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I

(Information)

COURT OF AUDITORS

OPINION No 2/97

concerning a proposal for a Council Regulation (Euratom, ECSC, EC) determining the powers and obligations of agents authorized by the Commission pursuant to Article 18 (2) and (3) of Regulation (EEC, Euratom) No 1552/89

(97/C 175/01)

THE COURT OF AUDITORS OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Coal and Steel Community, and in particular Article 78h thereof;

Having regard to the Treaty establishing the European Community, and in particular Article 209 thereof;

Having regard to the Treaty establishing the European Atomic Energy Community, and in particular Article 183 thereof;

Having regard to Council Decision 94/728/EC, Euratom of 31 October 1994, on the system of the European Communities' own resources ⁽¹⁾, and in particular Article 8 (2) thereof;

Having regard to Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989 implementing Decision 88/376/EEC, Euratom on the system of the Communities' own resources ⁽²⁾, as last amended by Council Regulation (Euratom, EC) No 1355/96 of July 1996 ⁽³⁾;

Having regard to Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 on the definitive uniform arrangements for the collection of own resources accruing from value added tax ⁽⁴⁾;

Having regard to Council Regulation (EEC, Euratom, ECSC) No 165/74 of 21 January 1974 determining the powers and obligations of agents authorized by the Commission pursuant to Article 14 (5) of Regulation (EEC, Euratom, ECSC) No 2/71 ⁽⁵⁾;

Having regard to the Financial Regulation of 21 December 1977 applicable to the general budget of the European Communities as last amended by Council Regulation No 2335/95 of 18 September 1995 ⁽⁶⁾, and in particular Article 85 thereof;

Having regard to the proposal for a Council Regulation, submitted by the Commission on 10 January 1997 ⁽⁷⁾;

Having regard to the Council Decision of 14 February 1997 to consult the Court of Auditors on that proposal;

Whereas the object of the proposal is to regulate the powers of agents authorized by the Commission,

HAS ADOPTED THE FOLLOWING OPINION:

1. Council Regulation (EEC, Euratom, ECSC) No 165/74 of 21 January 1974 determining the powers and obligations of agents authorized by the Commission has

⁽¹⁾ OJ L 293, 12. 11. 1994, p. 9.

⁽²⁾ OJ L 155, 7. 6. 1989, p. 1.

⁽³⁾ OJ L 175, 13. 7. 1996, p. 3.

⁽⁴⁾ OJ L 155, 7. 6. 1989, p. 9.

⁽⁵⁾ OJ L 20, 24. 1. 1974, p. 1.

⁽⁶⁾ OJ L 240, 7. 10. 1995, p. 12.

⁽⁷⁾ OJ C 95, 24. 3. 1997 (97/C 95/06) COM (96) 717 final — 96/0016/(CNS), p. 33.

not been amended to take into account the extension of the Commission's powers of inspection, which has been part of Community legislation since 1989. Nevertheless, the successive amendments to Community Regulations concerning own resources necessitate the updating of the conditions implementing the new provisions of Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989.

2. The proposal for a regulation repeals Council Regulation (EEC, Euratom, ECSC) No 165/74 of 21 January 1974. The Court proposes that the title of the new regulation should specifically refer to own resources generally, as they are all affected by the new regulation.

3. In particular, the proposal for a regulation lays down, within the framework of the new system of controls, the procedures which the Commission will follow during the on-the-spot inspections carried out by its authorized agents pursuant to Article 18 (3) of Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989. Article 3 (3) sets out the procedure to be followed by the authorized agents as regards the organization of the work, relations with the departments concerned and, where necessary, with the taxable persons concerned by the inspections.

4. The Commission has also proposed extending the concept of authorized agent to include temporary staff,

and adopting special provisions for national experts seconded to the Commission, for officers of other Member States and for outside agencies.

5. The Court notes that the extension of the concept of the authorized agent, or of the agent who may participate in the inspections, has been proposed by the Commission to provide for the necessity of having recourse, should the need arise, to specialist auditing skills. For the same reasons, the provisions relating to the presence of national experts seconded to the Commission, officers of other Member States and outside agencies should be equally applicable to traditional own resources and to own resources accruing from VAT and GNP. The Commission's proposal, by excluding the latter two categories, introduces an imbalance in the system of controls on own resources.

6. The Court would also like to draw attention to the fact that Article 8 of the proposal and Article 11 (2) of Regulation 1553/89, taken in combination, effectively make the proposal for a regulation applicable in its entirety to the VAT resource. This introduces a contradiction as far as application of the proposed regulation to the VAT resource is concerned, depending upon whether one refers to Article 7 or Article 8 of the proposed regulation.

7. In the attached table the Court has set out its amendment and comment relating to the Commission's proposal.

This opinion was adopted by the Court of Auditors in Luxembourg at the Court meeting of 24 April 1997.

For the Court of Auditors

BERNHARD FRIEDMANN

President

OPINION OF THE COURT OF AUDITORS CONCERNING THE PROPOSAL FOR A REGULATION
RELATING TO THE POWERS AND OBLIGATIONS OF AGENTS AUTHORIZED BY THE
COMMISSION

Present text of the proposal	Amendment proposed by the Court	The Court's comment
<i>Article 7</i> The provisions laid down in Articles 2 (2), 2 (3), 3 (1) (a), 3 (1) (b), 3 (3), 4 (1), 5 and 6 shall also apply to inspections carried out by officials or other servants of the Commission pursuant to Article 11 (1) of Regulation (EEC, Euratom) No 1553/89 and Article 19 of Regulation (EEC, Euratom) No 1552/89.	<i>Article 7</i> The provisions laid down in <i>Article 1</i>, and in Articles 2, 3 (1) (a), 3 (1) (b), 3 (3), 4 (1), 5 and 6 shall also apply to inspections carried out by officials or other servants of the Commission pursuant to Article 11 (1) of Regulation (EEC, Euratom) No 1553/89 and Article 19 of Regulation (EEC, Euratom) No 1552/89.	The object of the proposed amendment is to mention the provisions which are applicable to the own resources accruing from VAT and GNP, in order to ensure a single, coherent system for all own resources.

SPECIAL REPORT No 3/97

concerning the decentralized system for the implementation of the PHARE programme (period 1990 — 1995) together with the Commission's replies

(submitted pursuant to Article 188C, paragraph 4, indent 2, of the EC Treaty)

(97/C 175/02)

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1. INTRODUCTION

1.1. The PHARE programme was created in December 1989 under Council Regulation (EEC) No 3906/89 (OJ L 375, 23.12.1989) in order to support the process of reform in Poland and Hungary and, in particular, to finance economic restructuring projects ⁽¹⁾. Since then the PHARE programme has been extended, first to Bulgaria, Czechoslovakia and Romania ⁽²⁾, then to Albania, Estonia, Latvia, Lithuania ⁽³⁾, as well as Slovenia ⁽⁴⁾ and, more recently, Croatia ⁽⁵⁾, Bosnia-Herzegovina ⁽⁶⁾ and the former Yugoslav republic of Macedonia ⁽⁷⁾. Since the Essen summit in December 1994, the role of PHARE has increased, to the point where it has become the main financial instrument in support of the strategy leading up to the accession of the countries of central and eastern Europe to the European Union. As of 30 June 1996 a total of 5 757 Mio ECU had been committed since 1990. In each country the aid has been distributed over a wide range of economic sectors, as Annex 1 shows.

1.2. States which are in receipt of Community external aid usually participate in the management of the funds which they receive, but the degree of decentralization and the procedures used vary considerably from one programme to another. In the case of PHARE, specific procedures, known as decentralized implementation systems (DIS) ⁽⁸⁾ have been introduced.

1.3. A growing proportion of PHARE aid is sent using this system of decentralized procedures. For example, whereas in 1990 38 Mio ECU, out of a payments total of 171 Mio ECU (22%), was channelled through decentralized procedures, the corresponding amount in 1995 was 415 Mio ECU, or 54% of the payments. At the end of 1995, decentralized procedures provided the main channel for implementation of PHARE in Bulgaria, the Czech Republic, Romania, Slovakia, Hungary and Poland (see *Table 1*). DIS was expected to be put in place in the other PHARE countries in 1996 ⁽⁹⁾. Most of the 6 700 Mio ECU granted for PHARE by the European Council at the Cannes summit in June 1995 for the period 1996-1999 will thus be implemented via DIS ⁽¹⁰⁾. In the introduction to its manual for the decentralized implementation system, the Commission emphasized that the object of decentralization was to streamline the programmes and speed up the mobilization of financial resources. This belief that the decentralization of procedures would help to increase the rate at which budgetary appropriations were implemented is rather widely held, but it is not confirmed in practice (see paragraphs 2.2 and 2.3). The fact is that the implementation of programmes is still being hampered to a considerable extent by institutional shortcomings in the beneficiary countries (see paragraph 3.2).

⁽¹⁾ Article 3 (1) second paragraph of Council Regulation (EEC) No 3906/89 of 18 December 1989 (OJ L 375, 23. 12. 1989) provides for the financing of projects, 'in particular in the fields of agriculture, industry, investment, energy, training, environmental protection and in trade and services'.

⁽²⁾ Council Regulation (EEC) No 2698/90 of 17 September 1990 (OJ L 257, 21. 9. 1990). This Regulation also provided for PHARE assistance to the German Democratic Republic and Yugoslavia. However, Council Regulation (EEC) No 3800/91 of 23 December 1991 (OJ L 357, 28. 12. 1991) terminated aid to the GDR following German unification and PHARE assistance to Yugoslavia was suspended in 1991, because of the conflict. As of January 1993, two separate aid programmes were established for the Czech Republic and Slovakia following the partition of Czechoslovakia.

⁽³⁾ Council Regulation (EEC) No 3800/91 of 23 December 1991, OJ L 357, 28. 12. 1991.

⁽⁴⁾ Council Regulation (EEC) No 2334/92 of 7 August 1992, (OJ L 227, 11. 8. 1992).

⁽⁵⁾ Council Regulation (EC) No 1366/95 of 12 June 1995, (OJ L 133, 17. 6. 1995).

⁽⁶⁾ Council Regulation (EC) No 462/96 of 11 March 1996, (OJ L 65, 15. 3. 1996).

⁽⁷⁾ Council Regulation (EC) No 463/96 of 11 March 1996, (OJ L 65, 15. 3. 1996).

⁽⁸⁾ The decentralized implementation systems (DIS) were reinforced in 1994 with the publication of a new manual of procedures.

⁽⁹⁾ The countries in which contracts were concluded mainly or entirely by means of centralized procedures in 1995 are: Albania, Estonia, Latvia, Lithuania, Slovenia and the former Yugoslavia.

⁽¹⁰⁾ For its part, the European Parliament has always insisted that PHARE programme management should be decentralized as far as possible (1994 discharge report by Ms E. Kjer Hansen, March 1996, PE 215.707, paragraph 2.1).

TABLE 1

Table of PHARE aid by country and type of procedures used for 1995 transactions

Country	Payments under DIS procedures ⁽¹⁾		Payments under centralized procedures ⁽²⁾		Total payments
	(Mio ECU)	%	(Mio ECU)	%	(Mio ECU)
Albania	1,89	6,56	26,94	93,44	28,83
Bulgaria	29,54	66,35	14,98	33,65	44,52
Czechoslovakia	26,87	86,68	4,13	13,32	31,00
Czech Republic	30,51	79,29	7,97	20,71	38,48
Estonia	0,00	0,00	12,30	100,00	12,30
Hungary	73,26	83,60	14,37	16,40	87,63
Latvia	0,00	0,00	12,95	100,00	12,95
Lithuania	0,00	0,00	23,40	100,00	23,40
Poland	174,00	83,90	33,39	16,10	207,39
Romania	43,96	54,89	36,13	45,11	80,09
Slovenia	0,80	7,31	10,14	92,69	10,94
Slovakia	16,63	71,50	6,63	28,50	23,26
Ex-Yugoslavia	0,00	0,00	19,51	100,00	19,51
Multi country	17,66	12,27	126,27	87,73	143,93
Total	415,12	54,32	349,11	45,68	764,23

Source: EC Commission.

⁽¹⁾ Based on advance payments by Commission to PMUs.⁽²⁾ Based on advance payments by Commission to contractors.

1.4. The Court decided to examine the functioning of the decentralized systems because of their increasing importance for the implementation of the PHARE programme. This report is thus concerned with the DIS during the period 1990-1995. It is based both on on-the-spot audits and audits at the Commission. The reader will note that it does not attempt to evaluate the effect and impact of the sectoral programmes in the various beneficiary countries.

1.5. The main features of the DIS and its place in the overall management of PHARE funds are summarized in Annex 2. The DIS comprises two levels of decentralization:

- (a) within the Commission: its supervisory role has been partly delegated to the Delegations ⁽¹¹⁾;
- (b) in the beneficiary countries contracting and disbursement functions have been delegated to sectoral management units ⁽¹²⁾.

⁽¹¹⁾ In the recommendations and resolutions accompanying the 1994 discharge, the Council and the European Parliament insisted that the Delegations should play a larger part in the decentralized management of the PHARE programmes.

⁽¹²⁾ Programme Management Unit (PMU).

1.6. In setting up a decentralized management system, the Commission set itself two major objectives: firstly, to put into practical form its determination to treat beneficiary countries as partners and to prepare them for their applications to join the European Union by involving their administrations in the management of PHARE funds; secondly, to increase the effectiveness of programme implementation: this would not have been possible under centralized procedures, because of the limited staff resources available at the Commission. In this context, the Commission must take account of the provisions of the Financial Regulation which stipulate that aid projects are to be implemented in close collaboration between the beneficiary and the Commission, and thus set a limit to decentralization, since the latter organization retains responsibility for the utilization of appropriations ⁽¹³⁾.

⁽¹³⁾ Article 107 of the Financial Regulation, as revised by Council Regulation (EC, Euratom, ECSC) No 2335/95 of 18 September 1995 (OJ L 240, 7. 10. 1995, p. 12).

2. FUNCTIONING OF THE DECENTRALIZED MANAGEMENT SYSTEM

Analysis of PHARE budget implementation rates

Level of budgetary commitments

2.1. Table 2 summarizes the position for PHARE appropriations during the period 1990 — 1995.

TABLE 2

Implementation of PHARE appropriations 1990 — 1995

(Mio ECU)

Appropriations	Budgetary commitments (programme decisions)	Contracts concluded	Payments disbursed (budgetary payments)	Final expenditure
5 439	5 417	3 444	2 897	2 400
100 %	99,6 %	63 %	53 %	44 %

Source: European Commission.

This table shows that the performance of the programme in financial terms cannot be judged only on the basis of the rate at which commitment appropriations are implemented, since the procedures for implementing the PHARE programme are such that, for any given project, there is normally a space of three to four years between the initial commitment and the project's completion.

2.2. The rate for contracts concluded in countries primarily using DIS was 59%, whereas the equivalent rate for countries where centralized procedures were widely used was higher (70%). As of 31 December 1995 a balance of 497 Mio ECU remained on PMU bank accounts: this figure represents around 38% of the funds channelled through decentralized procedures (1 294 Mio ECU for the period 1990-1995).

2.3. The payment figures published in the accounts thus do not give a true picture of the implementation of PHARE programmes because funds paid over by the Commission to the PMU by way of advances are treated as final expenditure. A similar situation may be observed in the accounting management of the EU's Structural Funds. Here, again, the payments relating to contracts subject to DIS procedures are slightly lower than those dealt with under centralized procedures (68% compared with 73%).

Delays in implementing programmes

2.4. Not all the factors which delayed implementation of the programmes were attributable to the DIS. In fact, the

programme calls for close collaboration between the Commission and beneficiary countries and the responsibility for delays is very often equally divided.

Delays affecting the PHARE programme overall

2.5. When the PHARE programme was drawn up and its annual budgets established, the Commission's capacity to manage it was not taken into account. The PHARE programme was thus entered in Part B of the Commission's budget (operating expenditure), but the appropriations available under the budget for administrative costs did not cover the cost of the additional staff required for sound management. Nor was the PHARE programme established in terms of the absorptive capacity of the beneficiary countries. It was in fact observed that, after annual budgets had been committed, these countries were often slow to convert the sectoral framework programmes into concrete projects, whereas, under the demand-driven approach to the PHARE programme, the primary responsibility for the programme content rests with them. Lastly, national administrations had not always adopted a sectoral strategy, or had not completed legislative reforms prior to implementation of the programmes, despite the technical assistance made available to them.

2.6. Somewhat paradoxically, the 'efficiency' of committing budget appropriations throughout the year slowed down the implementation of certain programmes as a result, because the financing proposals (see Annex 2,

Part A2) were prepared to excessively tight timetables (see paragraph 2.2). This resulted in programmes which were vague and thus delayed implementation of the projects. This was true of the 1994 indicative programme for Poland, which was not approved until mid-October 1994, which left barely three months in which to draw up the 15 financing proposals required for commitment of the 174 Mio ECU earmarked for the programme. When this happens, either considerable extra time is needed to finalize programmes after the funds have been committed, or the progress of operations is hampered as a result of over-hasty preparation.

2.7. When implementing the PHARE programme, the Commission paid insufficient attention to limiting the number of programmes, projects and contracts⁽¹⁴⁾. Moreover, in each country, the PHARE funds were

divided between too many ministries, with the result that financing was spread too thinly. The funds should be concentrated more on a limited number of programmes corresponding to clearly defined priorities and objectives. The various programmes are often implemented via numerous small projects, which in turn require a large number of contracts for their implementation. Whilst the conclusion of small contracts does allow small firms of consultants to compete on equal terms with larger firms, this must not be used as a pretext for the current dispersal of funds. Lastly, the relatively low threshold at which contracts become subject to compulsory tendering (50 000 ECU)⁽¹⁵⁾ increases the administrative workloads of both PMUs and the Commission, with a resultant slowdown in the rate of implementation. Table 3 provides an overview of the number of programmes per year in the countries where DIS was the main channel for PHARE implementation (see paragraph 1.3).

TABLE 3

Number of PHARE sectoral programmes per year for countries where DIS is used primarily

Beneficiary	1990	1991	1992	1993	1994	1995	Total number	Total value committed (Mio ECU)	Average value (Mio ECU)
Bulgaria	3	11	7	18	10	7	56	477	8,5
Ex-Czechoslovakia	2	8	7	—	—	—	17	233	13,7
Czech Republic	—	—	—	5	7	6	18	230	12,8
Hungary	11	12	10	6	7	14	60	583	9,7
Poland	12	15	15	17	14	9	82	1 186	14,5
Romania	3	13	10	6	8	5	45	608	13,5
Slovakia	—	—	—	6	9	21	36	126	3,5
Total	31	59	49	58	55	62	314	3 443	11,0

Source: Court of Auditors.

⁽¹⁴⁾ See the Court of Auditors' Annual Report for 1990, paragraph 12.77 (OJ C 324, 13. 12. 1991).

⁽¹⁵⁾ Compared with 300 000 ECU for TACIS, for example.

Delays in DIS procedures

2.8. Before any contracts are concluded under a sectoral programme, a programme authorizing officer (PAO) must be appointed, a PMU established and a work programme drawn up. The latter must be prepared by the PMU and accepted by the Commission in Brussels. The work programme system in fact ensures that the PMUs state clearly, in advance, how the funds will be used during the implementation period (usually six months). This procedure is a major guarantee of the sound financial management of the DIS, but, in practice, it has given rise to delays in both the submission of work programmes by the PMU and their subsequent approval by the Commission.

2.9. Analysis showed that the interval between the start of the programme (date of the Commission financing decision which makes it possible for the appropriations to be committed) and the Commission's approving the first advance was around one year (see Table 4).

TABLE 4

Interval between the start of PHARE programmes and payment of the first advance to the PMU (1990 — 1995)

Country	Average interval (months)
Bulgaria	14,1
Ex-Czechoslovakia	11,3
Czech Republic	9,7
Hungary	11,3
Poland	13,2
Romania	11,8
Slovakia	10,6
DIS average	11,7

Source: Court of Auditors.

2.10. On average, during the first half of 1994, the final versions of work programmes were not submitted by national authorizing officers until 34 days after the start of the implementation period. For the first six months of 1995 the situation improved, insofar as the work programmes were submitted, on average, seven days before the beginning of the period covered. However, this still represents a serious delay, bearing in mind the Commission requirement for PMUs to submit their work programmes 90 days before the start of the period

covered, because the Commission needs the time to examine and approve the programmes.

2.11. The length of time required by the Commission for approval of the work programme is due to the cumbersome nature of the approval process itself (transit through Commission Delegation, central operational and financial services and approval by Financial Controller). During the first half of 1994, this process took 106 days on average. During the first half of 1995, the average time was reduced to 87 days, which was still excessive, as it meant that, on average, work programmes were not approved until the second half of the period covered by them.

2.12. A further important source of delays was the requirement that contracts with a value of more than 500 000 ECU must be submitted to the Commission in Brussels for endorsement at three different stages: firstly, the tender dossier and the shortlist of tenderers; then the evaluation report on the bids received; finally, the contract itself. The procedure leading up to the Commission's final endorsement took, on average, seven weeks from the date on which the contract was signed by the programme authorizing officer. On a number of occasions PMUs trimmed contracts in order to reduce the value to less than 500 000 ECU and thus avoid the need for approval by the Commission in Brussels.

*Organization of the Commission departments ⁽¹⁶⁾**The role of the Delegations*

2.13. To a large extent the delays in approving work programmes and contracts were due to the involvement of the Commission in Brussels in the day-to-day running of the DIS, despite the provisions of the framework agreements concluded between the Commission and beneficiary countries, which emphasize the role of the Commission Delegations:

'For matters relating to the measures financed within the framework of this Agreement, the Commission shall be represented in ... by its Delegation which shall ensure, on behalf of the Commission, that the measure is executed in accordance with sound financial and technical practices' ⁽¹⁷⁾.

2.14. The role which was to be played by the Delegations was confirmed in an internal Commission note of April 1991, which assigned to each Delegation full responsibility for the implementation of projects and programmes in its country.

⁽¹⁶⁾ An outline organization chart of PHARE programme departments at the end of 1995 is contained in Annex 3.

⁽¹⁷⁾ Article 3 of the framework agreement.

2.15. In several countries the introduction of decentralized procedures was complicated by delays in setting up Commission Delegations (see Table 5).

TABLE 5

Year of establishment of Delegations in PHARE countries using DIS

Country	Year Delegation established
Bulgaria	1993
Czech Republic	1992
Hungary	1991
Poland	1990
Romania	1993
Slovakia	1995

Source: Court of Auditors

2.16. Moreover, the Delegations, once established, suffered particularly from a shortage of staff available for assignment to the PHARE programme. For example, the new Delegation opened in Slovakia (March 1995) had only two permanent expatriate posts: the Head of Delegation and an economic adviser. In Romania there have been only three expatriate staff at the Delegation since mid-1994. In Poland the Delegation was not given an agricultural adviser post until 1994 (although the Delegation was opened in 1990) despite the importance of agriculture in Poland, which received allocations of funds for agriculture amounting to 100 Mio ECU between 1990 and 1993. In order to cope with this situation, the Commission employed substantial numbers of locally recruited staff (see Table 6).

TABLE 6

Analysis of category A staff in post in Delegations in PHARE countries using DIS as at 31 December 1995

Country	Officials (category A)	Locally recruited staff (category A)	Total
Bulgaria	4	4	8
Czech Republic	4	6	10
Hungary	5	10	15
Poland	5	10	15
Romania	3	5	8
Slovakia	2	7	9
Total	23	42	65 ⁽¹⁾

Source: Court of Auditors

⁽¹⁾ A significant percentage of these staff are not directly involved in PHARE programme management.

2.17. Even when posts do exist in the Delegations' establishment plans there may be considerable delays in filling them. In Poland, for example, an agricultural adviser post was eventually created in July 1994 by abolishing the Delegation's press and information officer post, but the post had still not been filled at the end of 1995 (see paragraph 2.16). The Head of Delegation post in the same country remained vacant for ten months, from July 1994 to April 1995; the post of economic adviser was vacant from May to September 1994 and that of administrative attaché from July to November 1994. In Romania the Delegation opened in October 1993 but did not receive its two advisers until mid-1994.

2.18. The Delegations' compliance with DIS procedures was perfectly satisfactory in areas such as approval of contract terms of reference, lists of tenderers, work programmes and contractual clauses, but they neglected other essential aspects of their work. For example, they spent only a small amount of time monitoring project progress, either by means of on-the-spot visits to beneficiaries or by review of reports submitted by consultants. These limited contacts with final beneficiaries considerably reduce the effectiveness of the Delegations in PHARE countries.

The role of the Commission in Brussels

2.19. In April 1991 the Commission in Brussels asked its staff to establish guidelines for programming the use of funds and then to provide support to the Delegations in the identification and monitoring of the various programmes (see paragraph 2.14). In practice the role of the Commission's Brussels staff is much wider. In the case of the work programmes, their involvement duplicates the Delegations' work of checking the technical aspects. Moreover, Commission staff in Brussels are still using centralized procedures to commit part of the funds allocated to DIS countries (see Table 1).

2.20. In December 1995 the Commission published new instructions concerning the respective roles of its Brussels staff and its Delegations. These documents are certainly indicative of progress, but their value is considerably reduced by the continuing lack of job descriptions for Commission Brussels staff. In addition, the reporting lines require further clarification. For example, Heads of Delegation are answerable to the programme director in Directorate General (DG) I A for PHARE matters, and not to the desk officers in the same DG, although it would be logical for them to report to the latter. Regarding the advisers in the Delegations, it is not specified whether, for PHARE operations, they report to the Head of Delegation or to the Commission in Brussels.

Furthermore, the Commission does not require Delegations to report on the overall implementation of sectoral programmes.

2.21. The important role of Commission Brussels staff in the day-to-day execution of programmes is reflected in the distribution of posts between Brussels and the Delegations⁽¹⁸⁾. For PHARE 70 category A and B staff are located in three desk units at the Commission in Brussels, whereas there are only 23 in the Delegations. In addition, the Commission Brussels staff includes 19 persons who are employed in a sectoral support unit and a further 15 in a unit dealing with general policy questions and coordination with G-24 (see Annex 3). Since the Commission staff in Brussels are now being required to devote more time to the Europe agreements and the pre-accession strategy, their involvement in the day-to-day follow-up of the PHARE programme is, inevitably, being reduced.

2.22. The fact that all the contract and financial specialists are in Brussels detracts from the proper functioning of the Delegations. The provision of posts for financial specialists in the Delegations, partly, at least, by transfers of posts from Brussels, would increase the opportunities for decentralization.

3. THE PROGRAMME MANAGEMENT UNITS (PMUs)

The introduction of management units

The role of the programme authorizing officer

3.1. In accordance with the provisions of Articles 107 and 109 of the Financial Regulation the Commission has delegated considerable authority to the programme authorizing officers (PAOs) appointed by beneficiary countries. The first operational guidelines published by the Commission in 1990 made the PAOs responsible for the management of project bank accounts, advances, tendering and contracting and, more generally, for ensuring the proper and timely implementation of the project, and in particular for the utilization of the funds provided by the Community in accordance with the

provisions of the Financing Memorandum, and the principles of sound financial management, including those of economy and cost effectiveness⁽¹⁹⁾.

3.2. The Commission did not take sufficient account of the capabilities of the local administrations, which were usually not able to perform such wide-ranging functions satisfactorily, given that, for example, PHARE countries had only a limited tradition of transparency in accounting practices and public procurement. Moreover, decentralization took place without the Commission having satisfactory information on the procedures which had been put in place in the national administrations in order to ensure that the financial management was sound. This background constituted even more reason for local administrations receiving training before decentralization took place.

3.3. In practice, PAO posts have tended to be filled by high-ranking civil servants who cannot be involved in day-to-day programme management, by virtue of their office. A study carried out by the Commission in 1995 revealed, in fact, that a typical PAO could only devote a small proportion of his time to PHARE. As a result, the detailed planning of programmes and their implementation were delegated to PMUs, although there was no reference to these management units in the 1990 operational guidelines.

The growth of PMUs

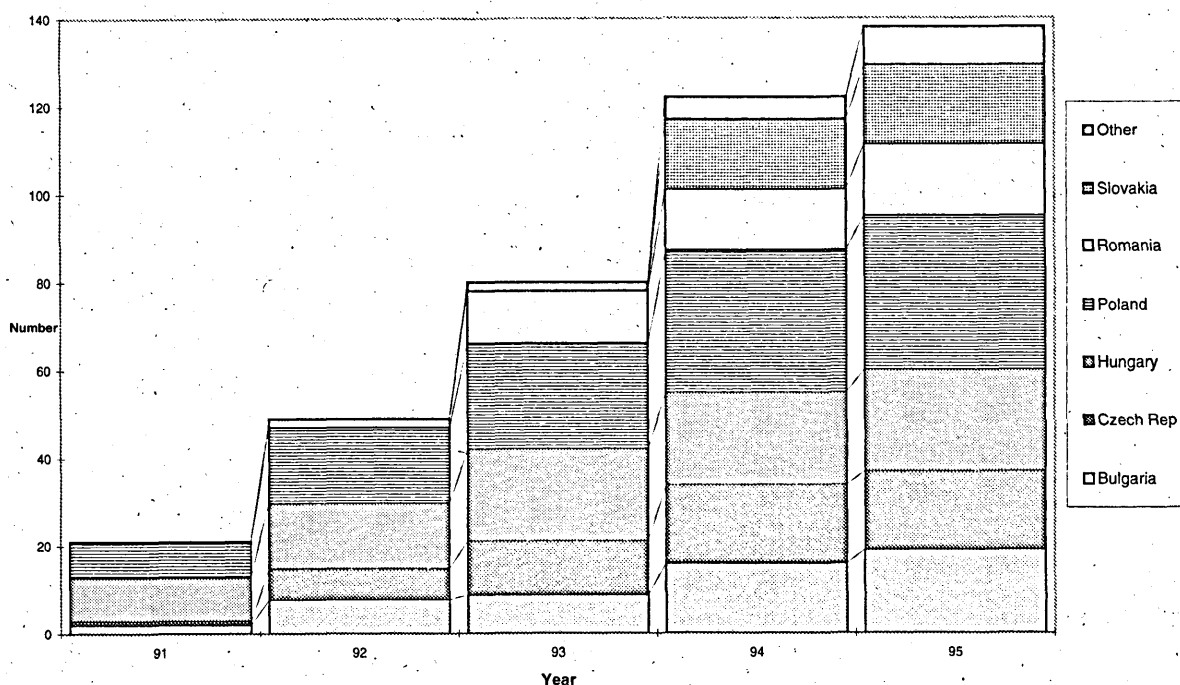
3.4. As a result of the allocation of funds over a wide range of sectors there has been a build-up in the number of PMUs: whenever a programme has started up in a new area of intervention a new PMU has almost always been created. Thus, as Table 7 shows, there was a steady increase in the number of PMUs over the period 1990-95, with the result that at the end of 1995 there were 138. For its part, at the time the Commission had developed no strategy for controlling the multiplication of PMUs.

⁽¹⁸⁾ See the Court of Auditors' Annual Report for 1993, paragraph 12.29 (OJ C 327, 24. 11. 1994).

⁽¹⁹⁾ Provisions for implementation of the advance payment system.

TABLE 7

Number of PMUs per country 1991 — 1995



Source: Court of Auditors.

The role of the management units

Main features of the management units

3.5. The advantage of the principle of decentralization is that it makes beneficiary countries participate in the management of PHARE funds. In practice, however, the quality of the services provided by PMUs has varied considerably. In all cases, a learning process was established in respect of PHARE procedures and, more broadly, methods for managing public funds. This learning process often had negative effects on the programmes and resulted, in particular, in delays in implementation (see paragraphs 2.8 — 2.10) and difficulties as regards contracting (see paragraphs 4.6 — 4.9), financial management (see paragraphs 4.14 — 4.21) and the mechanisms for drafting implementation reports (see paragraph 4.27).

3.6. The increase in the number of PMUs could have had a positive impact, insofar as it created more opportunities for the transfer of know-how. However, in practice, the development of management powers often proved to be a delicate matter. The fact is that, although the PMUs played an important bridging role between the

Commission and the ministries concerned in the early years, they were often poorly integrated within the ministries. This lack of integration reduced the transfer of know-how and led to programme management units being distanced from national policies and priorities.

3.7. Although the programme management units did serve as an intermediary for the national administrations it would have been preferable to view them as a temporary solution until the reform of public authorities and the experience gained by the Commission made it possible to integrate the PHARE programme completely into the work of the national ministries. Not only did the Commission not pursue a strategy of progressive integration of the PMUs' work into that of the national authorities, but the beneficiary countries did not give sufficient priority at the beginning of the PHARE programme to the reform of public administration either.

3.8. The development of management powers in the public administrations of the PHARE countries was also hampered by national budgetary constraints and by considerable differences between salaries in the private and public sectors. In other words, the national authorities were unable to provide the PMUs with appropriate posts or offer salaries that were sufficiently

high to keep highly qualified staff in those posts on a long-term basis. This had an adverse effect on the functioning of the DIS overall, and there was considerable staff turnover within the programme management units. Members of staff who had received training as part of the PHARE programme very often left their posts for better-paid jobs in the private sector. This regular haemorrhage of PMU staff slowed down transfers of know-how to the administrations.

3.9. In Poland, PMUs often took the form of 'foundations', which made it possible to skirt the recruitment problems caused by the low salaries paid in the public sector. These organizations are not bound by public pay scales and salaries paid by them may, in fact, be up to twice those paid by the administration. However, as these salaries still remain lower than those in the private sector, this device can only reduce staff turnover rather than eliminate it.

The role of technical assistance to the management units

3.10. The role of technical assistance to PMUs in PHARE countries is mostly dual in nature: to lend administrative support in the management of sectoral programmes and to provide operational support to the national authorities in formulating their sectoral policies and implementing projects financed by PHARE. Technical assistance thus constitutes the principal means of providing support for the PMUs to develop their management powers. It is financed by PHARE and provided by mostly Western consultants.

3.11. For the reasons described in previous paragraphs, the transfer of technical assistance know-how to PMU staff usually takes several years. Thus, in mid-1995, almost two-thirds of PMUs that had been operating for longer than three years and whose programmes were still being implemented were continuing to receive foreign technical assistance. Although technical assistance primarily exists to provide help for local staff, it has often been the main source of continuity in the decentralized management of the PHARE programmes. As a result, it has become indispensable.

3.12. Most of the contracts for this technical assistance are concluded according to centralized procedures. There are no standardized terms of reference for these contracts, despite the similarities between the services provided by these technical assistants. For example, in some cases, the terms of the contract emphasized the importance of transferring know-how whilst, in other

cases, this question was raised only briefly or not at all. Out of 30 contracts for technical assistance to PMUs in Romania, only four included clauses containing a clear reference to the transfer of know-how. Moreover, the persons in charge of technical assistance did not receive any special training in DIS procedures before taking up their duties in the beneficiary country and, furthermore, the results obtained were not evaluated ex post facto in any way by the Commission, despite the fact that technical assistance plays a major role in the DIS.

3.13. No specific procedure was established to examine cases of contracts which were close to expiry. The extension of such contracts was simply approved by the Commission when a programme's authorizing officers asked for technical assistance to be maintained. The reasons cited by these authorizing officers generally came down to the observation that know-how had not been transferred within the period initially provided for. In such cases, there is a risk that PMUs might seek to have contracts extended, not because consultants have technical skills that the PMUs do not possess, but simply so as to ensure that additional staff are available. For their part, firms of consultants clearly have every incentive to ensure their contracts are extended ⁽²⁰⁾.

3.14. The job of providing PMUs with technical assistance was complicated by a lack of clarity in the definition of their role and in the arrangements for presenting their accounts. It should be specified, in particular, whether the purpose of technical assistance is to supervise programme management units on behalf of the Commission and to what extent the aim is to advise these PMUs on the management of their programmes. The fact that the technical assistants' terms of reference are usually defined by the Commission, which subsequently draws up their contracts, leads to confusion, because the PMUs, like the consultants themselves, frequently believe that technical assistance is to assist the Commission rather than the PMUs. This assumption is often borne out by the contracts, which require consultants to make their reports to the Commission.

3.15. PMUs seldom take proper advantage of the training opportunities offered by technical assistance. In fact, they do not give their staff enough encouragement to cooperate closely with their technical assistance counterparts. PHARE was the first opportunity for many PMU staff to work with western consultants. Their absence of previous experience did, however, reduce the effectiveness of this cooperation. Moreover, the

⁽²⁰⁾ See the Court of Auditors' Annual report for the financial year 1994, paragraph 10.29 (OJ C 303, 14. 11. 1995).

considerable differences between the salaries of foreign experts and the salaries of national PMU staff have also been detrimental to cooperation.

Manual of DIS procedures

3.16. The Commission did not provide enough direct support in terms of training and advice for these units. For example, a manual setting out decentralized procedures was not published until 1994, even though such a manual was essential from the outset as a means of making the national administrations' management of PHARE more efficient. At that time, Part V-A of the manual, concerning contracts, had not been completed and the missing chapters, in particular that on works contracts, had still not been published at the end of 1995. Moreover, despite the importance of this manual to the national administrations, the Commission did not have it translated into the languages of the PHARE countries. A revised edition of the manual was timetabled for publication at the beginning of 1997 but it will probably not be issued before the end of 1997, after the Commission has redefined the priority guidelines for PHARE.

3.17. A large part of the job of drafting the manual distributed in 1994 was entrusted to a firm of consultants whose contract was concluded by direct negotiation in January 1993, although the value of the contract (59 581 ECU) exceeded the 50 000 ECU threshold authorized for contracts of this nature. Whilst work was scheduled to start in October 1992 and the manual was due to be completed in March 1993, the consultants continued to work until March 1994 and their total remuneration came to 212 634 ECU.

3.18. When the incomplete version of the manual was published in the PHARE countries in mid-1994, the Commission organized a week of DIS training in each country. Once this limited action had been taken, the Commission organized only a few periods of supplementary training on the DIS procedures. No Brussels-based Commission official was instructed to organize DIS training within the PMUs, and the Delegations, for their part, did not have enough time to ensure that the PMU staff's skills were upgraded on the job.

Financial costs of the management units

3.19. The costs of the PMUs are divided between the PHARE programme and the beneficiary countries.

However, it is impossible to know the exact cost to the PHARE countries because the financing agreements do not require them to declare their financial contributions to each programme. It is also impossible to establish which PMU costs are charged to the PHARE programme itself because the Commission has not created a sufficiently precise accounting framework for recording these costs. Indeed, it is not possible from the Commission's accounts to identify separately the PMUs' administrative costs, the technical assistance costs for administrative support and the technical assistance costs for operational support (see paragraph 3.10). Moreover, the nomenclature used varies from one sectoral programme to another.

Management units' operating costs

3.20. The budgetary constraints experienced by the PHARE countries (see paragraph 3.8), together with the proliferation of PMUs (see paragraph 3.4), put such pressure on the Commission that it contributed to the financing of the PMUs' operating expenditure, even though the PHARE Regulation (Article 6) restricted the financing of this expenditure:

'Maintenance and operating costs may be covered for training and research programmes and for other projects; however, for the latter such costs may be covered only in the start-up stage and shall be degressive'.

3.21. In this area, several shortcomings were noted in respect of the Commission, which did not define what is meant by 'operating expenditure', did not specify the length of the 'start-up stage' and did not adopt a rule for applying the principle of degressivity⁽²¹⁾.

3.22. This lack of an overall policy and of guidelines applicable to the financing of the operating expenditure of the PHARE programme led the Commission to adopt an ad hoc approach. Only in mid-1995 did the Commission commission a study on the organization of the PMUs. This study covered around a hundred PMUs and showed that the units had an average staff of nine or ten people, 57 % of whom were paid by PHARE. These staff financed by PHARE were in turn composed of an average of 1,2 foreign experts and 4,2 local employees. Table 8 gives a detailed analysis of the situation in mid-1995.

⁽²¹⁾ See 1991 Annual report, paragraph 14.46 (OJ C 330, 15. 12. 1992); 1993 Annual report, paragraph 12.10 (OJ C 327, 24. 11. 1994).

TABLE 8

Average staff of PMUs by country and origin of financing on 30 June 1996

Country	Staff financed by the beneficiary State			Staff financed by the PHARE programme			Total staff
	National officials	Contractual staff	% of staff paid by the country	Foreign experts	Local staff	% of staff paid by PHARE	
Bulgaria	4,1	0,0	61 %	0,8	1,8	39 %	6,7
Czech Rep.	2,0	1,5	56 %	0,7	2,0	44 %	6,2
Hungary	3,0	2,4	64 %	1,8	1,3	36 %	8,5
Poland	0,9	1,3	13 %	1,5	13,9	87 %	17,6
Romania	2,9	0,6	44 %	1,4	3,1	56 %	8,0
Slovakia	1,8	3,1	56 %	0,8	3,1	44 %	8,8
Average	2,5	1,5	43 %	1,2	4,2	57 %	9,4

Source: Court of Auditors

3.23. In Poland, the main beneficiary of PHARE, the PMUs are both numerous and large and have a total staff of 430 (of whom 87% are paid by PHARE), including foreign experts. In addition, in 60 % of these PMUs' salary costs are totally borne by PHARE. Owing to their dependence on PHARE financing, the ultimate viability of these PMUs, half of which are foundations (see paragraph 3.9), is not guaranteed. In this country, the two PMUs that received the most PHARE aid for the payment of staff salaries were:

(a) the Polish Agency for Regional Development (PARD), responsible for the important STRUDER programme⁽²²⁾ (76,7 Mio ECU): its 90 local members of staff were paid by the PHARE programme, i.e. 625 000 ECU in 1995;

(b) the Foundation for Assistance to Agricultural Programmes (FAAP): 49 out of 53 local members of staff were paid by the PHARE programme, i.e. 600 000 ECU in 1995.

3.24. In the other countries, although the proportion of PMU staff expenditure financed by PHARE was smaller, it was still between 35% and 55%. The cases below are

examples of PMUs where the PHARE financing was particularly high:

(a) the Foundation for International Management (FIMAN) and the Programme Management Unit responsible for education in Romania, where 32 out of a total of 33 local members of staff were financed by PHARE in 1995 (350 000 ECU);

(b) the programme management unit of the Bulgarian Ministry of Industry, the seven local employees of which were financed by the PHARE programme (35 000 ECU in 1995).

3.25. The lack of clear rules concerning operating expenditure may also hamper the implementation of individual programmes. For example, in Poland, the approval of the work programmes relating to the 1991 privatization programme (50 Mio ECU) was delayed in 1994 while the Commission reviewed the principle and extent of the funding for the salaries of the staff in the PMU and the ministry concerned. In this country uncertainty over future PHARE financing also contributed to high staff turnover.

3.26. The Commission proposed solving the problem of salary levels (see paragraph 3.8) by allowing the salaries of PMU staff to be topped up with PHARE funds, subject to the official agreement of the national administrations. This method was not adopted because of the tensions that large differences in salary might create within the national administrations. However, many PMUs top up salaries indirectly, for example by paying

⁽²²⁾ Programme for structural development in certain regions.

daily allowances to staff in respect of official travel. These daily allowances, which are calculated on the basis of United Nations' scales, are particularly high when compared with average monthly salaries. For example, in Romania, where the monthly salary of PMU directors was around 90 ECU in 1995, the daily allowance amounted to 224 ECU.

3.27. In addition to the financing of PMU staff expenditure, PHARE funds often covered purchases of vehicles and office equipment, as well as operating expenditure (telecommunications, fuel and maintenance of vehicles, rent, heating and electricity charges). The amount of PHARE financing in these areas is difficult to determine because of the lack of clear accounting for such expenditure. The study of the PMUs carried out by the Commission in 1995 cannot be regarded as reliable, insofar as it was based only on management unit declarations. However, it is clear that, in the case of certain management units, investment expenditure and operating expenditure (excluding salaries) were considerable. For example, the annual operating costs, excluding salaries, of the PMUs responsible for the three main PHARE activities in Poland (privatization, agriculture and regional development) were estimated at approximately 1,1 Mio ECU in 1995 by the expert assigned to carry out the study by the Commission.

3.28. Operating expenditure was financed in two ways: by making advance payments to PMUs once the work programmes had been approved or by including it in contracts to provide technical assistance support to the PMUs. However, this indirect financing complicates the monitoring and checking of costs. The Commission's Financial Controller therefore sought to enforce the provisions of Article 6 of the PHARE Regulation when requests for the payment of advances were being approved, but, as he does not participate in the procedures for approving contracts, he has not always been able to prevent this type of operating expenditure.

3.29. PMUs' staffing requirements are considerably increased by the fact that, under current arrangements, PMUs are still responsible for both technical management of the programmes (project identification and drawing up the terms of contracts) and also for financial management (payments to sub-contractors and management of bank accounts).

3.30. Another possible method of decentralization would have been to entrust technical management to the PMUs but to restrict financial management to just one

ministry or one agency in each country. This method was adopted in a modified version of the DIS applicable in 1997 in the Baltic States where central financing and contracting units (CFCU) were opened. As a result of this new method of organization it is possible to reduce the number of financial specialists, who are often expensive and difficult to recruit. An additional advantage of this system is that it simplifies the Commission's financial management, as the funds in question are managed by only one person in each country.

Cost of providing foreign technical assistance to management units

3.31. Technical assistance in support of programme management units (see paragraph 3.10) is costly. An examination of the technical assistance given to PMUs shows that, although the cost varies depending on the services requested, the average cost of the contracts was in the region of 700 000 ECU⁽²³⁾. In most cases, the assistance was provided by a team of two experts seconded for approximately two years to a management unit and assisted by other experts in the provision of specialized services for short periods. The average fees of a foreign expert seconded to a management unit totalled approximately 12 000 ECU per month. The fees were seldom below 10 000 ECU and occasionally reached 17 000 ECU.

3.32. An analysis of some 30 contracts financed by PHARE and concluded with individual consultants recruited by the EAC⁽²⁴⁾ revealed that the average monthly fee paid was around 8 000 ECU and no consultant had received more than 10 000 ECU. In one case, where the services of a consultant seconded for short visits to the management unit responsible for privatization in Slovakia had been invoiced by his firm at a monthly rate of 20 000 ECU, the Commission hired the same expert under a long-term EAC contract for a monthly fee of 9 000 ECU once the original contract had expired. In addition to covering the salaries of seconded consultants, the fees charged by consultancy firms also include the back-up support provided by the firms throughout the contractual period, as well as making a

⁽²³⁾ Not including extensions to contracts.

⁽²⁴⁾ European Association for Cooperation, a non profit-making association set up and managed by the Commission itself.

contribution to their overheads and profits. However, the actual support provided by the firm is often limited and, in many cases, additional support services are invoiced separately. As a result the main service provided by these firms of consultants is usually, in practice, to find experts and replace them during the contractual period should they leave the project early.

3.33. Although contracts to provide PMUs with technical assistance are concluded by means of a tendering procedure, the element of competition involved in this procedure does not always lead to lower expenditure. In the first instance, when tenders are being examined, the Commission emphasizes the technical quality of the tenders that it has received. The financial assessment subsequently counts for only 30% of the total assessment and companies' tenders are examined only if the technical assessment is above a certain threshold⁽²⁵⁾. This use of shortlists reduces price competition. Moreover, competition, which is measured in terms of the number of tenders received, is generally low when measured against the size of the contracts in question. For example, out of a sample of 35 invitations to tender to provide PMUs with technical assistance, the average number of tenders received was only 4,4 for every 7,6 companies invited to submit bids. The reason most commonly cited to explain the difference between the number of bids sought and the number of bids received is that companies placed on the shortlist of tenderers join forces to submit a joint bid. This practice is encouraged by the Commission, which issues a list of all short-listed companies when the invitation to tender is issued. The small number of tenders received in turn affects the number of tenders in respect of which a financing proposal is examined (an average of just 2,1 financing proposals were examined per contract). For 29 % of invitations to tender, only one financing proposal was examined. In such cases there is no price competition at all.

3.34. The initial duration of nearly 90 % of contracts for providing technical assistance to PMUs was extended at least once. The median increase in the value of contracts as a result of these extensions was 67 %. The following cases serve to illustrate this phenomenon:

- (a) in the case of the management unit responsible for agriculture in Hungary, the initial contract (value 0,6 Mio ECU) that was concluded in October 1990 for a period of 15 months was extended on three occasions until July 1995; the value of the amendments totalled 2,3 Mio ECU. Only on this latter date was a new

invitation to tender issued in respect of an additional contract worth 1 Mio ECU;

- (b) in the case of the management unit responsible for privatization and restructuring in Hungary, the initial contract worth 2,6 Mio ECU covered the 1990 and 1991 programmes and ran until June 1994. It was renewed twice until the end of 1996; the corresponding amendments totalled 1,7 Mio ECU;
- (c) in the case of technical assistance in respect of the environment in Czechoslovakia, the initial 1,0 Mio ECU contract, which was valid for a period of 18 months starting from May 1991, was extended three times until June 1994 and was increased to an overall amount of 2,6 Mio ECU;
- (d) in the case of the contract to provide support for the management unit at the Bulgarian Ministry of Industry, the initial contract for 1,6 Mio ECU signed in June 1991 for a period of 30 months was extended by 12 months at an additional cost of 1,0 Mio ECU. Including other amendments concerning the payment of local staff and additional experts engaged for short periods, the total cost of the contract was 2,9 Mio ECU.

4. THE TRANSPARENCY OF THE DECENTRALIZED MANAGEMENT SYSTEM

4.1. If a management system lacks transparency, it can prove difficult, if not impossible, to establish the legality and regularity of the transactions. This is why the transparency of the procedures and the transactions authorized under them are the first questions to be examined in this chapter. Secondly, the systems for reporting on the use of funds will be assessed. Lastly, the mechanisms for evaluating the results will be examined.

Award of contracts

4.2. Approximately 80 % of the PHARE funds that are managed on a decentralized basis are spent on contracts for services (technical assistance), supplies or works. Service contracts account for the bulk of the expenditure. The awarding of service contracts is governed by Article 118 of the Financial Regulation and Article 7 of the PHARE Regulation. The Financial Regulation lays down that these contracts are, without exception, to be awarded 'after restricted invitations to tender'. Article 7 of the PHARE Regulation stipulates that:

'In the case of assistance exceeding ECU 50 000 participation in invitations to tender and contracts shall be open on equal terms to all natural and legal

⁽²⁵⁾ In general, 65 % of the items that are assessed.

persons of the Member States [and of the PHARE countries]’.

The Commission gave preference to Article 118 of the Financial Regulation when it decided that service contracts worth more than 50 000 ECU would be subject to restricted invitation to tender. As a result, access was not always ‘on equal terms’, as required by Article 7 of the PHARE Regulation.

Brussels does not have a system to check in a global manner whether the principle was being applied by the delegations. An examination by the Court of shortlists concerning 320 invitations to tender in 1993 and 1994 showed that, depending on the PHARE countries concerned, companies from certain Member States were chosen from the lists more often than companies from other countries. In some PHARE countries, the tendency to defer the requirement for ‘reasonable geographical balance’⁽²⁶⁾ is particularly notable. Indeed, companies with offices in Poland and Hungary are by far the most frequently consulted (see Table 9).

4.3. Despite the importance attached to compliance with the principle of competitive tendering, the Commission in

TABLE 9

Number of restricted invitations to tender, indicating consultants’ countries of origin and the PHARE country organising the invitation to tender, for the period 1993–1994

Consultants’ country of origin	Number of consultations											
	Bulgaria		Czech Republic and Slovakia		Hungary		Poland		Romania		Total	
	No	%	No	%	No	%	No	%	No	%	No	%
Belgium	22	9	40	8	30	5	36	6	7	8	135	7
Bulgaria	6	3	0	0	0	0	0	0	0	0	6	0
Denmark	14	6	31	6	30	5	58	9	3	3	136	7
Former Czechoslovakia	2	1	46	9	1	0	0	0	0	0	49	2
France	35	15	68	13	53	10	70	11	16	18	242	12
Germany	38	16	82	15	69	12	62	10	13	15	264	13
United Kingdom	40	17	84	16	65	12	105	16	16	18	310	15
Greece	9	4	15	3	15	3	14	2	2	2	55	3
Hungary	0	0	0	0	114	21	1	0	1	1	116	6
International	1	0	1	0	33	6	4	1	0	0	39	2
Ireland	6	3	19	4	20	4	23	4	3	3	71	3
Italy	17	7	47	9	30	5	44	7	10	11	148	7
Luxembourg	0	0	1	0	5	1	1	0	0	0	7	0
Poland	1	0	0	0	0	0	138	21	0	0	139	7
Portugal	5	2	10	2	14	3	5	1	1	1	35	2
Romania	1	0	0	0	0	0	0	0	2	2	3	0
Spain	22	9	36	7	25	5	20	3	7	8	110	5
Netherlands	19	8	51	10	44	8	69	11	7	8	190	9
Other countries	1	0	0	0	5	1	0	0	0	0	6	0
Total	239		531		553		650		88		2 061	

Source: Court of Auditors

⁽²⁶⁾ Manual for contract and procurement rules under the DIS — Part 2-A, paragraph 5.

4.4. The frequency with which companies are chosen from the lists is also lacking in balance. Out of 1 102 companies invited to tender for the 320 contracts examined, 818 (i.e. approximately three-quarters) were consulted only once. On the other hand, a small group of 24 companies, i.e. 3 % of the total, were selected between 10 and 31 times (see Table 10).

TABLE 10

Frequency with which companies were consulted for the award of service contracts for the period 1993—1994

Frequency of consultation	Number of companies	Percentage	Running total
once	818	74 %	74 %
twice	130	12 %	86 %
3 times	55	5 %	91 %
4 times	26	2 %	93 %
5-9 times	49	4 %	97 %
10 to 19 times	16	2 %	99 %
More than 20 times	8	1 %	100 %
Total	1 102	100 %	100 %

Source: Court of Auditors

4.5. The most important aspect of restricted invitations to tender is the drawing-up of lists of companies which are invited to submit a bid (see paragraph 3.33). Under the decentralized system, PMUs are responsible for drawing up lists that are subsequently submitted to the Commission. The initial guidelines drafted in 1990 were particularly vague about the procedures for drawing up such lists, as they stated only that the Authorising Officer for the programmes would ensure that appropriate measures were taken to encourage broad participation in invitations to tenders and contracts. The 1994 manual on public contracts under a decentralized system confirmed the need to provide a 'reasonable geographical balance' and indicated certain criteria to be taken into account ⁽²⁷⁾.

⁽²⁷⁾ Eligibility, competence and experience of the company operating in the sector; experience in the PHARE country/countries concerned or in third countries; quality of services provided under previous contracts.

4.6. Whilst the size of a consultancy affects the number of contracts it may accept at the same time, this cannot however be the only explanation for the imbalances that were noted. These imbalances stemmed partly from the fact that the PMUs had no direct access to the Commission's central register of consultants, which contains all data on companies that wish to participate in PHARE contracts. Consequently, the management units tended to consult reputable major international companies with whose names they were familiar.

4.7. The important role played by the technical assistance that the PMUs were given when drawing up shortlists must not be overlooked, either, in particular where these units have little information themselves on potentially suitable companies. In such cases, there is a real risk that the consultancy providing technical assistance might recommend other consultancies with which it is on good terms for inclusion on the shortlist ⁽²⁸⁾. This is a practice for which it is difficult to quote precise figures.

4.8. The very procedure for assessing bids lacks transparency. For example, the minutes of the committees for assessing PHARE contracts, which should explain how the tenderer was chosen, are usually very brief and not very explicit as to the merits and weaknesses of the various bids or as to the reasons why the appraisals arrived at by the committee's members vary considerably.

4.9. The problem is due partly to the fact that the assessment committees are essentially or entirely composed of nationals of the PHARE countries whose experience of assessing bids is often limited. Furthermore, the DIS procedures make no provision for ascertaining whether the members of the committees are really independent in their judgments or that they actually have the linguistic and technical knowledge needed to assess the relative merits of the bids.

4.10. The manual on the decentralized system lays down that after the assessment phase, but before the contract is finalized, negotiations shall be entered into with the tenderer who submits the most attractive bid if the fees concerned exceed the usual ceiling set for the provision of services. However, the Commission has never indicated what this ceiling is.

⁽²⁸⁾ In the case of the 1991 programme for the expansion of the financial sector in Bulgaria, a contract for 28 770 ECU was even concluded by private treaty with the company which had been awarded the technical assistance contract at the PMU.

Expenditure

4.11. Under the DIS, payments are made by PMUs without any prior checks being carried out by the Commission⁽²⁹⁾. This very significant decentralization measure was adopted by the Commission even though it had no particular information on the inspections that are carried out at government level in the beneficiary countries or on the procedures established by the PMUs. However, standards of management and financial control vary considerably from one management unit to another and, in many cases, basic administrative checks in respect of the separation of duties, the countersigning of payment orders and comparisons of banking data had not been made. Furthermore, the Commission gave no clear instructions to the PMUs in this connection and even the 1994 manual deals only summarily with administrative and financial inspection procedures.

4.12. The Commission's checking of expenditure in respect of the decentralized system consisted of:

- (a) examining work programmes prior to adoption;
- (b) checking the terms of reference and the invitation-to-tender files;
- (c) checking contract awards and the related files, including the terms of payment: after signing in the case of contracts below 150 000 ECU and before signing for contracts above this threshold;
- (d) ex post accounting checks, which were entrusted to independent audit firms, in respect of the various programmes.

4.13. Although the Commission's 1990 guidelines provided for twice-yearly audits of the programmes, these audits were carried out on an ad hoc and limited basis between 1990 and the end of 1994. Thus, the fact that before 1995, only 34 of the 108 PHARE programmes financed from 1990 to 1992 had been audited constitutes a serious weakness in the Commission's inspection system. However, a significant improvement has been noted since early 1995 and programmes are now regularly audited at the half-way stage, on the scheduled expiry date and upon closure. As of mid-1996, however, little use had been made of the findings of these audits.

4.14. One significant weakness nevertheless remains in the procedures concerning payments to consultants. The PMUs did not systematically check that the consultant had actually worked the number of days stated in the

contract. This is an area which is, at the very least, lacking in transparency.

4.15. Although most PHARE payments cover expenditure relating to specific contracts, they may also relate to other transactions, such as programme running costs. This is a risk area, since such payments are made by the PMU to itself. In principle, the Commission checks such expenditure by requiring every measure to be described, with details of the timetabling and costs, in the work programmes that are submitted to it for approval. However, this form of control is inadequate in the case of running costs. In effect, even though control could be exercised by comparing expenditure with the budget estimates, there is no transparent accounting framework for running costs, and for some programmes there is not even a budget allocation. Moreover, even when there is a budget for running costs, PMUs may exceed it by charging payments to other programmes without the Commission's noticing, since the latter does not examine individual entries in the accounting system but only checks whether the various project budgets have been exceeded.

4.16. One particularly serious case of administrative costs being posted to operating budgets concerned the 1990 privatization programme in Poland. The programme budget had earmarked an amount of 1,22 Mio ECU for this, out of a total of 9 Mio ECU. However, an audit by the Court showed that total expenditure of 3,08 Mio ECU had been incurred in this area over the period 1991 — 1994, mainly for salaries (1,35 Mio ECU), equipment (0,8 Mio ECU) and rent (0,6 Mio ECU), but that most of the payments had been charged to budget headings other than institutional support.

4.17. The lack of control over payments not based on contracts has also led to situations where technical assistance to a PMU has been reimbursed for cost items that were already covered by the main contract. For example, technical assistance to the Hungarian Foundation for Enterprise Promotion received payments from the PMU for items such as vehicle maintenance and insurance, translation and secretarial costs, telecommunications and printing costs, for which it was already receiving payment under the terms of its contract. Similar problems were found in the 1992 programme for small and medium-sized companies in Romania.

4.18. Unexpected increases that were due to the inadequacy of internal control in some PMUs were also shown on two occasions in Poland. In the first case, the

⁽²⁹⁾ See 1993 Annual Report, paragraph 12.45 (OJ C 327, 24. 11. 1994).

former president of the Polish Foundation for Privatization authorized illegal payments amounting to 27.174 ECU to himself in 1992. The payments in question were recorded in the PMU's accounts as financial charges and the Commission did not take steps to recover the amounts in question. The PMU subsequently repaid them by diverting interest received on other deposits. In the second case, 127 338 ECU was transferred without authority in December 1994 from the Polish Industrial Development Agency's PMU account to a foreign bank account. The bank subsequently reimbursed the money to the management unit, once it had been established that the fraud had been carried out by a bank employee.

Revenue

4.19. PHARE programmes receive revenue in the form of bank interest on funds held in PMU bank accounts. The very high balances on these accounts are due to the long intervals between the transfer of funds by the Commission and the actual utilization of them. The Commission does not pay sufficient attention to this factor. Between the beginning of the PHARE programme and 31 December 1995, such accounts had generated a total of 34,7 Mio ECU in interest income. The Commission's monitoring of such interest income is still very inadequate, even though it represents a significant increase in the PHARE programme's resources⁽³⁰⁾. This lack of care is partly due to the fact that the Commission is not required to account for the interest earned by programmes.

4.20. The sum of 34,7 Mio ECU is indeed a substantial amount, but it was obtained by leaving the choice of bank and the negotiation of interest rates to the PMUs. In this way, PHARE funds have frequently been placed in bank accounts that were earning less in terms of interest than they could have.

4.21. Article 5 of the PHARE regulation provides that income received on aid payments is to be used for financing projects. Frequently, however, such income is used to increase the portion of programme expenditure devoted to management unit running costs. In Hungary, for example, interest received on the 1990 SME programme funds was used by the management unit at the end of the programme (December 1994) to buy 26

new motor vehicles at a total cost of 198 430 ECU. In Poland, the interest earned on the 1991 PHARE privatization programme amounted to 1,6 Mio ECU at the end of 1995 and was used entirely to finance operating costs, including the salaries of PMU staff. In this way the management unit was able to show a 0,4 Mio ECU reduction in the operating costs budget when it requested a reallocation of funds between the various programme components, whereas in reality operating expenditure had increased by 1,2 Mio ECU.

Accounting and financial reporting

4.22. The PMUs are required to maintain accounts which show clearly how the funds transferred to them have been used. Similarly, a rapid and efficient system of financial reporting which enables the Commission in Brussels to supervise and report on the use of funds is a key element in a transparent decentralized management system. No such system has yet been established, however.

4.23. Article 16 of the PHARE 'General conditions relating to financing memorandum' requires beneficiaries to 'maintain records and accounts adequate to identify the works, supplies or services financed under the financing memorandum in accordance with sound accounting procedures'. The keeping of reliable accounts is essential if control is to be carried out on an ex post basis. Accounting has proved problematic for PMUs in PHARE countries due not only to a lack of knowledge of financial management techniques but also the inadequacy of the practical guidelines and training supplied by the Commission. Every technical assistance group in the management units has set up its own accounting system, resulting in duplication of effort in one PHARE country after the other. Moreover, the systems introduced were seldom based on the principles of double-entry book-keeping. It is difficult to employ identical computerized accounting systems in every country because of differences in legal and accounting procedures. Nevertheless, it would have been possible to organize a common core for all PHARE programmes at national level in conjunction with national coordinators, and thus ensure a certain minimum level of consistency.

4.24. In the early years of the PHARE programme the Commission did not pay sufficient attention to financial

⁽³⁰⁾ See 1991 Annual report, paragraph 14.52, OJ C 330, 15. 12. 1992; 1992 Annual report, paragraph 11.96, OJ C 309, 16. 11. 1993; 1994 Annual report, paragraph 10.36, OJ C 303, 14. 11. 1995.

reporting and the establishment of reliable accounting systems, and the DIS is still suffering the consequences of that omission. It was not until 1992 that a common computer system (PHACSY) began to be introduced in management units. The 1994 DIS manual stated that 'as far as accounting is concerned, the PMU will operate and keep a detailed account of all transactions undertaken during the programme term; this is to be done through PHACSY, the reporting system set up for this purpose by the Commission'. In practice the system is used only for financial reporting, as it has not proved adequate for accounting purposes.

4.25. PHACSY is unnecessarily complex for the relatively simple task required of it, namely monthly reporting to the Commission on local contracting and disbursements, and is of limited use for providing detailed management information. It does not meet the PMUs' requirements, because it was not developed in consultation with them, and it has caused duplication of work, in that data have to be entered in the PMUs' accounting systems and then in PHACSY separately.

4.26. In 1994 the Commission hired consultants to resolve these problems in the system's operation, at a cost of 614 200 ECU, but the results of this initial work were far from satisfactory and a further contract for 188 770 ECU was concluded with new consultants in 1995. 900 000 ECU in total has thus been spent on consultancy contracts in an attempt to improve PHACSY. However, the underlying weaknesses of the system remained such that at the end of 1995 the Commission was considering replacing PHACSY with a new system. In this context it is perhaps worth pointing out that other Commission departments (and DG VIII in particular) already have accounting systems which allow them to monitor the progress of every financing agreement, contract by contract and payment by payment, and that some of these systems are decentralized and located at the Delegations.

4.27. Internal control of DIS has suffered as a result of the low reliability of the data in PHACSY. The PHACSY data are incomplete because several management units have not regularly reconciled their data with the bank statements. Delays in providing the Commission with PHACSY reports have been a further source of problems. In June 1995 38% of PMUs had not reported within the

last month, while 15% had not reported for three months. In Slovakia the figures were 57% and 29% respectively. Delays in submitting reports had been cut substantially in the second half of 1995.

4.28. The problems with the reliability and timeliness of PHACSY have seriously affected the external reporting on the PHARE programme, especially as regards the quarterly reports to the European Parliament on PHARE financial implementation. Until the recent improvement in reporting times the values of local contracts were substantially understated. In the reports in question the analysis of contracting is by year. This practice is confusing, because the figures refer to the year in which the contracts were accounted for in PHACSY, rather than the year in which they were concluded. As the introduction of PHACSY did not begin until 1992 and actual installation in PMUs was substantially delayed, the backlog in entering data was not finally cleared until 1995.

Reports on the effectiveness of measures

4.29. The need to evaluate the use of PHARE funds is another aspect of management transparency. The evaluation of programme results is particularly important in a system of decentralized procedures over which the Commission has no day-to-day control. Without reliable evidence of how far programmes are achieving their objectives it is not possible to know whether funds have been used properly. The Commission should, therefore, introduce procedures which ensure that the management of budget funds is sound⁽³¹⁾.

4.30. In many respects evaluation of the PHARE programme is difficult, in that it is based on the transfer of know-how rather than, for example, infrastructure projects, where results are more readily identifiable and quantifiable. On the other hand, the necessity of checking whether funds have been correctly applied is much greater, because of the intangibility of PHARE outputs. At the end of 1995, six years after the start of the PHARE programme, the Commission was still only at the

⁽³¹⁾ Article 2 of the Financial Regulation of 21 December 1977, as amended (OJ L 70, 16. 3. 1990).

stage of setting up an evaluation system that could show how well PHARE funds had been used ⁽³²⁾.

4.31. DG IA's neglect of the evaluation function is surprising, given the increased importance attached to this aspect since the end of the 1980s by DG VIII, which is the DG responsible for the European Development Funds. The unit responsible for evaluation has been considerably strengthened by its adoption of the so-called 'logical framework' method and systematic conduct of mid-term reviews and ex-post evaluations for all new programmes. This is another instance where PHARE could have taken advantage of expertise and techniques already developed by other sections of the Commission working in related areas.

4.32. From 1991 onwards financing agreements have included an annex setting out the 'logical framework' method, which was intended to facilitate evaluation by integrating the planning, monitoring and evaluation phases of the project cycle. From the 1993 programmes onwards, a detailed logical framework matrix has formed an important part of the strategic plan which the manual requires PMUs to draw up at the beginning of a programme. In the same context the manual also requires PMUs to draw up 'monitoring and assessment reports' which were designed to provide an annual overview of each programme's performance and achievements and to form the basis for revision of the strategic plan each year.

4.33. The DIS manual offers some practical guidelines for the preparation of logical framework matrices and PMUs moreover received training in this area when the manual was first released. However, the quality of the matrices is still very variable, due to the complexity of the exercise and the weak statistical systems of some PHARE countries, which also makes the task of identifying reliable performance indicators difficult.

4.34. Whereas strategic plans have been produced almost systematically, this has not been the case for the monitoring and assessment reports which are supposed to come after. As of end-1995 approximately only 30 % of the reports due had been submitted.

4.35. A major step towards remedying this situation was taken in mid-1995, when a monitoring and assessment unit was set up as part of the reorganization of PHARE's headquarters. However, the unit's main activity in the second half of 1995 was organizing a call for tenders for the engagement of external consultants to carry out evaluations for DG IA. Moreover, as regards the necessity of giving greater emphasis to the evaluation process at all levels of the Commission in the context of the SEM ⁽³³⁾ 2000 initiative, the unit's role had still not been defined with regard to the evaluation unit set up within DG IA's Directorate of Finance.

5. CONCLUSION

5.1. The circumstances under which the PHARE programme has been implemented have been particularly difficult due to the constantly changing context in which it has operated. The volume of aid and the number of countries and sectors covered have all increased considerably (see paragraph 1.1), while the Commission, with limited staff resources and little experience of the countries of central and eastern Europe, has been under pressure to commit the PHARE programme budget in full each year. In this particular context, the Commission did not turn its experience of external aid to advantage in its ex post evaluations (see paragraph 4.31) and in monitoring the projects' accounts (see paragraph 4.26).

The operation of the DIS

5.2. The Commission gave high priority to fully committing the PHARE annual budget, and was successful in that aim (see paragraph 2.2). However, contracting and disbursement of funds have not been accomplished at the same rate. The decentralized procedures have slowed down, rather than accelerated, the award of contracts (see paragraph 2.2). The Commission's reporting of disbursement rates does not reflect the real expenditure situation, in that there was an outstanding balance of 497 Mio ECU (i.e. 38% of the funds channelled through the DIS) on deposit in PMU bank accounts at 31 December 1995 (see paragraph 2.3).

⁽³²⁾ See 1990 Annual report, paragraph 12.72 (OJ C 324, 13. 12. 1991); 1991 Annual report, paragraph 14.55 (OJ C 330, 15. 12. 1992); 1993 Annual report, paragraph 12.132 (OJ C 327, 24. 11. 1994); 1994 Annual report, paragraph 10.62 (OJ C 303, 14. 11. 1995).

⁽³³⁾ Sound and Efficient Management.

5.3. Various factors affecting the PHARE programme as a whole and certain aspects of the DIS itself have impeded the progress of these measures. They include:

- (a) the fact that the Commission did not make sufficient staff available for the PHARE programme during the start-up phase in 1990 (see paragraph 2.5);
- (b) the low absorptive capacity of the beneficiary countries (see paragraph 2.5);
- (c) the undue emphasis given to full commitment of the annual budget (see paragraph 2.2), which mobilized resources at the expense of the preparation of individual projects;
- (d) insufficient limitation of the number of programmes, projects and contracts in the light of the limited staff resources available at the Commission in Brussels (see paragraph 2.7).

As for the DIS itself, there have been significant delays in the submission and approval of work programmes and contracts by Commission headquarters (see paragraphs 2.10 — 2.12).

5.4. The problems that were found reflect shortcomings in the Commission's supervision of the DIS. Decentralization to the Commission Delegations has only been partial, with the Brussels-based departments continuing to play a major part in day-to-day management (see paragraphs 2.19 — 2.22). The Delegations have suffered from staff shortages (see paragraphs 2.15 — 2.17) and delays in filling posts.

5.5. The Delegations should be made fully responsible for the day-to-day monitoring of PHARE measures, which was the principle adopted originally. However, Delegation staffing will have to be strengthened, with financial and contract management specialists in particular, if all work programmes and contracts are to be approved by them (see paragraph 2.22). Redeployment of staff from PHARE headquarters and other Delegations to the Delegations that have been opened in PHARE countries should be speeded up.

5.6. The role of staff at the Commission in Brussels should be focused on the development of policies and procedures and the monitoring and evaluation of programmes as a whole (see paragraph 2.21). The Commission should seek to restrict the number of programmes financed, as well as the number of projects and contracts within each programme, to a level at which its staff are better able to monitor them.

Programme management units

5.7. Although there was no provision for them at the outset of the PHARE programme, there has been a rapid proliferation of PMUs as the Commission did not seek to limit their numbers (see paragraph 3.4). The difficulties caused by devolution in favour of PMUs with limited experience may be seen as the result of a compromise which reduces the efficiency of implementation in the short term. In the medium term, however, national administrations' management skills should be reinforced through their participation in the PHARE programme (see paragraph 3.5).

5.8. The acquisition of management skills on the part of national administrations has been hampered by the marginalization of many PMUs (see paragraphs 3.6 — 3.7) and the budgetary constraints of beneficiary countries, which limit the possibilities of filling posts and recruiting quality staff on a long-term basis (see paragraph 3.8).

5.9. Western technical assistance has been the main instrument used by the Commission to support PMUs, but the effectiveness of the transfer of knowledge has been reduced, due to:

- (a) an ambiguous definition of the role of technical assistance (see paragraph 3.13);
- (b) the conditions governing the drafting of technical assistance reports (see paragraph 3.13);
- (c) the lack of ex post evaluation of the performance of technical-assistance measures (see paragraph 3.11);
- (d) a little-supervised system of extending technical-assistance contracts (see paragraph 3.12);
- (e) lack of experience and training among national staff of PMUs were obstacles to collaboration with western technical assistance (see paragraph 3.15).

5.10. The Commission has paid insufficient attention to developing alternative forms of backup support for PMUs. Its manual on decentralized procedures was only published and issued in 1994 and was not translated into the languages of the PHARE countries. Furthermore, the Commission provided only limited training in DIS procedures for the PMUs (see paragraphs 3.16 — 3.17).

5.11. Financing PMU operating costs was a problem for the PHARE countries and has resulted in the Commission's taking over part of the cost burden, so as to ensure that programmes are correctly implemented (see paragraph 3.20). However, the Commission has not developed any policy which takes account of Article 6 of the PHARE Regulation, whereby such financing should not only be limited to the programme start-up period but also reduced progressively (see paragraph 3.21). Moreover, it has not established an accounting framework for recording, monitoring and controlling such costs (see paragraphs 3.18 and 3.26 — 3.29).

5.12. The extensive use of foreign technical assistance to PMUs has been expensive (see paragraphs 3.31 — 3.34) and the PHARE procedures for calls for competition have not always led to a reduction in this expenditure (see paragraph 3.33).

5.13. The problem of PMU operating costs must be resolved. One possible approach would be to require the beneficiary countries to include in the financing agreements an undertaking regarding the staff to be provided and the other costs to be defrayed by the beneficiary. There should also be a schedule setting out the increases in the contribution over the course of the programme. The Commission should check that the undertaking is respected and take firm action if it is not.

5.14. Consideration should also be given to the possibility of transferring financial functions to a central unit, for example, the Ministry of Finance, in each country. The principle of having only one cash fund, if applied, would reduce the costs of PMU administration and, at the same time, improve financial management of the PHARE programme (see paragraph 3.30).

5.15. Better-staffed PMUs with reduced functions would lessen the need for technical assistance and accelerate the transfer of know-how. Steps should also be taken to strengthen collaboration between the PMUs and technical assistance, by training PMU staff in contract management and providing training in the drafting of consultants' terms of reference. PMUs should systematically receive copies of each technical assistance contract. Finally, there should be clear procedures for evaluating the work of technical assistance and for renewing their contracts.

Transparency of the DIS

5.16. Contracting has sometimes not been transparent. Although the PHARE Regulation requires that participation in invitations to tender and contracts is to be open to all on equal terms, the Commission in Brussels has not always ensured that this rule is applied globally. The invitations to tenders that were examined by the Court showed that certain countries and consultancies have enjoyed particularly favourable terms of access to contracts (see paragraphs 4.2 — 4.7).

5.17. The revision of Article 118 of the Financial Regulation, which was completed at the end of 1995 and which concerns restricted tendering procedures⁽³⁴⁾, should improve the transparency of contracting under the DIS framework. The Commission should, however, monitor the situation, so as to ensure that PMUs actually follow the new provisions.

5.18. Since 1990 the Commission's control of PMU disbursements has, in principle, been based on ex-post checks of payments (see paragraph 4.12), but it was only at the end of 1994 that the Commission established such checks on a regular basis and utilization of the results is still quite limited (see paragraph 4.13). Checks on whether consultants have worked the number of days required under their contracts and on payments made by PMUs to cover their operating costs are still ineffective (see paragraphs 4.14 — 4.18).

5.19. All invoices received from consultants should be accompanied by time sheets signed by a management unit. Delegations' ex post financial controls should focus on this and on expenditure on PMU operating costs. In this context, it might prove useful to employ local auditors for this purpose.

5.20. As of 31 December 1995, the substantial balances on PMUs' bank accounts had generated 34,7 Mio ECU of interest income. However, many PMUs keep deposits in low-interest bank accounts. The Delegations should monitor interest rates on PMU bank accounts more and should also encourage PMUs in the same country to act

⁽³⁴⁾ The revision concerns the publication of forecasts of service contracts in the Official Journal of the European Communities, in order to provide more information for tenderers regarding the possibilities of participation.

jointly to take advantage of the competition between banks by negotiating higher rates (see paragraphs 4.19 — 4.20).

5.21. As the Commission has not introduced uniform accounting packages in the PMUs, each unit has borne the costs of developing its own system (see paragraphs 4.22 — 4.23). Installation of the financial reporting system which was to enable the Commission to monitor the financial implementation of programmes was delayed and suffered from fundamental weaknesses which expensive intervention (costing more than 900 000 ECU) by consultants has only partially remedied (see paragraphs 4.24 — 4.27). The reliability of the Commission's reporting has been affected as a result (see paragraph 4.28).

5.22. The PHACSY financial reporting system currently used by the Commission for monitoring PMU contracts and payments should be replaced with a system that is better suited to PMU requirements and can be integrated into their accounting systems (see paragraphs 4.25 — 4.28).

5.23. The absence of clearly defined objectives for numerous projects financed by PHARE, combined with the fact that most of the budget is intended for technical assistance with usually not very tangible results makes it all the more difficult to assess how soundly the funds have been spent (see paragraph 4.30). After six years of the PHARE programme the Commission was still in the process of establishing an evaluation system. It is important for programme results to be evaluated carefully, particularly as the system in question is a

decentralized system over which the Commission has limited direct control. The problems with the system for the annual evaluation of projects (see paragraphs 4.32 and 4.34) have resulted in a lack of clear evidence of how far individual programmes have achieved their objectives. This being the case, the utilization of PHARE funds lacks transparency. The division of responsibilities for evaluation within the Commission should be clarified. Each sectoral programme should be evaluated systematically (see paragraphs 4.29 — 4.34).

General conclusion

5.24. The Court subscribes to the principle that decentralization, at both Delegation and Member State levels, should take place as soon as local conditions permit, particularly in view of the preparation of PHARE countries for accession. However, application of this principle must be rationalized, by means of clearer task definition and a reduction in the number of programmes. There should be an appraisal of human resources in the Commission Delegations with a view to the extension of their role in overseeing the implementation of sectoral programmes. Moreover, the beneficiary countries ought to be gradually brought in as partners in the financing programmes and systematic evaluation should be carried out to provide a basis for allocating funds between the various countries and sectors.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 19 March 1997.

For the Court of Auditors

Bernhard FRIEDMANN

President

ANNEX 1

TOTAL OF NON-REPAYABLE AID GRANTED BY EU TO PHARE COUNTRIES AT 30 JUNE 1996

(Mio ECU)

Sector \ Country	Country															Total
	Albania	Bulgaria	Bosnia-Herzegovina	Ex-Czechoslovakia	Estonia	Hungary	Latvia	Czech Republic	Lithuania	Fyrm (!)	Poland	Romania	Slovenia	Slovakia	Multi-Country	
Agriculture	30,0	56,0	0,0	0,0	3,0	78,5	0,8	4,5	4,5	2,0	180,5	81,0	8,3	10,6	0,0	459,7
Infrastructure	61,4	160,5	0,0	21,0	15,0	73,3	11,3	125,0	46,1	0,0	290,2	72,0	14,3	19,7	162,5	1 072,3
Private sector and restructuring	7,0	51,5	0,0	70,0	21,1	136,0	12,7	28,0	22,9	0,0	193,5	133,4	18,6	33,2	150,5	878,4
Education and research	9,6	63,5	0,0	37,7	13,4	111,5	12,1	21,5	15,7	0,0	180,3	104,0	13,9	19,0	157,7	759,9
Civil service, legislation	5,8	19,2	0,0	0,0	10,8	27,0	17,3	16,0	18,3	0,0	82,2	19,6	0,0	9,0	71,5	296,7
Social sector	13,0	32,0	0,0	15,0	2,9	41,0	11,6	24,0	7,2	0,0	54,2	40,0	6,4	12,9	26,0	286,2
Financial sector	105,0	15,0	0,0	0,0	0,5	19,0	18,7	0,0	18,4	0,0	65,7	5,0	3,5	8,0	0,0	258,8
Environment and nuclear safety	3,3	61,1	0,0	35,0	3,5	74,5	6,6	0,0	3,5	0,0	109,0	5,0	0,0	1,0	200,5	503,0
Humanitarian aid	77,0	25,0	162,3	0,0	0,0	0,0	0,0	0,0	0,0	83,0	0,0	81,7	0,0	0,0	88,7	517,7
Democratization	0,0	1,2	0,0	4,0	0,0	0,0	0,0	0,0	0,5	0,0	0,0	5,0	0,0	0,5	35,0	46,2
Integrated regional measures	8,5	0,0	0,0	0,0	1,5	15,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	1,5	56,8	83,3
Miscellaneous	11,4	1,5		50,0	21,0	7,0	34,0	11,0	32,5	0,0	30,0	69,0	21,8	10,6	273,6	573,4
Total	332,0	486,5	162,3	232,7	92,7	582,8	125,1	230,0	169,6	85,0	1 185,6	615,7	86,8	126,0	1 222,8	5 735,6

Source: European Commission.

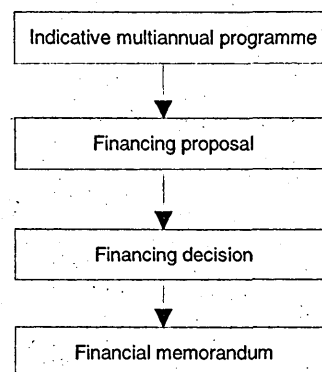
(!) Former Yugoslav Republic of Macedonia.

ANNEX 2

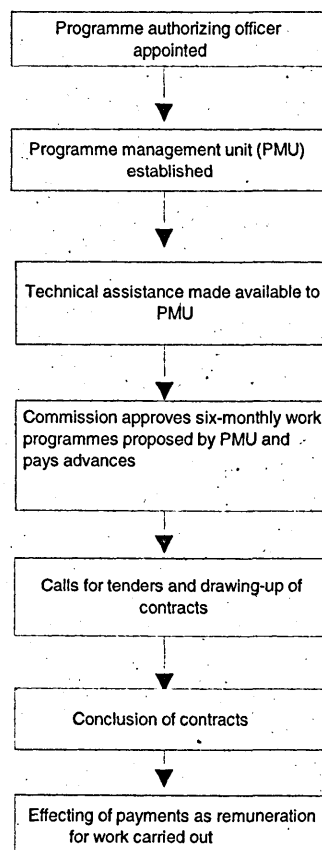
STAGES OF PHARE IMPLEMENTATION UNDER DECENTRALIZED PROCEDURES

A - Programming stage:

- A1 Sectoral priorities agreed between beneficiary State and Commission
- A2 Sectoral programmes approved by PHARE management committee
- A3 Commission decision making it possible to commit budgetary appropriations
- A4 Agreement between beneficiary State and Commission forming the legal base for the sectoral programme

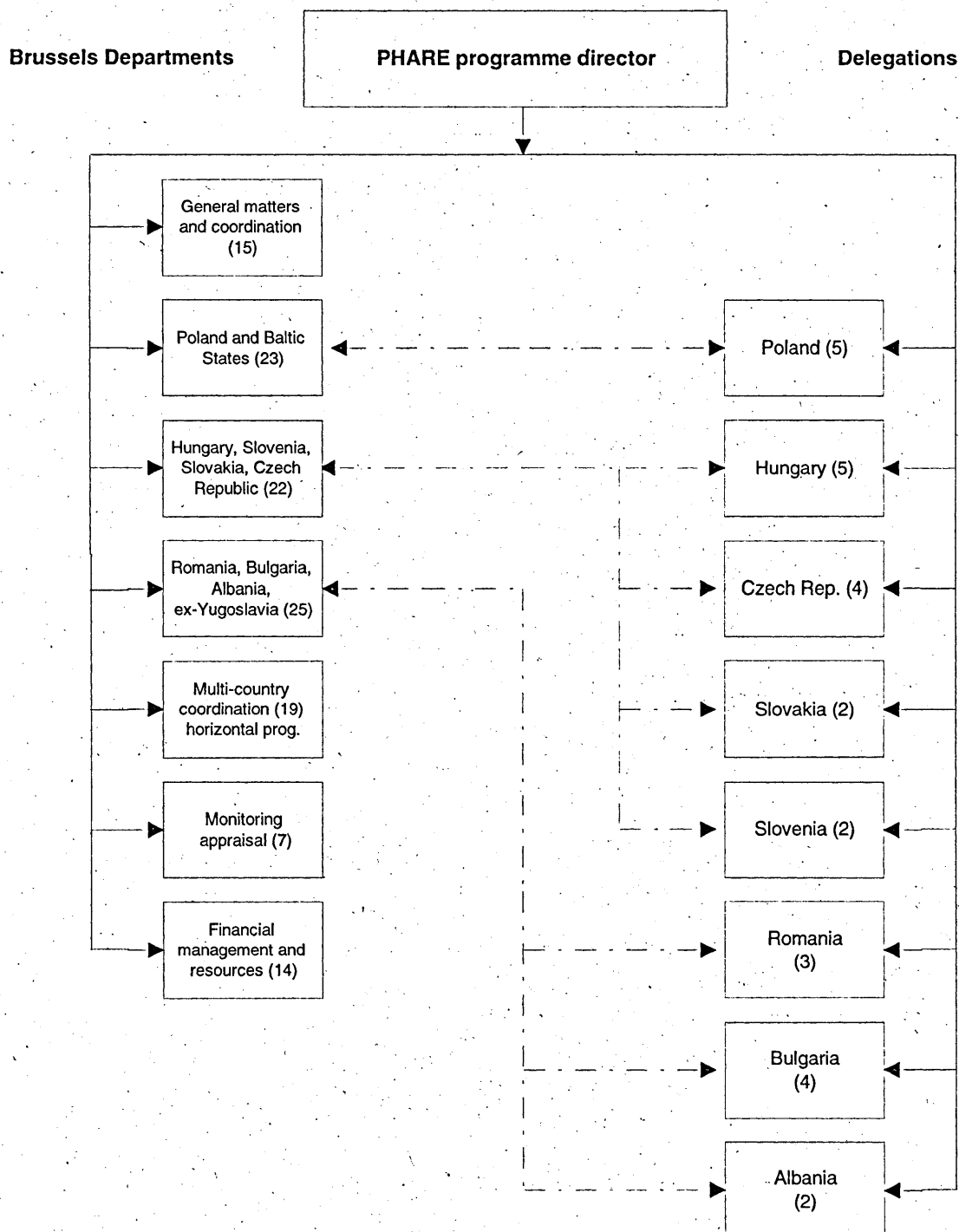
**B - Implementation stage (DIS):**

- B1 Appointment by beneficiary State
- B2 Decision by beneficiary State
- B3 Joint decision by beneficiary State and Commission Delegation
- B4 Final authorization by Commission in Brussels, which then transfers funds to beneficiary PMU
- B5 On PMU's proposal, approval by Delegation if 500 000 ECU or less, or by Brussels if more than 500 000 ECU
- B6 Approval by Delegation if between 150 000 and 500 000 ECU. Approval by Brussels if more than 500 000 ECU
- B7 Authorization by PMU



ANNEX 3

ORGANIZATION CHART OF DG 1A/B AND DELEGATIONS AT 31. 12. 1995



Notes:

1. Number of (A + B) posts in brackets. For the geographical divisions and Delegations the posts relate only to those involving responsibility for PHARE programme implementation.
2. At the end of 1995, the Commission did not yet have Delegations in the Baltic States, Croatia, Bosnia and the former Yugoslav Republic of Macedonia, as the last three only became part of PHARE in 1996.

REPLY OF THE COMMISSION

2. FUNCTIONING OF THE DECENTRALISED IMPLEMENTATION SYSTEM

Analysis of the rate of Phare budgetary implementation

Level of budgetary commitments

2.1 Annex 1 provides a breakdown of the figures per year, which clearly reflects the 3-4 year cycle of programmes.

2.2 In many countries there is a mixture of programmes implemented through DIS and programmes implemented centrally (see 2.7) which makes it difficult to compare the rate of implementation. Even inside a specific programme there could be components financed through DIS and components contracted centrally.

In addition, under the DIS, work programmes, in which all projects to be contracted are identified and justified in the context of the financing memorandum, must be approved by the Commission before tendering and contracting can take place and funds can be transferred to the countries. This is a requirement which does not apply for projects managed directly by the Commission's central services. This partly explains the difference in the rate of implementation quoted by the Court between DIS and centrally managed programmes.

2.3 The current system is linked to the requirements of the financial regulation for all Commission accounting. With regard to the final payments made by the PMUs, an internal system does exist, which measures and records the final payments made by the PMUs (PHACSY). In addition, it should be noted that the final amount transferred to PMUs in advance payments, is verified in advance by the Commission to ensure that it corresponds as closely as possible to the actual payment obligations of the PMUs, on the basis of disbursement forecasts through work programmes.

Delays in the implementation of programmes

Delays affecting the Phare programme in general

2.5 The Commission agrees with the first observation of the Court. The overall Phare budget was predominantly defined on political criteria rather than on the absorption capacity of the countries. Annual budgetary allocations to individual countries in the period in question have been

defined by the Commission not only linked to economic parameters, size of population, progress in transition, a general needs assessment but also according to the absorption capacity.

The definition of annual sector programmes was primarily a function of the internal decision making structure of a given country, taking account of the demand driven nature of Phare defined in the Phare Regulation. As a result, delays were sometimes incurred as detailed programmes could only be agreed following the conclusion of an indicative programme with the Government, followed by the signature of the Financing Memorandum.

2.6 The annual programming and commitment cycle used prior to the introduction of the multi-annual indicative programmes from 1995 meant in practice that the programming and commitment cycle had to be started from scratch at the beginning of each year. This in effect led to the undesirable pattern of commitments over a given year being concentrated in the last part of the year in question.

The multi-annual programming framework, introduced in 1995, has partially remedied this problem, i.e. operating in the context of national strategies and objectives defined up front with indicative budget allocations.

The Polish 1994 Programmes is used in this connection as an example, when the Annual Indicative Programme was adopted only in October of that year when negotiations with the Government were concluded and hence the Financing Proposals had to be elaborated in 3 months only. In the case the setting of priorities is part of a continuous dialogue with the partner country and, in the case of Poland in 1994, many of the programmes to be financed had been the subject of intense discussions with the Polish authorities in the months prior to October 1994 and, hence, the Financing Proposals could only be elaborated in a short period of time, all the more so because some of these were follow-up phases of programmes approved in earlier years. The Financing Memoranda for the 1994 programmes were signed in February and March 1995 and this provided an additional 3 months to further design the programmes concerned, before the legal agreement occurred between the Commission and the Polish authorities.

2.7 The early phase of the transition justified a broad sectoral focus, and it would have been politically unacceptable for the Commission to justify that some important sectors could not be included in a given country programme because of staff constraints on the side of the Commission.

The Commission has recognised the problem that some programmes were being implemented through a large number of small and medium-scale contracts, and that this in some cases has led to a large administrative and management burden both on the side of the PMUs and on the side of the Commission. However, the number of contracts registered in DESIREE (the Commission's database) in itself can be misleading because even small PMU expenditures (e.g. communications, small scale purchase, etc.) are registered as individual contracts. While recognising that small contracts in many cases were justified in view of their flexibility their volume could not be sustained. Therefore, the Commission introduced in August 1996 13 sectoral framework contracts through which all projects up to 300.000 ECU in principle should be implemented. The framework contracts will lead to a significant reduction of small contracts.

Table 3 does not reflect that programmes in many cases are a continuation of a previous years programme (e.g. five of the programmes in Hungary are respectively the 1990, 91, 92, 93 and 94 environment programmes managed by the same PMU). The Commission estimates that on average each PMU in the period in question managed between 3 — 4 programmes. In addition, it includes programmes not managed through the DIS, for example in Bulgaria where 15 out of the total 56 programmes have not been implemented through DIS.

Delays registered linked to DIS procedures

2.9 It should be noted that for DIS managed programmes an intermediary and conditional step between the financing decision and the first advance payment is the signature of a Financing Memorandum by the Partner Country and the Commission which partly explains the delay.

2.10 As the Court's observation shows, the introduction of the DIS manual providing clear procedures for work programmes had a positive impact from 1995 onwards.

2.11 Whilst the Commission recognises that a processing time of 87 days is not optimal, it did make a realistic assessment of the time needed for this which was reflected in the introduction of the rule in the DIS

Manual that all work programmes should be presented by the PMUs to the Commission 90 days in advance.

In the context of the revised DIS Manual the procedure for work programmes will be streamlined and simplified.

2.12 The financial regulation requires the endorsement of contracts by the Commission. Endorsement by Headquarters of contracts above 500.000 ECU was necessary in the first years of Phare to ensure appropriate financial control of the programme, given the lack of resources in the Delegations. The Commission is in the process of reviewing this and a new threshold for the endorsement of contracts by HQ may be agreed on a case by case per country, in relation to the capacity of the Delegation to take on this increased responsibility.

Organisation of the Commission services

Role of the Delegations

2.13 See section 2.19 with regard to work programme approvals.

2.16 As the opening of the Central European Delegations took place between 1990 and 95 and was implemented with very limited resources, the Commission was therefore not able to reinforce the presence of its services in the field, as requested by the Budgetary Authority and the Court of Auditors.

However, recognising the weakness of its resources in the Delegations the Commission decided, in March 1996, whilst attributing new posts and during a first redeployment of officials of the External service, to give priority for reinforcing the Delegations mentioned in table 6. Furthermore, in the context of the 1996 allocation of resources, there has been a substantial increase (30 %) in the number of local agents. This allowed them to significantly increase the total amount of personnel under table 6, from 65 to 80 people (+ 20 % in 96).

In order to reinforce the capacity of management, evaluation and control of the services of the Commission, both at Headquarters and in the Delegations, the budgetary Authority has modified the Phare budgetary remarks. Therefore, between 20 and 25 new ALAT (Agents locaux d'assistance technique) posts will be placed in the Delegations responsible for the management of the Phare programme.

2.17 The considerable delays in the filling of vacant posts, mentioned by the Court, can be put down, amongst others, to the difficulties encountered in the recruitment of specialised personnel, demonstrated by the

fact that the vacant agricultural post in Delegation had to be published twice. With regard to the Head of Delegations, the appointments have to be made within a broader context, considering various parameters such as the repercussions for Headquarters and Delegations.

The Commission recognises the consequences of these delays, and has already, especially within the context of the rotation exercise, taken measures to ensure that the appointments to posts at different levels are made within the normal period foreseen in order not to cause major difficulties to the Delegations.

2.18 In accordance with the provision of the Framework Agreements and the specific Financing Memoranda, Phare implementation under DIS is the responsibility of the Programme Authorising Officer (PAO) who is liable for the respect of procedures and appropriate use of Community Funds. The Commission is, however, responsible for ex-ante supervision, as defined in the financial regulation.

Due to staffing constraints, Delegations have primarily concentrated on financial and transparent management of the funds i.e. the aspects specifically highlighted in the financial regulation — tendering and contracting procedures, rather than on monitoring of project implementation and contacts with final beneficiaries which has been assured through contracting external experts.

With the establishment of the Monitoring and Assessment System in 1995 (see point 4.29) operating on a regional basis, the situation has improved, although the basic problem of insufficient resources persists. The modified Phare budgetary remarks will provide an essential contribution to this, through the financing of staff specifically devoted to supervising the project implementation.

Role of the central services of the Commission

2.19 The system whereby the Work Programme is firstly screened by Delegations and then approved by Headquarters was put in place for several reasons:

- a) to draw on the Delegations' local knowledge and expertise, whilst recognising their human resource constraints.
- b) HQ involvement is necessary to ensure the link between programming and implementation, respecting the general principle that HQ is in charge of ensuring

strategic orientations of a Financing Memorandum are adhered to.

- c) Work Programmes form the basis for transfers of advance payments which must be approved and carried out by HQ. Under this system final approval rests with Commission HQ. A revised system which will more clearly distinguish between the roles of the Delegation and Headquarters will be introduced with the revised DIS Manual.

2.20 (a) Job descriptions for the central services are partially available and the remainder are under preparation. However, where formal job descriptions are missing, the functions of individual staff members have been defined in documents at departmental level.

- (b) Whilst the channels established for the reporting of Phare related matters have to respect the general organigram the exchange of communications on operational and implementation aspects of Phare is between the Head of Unit and the Head of Delegation. This was facilitated by the reorganisation of Directorate B on a geographical basis in 1995. All staff in the Delegations report to the Head of Delegation, including the advisers.

2.22 Whilst it is important to ensure that the Delegations are staffed with specialised staff to deal with contractual and financial matters, it is not an option to deploy the staff dealing with these matters from Headquarters to the Delegations. A capacity to deal with these matters must be maintained in Headquarters, not only to deal with the contracts which require signature and endorsement by Headquarters, but also for the approval of work programmes and establishment of rules and procedures for the entire Phare programme — which rests the responsibility of the central services. Because of the lack of specialised staff in the Delegations, a number of responsibilities for finance and contracting have been retained at Headquarters in the interest of sound financial management (see point 2.12).

3. PROGRAMME MANAGEMENT UNITS (PMUs)

Setting up of Programme Management Units

Role of the authorising officer of the programme

3.2 The Commission recognises that the administrative capacity of the national administrations to manage the Phare programmes was limited. However, given the political desire for a decentralised approach it is partly in

recognition of these deficiencies in the partner countries that the PMU system was established, and an important role in their supervision was attributed to the Commission's central services as well as to Delegations.

The Commission had to impose specific procedures for the implementation of Phare in order to meet the requirements of the financial regulation including both standard tender and contracting procedures, specific formats for technical and financial reporting, etc.

Training in applying these rules and procedures had to be provided in parallel with implementation of programmes. In order to assist this process a significant component of the programmes was the provision of technical assistance to the PMUs. In addition, Delegations provided extensive advice and assistance to PMUs through their regular contacts on a daily basis.

3.3 A Programme Authorising Officer normally occupies the rank of State or Deputy State Secretary thus ensuring the full integration of the Phare programme into the policies of the Government. Whilst recognising that some PAOs are using only a small part of their time for this specific function, this is an important way to ensure that Phare is integrated as far as possible in the overall policies of the administration in question. The role of the PAO in DIS is (1) to provide strategic guidance and policy orientation for the implementation of the programme and (2) ensure that the administrative capacity is sufficient to ensure that the Phare procedures and the principles of sound financial management are respected.

It should be noted that, the DIS allows for the sub-delegation of certain administrative tasks to up to two persons; although this does not relieve the PAO of the overall responsibility he has for the management of the Phare programme in question.

Development of the programme management units

3.4 For Table 7, the following explanations can be given:

- a) Between 1991 and 1994 the number of countries implementing programmes under the DIS increased from 4 to 6.
- b) In 1994, the cross-border budget line was established by the European Parliament creating a new type of programme with specific implementation modalities which could not be integrated into existing PMUs.
- c) The split of Czechoslovakia in 1993 led, overnight, to the need for establishing parallel structures in

Slovakia in 1994 in order to ensure continuity in programme implementation.

- d) A stabilisation of the number of PMUs since 1994.

It is recognised that in the early days there was no specific strategy on the number of PMUs. However, as programmes expire a number of PMUs will close, for example it is envisaged that in 1997 three PMUs in Bulgaria will have completed their task and closed, and in Hungary, two.

In addition, the Commission is pursuing a strategy to prevent the opening of new PMUs: the PMU structure would not be replicated in countries where the DIS was to be introduced (Slovenia and the Baltic States), but would rather be replaced by a Central Finance and Contracting Unit (see 3.30) which would be responsible for the financial management of the programmes and leave the responsibilities for the policy and strategy definition of the Phare programme to the responsible ministries themselves.

In Slovakia the 25 PMUs will be phased down to 5 and a CFCU will be set up. This approach is being discussed with the National Coordinators of other countries, although it may not be possible to implement everywhere if the smooth implementation of ongoing programmes is to be ensured.

Through the 1997 annual programming exercise, the Commission is continuing to address how to avoid the creation of new PMUs, as well as an increased concentration of Phare programmes in each country. The ultimate objective is for the PMU function to be absorbed and fully integrated into the national administration. This has been possible in certain cases, such as the PMUs in the National Fund for Environmental Protection and the Ministry of transport in Poland.

Role of the Programme Management Units

Main characteristics of the programme management units

3.5 The Commission accepts the observation that the PMUs are of varying quality, and that the insufficient quality of the work of the PMU in question in some cases have resulted in delay of implementation. Nevertheless the procedures for tendering and contracting and thus the appropriate use of community funds have not been compromised since the steps in the procurement process

have been supervised by the Commission and can be verified through ex post audits.

3.6 The Commission agrees with the Court's overall analysis. However, it is important to distinguish in terms of 'integration' between policy and implementation.

Through the function of the PAO most Phare programmes have been reasonably integrated in the general policy development and the strategy development work of the administration in question. Because of the requirements of the financial regulation, and in the need for transparency, in the period in question, it was not always possible to further integrate Phare in the administrative procedures and practices of a given administration.

3.7 It is correct that no strategy existed at the outset of Phare in 1990/91 for the integration of the management of Phare into the administration in question. This not least because Phare was originally not intended to be a long term programme, and because of the insufficient administrative capacity in the countries of central and central Europe. As mentioned in 3.4 an active strategy for the 'full' integration of Phare is being pursued, where sufficient progress has been achieved with public administrative reform. In some cases this has already proved successful, as mentioned in 3.4 above, especially where the national implementation structures have funds to manage from the national budget or other donors.

3.8 The problem with high turn over of PMU staff is a problem facing all assistance programmes and will only be solved on the basis of a general reform of the public administration in each of the countries. While the Commission has accepted the principle of 'topping up' in order to keep the Phare staff in their position, there has been a general and understandable reluctance on the side of the Partner administrations to use this possibility which would imply having different salaries inside their administrations.

The high turn-over of staff does actually reflect the dilemma that through working with Phare civil servants have increased their qualifications and market value and thus become attractive to the private sector, offering higher salaries.

3.9 With regard to salary scales for PMU (Foundation) staff, the National Coordinator in Poland issued guidance on this for the first time in January 1994.

Role of technical assistances in the programme management units

3.10 As the Court indicates, two types of technical assistance exist. Only the administrative technical assistance is directly linked to the development of the

management capacity of PMUs. The operational technical assistance (for policy advice and institutional building) does not fall in the same category.

3.11 As the Court indicates in 3.10 technical assistance has a dual function. On the policy side it is not unreasonable that technical assistance is still required in mid-1995 as this is an integrated operational aspect of programme implementation. On the other hand, administrative support, in this period, is justified given that the DIS manual introduced new requirements for strategic planning and reporting by PMUs which required training in new skills.

3.12 As well as through daily interaction and cooperation between technical assistants and PMU staff, know-how transfer to PMU staff has been achieved through a variety of means including: on the job-training, specific training courses in programme management and related training, often provided as a part of the TA contract.

Whilst the term 'transfer of know-how' has not always been explicitly written into the contract, other terms have been used to the same effect such as 'advise, assist, support'. However, the Commission will follow up the Court's observation and ensure the standardisation of terms of reference in this regard.

It is correct that TA experts do not receive specific training in DIS Procedures prior to being contracted the reason being that one of the criteria for their selection is familiarity in all aspects of the programme management cycle including administration of donor funds. The Commission recognises that before the DIS Manual was distributed there was less clarity on procedures which was a constraint.

Ex-post evaluation of technical assistants is an integral part of the final programme assessments, which is part of the new monitoring system introduced in 1995, and which took effect in 1996. In addition to this systematic evaluation, technical assistance is monitored on a continuous basis by the Commission and under performing experts have been replaced accordingly.

3.13 Prior to 1994 there were no limits on the extension of contracts. In each case the request for a contract addendum could only be examined by the Commission if submitted by the PAO and always on the basis of the past performance and the circumstances.

This issue was overlooked in the DIS Manual distributed in February 1994 and therefore was communicated separately via the Delegations in March 1995. The basic

rules that were subsequently applied and are still in force are:

- a) the cost and duration of contract addenda may not exceed the cost and duration of the original contract,
- b) the fee rates and other cost levels of the original contract should be maintained for any subsequent addenda,
- c) the addenda should be signed before the expiry of the original contract.

The Commission has been working on a further elaboration of these rules which will be included in the revised DIS Manual.

3.14 The role of the technical assistance experts to PMU's is defined in the terms of reference of their contract. Where experts were required to report to the Commission, this was usually due to the fact that the Commission was acting as contracting authority.

3.15 In the early years of Phare, particular efforts were made by the Commission, through day to day contacts by the Delegation, to ensure an appropriate working relationship was built up between the PMUs and the Technical Assistance experts. Experience has been gradually built-up within the PMUs to manage technical assistance effectively with far fewer interventions needed by the Commission.

DIS Manual of Procedures

3.16 The first set of procedures were issued in 1990 in a document entitled 'Provisions for Implementation of the Advance Payments System for projects financed under the EC Phare Programme.' This was supported by standard tendering and contracting documents. A comprehensive manual of procedures was distributed in February 1994. Furthermore, both Delegation and Headquarters staff use considerable resources on assisting PMUs with the application of these procedures.

As far as the completeness of the manual is concerned, although the standard contracts were not subsequently distributed as part of the manual — standard models for each of these contracts have been elaborated and are available on request. As most of these types of contracts are not issued by PMUs but rather by the Commission in Brussels, the non-distribution of these contracts through the Manual has not posed any difficulties.

In order to avoid misunderstandings on the terminology used in Phare, the Commission has not issued official

translations of the Manual for Decentralised Implementation into different Phare country languages. The Commission would not have been able to control the accuracy of such translations. However at least two of the Phare countries (Poland and Hungary) have translated the Manual into their own language under their own responsibility and this approach will be extended in other countries if appropriate.

3.17 It is correct that the value of the original contract signed with the company increased from 59.581 ECU to 212.000 ECU before the project was finalised in March 1994. However, given the need to distribute a comprehensive manual to all involved in the Phare programme, and the under estimation of the amount of work involved, it was considered to be in the best interests of the programme to extend the contract and build on the experience already gained, rather than to disrupt the work and launch a new call for tenders.

3.18 The Commission recognises the short-comings related to the follow up of the original DIS training, and will in connection with training to be provided in the revised manual ensure appropriate follow up. However, it should be noted that in addition to the training seminars held in the countries, organised by the Commission's Financial Controller, in some cases the PMUs or national coordinators have organised training courses themselves for PMU staff. In addition, both the Delegations and headquarters staff have supported PMUs with advice on a day to day basis.

Cost of the Programme Management Units

3.19 The Commission has recognised this and the Revised DIS Manual will include specific provisions for the Phare financing of PMU management and running costs.

Cost of the functioning of the Programme Management Units

3.22 The issue has so far been addressed on an ad hoc basis especially through the approval of work programmes. Conscious of this problem the Commission will address this issue in the revised DIS Manual.

3.23 The Commission points out that foreign experts which are included in Table 8, whilst frequently based in PMUs, should not be considered as members of the PMU's staff.

3.24 The Court has already identified in point 3.9 the specific case of PMUs in Poland. The pace of public administration reform has been a constraint in resolving the overall problem. However, the new civil service law

(a 1992 Phare project) will finally come into effect on 1 January 1997, following its adoption by Parliament in August 1996, a professional, well paid civil service will come into being, and take over the role of the Foundations.

It is however clear that the contribution of Phare for the operating costs, including salaries, of such programmes should be degressive over time. The Commission has therefore inserted a condition in the 1996 COP (Country Operational Programme) that a Memorandum of Understanding will be agreed with the Polish authorities, before finalisation of the 1997 COP, indicating how the Government intends to take over the running costs over a 3 year period (e.g. by fixing a certain percentage of the annual COP that Phare will digressively contribute) for all PMUs in Poland.

(a) PARD (the PMU for the STRUDER programme) employs 28 persons paid by the Phare programme. The other 62 persons mentioned by the Court are paid for by Phare to reinforce the 6 Regional Development Agencies through which the Phare programme is implemented. The RDAs self-sustaining institutions financed from the national budget.

(b) It should be noted that the 49 persons includes 21 persons around the country needed to ensure that projects can be implemented efficiently in such a big country with wide regional disparities.

3.25 Romania: Out of the 32 staff members, 19 are working in FIMAN. FIMAN was created at the inception of the Phare programme due to the lack appropriate structures within the national administration. It has been used as a PMU for the implementation of a number of programmes where no alternative existed. Recognising the problem identified by the Court, a technical, financial and management audit of FIMAN has been commissioned by Commission and will be completed in the first quarter of 1997. There is agreement in principle with the new Government of Romania that the functions of FIMAN should be reviewed and programme management refocused within national administrations wherever possible.

3.26 The content of the programme was reviewed in 1994 resulting in a reallocation of funds to the Mass Privatisation Programme and an extension of the expiry date of the programme. The three members of the PMU staff who left the PMU in the course of 1994 did so for reasons which were not connected with this process.

3.27 The daily allowances to which the Court refers have only been paid from Phare funds where the missions themselves have been justified in the context of implementation of the programme.

The Commission recognised that the UN rates applied for daily allowances to local staff were out of proportion with the local salaries. In October 1996, the Commission introduced new rules lowering the rates.

The Commission has, in recognition, of this crucial point, in the revised DIS Manual, clearly defined the provisions for topping up salaries of local civil servants.

3.28 In these cases, the nature of the programmes, especially agriculture and regional development, can explain the reason for the relatively high non-salary related running costs, due to the need for regional focal points for the programmes' implementation.

3.29 The Financial Controller has indeed raised the issue of degressivity of PMU running costs (art. 6 of the Phare Regulation) as early as 1991 following spot checks in Poland and has insisted continuously that the relevant provisions be respected. The fragility of national administrations and absence of sufficient financial resources to cover these costs have made it impossible so far to apply full scale degressivity without running the risk of jeopardising further implementation of programmes already well under way. However, in the framework of current efforts aiming at a substantial streamlining of Phare, implementation of degressivity (together with the gradual phasing-out of long-term expatriate consultancy in the PMU's) will be addressed in various ways i.e. by continuously reducing the number of PMU's and expressly stipulating degressivity in the provisions relating to the setting-up of the CFCU's (on request of the Financial Controller full financing of CFCU running costs has been strictly limited to three years maximum, with a clearly-defined phasing-out over the following three years).

3.31 The possibility of creating a Central Finance and Contracting Unit has been developed since 1994 but due to the complexity of the matter — particularly on the side of the partner countries, the setting up of these Units will only commence in 1997. The basic characteristics of a CFCU is that one Unit is responsible for the administrative aspects including tendering, contracting,

financial reporting, etc. for all or most of the programmes in a given country.

The Commission has decided that decentralised implementation should be extended to the rest of the countries only through the creation of a Central Finance and Contracting Unit as opposed to PMUs. In the Baltic States agreement has been reached and it is envisaged that CFCUs will be operational in April/May 1997.

The Commission will, in the first quarter of 1997, sign a memorandum of Understanding with Slovenia on the establishment of a CFCU, with technical implementation of Phare remaining within the competence of each Ministry or other responsible Implementing Authority, in conformity with the Financing Memorandum. This CFCU, within the Slovenian Ministry of Finance, will be composed of Slovenian civil servants paid by the Government and local agents paid by Phare. This CFCU will take charge of the accounting of all of the decentralised programmes using one common method of accounting. It will also be in charge of overseeing the respect of rules and regulations and act as an advisory body in the preparation of all tendering procedures, and their contractual implications, initiated by the Technical Units in charge of programmes.

Cost of foreign technical assistance supporting the programme management units

3.32 — 3.35 In this section the Court refers to technical assistance supporting PMUs (as indicated in the heading) but includes observations that relate to high level policy support and institutional building which are integral parts of programme implementation and are considered to be operational costs of the programme and not costs of the PMUs. These operational costs are necessary even for programmes not implemented through the DIS. These two types of technical assistance have frequently been contracted within the same contract.

3.32 Phare fee rates reflect the market rates as they are determined through tender, where the economically most advantageous offer is retained through a process where the technical merits is rated with 70 % and the financial aspects with 30 %. Fee rates vary according to the nature of tasks and sector concerned. For some specialised sectors higher rates such as 17,000 ECU are justifiable for very specialised expertise, e.g. in the privatisation and banking sectors.

3.33 The observation is not restricted to the DIS, but is rather a general one concerning the Phare programme.

However, contracts have only been issued through AEC in limited cases. The main reason being that there are clear benefits to contracting experts through companies which can offer back stopping services, quality control, administrative support as well as continuity in cases of force majeure and non-performance of experts. These additional services which AEC cannot offer clearly have a price. Therefore, in many cases, the additional benefit of working through companies is not limited to replacing experts.

3.34 The observation of the Court is broader than the DIS itself. The Commission considers it essential to ensure in the interest of the projects and sound financial management that appropriate weighting is given to the technical quality as well as the cost of the tenderers' proposals, which explains why only 30% of the evaluation is for the financial offers.

Whilst communicating the short list to all tenderers and permitting the formation of consortia (which do have clear benefits in attracting expertise from a number of different Member States and organisations), the instructions to tenderers do specifically state that the creation of consortia amongst short listed companies must nevertheless respect the need for competition.

3.35 The general observation has been addressed under point 3.12.

The Commission has the following comments on the specific examples mentioned:

- a) The contract in question provided the necessary Technical Assistance to the Ministry of Agriculture for the implementation of the Phare Programmes HU9004 (20 Mecu), HU9104 (13 Mecu), HU9202 (5 Mecu), HU9304 (30.5 Mecu). The lack of personnel in the Ministry and the necessity to guarantee some continuity of the experts in order not to jeopardize the establishment of the first projects, have characterized the first difficult years of the Phare programme. These facts have justified for the Commission the several extensions of this contract of TA to the Ministry of Agriculture. It has to be pointed out that this TA contract was extended several times from 1990 until 1995 under the request of the Ministry of Agriculture. As soon as a PMU was established in the Ministry with government officials, and people trained, the Commission launched a new tender for a different type of assistance, more oriented to advising on European integration issues.

- b) The extensions of the contract were not only to finalise the 1991 programme but also to provide continuity for the 1994 and 1995 programmes, which due to the complexity of the privatisation process required this specialised expertise.
- c) The original contract was concluded following a tender, in order to assist the former Federation of Czechoslovakia and later the Czech Republic in the implementation of the environment sector projects of the national programmes CS 1990 and 1991. The Commission considered in December 1992 that the extension of the contract was necessary for ensuring continuation in the implementation of the 1990 and 1991 Environmental Sector Programmes during the unstable period due to the split of Czechoslovakia. Separate Project Implementation Units were established in respectively the Czech Ministry for Environment and Slovak Ministry for Environment. The only continuity during the splitting of the programmes were the experts. The last amendment covering the period April — June 1994 was accepted by the Commission to bridge the gap until a new tender.
- d) This is a good example where the transfer of know-how has been effective. The original foreign expert team in 1991 comprised 2 resident advisers, 3 part time advisers as well as short term experts, the current team comprises one resident adviser, one part time adviser as well as short term experts.

4. CLARITY OF THE DECENTRALISED SYSTEM

Tendering

4.2 This observation does not strictly pertain to the DIS. It questions the general compatibility of the Financial Regulation with the Phare Regulation, on restricted Tendering. In October 1995, article 118 of the Financial Regulation was modified, requiring the prior public announcement of all tenders, which means that restricted tenders are launched following a prequalification of expressions of interest received from all interested companies.

4.3 In the Commission's opinion, the principle of open competition in the framework of the DIS is respected. All shortlists for restricted tenders require the advance approval by the Delegation and/or Headquarters as well as the evaluation reports. In addition, since 1995 all Delegations report to Headquarters on a monthly basis with statistics on short listing and award of contracts in each country. Prior to the modification of article 118

mentioned in 4.2, short lists for restricted tenders have been based on those companies registered in the Central Consultancy Register, registration in which is open to any individual or company registered in the European Union or one of the Phare countries. In the DIS manual the obligation to respect a balanced geographical distribution of short listed companies was an additional safeguard in order to ensure equal opportunity. With regard to the observation on Polish and Hungarian companies, the following explanations can be provided:

- a) the frequent shortlisting of Polish and Hungarian companies does not compromise Article 7 of the Phare regulation, in itself, as Article 7 is intended to ensure equal competition for all eligible countries, including the partner countries;
- b) The Court's observation reflects the increased capacity and presence of local consulting companies and is a logical and welcome development, since such companies are well placed to participate in Phare tenders, given their familiarity with the local situation and their knowledge of the language.

4.4 The Commission attaches great importance to the diversification of short lists in order to ensure equal competition and avoid any element of privileged market share for certain companies.

In the view of the Commission the figures confirm that the principle of equal competition has been respected in that 1,102 companies were short listed for 320 tenders examined. The fact that 24 companies were short listed between 10 and 31 times can be explained as follows:

- a) For some highly specialised sectors only a limited number of companies can offer the required expertise.
- b) All short lists are endorsed by the Delegation in each country. Whilst this process aims to ensure — *inter alia* — equal competition this can only be done on a country by country basis.
- c) It must be recognised that although the basic formal requirement for short listing is registration in the CCR (Central Consultancy Register), many companies have been far more proactive in marketing their services directly with PMUs and the Delegations. This significant investment on the side of the companies has often given them an understandable comparative advantage, especially given the relatively limited knowledge within the PMUs of western companies.

4.6 Access by the PMUs to the CCR has always been possible via the Commission Headquarters. In 1994 and during 1995, the database was installed in each of the Delegations to facilitate this access further (in Hungary access was already available in 1993). The Court's observation that PMUs tended to consult large companies is explained in 4.4 above.

4.7 In each case the final constitution of the short list has been the responsibility of the PAO and not the Technical Assistance experts, and subject to the endorsement of the Commission. The role of the Commission is of particular importance in safeguarding against an influence of consultants on the shortlisting process. The modification of article 118 of the Financial Regulation has introduced additional transparency (see point 4.2). The Commission will issue specific instructions to the PAOs that external consultants should not be involved in the short listing procedure as an additional safeguard.

4.8 Under the DIS, the Delegation usually attends tender evaluations as observer, which does provide the Commission with a means of monitoring the tender evaluation process. The quality of minutes of tender evaluations has been variable. However, in October 1996 the Commission issued a standard model for tender evaluation minutes which is now in use and provides a comprehensive account of the tender evaluation process as well as comparative appreciation of the various offers received.

4.9 Whilst the Committee members may not have always had experience in tender evaluations, they have had the necessary sectoral experience to evaluate the offers. The possible lack of experience in procedures was compensated by technical assistance and the presence of the Delegation. Each member of the tender evaluation committee is required to sign a declaration of impartiality. If it becomes apparent that the member of the committee has any connections with one of the tenderers then that person is disqualified from the evaluation committee and his/her marks discounted.

4.10 The Commission has not issued guidelines on standard fee rates. Market rates vary enormously depending on the sector in question. The manual's intention is to ensure that market rates are applied and to avoid distortion of fee rates. This is particularly important for those tenders where no competition in the financial evaluation has been possible. Experience shows that PMUs have gathered sufficient experience to apply this rule, and as all contract negotiations require the advance approval of the Delegation, there is sufficient monitoring of the application of this rule.

Payments

4.11 The Commission is not involved in the ex-ante approval of payments under the DIS. It is after the final audit for programme closure that the Commission gives clearance of accounts, thus accepting all authorised transactions authorised under a given programme. One safeguard, as stated in the DIS manual, is the requirement for double signatures for PMU bank accounts, which is a precondition for the transfer of funds from the Commission. Recognising that the procedures for control of payment were not sufficiently defined, the Commission will clearly address this in the revised manual.

4.13 Due to a lack of resources in the early years of Phare, the Commission concentrated on the ex ante control of financial management (approval of work programmes, etc.) in the first instance, rather than audits. This was also due to the relatively slow rate of implementation in the period 1990-2 which meant that audits were not of top priority in that period. However, as soon as additional resources were available the situation was improved. Thus, in the period 1990-6 a total of 219 audits have been carried out, of which 173 were in the period 1994-6. Many of the findings from these audits have provided material for the improvement of the DIS manual which is being revised.

4.14 Payments are primarily based on the fulfillment of reporting requirements stated in the contract, as well as a verification of the actual number of days worked by the experts. The Commission has identified and recognises this weakness and will address it in full in the revised DIS manual.

4.15 The Commission considers that the control envisaged by the Court would be excessively cumbersome and not cost-effective given the marginal amount of the expenditure in question vis-à-vis the operational expenditure.

The running costs are reported by the local authorities through the work programmes and through the informatic reporting system (PHACSY, see points 4.24/4.28), which has a different code to distinguish such kind of expenditure from the rest of operations. This has been sufficient for the management needs of the Commission, although the possibility of having a more detailed codification of such costs will be considered.

The whole system relies on the accuracy of posting of expenditure against the appropriate project budget and on the accuracy of its reporting. Both functions being performed by the local authorities, the Commission will

insist on the importance of its respect for sound financial management.

Finally, the Commission's control on the implementation of a programme, including the running costs, is performed with the final audit, on the basis of which the accounts are cleared.

4.16 The amount originally foreseen for running costs was raised from 1.22 MECU to 2.4 MECU through a reallocation of funds. As part of the overall support for the Government's privatisation policy, it was crucial to provide support to the newly established Privatisation Agency, as well as to the Privatisation Centre, both of which would otherwise have failed. The Commission therefore considered that an exception was justified. The Agency was subsequently transformed into the Ministry of Privatisation; the Privatisation Centre has been fully self-financing since 1995, and is considered to be the best training centre on privatisation in Poland, providing strategic advice and training to many governments of CIS states.

4.17 In the case of double funding in Hungary, the Hungarian Foundation for Enterprise Promotion immediately took steps to reach a settlement with the contractor. As a result they claimed and obtained a refund for the corresponding expenditures.

In the case of Romania an audit conducted by the Commission did not reveal any such irregularities. The Court's observation will be followed up by the Commission.

4.18 The Commission cannot be criticized for its internal controls in this respect. In the first case — payment of 27,174 ECU of salary to the former president of the Privatisation Foundation — the Commission neither authorised nor agreed to such a payment. On 23 January 1996 the Commission wrote to the PAO to inform that, on the basis of the final audit of the programme, the amount of 27,147 ECU will be recovered in its entirety.

Receipts

4.19 See reply given in 4.21.

4.20 Under the DIS each PMU is required to open an interest bearing ECU account before any funds can be transferred to the partner country. This is a specific requirement stated in each financing memorandum. In addition the revised DIS manual will highlight the importance of the selection of banks by the PMUs. The

rate of interest paid by the bank is not the only criteria for selection — bank credibility and security is also of great importance to ensure complete transparency of the bank accounts. The Commission attaches particular importance to this problem, and the Delegations are verifying the bank selections made by PMUs in each country. However, the Commission will pursue with the Delegations the possibility of carrying out a preselection of banks, on the basis of specific criteria, in each country which would be subsequently eligible for banking Phare funds.

4.21 The interest earned on a programme may be reinvested in that programme, however, in each case the PMU is required to report in a work programme the amount of interest earned on the account and the projects which it envisages to finance from this interest. The advance approval of these projects by the Commission is required in all cases. In each case, only those projects which meet the objectives of the financing memorandum may be financed from interest.

Hungary: The purchase was approved by the Commission in the Work Programme approved in November 1994. The approval was based on the request and justification from the HFEP and the 20 local agencies, already communicated to the Commission previously. The need for vehicles for activities outside the offices, especially the follow up of the micro-credit loans, was recognised and the approval of the purchase was not motivated by the increase in the available budget through accrued interest.

Poland: The interest accrued on the bank account of the 1991 Privatisation Programme mounted to 1,6 MECU and was allocated to the general support budgetline. In the end, this budgetline was not fully disbursed and 150.000 ECU will be recovered by the Commission. In addition, it must be noted that expenditure under this budgetline has not been exclusively for running cost. Although, 0,6 MECU was for PMU running cost, 0,8 MECU was to finance local privatisation expertise and 0,2 for foreign technical assistance.

Accounting and Financial Reports

4.23 — 4.24 The Commission has devised a uniform financial management information system for the purpose of financial reporting and transparency, known as Phacsy, which is used by all PMUs and providing all the information required by the General Conditions.

4.25 As indicated in 4.23 Phacsy is a financial information system and not an accounting system. While

recognising that Phacsy has to be improved or completely changed, the Commission does not share the opinion of the Court on this point. An informatic reporting system for the Commission's purposes can not be elaborated in cooperation with more than one hundred PMUs. The double entries in certain PMUs will continue to exist as long as their accounting or informatic systems are incompatible with the Commission's standards for reporting.

4.26 The contracts mentioned by the Court were intended to ensure Phacsy's functioning in and implementation by all the PMUs so that they report to the Commission. In parallel some minor improvements have been introduced on the Commission's request.

The results have been that between May 1994 and the end of 1995, the level of reporting by PMUs has increased — the number of contracts and payments reported have increased by 211% and 274% respectively. Given the constraints on the Commission resources, the alternative to such contracting out would have been the non availability of DIS data.

For the Phare programme it was not possible to draw directly on the experience of other aid programmes managed by the Commission with regard to the setting up of an accounting system as they do not operate on the same basis as the Phare programme.

4.27 — 4.28 The improvements observed by the Court during 1995, that have continued during 1996, are the result of the contracts placed with external experts mentioned on point 4.26.

Reports on the efficiency of the actions

4.29 — 4.35 General reply:

The Commission has always recognised the importance of evaluation in order to ensure the appropriate use of Community Funds. Whilst it is natural that during the first years of programme implementation attention was focused more on the definition and launching of programmes, regular missions by Commission staff to the countries took place as well as ad hoc evaluation studies. The additional constraint of limited human resources prevented the Commission from being more active in this area, and is a continuing problem.

Nevertheless, with a view to focus programmes on producing results and achieving objectives, measures were taken in relation to mechanisms of programme design and programme follow-up. An integrated project cycle approach was introduced in 1992 following the logical framework methodology, drawing on DGVIII's

experience. It is recognised that this is complex, and PMUs have organised their own training in addition to that provided by the Commission. A more targeted refresher course is envisaged once the revised DIS Manual is distributed.

Whereas separate elements had already been introduced in the early years, a new structured and comprehensive monitoring system was introduced in 1994 and included in the DIS manual. The system expanded the strategic planning and reporting of the work programmes and progress reports, by introducing strategic plans for each programme and, for the first time, yearly 'monitoring and assessment reports' — where PMUs were to indicate progress and difficulties in achieving the objectives of the programme. A reinforced evaluation clause was also included in the framework agreements. Guidelines for presenting the basic programme documents (financing proposals/memoranda) were issued. Thus, by improving all aspects of the programme cycle in terms of strategic planning and setting clear objectives, the measurement of effectiveness would be facilitated.

The yearly 'monitoring and assessment reports' required by the DIS Manual and to be produced by the PMUs, proved very soon not to generate the qualitative and substantive programme progress and performance information suitable for adequate management purposes. Therefore, the first issue addressed by the new Monitoring and Evaluation unit installed mid 1995, was the definition of a better instrument for improving programmes during their life. The new approach opted for a move from self-assessment by the PMUs to systematic annual assessments operated according to a standardized method with the help of independent experts but in a participative effort with the relevant partner country and Commission services. This new approach took effect in mid 1996. The existing DIS manual was completed by a 'Monitoring and assessment' submanual distributed to all relevant Phare partners. The regular flow of reports produced according to this new approach started in December 1996, replacing the previous 'Monitoring and Assessment reports'.

Individual Phare evaluations, ranging from country wide studies (Hungary, Romania) to specific programmes or components, have taken place throughout the period 1992 — 96. In total, more than 70 such studies have been produced, with gradual intensification (almost half of the reports were produced in 1996). Recommendations and lessons learned have been fed back to the programmes and used for future ones where relevant and possible. However, it must be recognised

that evaluation of technical assistance programmes is more difficult than that of infrastructure programmes.

In addition to the reinforcement of the operational monitoring and assessment of programmes ensured via the unit created in 1995, the Commission strengthened its attention to all other stages of evaluation by setting up a new Evaluation unit in 1996. This unit is within the new DGIA Directorate for Financial and Human Resources, set up in the context of the SEM 2000 initiative.

5. CONCLUSION

5.1 The Court's appreciation of the complexity of the circumstances in which Phare was created, and the limited human resources available is shared by the Commission. However, the political context requiring a decentralised approach (see section 1.6) should be noted. This was of particular importance given the objective of Phare (support economic reform and transition), as to be successful it was dependent on the full commitment of the countries themselves. It was therefore essential that Phare was not conceived as an aid programme in the traditional sense.

Where possible, the Commission did draw on experience gained from the implementation of other aid programmes. However, in the field of ex-post evaluation there are particular difficulties, experienced by all donors, in evaluating technical assistance programmes of which output can be easily measured, although impact assessment is more difficult. However, the setting up of the evaluation unit in 1996 within the context of SEM 2000 has been carried out drawing on the global experience of the Commission in this field.

With regard to the accounting system the particular characteristics of Phare have not made it possible to replicate other systems operated by the Commission.

Functioning of the Decentralised Implementation System (DIS)

5.2 The Commission recognises that under the DIS the requirement for a work programme as the basis for any transfer of funds is an additional step which does not exist for centralised programmes. However, this is an essential requirement for the transfer of funds to the partner countries and is clearly in the interest of sound financial management. Although the Commission is improving on this system it cannot abolish it and thus it is likely that the rate of implementation will remain slower than centralised programmes.

5.3 a) It must be recognised that Phare started up with only 2 countries and a budget of 500 MECU in 1990 and with the general understanding that Phare would be a 2-3 year programme. The original staffing level was defined on this basis. It can today be recognised that the increase in staff in the period up until 1994/95 in no respect reflected the rapidly increasing number of countries eligible for Phare and the increasing budget. The Commission therefore agrees with the general conclusion that insufficient human resources were made available for the management of Phare.

b) As indicated above the Commission agrees that the overall Phare budget primarily was defined on the basis of political considerations, rather than on actual absorption capacity.

c) The full commitment rate has never — in itself — compromised the quality of programme preparation or resulted in inappropriate use of community funds. Project implementation has always been dependent on the identification of appropriate projects respecting the objectives of the financing memoranda, approved by the Commission through work programmes prior to any transfer of funds.

d) The early phase of the transition justified a broad sectoral focus, and it would have been politically unacceptable for the Commission to justify that some important sectors could not be included in a given country programme because of staff constraints on the side of the Commission.

In the approval of work programmes and contracts, the Commission delays have been experienced primarily due to staff constraints. However, in addition, the Commission has been careful to ensure that approval is given primarily on the basis of respect of procedures and quality rather than merely to accelerate implementation.

5.4 — 5.5 Since the European Parliament called for greater decentralisation to the Delegations in its 1994 budget discharge, the Commission has been actively working on implementing this policy. However, it would be in contradiction with the principles of sound and efficient management to increase the responsibilities of the Delegation without providing them with the means to assume this task.

In order to address this the Commission has pursued a policy of redeployment of delegation staff, although the limited resources as compared with the actual needs (not

only in central Europe where new Delegations have been opened but also in other parts of the world) has meant that this policy has had little real impact in the Delegations in the Phare countries.

It is expected that real progress on the reinforcement of Delegation staff will be made in 1997, following the modification of the Phare budgetary remarks which have opened up the possibility of recruiting additional staff to Delegations in central Europe. In parallel with this, an increased deconcentration is envisaged for the supervision of the DIS.

5.6 The Commission agrees with the Court's recommendations and has already been pursuing this approach through:

- a) concentration and limitation of interventions on the basis of the Essen Preaccession Strategy, though multi-annual indicative programming;
- b) establishment of an operational monitoring and assessment unit;
- c) increased capacity of Delegations to supervise the implementation of Phare through reinforcement of staff made possible through the modified Phare budgetary remarks;
- d) streamlining contract management through the introduction of framework contracts;
- e) revision of the DIS Manual Procedures.

Programme Management Units

5.7 Sharing the overall conclusion, the Commission has adopted a strategy on PMU's which should result in a reduction in their number from 1997. (See section 3.4).

5.8 Many of the staff working in the PMUs are Ministry staff, and therefore the skills being learnt in management techniques exist for the Ministries. However, the high turnover of staff in the PMUs is problematic — although also an indicator of the successful transfer of know how, making the staff attractive to the private sector.

5.9 The Commission contests the conclusions for point a, b, d and e. The role of technical assistance is defined in the terms of reference in each case and reporting requirements are established in the project context and depending on the contracting authorities's requirements. The Commission recognised the lack of experience of the local staff in PMUs but addressed this through training and day to day advice provided by the Commission —

mainly through its Delegations. Whilst specific rules on contract addenda were not included in the DIS manual, these were subsequently elaborated and notified to PMUs. With regard to ex post evaluation of technical assistance this is carried out in the context of the final programme assessments.

5.10 Whilst at the beginning of Phare there was no comprehensive manual of procedures, the basic guidelines for the advance payment system and tendering and contracting were made available to PMUs. The Delegations on the spot were available on a day to day basis to provide assistance to the PMUs on all aspects of the DIS. The Commission did not translate the manual into the local languages, as it could not take responsibility for the accuracy and quality of the translations, and as this was not a top priority given that the majority of staff working in PMUs are familiar with English. However, the Commission supported those countries which took the initiative to translate the manual under their own responsibility, e.g. Poland (in 1994) and Hungary. Training has been provided by the Commission and organised in the countries themselves.

5.11 The need for degressivity in the financing of running costs is recognised by the Commission, and steps have been taken to address this, the results of which can only be judged after 1996.

5.12 In the Commission's opinion the cost of technical assistance to PMUs is justified. The examples quoted in 3.32 — 3.35 in many cases refer to specialised technical assistance for policy support and institutional building and not administrative technical assistance to PMUs. In addition, the Commission considers that the procedures to ensure competition have been successful in ensuring an appropriate balance between cost effectiveness and technical quality.

5.13 The recommendation of the Court is already being pursued, for example in Poland and in the revised DIS manual.

5.14 Where possible Central Finance and Contracting Units are being set up with the aim of reducing the administrative costs and increasing efficiency. However, whilst not excluded in countries already operating the PMU system, this approach cannot be implemented systematically as it risks the disruption of the implementation of ongoing programmes. In these cases, the absorption of the PMUs into national administrations is the main target although, for certain types of programmes (e.g. civic society), the reduction of central

government control is sought because of the nature of the programme. See reply under points 3.4 and 3.30.

5.15 It is not planned to reduce the number of tasks attributed to PMUs given the interest of both sides to build up the capacity within the country to manage funds efficiently and transparently. Whilst, in the period 1990—there was an increase in the need for technical assistance, it is anticipated that this trend will be gradually reversed in the forthcoming period, although allowances for new skills that may be required with the introduction of new more pre-accession focused programmes will have to be made.

A comprehensive training programme is planned to accompany the distribution of the revised DIS manual, including refresher courses.

Whilst systems are already in place for the evaluation of technical assistance and prolongation of contracts, for the latter, improved measures will be introduced with the revised DIS manual.

Clarity of the Decentralised Implementation System

5.16 It is primarily the role of the Delegation to ensure transparency in the establishment of short lists under the DIS and not the central services of the Commission, except in cases where the contract value exceeds 500,000 ECU. However, the central services are to monitor this through monthly reports prepared by the Delegations.

5.17 The modification of article 118 has introduced the system whereby all projects are publicly announced before they are tendered, and the short list is established on the basis of the list of companies that have expressed interest in the project, following a pre-qualification exercise. This system has been applied by the Commission headquarters since August 1996 and by the PMUs under the DIS since October 1996.

5.18 The control of payments has been carried out by the Commission through audits. However, due to a lack of resources in the early years of Phare, the Commission concentrated on the ex ante control of financial management (approval of work programmes, etc.) in the first instance, rather than audits. This was also due to the relatively slow rate of implementation in the period 1990 — 2 which meant that audits were not of top priority in that period. However, as soon as additional resources were available the situation was improved, resulting in a total number of 219 audits having been carried out in

1990 — 6. Many of the findings from these audits have provided material for the improvement of the DIS manual which is being revised.

5.19 The control of invoices is the responsibility of the PMU under the authority of the PAO, and subsequently verified by the Commission through ex-post audits (see point 4.13). The Commission recognises that the quality of the PMUs' control varies. Under the revised DIS manual, a detailed section on the principles of sound financial management will be provided including procedures to follow on the verification of invoices. In addition, the Commission is examining ways in which to reinforce the capacity and further integrate the partner countries' own financial control bodies.

The possibility of using local auditing companies as suggested by the Court will be explored by the Commission.

5.20 While commercial criteria in terms of levels of interest rates and quality of services should play an important role in the choice of bank, security of funds must also be taken well into consideration. The recent Bulgarian banking sector problems and consequent freezing of Phare accounts is an obvious point in case. However, whilst bearing this in mind, the Delegations are pursuing this issue with the partner countries. In addition, the revised DIS manual will highlight the importance of the selection of banks by the PMUs.

5.21 — 5.22 A uniform accounting system cannot be put in place in each PMU. However, the Commission has put in place a financial reporting tool, known as Phacsy, which is used in each PMU in order to report on the use of the advance payments made by the Commission to each PMU. The Commission commenced work to improve this system in January 1996 and will be installing the revised system in PMUs during 1997.

5.23 The Commission has gradually developed and sought to constantly improve its evaluations systems. The milestones are: 1992 when the logical framework approach was introduced, 1994 with the monitoring and assessment system being introduced in the DIS manual, 1995 with the setting up of a monitoring and assessment unit and an improved monitoring system replacing that introduced in the DIS manual and 1996 with a new unit for ex post evaluation of Phare and other aid programmes. Under the new monitoring system each sector programme will be subject to an annual and final assessment. In addition, selective evaluations will be carried out. The necessary measures have been taken to ensure that the results of these exercises are effectively

taken into consideration when defining new related programmes.

Overall Conclusion

5.24 The Commission, in recognition of some of the weaknesses of the Phare decentralised implementation system, has already introduced some measures to improve the system, such as the MIPs (Multi-annual indicative programmes) for improved programming and strategic planning, more transparent tendering procedures following the modification of article 118 of the financial regulation, the creation of a new Financial Directorate within the context of the SEM 2000 initiative. This, together with the systematic operational monitoring of programmes by the Commission and the creation of the Financial Directorate with a new unit for evaluation will contribute to improving the financial management and performance of the Phare programme.

Further decentralisation of the programme to the Delegations and partner countries can only be done where the local conditions allow it. The Commission has already commenced an analysis of these conditions.

Preparations are being made to reinforce the Delegations especially with financial officers, and where the capacity exists, to increase their responsibilities for supervising the DIS. This has been made possible by the authorisation to use 2 % of the operational budget to recruit staff to assist with the implementation of Phare programmes (modified Phare budgetary remarks) and already with 1996 funds it is envisaged to recruit 20 — 25 ALAT staff for the Delegations in central Europe. It is expected that

a decision on further decentralisation to the Delegations will be taken in the first quarter of 1997.

The revised DIS manual will not only simplify the existing procedures for work programmes and streamline the approval procedure, but also provide detailed guidance on financial management and improved procedures for procurement. It will tackle the problem of Phare financing of running costs and will open the possibility for extended decentralised implementation of programmes where the implementation structure can comply with predefined criteria. However, this will in each case, be subject to a separate memorandum of understanding clearly specifying the legal obligations and financial liability and subject.

In parallel, the Commission is addressing the need for rationalisation and concentration of programmes, through the mid term review of Phare which is underway and is actively pursuing a strategy to reduce the number of PMUs.

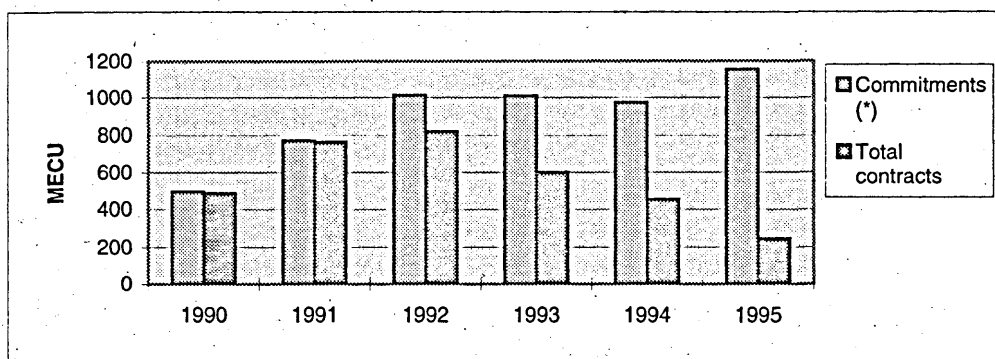
The Commission is also introducing a more targeted approach to audits of programmes. It will, on the one hand, target audits of expired programmes in order for their official closure to be finalised and, on the other hand, pursue a programme of interim audits of programmes under implementation on a sample basis. These will be targeted on a country or sectoral basis. In addition, it is intended to intensify cooperation with the national control bodies in each country with a view to their further integration in the control of the use of Phare funds under the DIS.

PHARE PROGRAMME

GENERAL OVERVIEW OF CONTRACTS 1990 — 1995
(Situation at 31. 12. 1995 in MECU)

(contracts concluded by the Commission headquarters and by the partner countries)

Year 1	Commitments (*) 2	Contracts concluded in						(*)	
		1990 3	1991 4	1992 5	1993 6	1994 7	1995 8	Total contracts 9	% 10 = 9/2
1990	495,1	154,7	99,5	103,6	27,8	72,2	29,1	486,9	98,4
1991	773,6	0,0	197,6	179,8	115,3	102,2	171,2	766,1	99,0
1992	1 012,3	0,0	0,0	258,8	186,0	156,9	219,3	821,0	81,1
1993	1 007,9	0,0	0,0	0,0	243,0	149,0	209,1	601,1	59,6
1994	973,3	0,0	0,0	0,0	0,0	184,9	268,7	453,7	46,6
1995	1 154,7	0,0	0,0	0,0	0,0	0,0	245,3	245,3	21,2
Total	5 416,9	154,7	297,1	542,2	572,1	665,2	1 142,9	3 374,2	62,3



(*) In assessing % of column 10, it should be noted that taking account of the cycle of the programmes, contracts and payments only begin a year after the budgetary commitment.

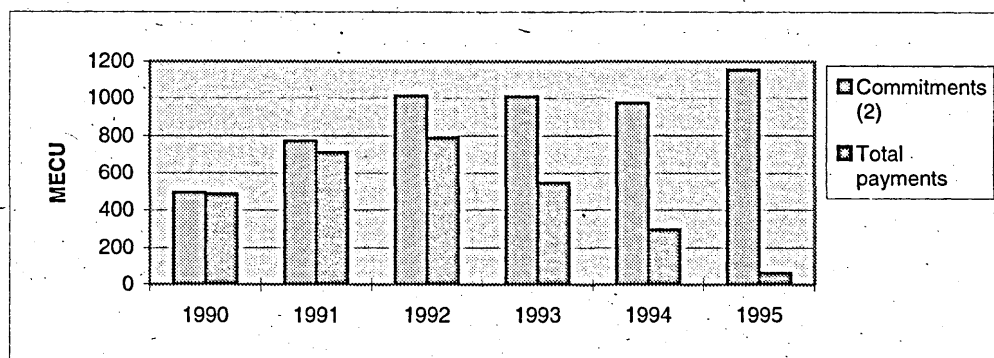
PHARE PROGRAMME

GENERAL OVERVIEW OF PAYMENTS 1990 — 1995

(Situation at 31. 12. 1995 in MECU)

(Payments on commission headquarters contracts + advance payments ⁽¹⁾ to partner countries)

Year	Commitments (²)	Paid on Budget year						⁽²⁾	
		1990	1991	1992	1993	1994	1995	Total payments 9	% 10 = 9/2
1	2	3	4	5	6	7	8		
1990	495,1	171,0	131,9	51,2	68,6	52,5	11,7	486,8	98,3
1991	773,6	0,0	152,1	169,4	148,0	160,8	83,7	714,0	92,3
1992	1 012,3	0,0	0,0	215,7	161,4	251,8	159,2	788,2	77,9
1993	1 007,9	0,0	0,0	0,0	143,0	183,5	222,6	549,1	54,5
1994	973,3	0,0	0,0	0,0	0,0	74,1	221,4	295,4	30,4
1995	1 154,7	0,0	0,0	0,0	0,0	0,0	63,7	63,7	5,5
Total	5 416,9	171,0	283,9	436,3	521,1	722,7	762,4	2 897,3	53,5



(¹) Advance made by the Commission to local institutions in charge of the decentralised implementation (including signature of contracts) of the programmes. This explains that the amount of cumulated payments can sometimes exceed the amount of cumulated contracts.

(²) In assessing % of column 10, it should be noted that taking account of the cycle of the programmes, contracts and payments only begin after the budgetary commitment.

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