Commission as regards its supervisory and control systems, the Court's audit revealed that some systems should be improved and an overall control strategy developed to ensure a more efficient and effective implementation of the supervisory and control activities. The Court notes that many of the issues raised in its report are being addressed by the Commission and welcomes the positive response given by the Commission to its recommendations.

27 September 2007

Hubert WEBER
President

European Court of Auditors
12, rue Alcide De Gasperi, L-1615 Luxembourg

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*Information in support of the Statement of Assurance***Scope and nature of the audit**

12. The aim of the work on the reliability of the accounts of the EDFs is to obtain sufficient evidence to conclude on the extent to which all revenue, expenditure, assets and liabilities have been properly registered and that the annual accounts faithfully reflect the financial positions at the end of the year. The observations regarding the reliability of the accounts, set out in paragraph II of the Statement of Assurance, are based on an audit of the consolidated financial statements⁽¹⁵⁾ and the consolidated report on the financial implementation of the sixth, seventh, eighth and ninth EDFs⁽¹⁶⁾. The audit comprised an appropriate range of audit procedures designed to examine, on a test basis, evidence relating to the amounts and disclosures. It included an assessment of the accounting principles used, significant estimates made by management and the overall presentation of the consolidated accounts.

13. The observations regarding the legality and regularity of the underlying transactions, set out in paragraphs III to V of the Statement of Assurance, are based on:

- (a) an evaluation of the supervisory and control systems at EuropeAid's central services and in five Delegations (Cameroon, Gabon, Jamaica, Mozambique and Sierra Leone) covering eight countries;
- (b) an examination in each Delegation visited of a statistically selected sample of transactions covering all domains except budget support. A total of 78 payments and 18 individual legal commitments were audited. This process included on-the-spot examinations of 21 projects related to 57 transactions;
- (c) an examination of the budget support paid to two of the countries visited (Mozambique and Sierra Leone);
- (d) an examination of 12 payments and two individual legal commitments authorised by EuropeAid's central services;
- (e) an examination of 40 transactions already checked *ex post* by EuropeAid's central services;

⁽¹⁵⁾ See Article 100 of the Financial Regulation of 27 March 2003 applicable to the ninth EDF: the financial statements shall comprise the balance sheet, the statement of economic outturn, the statement of cash flow and the table of items payable to the EDF.

⁽¹⁶⁾ See Article 101 of the Financial Regulation of 27 March 2003 applicable to the ninth EDF: the reports on financial implementation shall comprise tables describing the appropriations, the commitments and the payments.

THE COURT'S OBSERVATIONS

- (f) an examination of the Annual Activity Report and the declaration by the Director-General of EuropeAid and the procedure for preparing them.

Reliability of the accounts

14. For the second year, the Commission had to prepare the financial statements of the EDF by applying accruals accounting principles.

15. The use for the EDF of the accounting system already used by the Commission to account for budgetary expenditure was postponed from the start of 2007 until the start of 2008 to allow EuropeAid to make its accounting system compatible with ABAC, the Commission's general accounting system. The delay also takes into account technical difficulties as well as organisational difficulties linked to the deployment of a new system in all the ACP Delegations. The accounting system currently in use does not have all the features necessary for efficient and effective reporting of economic information on an accruals basis. Consequently, annual accrual adjustments to the accounting data must be processed manually, thereby weakening the effectiveness of accounting controls. Moreover, the financial impact of variations in currency exchange rates cannot be identified separately by the accounting system nor can it be extracted manually ⁽¹⁷⁾.

16. In the Activity Report for 2005, the Director-General for the Budget made a reservation for the unavailability of the new accounting system, as this fact reduces the ease with which controls can be made and could thus lead to an imperfect presentation of the EDF accounts. Although the new accounting system is still not implemented and the accounts still have to be drawn up by applying manual corrections, the Director-General for the Budget withdrew the reservation in the Activity Report for 2006.

17. The financial statements contain a provision for the costs incurred in the reporting period but for which no invoices have been received at the year end. This provision is statistically estimated on the basis of a number of assumptions and amounts to EUR 1 924 million which corresponds to 92 % of total liabilities. The validity of the assumptions used for its estimate has not been demonstrated by the Commission.

THE COMMISSION'S REPLIES

15. *The limitations of the accounting system (OLAS) should be overcome with the introduction of ABAC FED as from 2008.*

The accrual adjustments to the cash-based accounting data are done manually using aggregate figures extracted from the current accounting system and therefore its encoding respects the same controls as the cash-based information.

The new ABAC system will allow for identification of the financial impact of variations in currency exchange rates.

The number of contracts in local currency is not considered to be material in relation to the total contracts signed. Therefore, the Commission does not consider these potential exchange differences to be material in relation to the accounts as a whole.

16. *The reservation, which was first made in the 2004 Annual Activity Report, was maintained in 2005 due to doubts surrounding the ability of the local IT system (OLAS) to produce a first set of fully accrual compliant financial statements. Furthermore, additional data quality control mechanisms were put in place during the year end closure period, and the Court of Auditors gave the 2005 financial statements a positive Declaration of Assurance (DAS).*

17. *The statistical approach used to form this provision is based on the assumption that the charges generated by all ongoing contracts follow a linear trend throughout successive financial years. The validity of the assumptions used by the Commission is borne out by the constant overall percentage of contract completion (83 %) over a number of years. Moreover, it will be reviewed in the medium term. Lastly, it has been refined and improved on the basis of recommendations made by an international audit firm.*

⁽¹⁷⁾ Its disclosure is required by IPSAS 4 — The Effects of Changes in Foreign Exchange Rates.

THE COURT'S OBSERVATIONS

18. Encoding mistakes ⁽¹⁸⁾ affect the accuracy of some data used for the preparation of the annual accounts, notably with respect to guarantees. The amount of guarantees disclosed in note 1.12 to the financial statements totals EUR 723 million as at the end of 2006. However, the Court's audit revealed both that some existing bank guarantees had not been recorded and that some recorded guarantees had already expired or been released. The estimated net effect of these errors is an overstatement of 5,8 %. The Court notes that the Commission is making a considerable effort to improve the recording of guarantees.

Legality and regularity of the underlying transactions*Substantive testing of transactions***Commitments**

19. The Cotonou Agreement ⁽¹⁹⁾ requires that financing agreements between the Commission and the ACP State or States concerned are drawn up within 60 days of the Commission's decision. The Court's audit revealed that a significant number of financing agreements were not signed by the recipient country within this time limit.

20. Some errors regarding individual legal commitments were found concerning adherence to tendering rules relating to publicity and documentation by a UN organisation and the legally prescribed bank guarantees in support of contracts (four errors affecting four out of the 78 transactions checked).

Project Payments

21. The Court's audit of payments authorised by EuropeAid's central services did not reveal errors.

THE COMMISSION'S REPLIES

18. *During 2006 the Commission made major efforts to enhance the quality of data recorded in the accounting system. During the annual closure-of-accounts exercise, additional checks were carried out for the purpose of drawing up the annual accounts. The impact on the annual accounts is therefore very limited and considered not to be material.*

19. *The Commission and the recipient countries have not breached the 60 day rule in the Cotonou Agreement as this rule concerns the drawing-up and not the signing of the financing agreements. The deadline for signing financing agreements is 31 December in year N+1 (Article 54(2) in the Financial Regulation applicable to the 9th EDF). As a matter of diligent practice, the Commission does in virtually all cases not only draw up but also sign financing agreements within 60 days of the Commission decision.*

20. *Three cases concern the renewal of guarantees covering contracts nearing completion, where the residual risk was zero.*

As regards the other case, relations between the Commission and the United Nations are governed by a framework agreement (FAFA) which contains specific provisions on procedures.

⁽¹⁸⁾ E.g. contract type, contract dates and payments that are wrongly recorded as advances, information concerning guarantees.

⁽¹⁹⁾ Article 17, paragraph 2 of Annex 4.

THE COURT'S OBSERVATIONS

22. The Court's audit of payments authorised by Delegations revealed a material incidence of errors (12 errors affecting 10 out of the 78 transactions checked) affecting the amount of the underlying transactions audited which mainly concern:

- the eligibility of the expenditure, such as payments made outside the permitted period, payment of VAT and the use of inappropriate procurement procedures (three errors affecting three out of the 78 transactions checked),
- payments of improper sums, mainly as a result of calculation errors, but in some cases for quantities declared that did not correspond to reality (six errors affecting six out of the 78 transactions checked),
- costs not supported by all the documents required (three errors affecting three out of the 78 transactions checked).

23. Most of the errors are due to inadequate controls carried out by supervisors or auditors (see paragraphs 32 and 36). The remainder indicates weaknesses in some checks performed by the Delegations before the payments were authorised (see paragraph 34). Some errors, made on advance payments, are likely to be corrected on a subsequent or final payment. In spite of the shortcomings already noted, planned audits might have detected and corrected some other errors. The residual errors remain significant, notwithstanding these possible future corrections.

24. The Court's audit also revealed other recurring errors that may have an impact on the amount of the underlying transactions, mainly concerning compliance with provisions governing external audits and supporting documents (six errors affecting six out of the 78 transactions checked). Errors which do not have an impact on the amount of the underlying transactions have also been identified, such as the premature application of contractual modifications and the lack of visibility given to the EDF's financial support (12 errors affecting 12 out of the 78 transactions checked).

Budget aid

25. The Cotonou Agreement states that budgetary assistance shall only be granted where public expenditure management is sufficiently transparent, accountable and effective ⁽²⁰⁾. The Commission interprets this condition dynamically ⁽²¹⁾. In its view, the weaknesses affecting public finance management at the time of

THE COMMISSION'S REPLIES

22. Most of the errors detected by the Court concern payments made by the Commission under contractual and regulatory provisions, on the basis of either an audit report or a statement of account drawn up by the project supervisor, and in compliance with the general regulations. Furthermore, the legality and regularity of the expenditure on the projects and contracts concerned and analysed are certified by audit reports.

One transaction was described by the Court as an error because an audit report was missing for clearing an advance. However, strictly speaking this was not a condition for clearance of the advance. The residual errors are mistakes in calculations concerning small amounts.

23. Most of the cases mentioned concern payments made on the basis of audit reports and statements of account drawn up by the project supervisor, which can be corrected later when final payments are made.

The Commission notes that the level of residual error is not materially significant.

24. The Commission strives to implement development aid in an effective manner, while respecting formalities and taking account of the situation on the ground.

⁽²⁰⁾ Article 61(2)(a).

⁽²¹⁾ See paragraphs 28 and 29 of Special Report No 2/2005 concerning EDF budget aid to ACP countries (OJ C 249, 7.10.2005).

THE COURT'S OBSERVATIONS

the financing decision do not preclude the launch of a budget aid programme, provided that the will for reform exists and the reforms are deemed to be satisfactory.

26. The Court's audit in Sierra Leone revealed that the Commission is not able to demonstrate that it has complied with the above provisions of the Cotonou Agreement, particularly in view of its 'dynamic interpretation'. There is a tendency for the Commission to rely upon indicators which seek to predict future progress when making disbursement decisions. The accuracy of those predictions is questionable. Moreover, the indicators designed to measure progress in public finance management (PFM) do not always permit clear evidence of progress to emerge; some of the information used to track progress against the common action plan was unreasonably optimistic; and the data relied upon was not scrutinised with sufficient rigour, particularly in connection with the failure to produce public accounts. At the time of the Court's audit ⁽²²⁾ the most recently published central government accounts related to the financial year 2001. Transparency and accountability cannot be demonstrated without the timely production of annual accounts as they make a vital contribution to public expenditure management. Compliance with the Cotonou Agreement is not, therefore, assured.

27. The Court's audit in Mozambique provided evidence that the Delegation's monitoring of the implementation of public finance management reforms is of a good standard. The financing agreement makes reasonably explicit the coherence between the public finance management weaknesses presented, the measures implemented or planned and the conditions governing the disbursement of the EDF financial support. However, it does not sufficiently demonstrate in a formalised and structured manner that the recipient country has a suitable long term reform programme to address all significant public finance management weaknesses. The performance indicators used do not allow the effectiveness of public finance management system reforms to be comprehensively assessed. Moreover, insufficient attention was

THE COMMISSION'S REPLIES

26. *The production of government accounts is one among several features of a robust PFM system. A decision on disbursement of the fixed tranche is adopted in the framework of comprehensive monitoring, consisting of an appraisal of performance (i.e. checking against the general conditions of the Financing Agreement assessed on the basis of reports from the government and other public bodies) as well as various diagnostic exercises of the overall PFM system ⁽¹⁾. A progress report is submitted to donors annually by the government to inform them of progress made in the implementation of PFM reforms. The Commission makes use of any other information allowing it to judge the latest relevant developments on PFM reforms before taking a disbursement decision.*

The decision to disburse the fixed tranche was based on i) information on the production of government's accounts that appeared realistic at that time, ii) an assessment of progress in the rest of the reform programme.

The dialogue and the follow up by MDDBS (Multi Donor Budget Support) donors on the issue of production of government accounts has given some results. By June 2007 the backlog with final government accounts has finally been cleared.

Taking into account the achievement in strengthening the Sierra Leone PFM system and the comprehensive analysis carried out by the Delegation, the Commission is of the view that it has scrutinised with sufficient rigour the data available and has acted in full respect of the relevant provisions of the Cotonou Agreement.

27. *The PFM indicators used by development partners including the EC in the context of the PRBS are essentially meant to allow for the monitoring of the direction and magnitude of change in PFM reform and are therefore mostly process indicators.*

The Commission considers that the Financing Agreement demonstrated in a sufficiently detailed manner the reform programme to address PFM weaknesses, but the Commission recognizes that, with the widespread use of the PEFA assessment tool, the analysis of PFM will become more formalised and better structured.

⁽²²⁾ November 2006.

⁽¹⁾ PEFA Assessment, Public Expenditure Reviews, Country Financial Accountability Assessments, etc.

THE COURT'S OBSERVATIONS

given to anti-corruption measures. Relations and dialogue between donors, including the Commission, and the Supreme Audit Institution have improved recently. Contact with the Parliament, although desirable, had not developed to the same extent.

Activity Report by the Director-General of EuropeAid

28. The activity report by the Director-General of EuropeAid presents the policy achievements, the management performance of the services and the main results of the controls. It also reflects the Commission's follow-up of recommendations made by the Court of Auditors, the Internal Audit Service (IAS) and the Internal Audit Capability (IAC) of EuropeAid.

29. The Director-General of EuropeAid declared that he had obtained reasonable assurance that the control procedures put in place gave the necessary guarantees concerning the legality and regularity of the underlying transactions. However, the Court's audit reveals that the incidence of errors should be reduced by improving the supervisory and control systems.

Supervisory and control systems

Overall control strategy

30. Numerous control activities are carried out by many actors to ensure that transactions are legal and regular. Beneficiaries, supervisors, ACP States, Delegations and EuropeAid's central services carry out controls on transactions before they are authorised. Subsequently, there is monitoring and verification by the Delegations, EuropeAid's central services and the Internal Audit Capability (IAC). EuropeAid has yet to develop an overall control strategy, as stressed by the Court on several occasions⁽²³⁾, to ensure efficient and effective implementation of these various control activities. It is EuropeAid's intention to formulate this control strategy in 2007.

⁽²³⁾ See Opinion No 2/2004 of the Court of Auditors of the European Communities on the 'single audit' model (and a proposal for a Community internal control framework) (OJ C 107, 30.4.2004) and the Annual Report on the activities funded by the sixth, seventh, eighth, and ninth EDFs concerning the financial year 2005 (OJ C 263, 31.10.2006, p. 224, paragraph 40).

THE COMMISSION'S REPLIES

More recently, as regards paying attention to issues related to corruption, the Performance Assessment Framework (PAF) utilised by all 19 participating donors includes 3 indicators on corruption. In addition, as issues related to corruption have to be seen in a much wider context and are not only related to budget support but relevant to all development aid, the EC is, for example, also within its development program dealing with Justice looking in more detail at corruption.

29. *The supervisory and control system in place enabled the Director-General to give reasonable assurance on the legality and regularity of the transactions carried out by EuropeAid in 2006.*

The Commission fully agrees that there is room for improvement.

30. *The Commission Services are fully aware of the need to have and apply a control strategy that is cost effective. Indeed, the control strategy applied integrates audits, evaluations, assessments, monitoring and supervisory activities.*

In line with the Court's Opinion No 2/2004 and following the principles set out therein, a gap assessment was carried out in July 2005, which was followed by an ambitious 'Action Plan towards an Integrated Internal Control Framework', adopted by the Commission in January 2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Beneficiaries

31. Small entities which manage programme estimates ⁽²⁴⁾ and beneficiaries of grant agreements have simple control systems and do not always have an appropriate accounting system to record project expenditure.

31. The practical guide for programme estimates requires organisations managing them to have an appropriate accounting system to record project expenditure and segregation of duties between the accountant and the authorising officer. Regular training is given in order to reinforce management capacity.

Supervisors

32. For important works, supply or service contracts, an external supervisor is designated to direct and/or monitor the execution of the contract. The Court's audit has shown that the quality of the controls carried out by supervisors varies considerably (see paragraph 23).

32. The system of supervision written into works contracts is an integral part of the control system and has been defined in the general regulations (Decision 3/90). The Commission has considerably improved the system, in particular by encouraging a situation in which the works are designed and monitored by the same body. The statements of account drawn up by supervisors are checked by the Delegations. Moreover, these statements do not become final until final acceptance of the works and up until then can be corrected.

ACP States

33. The Commission continued its efforts to increase the capacity of the National Authorising Officer (NAO) administrations by providing technical assistance, equipment and training in order to enable effective control of EDF expenditure by NAO administrations. The results are variable, mainly due to a lack of involvement by the ACP States. This means that many Delegations can place only limited reliance on the controls performed by the NAO administrations, resulting in a heavier workload.

33. Training courses are held regularly in ACP countries in order to increase the capacity of administrations. 21 courses on EDF financial and contractual procedures were run in 2006.

Delegations

34. The authorisation of each individual payment follows a procedure involving the completion of control check-lists and approval by five individuals. Part of the errors identified by the Court should have been detected and corrected at this stage (see paragraph 23) which indicates weaknesses in the quality of some checks made. This is aggravated by an insufficient presence of Delegation staff in the field to monitor the work of supervisors.

34. As the Court points out, the Commission has set up financial circuits and introduced the use of standard check-lists for each transaction. This contributes to the harmonisation and quality of controls carried out by Delegations when payment transactions are validated.

Devolution of aid management should enable Delegations to have a greater presence on the ground.

⁽²⁴⁾ Public or semi-public agencies or departments of the State or States concerned or the legal person responsible for executing the operation.

THE COURT'S OBSERVATIONS

35. Audits of expenditure, mostly entrusted to private audit firms, are one of the key elements of the Commission's supervisory and control systems. They are in general performed at the end of the implementation period of a commitment in order to clear expenditure and close projects. They are not intended to assess systems and do not contribute to the prevention of systemic errors. Furthermore, the number of audits provided for by the Delegations in the initial annual audit plan (AAP) for 2006 was 649 ⁽²⁵⁾. The number of audits actually commissioned by the Delegations was significantly lower than the number planned ⁽²⁶⁾, partly due to the Delegations' limited capacity to organise and follow up audits.

36. The audits initiated by the Delegations are not subject to standardised terms of reference which clearly set out audit objectives and materiality considerations. As a consequence, the quality of the external audits is variable, and the forms of opinion and supplementary information provided in the audit reports vary considerably. This reduces the contribution that this potentially rich source of assurance can make to the overall control framework.

Monitoring by the central services of EuropeAid

37. The monitoring of the implementation of the EDFs by EuropeAid's central services comprises a wide range of activities including the analysis of risks, the review of management reports, the examination of a sample of external audit reports and the analysis of management information available from the accounting system.

THE COMMISSION'S REPLIES

35. *External audits are one of the components of EuropeAid internal control system as part of a set of checks on the legality and regularity of operations.*

When necessary, audits are launched at an early stage of project implementation, so as to provide information on the functioning of the management and control system of the contractual partners.

Amongst the measures taken, the new terms of reference and related guidance should have some positive effects on timely implementation of the Annual Audit Plan.

36. *The elements mentioned by the Court are already part of the standard audit techniques and methodologies used by the audit firms carrying out audits of external aid operations.*

EuropeAid has adopted standardised terms of reference which clearly define objectives and materiality criteria. The forms of opinion will thus be better harmonised, so that the contribution of this control tool can be improved even further.

⁽²⁵⁾ The figures relate to the annual audit plan of ACP countries and include audits of both EDF and general budget expenditure.

⁽²⁶⁾ The lack of centrally-managed data on the execution of Delegation-mandated audits makes the exact extent of this phenomenon difficult to quantify, although a review of 49 EAMRs received from Delegations revealed that only six Delegations reported having implemented their Annual Audit Plan in full. At least six Delegations had not been able to carry out any audits in their Annual Audit Plan for 2006 and many Delegations reported low implementation rates.

THE COURT'S OBSERVATIONS

38. EuropeAid has embedded risk management into the Annual Management Plan (AMP) process in order to identify risks at a stage where preventive action can be taken. A risk register has been established that includes an action plan to mitigate identified risks. The register is monitored and updated regularly. However, the risk management exercise at Delegation level is often carried out in a formal way which limits its contribution to EuropeAid's risk analysis. It is a self-assessment based on pre-defined risks which is not carried out in a participative manner nor followed up by the adoption of an action plan.

39. The risk of ineligible project expenditure is considered significant. The action defined to address this risk concentrates on activities designed to detect the occurrence of ineligible expenditure, such as external audits. The action does not mention activities which might reduce or eliminate ineligible expenditure in the first place. Nevertheless, the Court notes that this action plan provides for the formalisation of EuropeAid overall control strategy.

40. The main tool for monitoring the Delegations is the External Assistance Management Reports (EAMRs), six-monthly management reports prepared by the Delegations. They are a periodic information source which enables the devolved Delegations to send EuropeAid's central services the most important items of information on internal organisation, project implementation and external audits. Despite the improvement of the EAMR templates in 2006, the Court's audit has revealed that Delegations' reporting practices are inconsistent providing limited information on external audit results and the follow-up given.

41. As already mentioned by the Court in its previous two Annual Reports, there is no centralised management information relating to the coverage and results of the audits initiated by the Delegations. This means that the level of assurance that can be derived from these audits is much reduced compared with what could be obtained if a robust management information system were in place. Although a computerised tool, CRIS Audit, was developed to monitor audits and analyse their findings, it is still

THE COMMISSION'S REPLIES

38. *Delegations carry out an annual risk self-assessment through a harmonised and dedicated methodology which allows them to identify major risks and corresponding mitigating actions in relation to the objectives set in their Annual Management Plan (AMP) as well as a consolidation of the results at central level. Each geographic Directorate receives the results of the exercise.*

The instructions on the preparation of the AMP 2007 of EuropeAid expressly indicate that the results of the latest Risk Assessment exercise performed in Delegations (attached to the instructions) shall be taken into account.

Delegations will be encouraged to carry on the risk management exercise in a fully participative manner.

39. *The annual risk self-assessment is a high-level risk assessment which complements other and more detailed risk analyses, carried out for instance in the context of the establishment of the AAP. It focuses on residual risk taking account of the control and other mitigating mechanisms already in place.*

Actions are mainly focused on issues bearing an impact on the overall management of external aid, including delegations. EuropeAid is committed to formalise the overall control strategy before the end of 2007.

40. *The monitoring of the implementation of delegations' devolved management comprises a wide range of activities and tools, including the EAMR, in which Delegations report back to Headquarters on the implementation of the AAP. Delegations are also requested to underline key elements concerning the legality and regularity of the operations notably when they concern issues which go beyond the single project and bear a general interest for headquarters. The EAMR however is not the tool for performing a complete analysis of all the findings in all the audit reports received during the reporting period.*

41. *EuropeAid has developed appropriate tools to conduct audits while several mechanisms contribute to their quality control as well as to the consolidation and use of the systemic audit findings.*

The planning and follow-up of audit results are both ensured by the authorising departments concerned at Headquarters or in Delegations.

THE COURT'S OBSERVATIONS

not delivering the expected results because it is not fully developed and the necessary data are not entered into the system. It is planned that CRIS Audit will be modified, but it is currently not a priority.

42. A first review of a sample of audit reports was started in 2006, but the sample is not representative and the review was carried out a long time after the reports were prepared. The quality control of audits initiated by the Delegations is not yet adequate. Therefore, the conclusions contained in the eventual feedback report might lack relevance and are unlikely to result in the identification of matters of wider significance.

Verification by the central services of EuropeAid

43. Verifications by EuropeAid's central services include missions to verify the functioning of the Delegations' internal control systems, *ex post* controls and external audits initiated by EuropeAid's central services.

44. In 2006, EuropeAid's central services carried out two missions to Delegations consisting of an examination of the set-up and functioning of the supervisory and control systems. The missions were well designed and provided practical recommendations for improvements to control systems. EuropeAid is currently developing a standardised methodology for these missions. Although the Court recommended an increase in the number of missions in its Annual Report concerning the financial year 2005⁽²⁷⁾, fewer were carried out than in 2005⁽²⁸⁾, and considerably fewer than initially planned⁽²⁹⁾.

45. EuropeAid has reviewed some aspects of its transactional *ex post* control system. The control coverage was reduced and the scope of the checks slightly extended. Aspects related to legal commitments as well as detailed supporting documentation for work programme expenditure, however, remain outside the scope of the exercise. The checks relating to 2006 were carried out in a timely manner and recorded using a newly-introduced system, representing a significant improvement compared with the 2005 exercise. As mentioned in the Annual Report concerning the financial year 2005⁽²⁷⁾, the transactional *ex post* control can make only a limited contribution to the overall assurance on systems and procedures, and the legality and regularity of the underlying transactions. The Court's review of a sample of transactions

⁽²⁷⁾ OJ C 263, 31.10.2006

⁽²⁸⁾ 10 missions were carried out in 2005.

⁽²⁹⁾ See the Commission's reply to paragraph 42(c) of the Court's Annual Report on the activities funded by the sixth, seventh, eighth and ninth EDFs (OJ C 263, 31.10.2006).

THE COMMISSION'S REPLIES

EuropeAid intends to further improve the operation of CRIS-Audit, building on the experience gathered, as a complementary tool to the current system.

42. *After a pilot project in 2006, the quality control system for audits will be improved in 2007 by adopting a more systemic approach.*

44. *The Commission has made sure that Delegations operate smoothly and are capable of managing projects on a devolved basis. 2006/2007 should be regarded as a transitional period during which the missions carried out — the quality of which was highlighted by the Court — were carefully targeted. A new overall framework will be defined now that devolved management is fully operational.*

45. *Setting up a transactional ex-post control system, and defining its characteristics, are both based on an appreciation of residual risk and of the interaction with the other components of the control system. Ex post transactional controls provide an additional layer of assurance for the appreciation of the elements which are subject to such control.*

This covers payments, recoveries and clearance of pre-financing transactions carried out by the Commission. Legal commitments however are not neglected, as all these transactions take place within the legal context of the contract signed by both parties. The study of each transaction entails a systematic checking of the applicable contractual conditions.

The documentation requested for each type of transaction selected is clearly set out in the ex post transactional control manual.

THE COURT'S OBSERVATIONS

checked *ex post* also revealed that the controls had not, in some cases, been appropriately documented, and some errors had not been detected.

46. Audits initiated by EuropeAid's central services are subjected to a rigorous quality control procedure and the results of the reports are examined and collated with a view to making methodological improvements and identifying issues which may be of a significance that extends beyond the audited project. These audits reveal an incidence of error consistent with the findings of the Court. In the absence of documentation on the risk analysis carried out to select the projects to be audited, EuropeAid is, however, unable to demonstrate that it has selected for audit all suitable subjects.

47. The current terms of reference governing external audits initiated by EuropeAid's central services do not incorporate materiality considerations or provide guidance concerning sampling. This can lead to similar errors being treated differently and to an expectation gap between the preparers and the users of audit results. A significant number of the audits finalised in 2006 were affected by a limitation of scope. New standardised terms of reference for these audits have been adopted recently.

Internal audit

48. The principal objective of EuropeAid's internal audit capability (IAC) is to assess and evaluate the internal control system. The IAC effectively performs its function. In 2006, the IAC completed audits of EuropeAid's risk management system, and of goods and services procurement. Additionally, a follow-up of control system audits in three Delegations ⁽³⁰⁾ was performed. The conclusions of the IAC are generally consistent with the Court's findings.

THE COMMISSION'S REPLIES

46. *The establishment of the Annual Audit Plan is accompanied by a note, per Directorate, describing the criteria applied for the selection of audit subjects as well as the results of the analysis.*

Even if the Commission endeavours to better document the risk analysis, results of external audits, notably risk-based, reveal that this control tool is effective in detecting errors and corroborates the validity of risk criteria used in preparing the Annual Audit Plan.

47. *Audit firms contracted by EuropeAid apply international audit standards. The new terms of reference clearly define the materiality criteria.*

The scope limitations as identified by the Court were cases of projects which had been subject to a risk analysis and are often part of a previous Annual Audit Plan. One of the possible consequences of a risk assessed programme is that the results may indicate a scope limitation. In addition, the role of task management was often assumed by Headquarters waiting for the full implementation of the audit function at Delegation's level.

⁽³⁰⁾ Madagascar, the Dominican Republic and Kenya.

THE COURT'S OBSERVATIONS

49. The Commission's Internal Audit Service (IAS) performed a validation of the self assessment of EuropeAid's Internal Audit Capabilities. The overall conclusion was positive although there were a number of recommendations relating to staff skills and training, quality assurance, documentation of planning and audit work, and the role of the IAC as supporter of an effective ethics programme.

50. A follow-up by the IAS of the progress made by EuropeAid in implementing recommendations that resulted from an in-depth audit carried out in 2003 concluded that most of the recommendations had been implemented and that the remainder were in progress.

51. The IAS also carried out an audit on the implementation of the financial and administrative framework agreement (FAFA) with the United Nations by EuropeAid and DG ECHO. Payments made in 2006 to United Nations (UN) organisations represent 4,8 % of total expenditure. The overall conclusion of the audit is that the control mechanisms still need to be effectively and further implemented at both project and UN organisation levels, but acknowledges that progress has been made and most of the issues concerned are being addressed. An institutional review of UN bodies, which was initiated by EuropeAid and designed to assess whether the policies and procedures in place adequately equipped these bodies to act as custodians of EDF resources, concluded that a globally satisfactory evaluation of the internal control systems could be provided in three out of 10 cases. For the other organisations, some limited aspects had to be studied later since not all the relevant data was available at the time the evaluation was undertaken. The Commission is currently working to agree terms of reference with the UN for verification work.

Conclusions and recommendations

52. The Court's audit revealed a material incidence of errors affecting the amounts of the underlying transactions authorised by Delegations which had not been detected by the supervisory and control systems of the ACP States, the Delegations and EuropeAid's central services. The residual errors remain significant, notwithstanding possible future corrections. This indicates the need to pursue efforts to improve the design and/or implementation of some of the systems. **Table 3** gives an overview of the Court's assessment of EuropeAid's supervisory and control systems.

THE COMMISSION'S REPLIES

51. *Draft terms of reference (the 'Common Guidelines') were drawn up by EuropeAid following the third Annual Meeting of the UN-EC Working Group on the FAFA (cf. the Operational Conclusions of this meeting, April 2006). These were first submitted to the UN in September 2006. Negotiation is ongoing with the UN on four issues deriving from the proposed guidelines.*

52. *The Commission considers that the type of error detected concerns mainly payments made on the basis of audit reports or statements of account drawn up by supervisors in accordance with contractual and regulatory obligations. The Commission also notes that the level of residual error is not materially significant.*


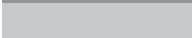

As the Court indicates in Table 3, the Commission has this year improved reporting by Delegations, ex post control, follow-up to audits and recovery order procedures.

The Commission intends to continue these improvements, in particular pursuing its efforts towards more harmonised presentation of the control strategy.

Table 3 — Assessment of supervisory and control systems

System concerned	Key internal control											Overall assessment	
	Procedures and manuals	Risk analysis and management	Management reporting	Controls performed before transactions are authorised	Monitoring missions		Ex-post controls	External audits					Internal audit
					Quality	Quantity		Quality	Quantity/ implementation of the audit plan	Follow-up of individual audit findings/ Effective recovery procedures	Overall monitoring by central services of audits commissioned by Delegations		
Central services EuropeAid													
Delegations					N/A	N/A	N/A				N/A		

Legend:

	Satisfactory
	Partially satisfactory
	Unsatisfactory
N/A	Not applicable: does not apply or not assessed

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

53. EuropeAid has started to remedy the shortcomings mentioned by the Court in its Annual Report concerning the financial year 2005. Some aspects of the transactional *ex post* control system have been reviewed and the support to operational and financial staff at the Delegations and in the central services has improved. EuropeAid has developed new terms of reference for external audits but the central monitoring of external audits initiated by the Delegations should be improved. Furthermore, the number of monitoring missions is still limited and EuropeAid's risk analysis does not sufficiently involve the Delegations nor adequately address inherent and control risks relating to the legality and regularity of operations.

54. The Court welcomes the efforts made by EuropeAid to develop a control strategy to ensure the efficient and effective implementation of the numerous supervisory and control activities of the various actors involved. The following recommendations should be considered in this context:

- (a) the control strategy should be established and made operational by the end of 2007. As already indicated by the Court ⁽³¹⁾, it should establish clear and consistent objectives, ensure coordination and set the type and intensity of checking. This should necessarily entail a balancing act between the costs of the various controls and the accompanying benefits, whilst taking account of the tolerable risk of errors in the underlying transactions. The control strategy should include a well-structured and documented risk analysis that formally involves the Delegations in a fully participative manner;
- (b) the management of projects financed by work programmes should be better supported. This should involve greater presence of Delegation staff in the field supporting accounting systems and training. Carrying out more audits at an early stage of the implementation of projects would also help to monitor and, where necessary, improve the quality of the control systems implemented by beneficiaries;
- (c) checks performed by the Delegations before authorising payments should better scrutinise the payment requests and intensify the focus on the reality, eligibility and accuracy of the expenditure. The quality of the work performed by supervisors should be better monitored;

54. *The Commission services are fully aware of the need to have and apply a control strategy that is cost effective. Indeed, the control strategy applied integrates audits, evaluations, assessments, monitoring and supervisory activities.*

- (a) *The Commission shares the Court's view. It has set up an Action Plan 'Towards an Integrated Internal Control Framework' which aims to perfect a common, coordinated approach and tools for all Commission services.*
- (b) *The Commission will continue to improve the quality of projects managed in the form of programme estimates. To that end, it has produced a new practical guide and specific training courses are held regularly in the ACP countries. The harmonisation of accounting aspects will be examined together with the Delegations.*
- (c) *Controls exercised by the Delegations follow the provisions of the Financial Regulation relating to the validation of expenditure by the responsible authorising officer, based on supporting documents attesting the creditor's entitlement on the basis of a statement of supplies actually delivered or work actually carried out or other documents.*

⁽³¹⁾ See Opinion No 2/2004.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The Commission will pursue its efforts to tighten up the quality controls carried out by Delegations and National Authorising Officers, while taking into account the costs and benefits of additional checks.

- (d) the quality of the controls performed by external auditors should be enhanced by ensuring that the new terms of reference include a clear definition of the purpose of the audit, the materiality threshold to be applied, the sampling, the nature of the audit procedures to be performed, guidance on how errors should be treated and how conclusions are to be reported upon. These standard terms of reference should also be used for all external audits initiated by the Delegations;
- (e) the central monitoring of the external audits organised by the Delegations should be improved so that the results can be effectively communicated to all relevant levels of management. This should be enhanced by the availability, by the end of 2007, of a management system that provides information on the audit process and facilitates access to relevant audit results;
- (f) verification of the Delegations by EuropeAid's central services should be enhanced by increasing the number of missions.

- (d) *The new terms of reference have been adopted and further enhance the elements of the audit work quoted by the Court.*
- (e) *The central monitoring of the external audits will be further improved during 2007. An information needs assessment is currently being performed by EuropeAid in order to identify the main priorities on the development of the information system. However, the immediate priority must remain the migration to ABAC-FED.*
- (f) *A new overall framework for missions to Delegations will be defined now that devolved management is fully operational.*

55. Regarding budget support, the Court previously recommended that the Commission should demonstrate in a more formalised and structured manner, setting out the reasons leading to its conclusion that the direction being taken by a beneficiary country is satisfactory, that there is compliance with Article 61(2) of the Cotonou Agreement, account being taken of the public finance management weaknesses revealed by the initial assessment⁽³²⁾. In view of the Commission's vigorous application of the 'dynamic interpretation' in Sierra Leone, compliance with the Cotonou Agreement is not assured. Therefore, the Court reiterates its previous observation, and recommends the following:

55.

- (a) compliance with the Cotonou Agreement should be benchmarked against baseline requirements, such as the availability of timely published and audited accounts. A clear, formal presentation of the conclusions reached would require the parameters of the 'dynamic interpretation' to be made explicit, thus enabling the appropriateness of disbursement decisions to be assessed;

- (a) *Understanding this to be a restatement of a previous recommendation (Special Report No 2/2005, paragraph 85), the Commission repeats its general agreement and flags the expected positive impact of the revised guidelines for General Budget Support. Noting that the short term risk that may be implied by its dynamic interpretation of Article 61(2) must always be viewed in relation to the ultimate objectives to be achieved, the Commission wishes to highlight the specific circumstances of fragile States.*

⁽³²⁾ Special Report No 2/2005, paragraph 85.

THE COURT'S OBSERVATIONS

- (b) in order to set out its conclusions in a structured manner, the Commission should ensure that the data used as a basis for disbursement decisions rely more on measurements of events that have already taken place than on predictions of future occurrences;
- (c) the indicators used should permit clear evidence of progress in public finance management to emerge where appropriate. This could be achieved by including indicators which can be measured over time, and compared from one period to the next, as opposed to indicators which rely on the performance of a one-off event.

THE COMMISSION'S REPLIES

- (b)** *The Commission agrees.*
- (c)** *The Commission agrees but underlines that some reforms can be designed and implemented relatively quickly but others will require several years.*

Table 4 — Follow-up of key Statement of Assurance observations

	Court observation	Action taken	Court analysis	Commission reply
1.	In its action plan towards an Integrated Internal Control Framework, the Commission should develop its overall control strategy. (Annual Report concerning the financial year 2005, paragraph 40)	The Commission has yet to achieve its stated aim to develop an overall control strategy to ensure an efficient and effective implementation of these various control activities. It is EuropeAid's intention to formulate this control strategy in 2007.	A control strategy should be established and made operational by the end of 2007.	See the Commission's reply to point 30.
2.	The financial control exercised by Delegations needs to be strengthened to prevent and detect errors. Controls of expenditure should focus more on the reality of goods delivered and works performed. This requires an intensified supervision of projects by carrying out more visits and controls on-the-spot throughout the duration of projects. (Annual Report concerning the financial year 2005, paragraph 41)	No specific actions were taken by EuropeAid. The number of errors revealed following the Court's audit of individual payments corroborates the observation that the financial control exercised by the Delegations needs to be strengthened.	Checks performed by Delegations before authorising payments should better scrutinise the payment requests and intensify the focus on the reality, eligibility and accuracy of the expenditure. The quality of work performed by supervisors should be better monitored.	<i>On-the-spot controls are carried out wherever possible, but they cannot be systematic, given the number of projects and the limited resources available. For that reason some of the controls are carried out externally. The Commission tries to conduct regular checks on the work of supervisors and feels that the control systems put in place operate satisfactorily.</i>
3.	The effectiveness of the management reporting by Delegations formalised by the External Assistance Management Reports (EAMRs) could be improved as feedback with support and instructions to Delegations is not always on time. (Annual Report concerning the financial year 2005, paragraph 31)	The central services of EuropeAid improved their response to EAMRs by providing more detailed and timely feedback.	Satisfactory action has been undertaken.	
4.	The number of missions to Delegations consisting of an examination of the setup and functioning of the supervisory and control systems is limited. (Annual Report concerning the financial year 2005, paragraphs 32 and 42)	The missions are well designed and provide practical recommendations for improvements to control systems. However, although more missions were planned for 2006, less were carried out than in 2005.	The verification of Delegations by the central services of EuropeAid should be enhanced by increasing the number of missions.	<i>The Commission has made sure that Delegations operate smoothly and are capable of managing projects on a devolved basis. 2006/2007 should be regarded as a transitional period during which the missions carried out — the quality of which was highlighted by the Court — were carefully targeted. A new overall framework will be defined now that devolved management is fully operational.</i>
5.	As the transactional <i>ex-post</i> controls are restricted in scope, they can only make a limited contribution to the overall assurance on systems and procedures and the legality and regularity of the underlying transactions. Moreover, they are carried out with much delay. (Annual report 2005, paragraphs 33 and 42)	EuropeAid caught up the backlog and reviewed some aspects of the approach. The control coverage was reduced and the scope of the checks slightly extended. The scope of the transactional <i>ex-post</i> controls still excludes however aspects related to legal commitments as well as detailed supporting documentation of expenditure of work programmes.	EuropeAid should consider extending the scope of transactional <i>ex-post</i> controls to aspects related to legal commitments as well as detailed supporting documentation of expenditure of work programmes.	<i>The characteristics of the transactional ex-post controls are based on an appreciation of residual risk and of the interaction with the other components of the control system. Transactional ex post controls provide an additional layer of assurance for the appreciation of the elements which are subject to such control (see also the Commission's reply to point 45).</i>
6.	The central monitoring of the implementation and follow-up of the audits initiated by the Delegations and the central services of EuropeAid needs to be improved. (Annual Report concerning the financial year 2005, paragraph 37)	No modifications were made to the computerised tool, CRIS audit. There is still no centralised management information relating to the coverage and results of the audit initiated by the Delegations.	The central monitoring of external audits organised by Delegations should be improved so that the results can be effectively communicated to all relevant levels of management. This should be enhanced by the availability, by the end of 2007, of a management system that provides information on the audit process and facilitates access to relevant audit results.	<i>The current system for the planning and centralised monitoring of external audits provides the information necessary for EuropeAid's risk analysis and audit strategy. EuropeAid intends to further improve the operation of CRIS-Audit, building on the experience gathered, as a tool complementary to the current system. Meanwhile, the Commission has made the Annual Audit Plan 2007 reporting format more detailed.</i>

Charts illustrating the consolidated sixth, seventh, eighth and ninth EDFs as at 31 December 2006

Chart I: Cumulative resources

Total = 44 608,5 million euro ⁽¹⁾

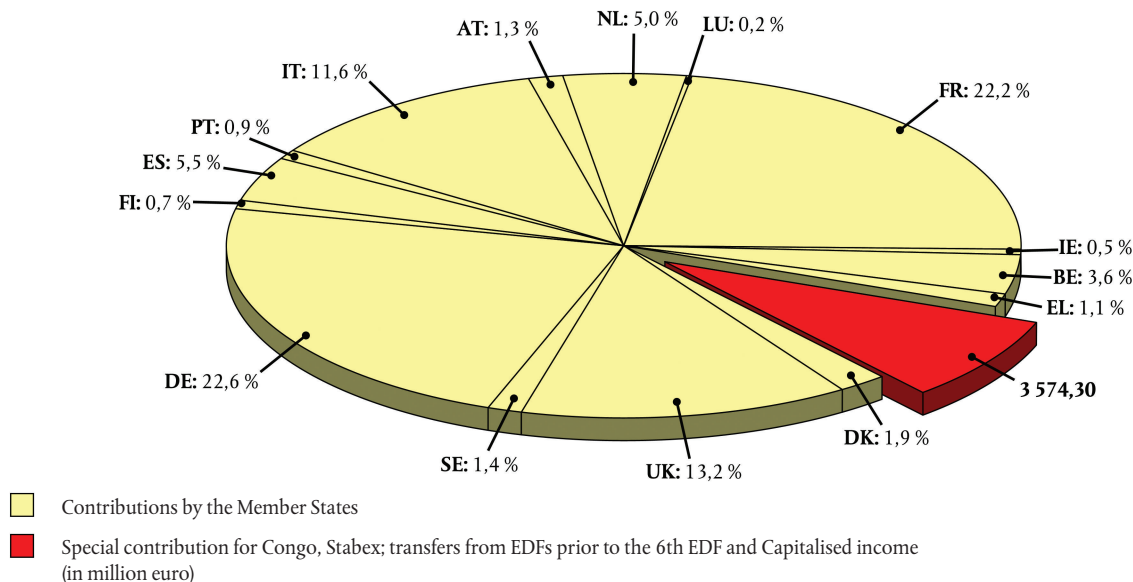
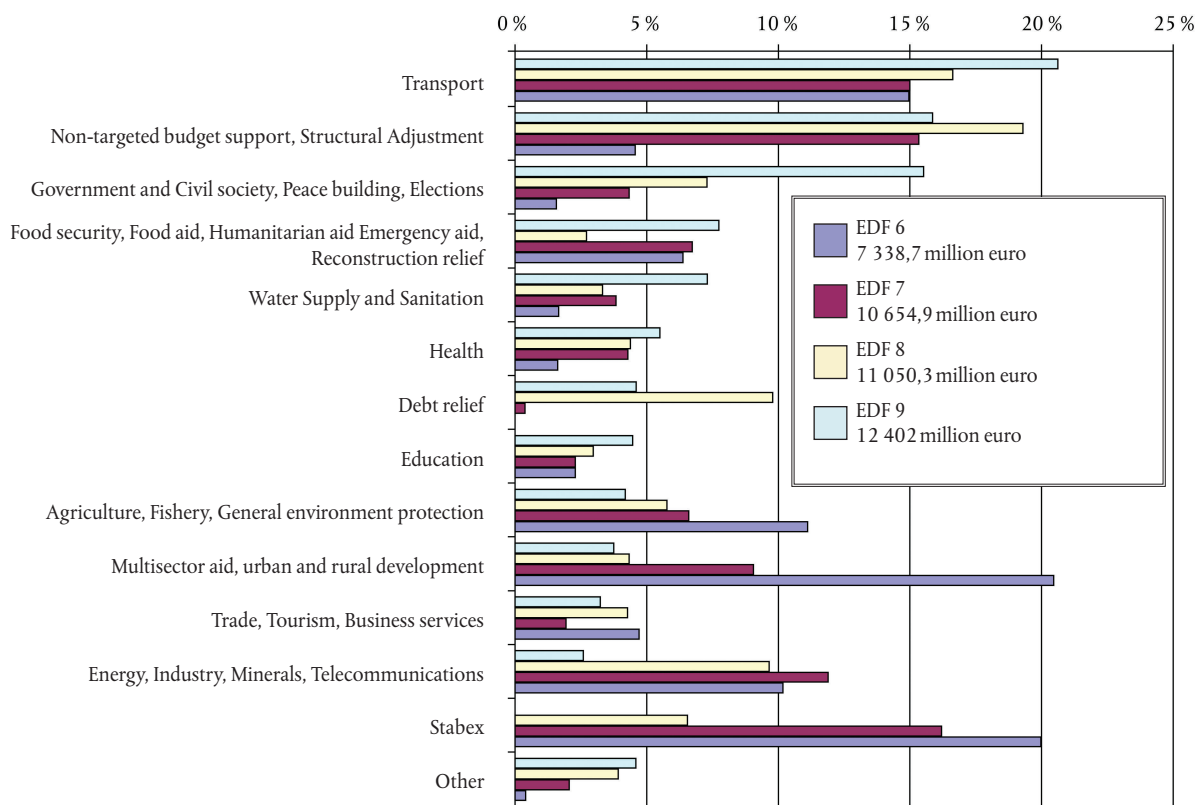


Chart II: Cumulative decisions

Total = 41 445,9 million euro ⁽¹⁾



Source: Court of Auditors, on the basis of the data in the accounting system.

⁽¹⁾ The difference between the cumulative resources (44 608,5 million euro) and the cumulative decisions (41 445,9 million euro) equals the available balance to be allocated (3 162,6 million euro).