

## I

*(Information)*

## COURT OF AUDITORS

## SPECIAL REPORT No 1/98

in respect of bilateral financial and technical cooperation with non-Member Mediterranean Countries together with the Commission's replies

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

(98/C 98/01)

## CONTENTS

	<i>Paragraph reference</i>	<i>Page</i>
GENERAL INTRODUCTION .....	1 – 7	2
Background to the audit .....	1 – 4	2
Approach adopted and scope of the audit .....	5 – 7	3
THE PROTOCOL SYSTEM .....	8 – 28	4
General Presentation .....	8 – 15	4
The special features of the Third and Fourth Protocols .....	12 – 15	6
Implementation of the Protocols .....	16 – 24	6
Progression from one Protocol to the next .....	16 – 18	6
Utilisation of appropriations as at 31 December 1996 .....	19 – 20	8
Budgetary presentation .....	21	10
Legality under Community law .....	22 – 24	10
Conclusions concerning the system of Protocols .....	25 – 28	10
OPERATIONS MANAGED DIRECTLY BY THE COMMISSION .....	29 – 103	11
Management and monitoring instruments .....	30 – 42	11
The financing agreements .....	30 – 33	11
Information technology .....	34 – 36	12
The organisation and resources of the departments involved .....	37 – 42	12
The consequences for the implementation of the projects .....	43 – 84	13
Schedule for the completion of the projects .....	44 – 49	13
Financial management and monitoring of the projects .....	50 – 68	14
Evaluation and external audits .....	69 – 71	16
Amendments to the initial decisions .....	72 – 80	17
Services provided by the technical assistance units .....	81 – 84	18

Management by those responsible for the projects and results obtained . . . . .	85 — 98	18
Observations in respect of the accounts and finances . . . . .	85 — 87	18
The results recorded and the survival of the projects . . . . .	88 — 98	18
Conclusions in respect of the management of the projects . . . . .	99 — 103	19
THE MANAGEMENT OF OPERATIONS ADMINISTERED BY THE EIB ON BEHALF OF THE COMMISSION AND THE AUDIT OF THESE OPERATIONS . . . . .	104 — 149	20
General presentation of the audit . . . . .	104 — 107	20
The system of risk capital management . . . . .	108 — 136	22
The purpose of risk capital and conditions of eligibility . . . . .	108 — 110	22
Description of the management system . . . . .	111 — 121	22
The Court's observations at the conclusion of the audit . . . . .	122 — 136	23
The management of interest-rate subsidies . . . . .	137 — 149	26
Introduction . . . . .	137 — 138	26
Audit findings . . . . .	139 — 146	26
Observations relating to the management of interest-rate subsidies . . . . .	147 — 149	29
GENERAL CONCLUSIONS . . . . .	150 — 160	29
Considerations relating to the system of Protocols . . . . .	150 — 152	29
Considerations relating to the Commission's system of management . . . . .	153 — 158	30
Considerations relating to the operations managed by the EIB on behalf of the Commission . . . . .	159 — 160	30
The Commission's replies . . . . .		31

## GENERAL INTRODUCTION

### *Background to the audit*

1. This report concerns the implementation of the protocols which are the most traditional instruments of cooperation with non-Member Mediterranean Countries (NMCs). More particularly, it concerns the management of the Third and Fourth Protocols and is a continuation of the Court's Special Report No 3/91 on the management of the first two series of Protocols<sup>(1)</sup>. This Report is the last part of the Court's overall audit of the New Mediterranean Policy (NMP) and therefore complements the ones on the structural adjustment support measures<sup>(2)</sup> and decentralised cooperation via the MED programmes<sup>(3)</sup>.

2. This report comes at a time when the NMP has been given a new dimension after the Council's adoption of Regulation (EC) No 1488/96 of 23 July 1996 relating to financial and technical measures to support the reform of

economic and social structures within the framework of the Euro-Mediterranean Partnership (MEDA). The latter, which is ultimately intended to provide a framework for all aid to the NMCs, has set an indicative amount of 3 424,5 Mio ECU for the period from 1995 to 1999. During this reference period the implementation of the Protocols will be pursued in parallel until the appropriations earmarked for this purpose have been used up.

3. The Court's work was concerned exclusively with measures funded from budgetary appropriations for the benefit of the seven Maghreb and Mashreq countries<sup>(4)</sup>. This includes operations that benefited from risk capital managed by the European Investment Bank (EIB) on the Commission's behalf and those that gave rise to budgetary financing in the form of interest-rate subsidies on loans granted by the Bank from its own resources.

4. In addition to its conclusions on the application of the Protocols themselves, the report sets out to highlight the structural problems which could still affect the management of cooperation with the NMCs, including cooperation falling under the new MEDA arrangements.

<sup>(1)</sup> See Special Report No 3/91 (OJ C 252, 26.9.1991).

<sup>(2)</sup> See the Court's Annual Report on the financial year 1994 (OJ C 303, 14.11.1995).

<sup>(3)</sup> See Special Report No 1/96 (OJ C 240, 19.8.1996).

<sup>(4)</sup> Algeria, Egypt, Jordan, Lebanon, Morocco, Syria and Tunisia.

*Approach adopted and scope of the audit*

procedures for selecting technical assistance and the examination of the services technical assistance provides.

5. The Court's audit includes an analysis of the system of Protocols and the Commission's management of them. In respect of the latter, it looks more specifically at the systems set up from the planning of the aid up to the ex-post evaluation of the projects, including the

6. The audit involved visits to four countries: Egypt, Jordan, Morocco and Tunisia. In this connection, detailed audits were carried out on a sample of 16 projects, which are shown in summary form in *Table No 1*.

TABLE 1

## SAMPLE — SUMMARY PROJECTS

Recipient country	EGYPT			
Name of project:	Helwan Waste Water Project — Phase II	Nile Valley Regional Project	Food Sector Development Programme	Ras Mohamed National Park
Total cost	35 Mio ECU	3 Mio ECU	Mio ECU — not indicated	4,2 Mio ECU
EEC Contribution	32 Mio ECU (3rd Protocols)	2,5 Mio ECU (3rd Protocols)	55 Mio ECU (3rd Protocols)	2,5 Mio ECU (3rd Protocols)
Ref. No	SEM/03/220/005A	SEM/03/220/008A	SEM/03/220/020A	SEM/03/220/025A
FA signed on	9.7.1988 (3/EG)	16.10.1989	16.7.1990 (7/EG)	28.4.1992 (11/EG)
Duration of project	Completion date 6.7.1993 — extended to 16.4.1995	4 years	4 years	extended to end 1996

Recipient country	JORDAN			
Name of project	National Soil Map and Land Use Project	Economic Geology Project	Ground Water Investigation in Hammad and Sirhan basins	Cooperation Project in Science and Technology
Total cost	not indicated	1,2 Mio ECU	4 Mio ECU	4 Mio ECU
EEC Contribution	3 Mio ECU (3rd Protocol)	1 Mio ECU (3rd Protocol)	4 Mio ECU (3rd Protocol)	3,5 Mio ECU (3rd Protocol)
Ref. No	SEM/03/628/005	SEM/03/628/013	SEM/03/628/028	SEM/03/628/033A
FA signed on	18.4.1989 (142/OJ)	23.4.1990 (147/OJ)	21.10.1991 (170/OJ)	29.9.1992 (183/OJ)
Duration of project	5 years (→ April 1995)	2 years	3,5 years	3 years — extended May 1997

Recipient country	MOROCCO			
Name of project	Agricultural Development Fund (ADF)	Contribution to the improvement of the system of teaching science and technology in Morocco	Contribution to the development of training structures in the textile and leather industries	Rehabilitation and protection of parts of the Ouarzazate and Moulouya disaster areas
Total cost	60 Mio ECU	64 Mio ECU	34,98 Mio ECU	5 Mio ECU
EEC Contribution	30 Mio ECU (3rd Protocol)	40 Mio ECU (3rd Protocol)	28,075 Mio ECU (3rd Protocol)	5 Mio ECU (3rd Protocol)
Ref. No	SEM/03/204/002	SEM/03/204/006	SEM/03/204/012	SEM/03/204/013
FA signed on	13.2.1990 (150/MAR)	26.10.1990 (159/MAR)	15.7.1991 (166/MAR)	30.7.1991 (169/MAR)
Duration of project	Completion date: 31.12.1994	Initially planned for 1990-1994 — extended until 30.6.1996	48 months (30.6.1995)	Completion date: 31.12.1993

Recipient country	TUNISIA			
Name of project	Agricultural Development to the south-west of Kef	Creation of the Rijm Maatoug palm grove	Loan operations for the benefit of small and medium-sized agricultural enterprises in Tunisia	Exploitation of water resources in the Governorate of Kasserine
Total cost	26 Mio ECU	32 Mio ECU	12 Mio ECU	7 Mio ECU
EEC Contribution	10 Mio ECU (3rd Protocol)	15 Mio ECU (3rd Protocol)	12 Mio ECU (3rd Protocol)	7 Mio ECU (3rd Protocol)
Ref. No	SEM/03/212/004	SEM/03/212/010	SEM/03/212/015	SEM/03/212/017A
FA signed on	9.7.1988 (123/TU)	11.8.1989 (153/TU)	29.4.1991 (167/TU)	30.9.1991 (171/TU)
Duration of project	5 years	5 years (commencing in November 89)	Initially planned for 1991-1992. The project was completed in 1993-1994 (2 years late).	5 years from 1992-1996, completion date: 9/1996

Source: Court of Auditors.

7. This Report consists of three parts. The first introduces the system of Protocols and includes the observations arising from the Court's examination of the model of cooperation created through the system of Protocols. The second is devoted to the operations that were managed directly by the Commission. The third, finally, deals with those operations which were managed under mandate by the EIB.

## THE PROTOCOL SYSTEM

### General Presentation

8. The Protocols, which are bilateral agreements under Article 238 of the EC Treaty, were initiated in 1979. They form an overall legal framework for financial and technical cooperation between the European Community

and each NMC for a given period (normally five years). Thus, this approach to cooperation is characterised by two levels of organisation, because the funding of any given project requires the signing of a specific financing agreement.

9. The Protocols adopt an overall budget, specify the source of the appropriations, depending on whether they come from the general budget of the Community or EIB own resources, and the nature of the financing — non-refundable aid, risk capital or loans.

10. The total aid budget made available to the seven countries in question amounted to 3 548 Mio ECU. Of this amount, 2 158 Mio ECU (60,8 %) was financed from EIB own resources and 1 390 Mio ECU (39,2 %)

from the general budget (1 273 Mio ECU in grants and 117 Mio ECU in the form of risk capital). *Tables No 2a and 2b* give a breakdown of this distribution for each of the countries concerned. Together with those for the first

two series of Protocols, these sums amount to 5 232 Mio ECU, 2 112 Mio ECU of which comes from the Community budget and 3 120 Mio ECU from the EIB's own resources.

#### OVERALL BUDGET FOR THE THIRD AND FOURTH PROTOCOLS

TABLE 2a

##### Cooperation under the Third Protocols

(Mio Ecu)

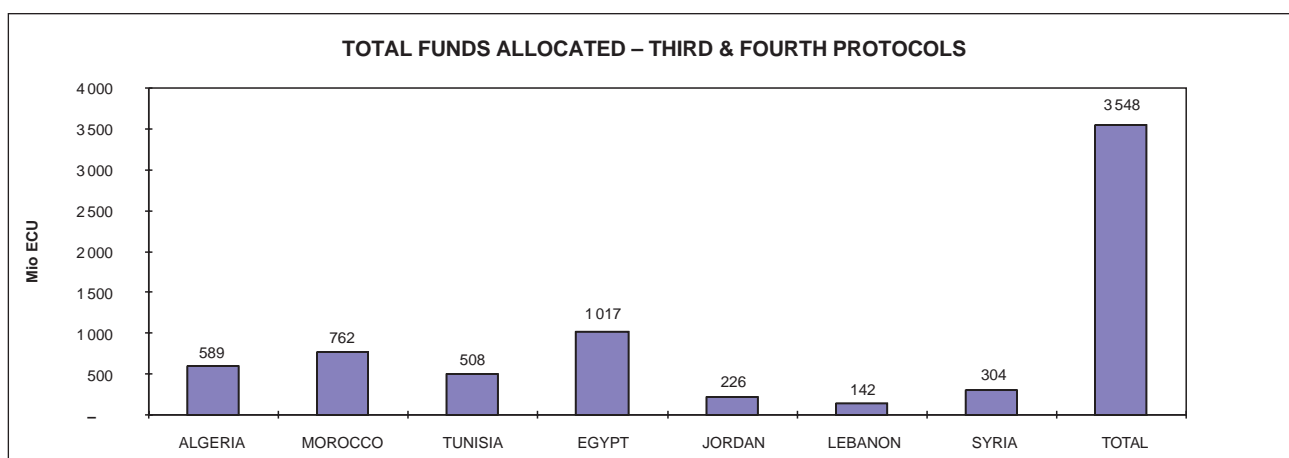
	ALGERIA	MOROCCO	TUNISIA	EGYPT	JORDAN	LEBANON	SYRIA	TOTAL
Signature of the Protocol	26.10.87	26.5.88	26.10.87	26.10.87	26.10.87	2.12.87	7.2.91	
Council Decision	21.12.87	30.6.88	21.12.87	21.12.87	21.12.87	21.12.87	16.11.92	
Entry into force	1.3.88	1.7.88	22.12.87	22.12.87	1.2.88	1.3.88	17.11.92	
— EIB loans	183	151	131	249	63	53	110	940
— non-refundable aid	52	162	87	189	35	19	34	578
— risk capital	4	11	6	11	2	1	2	37
Total	239	324	224	449	100	73	146	1 555

TABLE 2b

##### Cooperation under the Fourth Protocols

(Mio Ecu)

	ALGERIA	MOROCCO	TUNISIA	EGYPT	JORDAN	LEBANON	SYRIA	TOTAL
Signature of the Protocol	20.6.91	20.6.91	20.6.91	26.6.91	26.6.91	18.9.91	17.7.91	
Council Decision	16.3.92	16.3.92	19.12.91	16.3.92	16.3.92	16.3.92	24.1.94	
Entry into force	1.5.92	1.7.93	20.12.91	17.3.92	1.5.92	1.5.92	1.3.94	
— EIB loans	280	220	168	310	80	45	115	1 218
— non-refundable aid	52	193	101	242	44	22	41	695
— risk capital	18	25	15	16	2	2	2	80
Total	350	438	284	568	126	69	158	1 993



Source: Protocols.

11. Overall, budgetary resources for the Fourth Protocols were 26 % higher than for the Third. Appropriations made available for risk capital rose from 37 Mio ECU to 80 Mio ECU, i.e. an increase of 216 %, which underlines the importance that the Euro-Mediterranean partners will be attaching in future to assistance for the private sector.

### The special features of the Third and Fourth Protocols

12. The main new feature in the Third and Fourth Protocols, in comparison with the First and Second, consisted in a more precise definition of the specific objectives and the introduction of indicative plans. These changes were already given positive appraisal in the Court's Special Report No 3/91 <sup>(5)</sup>. Article 3 of the Third and Fourth Protocols defines the general cooperation objectives while the indicative plans, jointly prepared by the signatories and the EIB, define specific objectives, quantify aid to the various priority sectors of activity within the fields specified in the protocols and, in some cases, identify the projects to be undertaken.

13. An examination of the projects implemented during the 3rd and 4th Protocols shows that, generally speaking, the indicative plans have been adhered to as far as the areas of intervention are concerned. The Community interventions under these two last Protocols thus showed greater cohesion than under the previous series.

14. In contrast to the previous Protocols, neither the Third nor the Fourth Protocols provide, in respect of the NMCs covered by the audit, for special loans to be granted from budgetary resources.

15. Article 4 of the Fourth Protocols mentions 300 Mio ECU, which was made available in addition to the overall budget adopted in the Protocol, in order to finance projects in support of economic reforms undertaken as part of structural adjustment programmes. Since this

amount is not allotted *a priori* on a bilateral basis and the aid is committed according to macro-economic considerations, the EC is already anticipating, in the Fourth Protocols, the thinking behind the MEDA Regulation <sup>(6)</sup>. This concern is also to be found in the indicative programmes signed with Morocco, Egypt and Jordan, which reserve 10, 20 and 30 % respectively of the non-reimbursable aid in the overall budget for these operations.

### Implementation of the Protocols

#### Progression from one Protocol to the next

16. While, in theory, there was to be a smooth progression from one series of Protocols to the next, in practice the four series are running concurrently for all the seven countries covered by the audit.

17. This situation can be explained, on the one hand, by an accumulation of delays due to the slowness of the process of negotiation and ratification of the Protocols, combined with delays ensuing from the overestimation of the absorptive capacity of the recipient countries <sup>(7)</sup>, and, on the other hand, by the possibility contained in the Protocols for uses to be sought for all residual funds at the end of the period of application until they are exhausted. Frequently, these funds are not inconsiderable amounts.

18. Thus, on 31 December 1991, the commitment deadline stipulated in the texts of the Third Protocols, the amounts still to be committed totalled 123,4 Mio ECU, i.e. 20 % of the overall budget. This percentage, as *Table 3* shows, conceals great differences between the Maghreb and Mashreq countries, which alone account for 96,8 % of the residue. This situation is attributable to political reasons in the case of Lebanon and Syria and to technical and administrative reasons in the case of Egypt.

<sup>(5)</sup> Paragraph 3.24 of Special Report No 3/91 (OJ C 252, 26.9.1991).

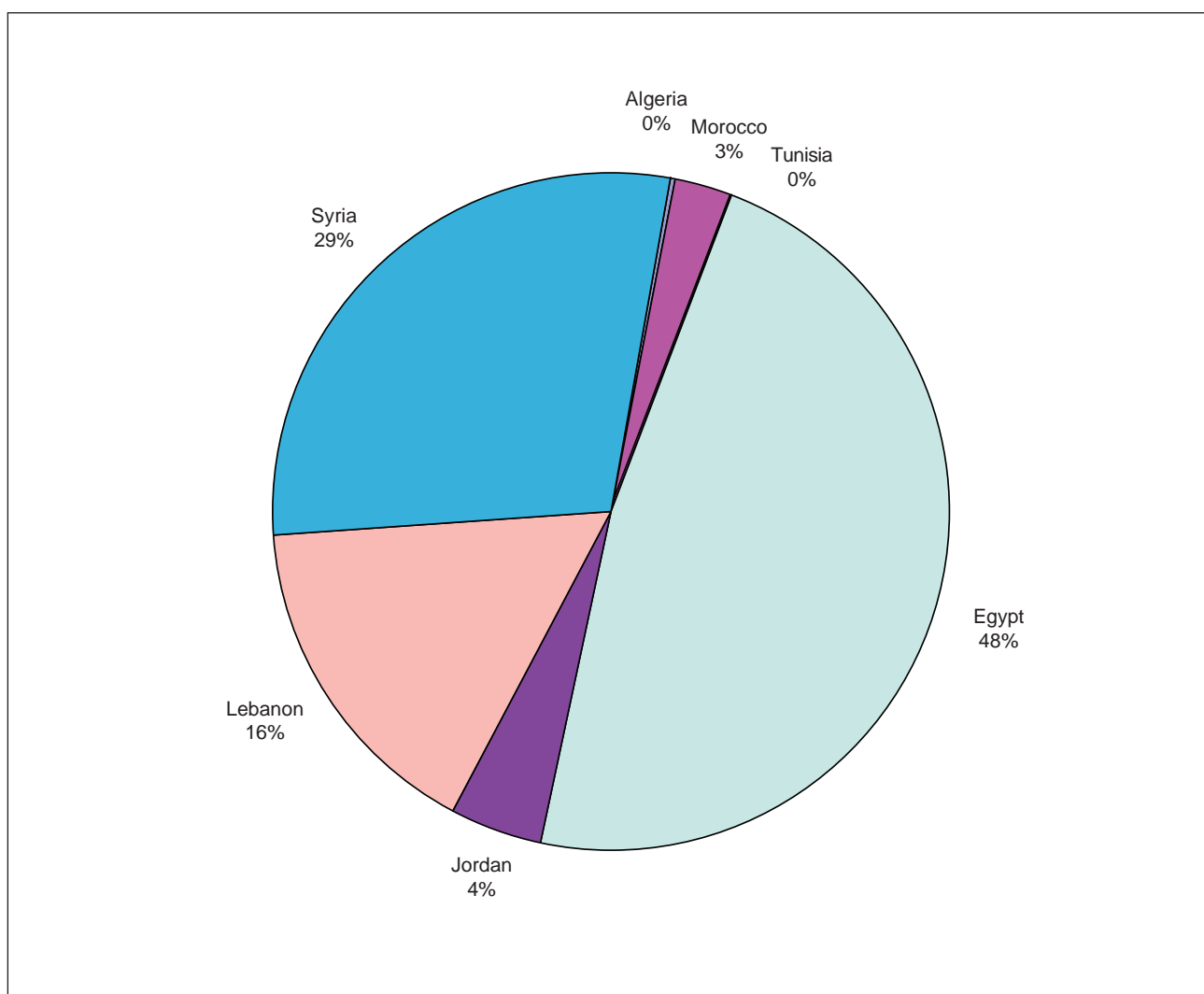
<sup>(6)</sup> See OJ L 189, 30.7.1996.

<sup>(7)</sup> The Court also identified the same problem in the context of the PHARE Programme (see Special Report No 3/97 on the decentralised system of implementation for the PHARE Programme (from 1990-1995) (OJ C 175, 9.6.1997, paragraph 2.5).

TABLE 3  
TOTAL FUNDS STILL TO BE COMMITTED AT CONCLUSION OF THE THIRD PROTOCOLS  
(As at 31.12.1991)

(Mio ECU)

Country	Budget	Committed				Total	Available
		1988	1989	1990	1991		
Algeria	56	0,6	26,8	10,9	17,2	55,5	0,5
Morocco	173	11,9	110,4	44,8	2,6	169,7	3,3
Tunisia	93	39,4	20,3	16,9	16,3	92,9	0,1
Egypt	200	33,9	10,4	86,9	10,7	141,9	58,1
Jordan	37	10,5	6,9	8,9	5,3	31,6	5,4
Lebanon	20					0	20
Syria	36					0	36
<b>Total</b>	<b>615</b>	<b>96,3</b>	<b>174,8</b>	<b>168,4</b>	<b>52,1</b>	<b>491,6</b>	<b>123,4</b>



Source: Commission SINCOM data.

## Utilisation of appropriations as at 31 December 1996

appropriations for these projects came, at that date, to more than 74,6 Mio ECU. It will be noted that, during the financial year 1996 alone, eight new operations were committed for a total of 15,76 Mio ECU.

19. Tables 4a and 4b show that 76 projects financed under the first two series of Protocols had still not been closed on 31 December 1996. The cumulative total of

## FIRST AND SECOND PROTOCOLS — BREAKDOWN OF REMAINING COMMITMENT BALANCES AS AT 31.12.1996

TABLE 4a  
Analysis by Value

(in Mio ECU)

	Year of commitment																		Grand Total
	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	
Algeria	0,00	0,00	0,01	0,00	0,00	0,05	0,00	0,00	11,79	0,00	0,00	3,03	0,01	0,00	0,00	1,92	0,00	10,65	27,46
Egypt	0,00	0,00	0,00	0,43	2,27	0,02	0,07	0,79	0,08	0,01	0,00	2,47	0,00	1,11	0,01	0,08	4,90	5,03	17,27
Jordan	0,00	0,00	0,00	0,00	0,06	0,00	0,14	0,45	0,17	0,04	0,01	0,00	0,00	1,36	0,72	0,00	0,00	0,03	2,98
Lebanon	0,00	0,00	0,13	0,15	0,00	0,00	8,10	0,00	0,00	0,00	0,00	0,00	0,00	2,26	0,00	0,00	0,00	0,00	10,64
Morocco	0,00	0,00	0,00	0,00	0,00	7,65	0,00	0,00	0,00	0,00	0,00	0,00	0,03	0,00	0,00	0,00	0,00	0,00	7,68
Syria	0,34	0,00	0,00	0,00	0,00	0,10	0,00	5,19	0,00	0,26	0,00	0,00	0,05	1,88	0,00	0,00	0,00	0,00	7,83
Tunisia	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,00	0,65	0,00	0,00	0,07	0,02	0,05	0,79
Grand Total	0,34	0,00	0,14	0,58	2,33	7,82	8,31	6,43	12,04	0,32	0,02	5,50	0,74	6,60	0,73	2,08	4,92	15,76	74,66

TABLE 4b  
Analysis by Number of Projects

(Number of projects)

	Year of commitment																		Grand Total
	79	80	81	82	83	84	85	86	87	88	89	90	91	92	93	94	95	96	
Algeria	0	0	1	0	0	1	0	0	6	0	0	1	1	0	0	1	0	2	13
Egypt	1	0	0	1	1	2	1	1	1	1	1	3	0	2	1	3	1	3	23
Jordan	0	1	0	0	1	0	2	4	2	1	1	0	0	1	1	0	0	1	15
Lebanon	0	0	1	2	0	0	2	0	0	0	0	0	0	2	0	0	0	0	7
Morocco	0	0	0	0	0	1	0	0	0	0	0	0	1	0	0	0	1	0	3
Syria	1	0	0	0	0	1	0	1	0	1	0	0	1	1	0	0	0	0	6
Tunisia	0	0	0	0	0	0	0	0	0	0	0	0	2	1	0	2	2	2	9
Grand Total	2	1	2	3	2	5	5	6	9	3	2	4	5	7	2	6	4	8	76

Source: Commission SINCOM data.

20. Table 5 breaks down the utilisation of commitment and payment appropriations by year and country for the Third and Fourth Protocols. As at 31 December 1996, 605,4 Mio ECU, i.e. 98 % of the appropriations which were made available under the Third Protocol, were committed but only 72 % had been paid. The level of

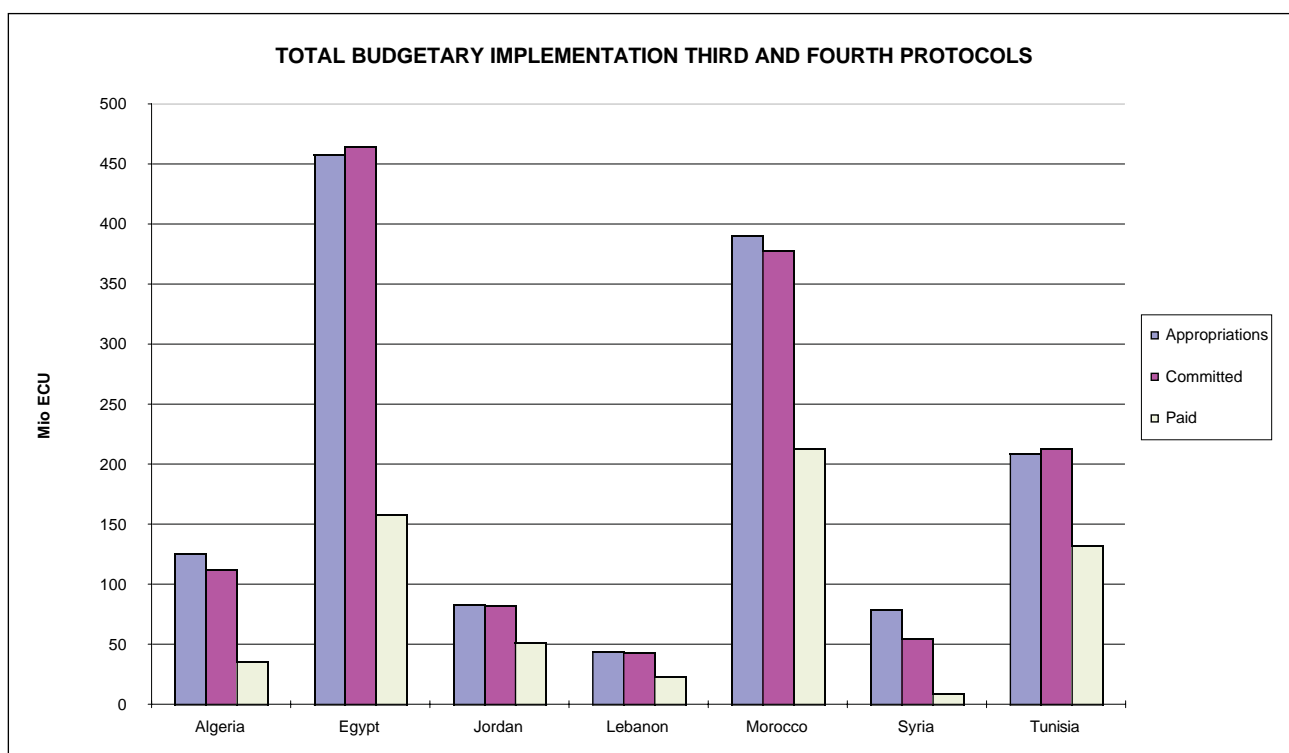
utilisation of the appropriations made available in the final series of Protocols is, naturally, lower at 714,5 Mio ECU, i.e. 92 % for commitment appropriations but only 23 % for payment appropriations. In the case of payments, those effected correspond, in the main, to the financing of the structural adjustment support measures.



TABLE 5  
Budgetary implementation as at 31.12.1996

(Mio Ecu)

	Third Protocols				Fourth Protocols							
	Appropriations	Committed	Decommit.	Paid	Appropriations	Committed	Decommit.	Paid				
1988		95,3	15 %	10,8	2 %							
1989		175,8	29 %	4,9	1 %							
1990		168,4	27 %	38,9	6 %							
1991		54,6	9 %	77,0	13 %							
1992		69,5	11 %	78,7	13 %	74,2	10 %	5,0				
1993		24,4	4 %	71,0	12 %	164,5	21 %	68,9				
1994		15,8	2,1	2 %	72,2	12 %	219,5	28 %				
1995		9,4	3,1	1 %	51,5	8 %	209,1	27 %				
1996		16,8	19,4	0 %	38,5	6 %	50,8	3,6				
<b>Total</b>	<b>615,0</b>	<b>630,0</b>	<b>24,6</b>	<b>98 %</b>	<b>443,5</b>	<b>72 %</b>	<b>775,0</b>	<b>718,1</b>	<b>3,6</b>	<b>92 %</b>	<b>181,5</b>	<b>23 %</b>
Algeria	56,0	60,1	7,5	94 %	20,3	36 %	70,0	52,0	—	74 %	15,9	23 %
Egypt	200,0	213,1	13,2	100 %	133,0	67 %	258,0	251,2	0,6	97 %	25,2	10 %
Jordan	37,0	37,6	0,8	99 %	29,6	80 %	46,0	44,9	0,0	98 %	22,1	48 %
Lebanon	20,0	20,3	0,7	98 %	17,4	87 %	24,0	23,2	—	97 %	6,2	26 %
Morocco	173,0	171,8	—	99 %	154,7	89 %	218,0	206,2	—	95 %	58,6	27 %
Syria	36,0	32,1	—	89 %	8,4	23 %	43,0	22,9	—	53 %	1,0	2 %
Tunisia	93,0	95,0	2,4	100 %	80,1	86 %	116,0	117,7	3,0	99 %	52,6	45 %



Remarks: For the commitments, the second column represents the decommitments which, according to the Protocol rules, remain available, for further use.

Source: Commission SINCOM data.

### Budgetary presentation

21. Budgetary appropriations made available under heading B7-4051 not only include the amounts agreed in the Third and Fourth Protocols but also the additional appropriations for the structural adjustment support programmes to which the Fourth Protocols refer. In the interest of greater clarity in the budget and its implementation, it would have been preferable to apply the principle of specification to these appropriations more rigorously, and to enter the Protocol budgets and those additional amounts involved in the structural adjustment support measures under separate headings.

### Legality under Community law

22. In its Special Report No 3/91 the Court points out that Council Regulation No 3973/86<sup>(8)</sup> only refers explicitly, in its recitals, to the Second Protocols. In its replies the Commission acknowledged the pertinence of this observation. The Court notes that Regulation (EEC) No 1762/92 on the application of the Protocols concluded between the Community and the NMCs concerning financial and technical cooperation was not adopted by the Council until 29 June 1992. As the Council had not taken a decision to extend the validity of Regulation No 3973/86, the third series of Protocols was implemented in the absence of any legal base.

23. This situation had consequences for the decision-making arrangements concerning interest-rate subsidies under the Third Protocols. In its Opinion No 2/86<sup>(9)</sup>, the Court argued that the procedure contained in the proposed regulation of 1986 was unsatisfactory, and that it was necessary 'to safeguard the prerogatives of the authority responsible for implementing the budget' by giving the Commission the power to decide in favour of, or against, granting an interest-rate subsidy on a loan awarded by the EIB. This observation was not taken into account when Council Regulation (EC) No 3973/86 was adopted. It was, however, taken into account in Council Regulation (EC) No 1762/92. Had steps been taken to ensure that there was a proper legal base for implementation of the Third Protocols, the power of the Commission to decide on interest rate subsidies could have been correctly set out in a regulation from 1988. As it was, the unsatisfactory decision rules continued for a further four years.

24. Unlike Regulation No 3973/86, which was adopted according to the procedure laid down in Article 209 of the EC Treaty and which requires a prior opinion from

the Court of Auditors, the 1992 Regulation was not adopted in accordance with this procedure although it was identical in nature. Similarly, the adoption of Council Regulation (EC) No 1488/96 (MEDA) did not follow the procedure set out in Article 209 of the EC Treaty either. Once any regulation comments on the provisions for the execution of the budget, its financial nature might justify a request for the Court's opinion prior to its adoption<sup>(10)</sup>.

### Conclusions concerning the system of Protocols

25. The Court's observations concerning the system of Protocols, contained in Special Report No 3/91, are still, for the most part, relevant, particularly:

- (a) the slowness of the process of negotiation and conclusion of the Protocols;
- (b) the absence of a procedure for the closure of the Protocols which, as a consequence, leads to the simultaneous implementation of four series of Protocols;
- (c) the negative consequences of the inflexible framework of the Protocols with a fixed and guaranteed amount for each recipient country.

26. The objectives set out in the 3rd and 4th Protocols are more precise than for the first two Protocols, and the nature of the projects or measures which can be financed is defined. The indicative plans drawn up within the framework of the implementation of the Third and Fourth Protocols have allowed greater consideration to be given to the priorities set out by the NMCs in their planning at national level.

27. In spite of the improvements introduced by the 3rd and 4th Protocols, the inability of the majority of the NMCs to absorb the sums involved within a reasonable amount of time has led the European legislature to take a more flexible approach to the MEDA Regulation. Under the new system, in contrast to the system of Protocols, the NMCs no longer dispose of a guaranteed amount of aid but conclude three-year indicative programmes with the Community which are based on their individual capacity to absorb the appropriations and which contain no precise financial commitment<sup>(11)</sup>.

28. As far as the legal provisions of the protocols are concerned, the Third Protocols were implemented in the absence of an adequate legal base and Council Regulations (EC) No 1762/92 and No 1488/96 were adopted without preliminary consultation of the Court of

<sup>(8)</sup> See OJ L 370, 30.12.1986.

<sup>(9)</sup> See OJ C 302, 27.11.1986.

<sup>(10)</sup> See the Court's Annual Report on the financial year 1993, especially paragraphs 13.19 and following (OJ C 327, 24.11.1994).

<sup>(11)</sup> According to Article 105(2) of the Financial Regulation, protocols are preferential agreements whilst MEDA covers aid granted autonomously.

Auditors by the legislator, although this requirement is stipulated in Article 209 of the EC Treaty.

#### OPERATIONS MANAGED DIRECTLY BY THE COMMISSION

29. In this section of the report key findings are presented concerning the instruments and resources which the Commission uses for the management and monitoring of projects. The weaknesses identified help to explain some of the problems and difficulties encountered in the implementation of the projects, at the level of the Commission and at that of project management on the spot.

#### *Management and monitoring instruments*

##### The financing agreements

30. In the context of the operations examined by the Court, the financing agreement (FA) is the basic document for the implementation of projects<sup>(12)</sup>. It formalises the culmination of the preparatory phase and its importance is determined by the following points:

- (a) the agreement constitutes a legal act which sets out the obligations of the signatories;
- (b) as a management instrument, the agreement, amongst other things, specifies the objectives to be achieved and the project's management structures, describes the implementing procedures and specifies the procedures for monitoring the operations and evaluating the results;
- (c) on the financial level, the agreement fixes the project's overall budget and defines the appropriations allocated to each of the identified expenditure headings.

31. In its previous reports, the Court pointed out the considerable weaknesses of the financing agreements drawn up by the Commission<sup>(13)</sup>, weaknesses which

<sup>(12)</sup> In the case of protocols, most of the projects are set up under a financing agreement concluded with the national authorities of the beneficiary country. In some cases, especially for projects worth less than 1 Mio ECU, a contract is enough.

<sup>(13)</sup> See the Annual Report on the financial year 1991, paragraphs 15.28 *et seq.* (OJ C 330, 15.12.1992) for the projects in Asia and Latin America. Paragraphs 5.20 – 5.32 of Special Report No 3/91 identify similar problems for the projects in the Mediterranean countries during the First and Second Protocols (JO C 252, 26.9.1991). Paragraph 5.23 of Special Report No 3/97 on the decentralised system of implementation for the PHARE Programme (from 1990-1995) (OJ C 175, 9.6.1997).

were confirmed during this audit. Examination of these agreements has shown, in fact, that for most of them:

- (a) neither the general nor the specific objectives which the project sets out to achieve are clearly defined or quantified. How the expected results are to be achieved from the means made available is not defined sufficiently clearly. The consequence is that the final evaluation of the projects' success is made more difficult;
- (b) the description of the structure of the management bodies with the definition of the various roles and responsibilities, including those of the technical assistance units, is too perfunctory<sup>(14)</sup>. This weakness may subsequently lead to conflicts between the various bodies responsible<sup>(15)</sup>; in addition, the agreements are not precise enough in the matter of the management's obligation to draw up work schedules, annual budgets and implementation reports;
- (c) the agreements examined did not contain an automatic obligation to carry out evaluations during implementation, regular external audits and ex post evaluations;
- (d) too often the texts did not permit a clear distinction between the contributions made by the authorities of the recipient countries in terms of finance and in terms of the human and material resources made available to the projects;

32. In order to complete the range of customary arbitration possibilities, in the Court's view the financing agreements ought to contain a clause stating the consequences should one or the other of the signatories default on his commitment.

33. As from 1992 the Commission undertook to introduce a method of managing cycles of projects called *Project Cycle Management*. This approach should allow greater control of the management of each stage of the project from the preparatory phase to the ex-post evaluation. However, this approach was not followed in the case of the projects of the Third Protocols since it was introduced after they were drawn up. Nor was it used in a systematic fashion for the projects financed within the framework of the Fourth Protocols.

<sup>(14)</sup> The same problems were already pointed out by the Court in the context of the PHARE Programme (see Special Report No 3/97 on the decentralised system of implementation for the PHARE Programme (from 1990-1995) (OJ C 175, 9.6.1997, paragraph 3.14).

<sup>(15)</sup> Economic Geology Project, Jordan, Science and Technology Project, Jordan.

## Information technology

34. In its Special Report No 3/91 the lack of an adequate system for the accounting and management of the Protocols was highlighted<sup>(16)</sup>. The situation has not improved very much since then. First, there are inadequate links between the Commission's financial accounts (SINCOM, OLAS-Budget<sup>(17)</sup>) and the RAP application developed in-house by DG 1B for project and financial management data concerning projects under the Protocols. Secondly, RAP suffers from a number of weaknesses which reduce its value as a tool for management and control purposes. Conceptual weaknesses include difficulties in accounting for projects where several currencies are used, and, where a single project is financed from more than one Protocol, the necessity to account separately for each of these financing components.

35. On a practical level, the lack of automatic links between the financial accounting systems and RAP means that the RAP database is not promptly updated. The use made of the system, and thus the quantity and quality of the data loaded by each Delegation varies considerably. The deficiencies of the system, and thus the limited value of it as a management tool, were confirmed by users in the Delegations.

36. As a result, the monitoring and management capacity of the Commission, especially in the Delegations is reduced. A new system, the MIS<sup>(18)</sup>, was intended to provide the services with a powerful tool for project monitoring and control, but was installed, in a simplified version, only in 1997<sup>(19)</sup> <sup>(20)</sup>.

## The organisation and resources of the departments involved

37. The preparation, implementation and monitoring of the projects financed within the framework of the Protocols is the task of the geographical units and the

technical unit of the Mediterranean Directorate and of the financial unit of DG IB. The Delegations set up by the Commission in the recipient NMCs also participate actively in the administration of the projects.

38. The division of responsibilities between the geographical units and the technical unit in the Mediterranean Directorate is not set out in any internal document<sup>(21)</sup>, and varies from one project to another. Although such an approach may favour a certain flexibility, it also creates uncertainties about the respective responsibilities of the various units in the management of the projects.

39. The distribution of tasks between the Commission's central departments and the Delegations is described in a DG IB internal document of July 1992<sup>(21)</sup>. Basically, this document attributes decision-making powers to the former while the latter are given an advisory role on the policies to be followed and on the selection of projects. The Delegations may also, on the basis of instructions given by headquarters, negotiate the conditions for the implementation of the projects with local authorities. The logic underlying the document is a very centralist one as the central departments retain the power of decision. In reality, the controls carried out showed that the Delegations often accept alterations, sometimes quite considerable ones, to the FA terms (see paragraphs 72 — 80). In addition, these changes are frequently made without any written or supporting documentation which would allow their justification to be examined. Whilst the Delegations actually are best placed to appreciate the relevance of a request for amendment which has been entered by the administration of the projects, at the present time no document authorises them to make this decision. Only the signatories of a document are empowered to amend it unless they delegate this competence. It is therefore for the Commission to decide to give the Delegations such powers, subject to them providing written justification, which would allow the Commissioner responsible to examine the decisions taken.

<sup>(16)</sup> Paragraphs 4.1 — 4.11.

<sup>(17)</sup> OLAS-Budget is an application managed by DG VIII which extracts and groups SINCOM payment data from different years by commitment. Since January 1996 the production of list and reports by DG VIII for DG 1B has ceased. OLAS stands for 'On-Line Accounting System'.

<sup>(18)</sup> Management Information System.

<sup>(19)</sup> See Annual Report concerning the financial year 1996, paragraphs 13.22 — 13.28 (JO C 348, 18.11.1997).

<sup>(20)</sup> The Court also pointed out serious and similar weaknesses in the computer systems used for the management of the PHARE Programme ((see Special Report No 3/97 on the decentralised system of implementation for the PHARE Programme (from 1990-1995), paragraphs 4.24 — 4.28 (OJ C 175, 9.6.1997)).

<sup>(21)</sup> A DGIB internal document of July 1992 set out the respective responsibilities of the Delegations and Commission headquarters relating to the management and monitoring of development aid and economic cooperation. This document refers explicitly to the situation of the programme in Asia and, to a lesser extent, to the situation in Latin America. It speaks of a future amended version which would reflect the particular aspects of cooperation in Mediterranean countries, but the Commission has not been able to supply the Court with this version.

40. Furthermore, the Delegations have increasingly to come to terms with an appreciable increase in their workload due to their increasingly political role, the development of their economic and commercial activities and those tasks involving representation and the supply of information.

41. With the resources available at present, both in respect of the number and the qualifications of the staff, the Delegations can only cope with this extra work by neglecting tasks relating to financial and technical cooperation.

42. The Commission has undertaken a thorough review of the development and management of its external services, which led to its approving a document on this subject on 8 April 1997. This document expresses a determination both to increase human resources and to improve working methods in order to make the best use of those resources. This document, which marks an awareness of the necessity of decentralisation and acknowledges that much remains to be done to remove the weaknesses that have been noted, should be complemented by a definition of the powers that are to be given to the Delegations and of the procedures for implementing those powers<sup>(22)</sup>.

### *The consequences for the implementation of the projects*

43. The Court's audits have identified a series of delays in the implementation of the projects and inadequate expertise in the financial management and monitoring of the projects. Major amendments to the terms of the FAs with the mere assent of the Delegations or the central departments have also been discovered.

### Schedule for the completion of the projects

44. As *Table 6* shows, for six of the sixteen projects audited, the period of time required for signing the FA, after the decision had been taken by the Commission, was more than 10 months and for five of them the period was one year or longer. In two extreme cases it was respectively 17 months and over 24 months. In addition, in the case of several projects, an extra year or eighteen months was necessary to select the technical assistance unit and/or send supplies due to the growing difficulties on the part of the Commission's departments in organising tendering procedures within acceptable time limits.

TABLE 6

#### PERIOD OF TIME REQUIRED FOR SIGNING THE FINANCING AGREEMENTS

Recipient country	EGYPT			
Name of project	Helwan Wastewater Project — Phase II	Nile Valley Regional Project	Food Sector Development Programme	Ras Mohammed National Park
Financing decision	19.12.1988	9.3.1989	2.4.1990	4.10.1991
FA signed on	3.5.1989	16.10.1989	16.7.1990	28.4.1992
Time lapse	5 months	6 months	3 months	2/3 years

Recipient country	JORDAN			
Name of project	National Soil Map and Land Use Project	Economic Geology Project	Ground Water Investigation in Hammad and Sirhan basins	Cooperation Project in Science and Technology
Financing decision		26.3.1989	5.12.1990	5.12.1991
FA signed on	18.4.1989	23.4.1990	21.10.1991	29.9.1992
Time lapse		13 months	11 months	10 months

<sup>(22)</sup> Similar problems concerning the division of responsibilities between head office in Brussels and the Delegations and the latter's powers were pointed out by the Court in the context of the PHARE Programme ((see Special Report No 3/97 on the decentralised system of implementation for the PHARE Programme (from 1990-1995), paragraphs 2.16, 2.19 — 2.22 and 5.24 (OJ C 175, 9.6.1997)).

Recipient country	MOROCCO			
Name of project	Agricultural Development Fund (ADF)	Contribution to the improvement of the system of teaching science and technology in Morocco	Contribution to the development of training structures in the textile and leather industries	Rehabilitation and protection of parts of the Ouarzazate and Moulouya disaster areas
Financing decision	2.6.1989	24.10.1989	6.7.1990	2.7.1990
FA signed on	13.2.1990	26.10.1990	15.7.1991	30.7.1991
Time lapse	8 months	12 months	12 months	13 months

Recipient country	TUNISIA			
Name of project	Agricultural development to the south-west of Kef	Creation of the Rijn Maatoug palm grove	Loan operations for the benefit of small and medium-sized agricultural enterprises in Tunisia	Exploitation of water resources in the Governorate of Kasserine
Financing decision	30.6.1988	27.6.1989	5.12.1990	9.7.1991
FA signed on	9.7.1988	11.8.1989	29.4.1991	30.9.1991
Time lapse	1 month	1,5 months	5 months	3 months

Source: Court of Auditors.

45. Although external factors — the Gulf crisis, for example — may explain, in part, the delays, they were principally caused by the Commission's difficulties in managing, in an efficient manner, the necessary stages in the launch of numerous projects.

46. The audits conducted showed that the most frequent causes of delays are the poor quality of the FAs and inadequate grasp of the public tendering procedures. One project involving loan operations for the benefit of small and medium-sized agricultural enterprises in Tunisia (SEM/03/212/015) thus began with a delay of two years due to the impreciseness of the FA in respect of the procedures for the release of funds, the rate of exchange to be applied when constituting the counterpart funds or even the provisions for intervention by the national accounting officer and the conditions regulating the use of bank accounts and the interest yielded. Two projects in Jordan also suffered such delays because of the time required by the Commission to conclude the technical assistance contracts in the case of the Economic geology project (SEM/03/628/013) and to acquire the laboratory equipment necessary for the implementation of the Cooperation project in science and technology (SEM/03/628/033A).

47. These delays in the launch of the projects increased costs and sometimes affected results. Generally speaking,

they resulted in a failure to meet the deadline for the implementation of the financial agreements for all 16 projects in the sample.

48. In Morocco construction costs increased from 58,6 Mio ECU to a total of 64 Mio ECU for a project involving the improvement of the education system (SEM/03/204/006) and work initially planned for a project concerning the rehabilitation and protection of irrigated areas in the Ouarzazate and La Moulouya regions (SEM/03/204/013) could only be partially completed.

49. In addition, within the framework of the implementation of the project for the development of training structures in the leather and textile industries in Morocco (SEM/03/204/012), 28 contracts for a cumulative total of 2,94 Mio ECU were not approved until after the deadline for the implementation of the financing agreement, which, in the absence of an additional clause to the FA extending this period, is irregular.

#### Financial management and monitoring of the projects

50. The audits carried out have highlighted partial knowledge of the situation of the projects, weaknesses in the monitoring of the accounts of the paying agencies and financial management which is often inadequate.

### *Knowledge of the situation of the projects*

51. Under the provisions of the FAs, the projects are, generally, jointly financed by the Commission and the recipient countries. The Court's audit showed that, for 12 of the 16 projects in the sample, the Commission was not in possession of any information about the payment of the national contribution and the use to which it is put. With the notable exception of the «Rjim Maatoug» project in Tunisia (SEM/03/212/010), the only cases in which the Commission had the necessary data available concerned projects where the local co-financing came from counterpart funds.

52. Where responsibility for monitoring the execution of the projects lies with the national administrations of the NMCs and/or large financial organisations, the Commission's monitoring is generally at its weakest. This weakness is accentuated in cases where a large number of operations involving individual allocations of subsidies or loans is being financed. Three projects in the sample fall into this category: the project involving loan operations for the benefit of small and medium-sized agricultural enterprises in Tunisia (SEM/03/212/015), the project for the improvement of the education system in Morocco (SEM/03/204/006) and the Agricultural Development Fund (ADF) in Morocco (SEM/03/204/002).

53. For this last project mentioned, the Commission did not possess, at the time of the audit, any information about the use of the final 10 Mio ECU tranche of its financial contribution. The reports sent by the management contained, moreover, anomalies that the Commission's departments had not been able to discover, since these reports had not been used. These anomalies can be explained by a change in the accounting for the operations which allowed reimbursements for purchases made by the beneficiaries prior to approval of the FA to be charged to it.

### *Administrative and financial management*

#### *Monitoring the accounts of the paying agencies*

54. Examination of the accounts of the paying agencies showed that for two of the four countries visited as part of the audit no reconciliation of bank accounts had been carried out and that there were transactions in respect of which final settlement had been pending since 1989. For one of these countries, final settlement only took place

during the Court's visit after joint research had been carried out by the Court's auditors together with Delegation staff.

#### *Selection of technical assistance*

55. Leaving aside the problems connected with the Commission's difficulties in managing, within reasonable time periods, the procedures for the selection of the technical assistance, the Court found two projects for which these selection procedures were questionable.

56. In the case of the project for the improvement of the system of technical education in Morocco (SEM/03/204/006), the Commission entrusted the monitoring of the project's implementation to the consultant who carried out identification and preparation. The Commission likewise awarded the technical assistance contract for the execution of the «Rjim Maatoug project» (SEM/03/212/010) to the same consultant who carried out the feasibility study.

57. This last project is jointly financed by the Commission, Italy and the state of Tunisia. The Italian contribution was managed by the Commission in accordance with a framework agreement concluded between the Commission and the Republic of Italy in 1985. The relevant Article 2.10 of the FA names the consultant to whom the contract must be awarded by private treaty. This procedure, for which there is provision in the framework agreement, is, however, only possible provided it is also expedient. Under the terms of the agreement, its expediency must be assessed by reference to the principles of cost and urgency and provided it has been the subject of an examination by the responsible Commission departments. The Commission's files contain no indication that its departments conducted such an examination.

#### *Cash management*

58. In November 1995, at the time of the Court's audit, of the 33,7 Mio ECU paid by the Commission for the loan part of the Food Sector Development programme (SEM/03/220/020A) since its launch, 9,3 Mio ECU was still unused. On the same date, total capital repayments and interest on loans came to 14,7 Mio and 1,6 Mio ECU respectively. Cash-in-hand totalled 25,6 Mio ECU, i.e. 54 % of the initial financing. The Commission

should have paid out the funds on the basis of a realistic analysis of the projects' cash-flow requirements <sup>(23)</sup>.

59. In addition, for this same project, the system established provided for the endowment of the imprest account with an advance equivalent to 50 % of the project's annual requirements. Due to an overestimation of the costs in the work schedules, the advances paid out exceeded the requirements of the project. The balance of unused funds on closure of the accounts at the end of the year came to 0,8 Mio ECU in 1993 and rose to 2,8 Mio ECU at the end of the following financial year. In 1995, the balance available on the imprest account still amounted to 1,2 Mio ECU.

60. 13,8 Mio Tunisian dinars (TD), i.e. 1,19 Mio ECU, were paid as from 27 December 1991 to the Tunisian bank which was responsible for the management of loans within the framework of an agricultural loan project (*SEM/03/212/015*) involving loan operations for the benefit of small and medium-sized agricultural holdings, although this credit line was not drawn upon until the month of October 1992. Interest yielded by the sums deposited in the accounts of the project between October 1992 and 21 November 1994, the date on which the project funds were exhausted, amounted to 13,5 Mio TD, i.e. 1,1 Mio ECU. The Commission did not become aware of this amount until the Court conducted its audit.

#### Payment of ineligible expenditure

61. Three cases of ineligible expenditure were revealed during the audits, either because the operations paid for by the Commission were concluded before the signing of the FA or because they were only partially eligible, or were completely ineligible, for payment from the Community contribution.

62. Thus operations carried out before the signing of the FA were nevertheless paid for by the Commission within the framework of a project in Morocco. This project involved aid for training in the textile and leather industries (*SEM/03/204/012*) for which the total of operations erroneously financed was estimated, at the conclusion of the audit, to be 212 000 ECU.

63. In Egypt, too, two payments for a total of 705 010 ECU were charged in 1991 to the accounts of the Food Development Sector programme (*SEM/03/220/020A*) for activities for which no provision had been made, and the

costs of which should have been charged to the counterpart funds made available for food aid.

64. The body responsible for managing the Nile Valley Regional Project in Egypt (*SEM/03/220/008A*) invoiced the Commission for 50 % of all its administrative costs while simultaneously managing five further projects which were financed by other international donors. No document supporting the invoicing of such a large percentage to the Commission was submitted to the Court's auditors. The Delegation was not aware of this situation. Complementary controls should be carried out by the Commission's departments to determine the amounts wrongly paid out.

#### Time taken for payment

65. In the case of the «Rjim Maatoug» (*SEM/03/212/010*) project in Tunisia, the excessively long periods of time taken for the payment of technical assistants' fees incurred 41 732 ECU in interest on arrears.

66. Similarly, the Commission had to pay 40 000 ECU in interest on arrears for the Ground water investigation project in Azzraq (*SEM/03/628/006*) because of payment delays caused by application of the wrong exchange rate <sup>(24)</sup>.

67. The contractor carrying out the Economy Geology project (*SEM/03/628/013*) has submitted a claim for interest due to late payment and, at the time of the Court's audit, an invoice was still outstanding after more than two years. No action had been taken by the Commission or by the Jordanian Natural Resources Institute to resolve these matters.

68. Analysis of the time necessary for the organisation of operations relating to the implementation of the textile and leather industries' training project in Morocco (*SEM/03/204/012*), revealed that, in four cases, it ranged between 121 and 221 days.

#### Evaluation and external audits

69. Three of the projects audited in Jordan were not subjected to an external audit since this was not stipulated in the FA. As for the fourth, the evaluation carried out during implementation was too late for those

<sup>(23)</sup> See the Annual Report on the financial year 1996, paragraph 13.37 (OJ C 348, 18.11.1997).

<sup>(24)</sup> This project was not included in the sample. The point was nevertheless identified during the mission to Jordan, where all the projects financed for the benefit of the country could be examined.



responsible for the project to take the results into account before completion of the work.

70. The project concerning the improvement of the system of teaching technology and science in Morocco (*SEM/03/204/006*) was not subjected to any evaluation or to an external audit. The FA, moreover, does not contain any obligation in this respect.

71. On this last point, the Court noted that the Commission now has a tendency to include in the text of the FA an obligation to accept external audits. The Commission should, however, define the objectives of these audits sufficiently precisely and improve the follow-up in order to draw maximum benefit from them and avoid situations like those met with in the Nile Valley Regional Project (*SEM/03/220/008A*). In spite of annual audits over five years of implementation, the excessive invoicing of administrative costs (see paragraph 64) by the technical assistance units was never noticed.

#### Amendments to the initial decisions

72. Examination of the files has shown that major amendments, or transfers of appropriations from one budget heading to another, were accepted by the Delegations, the management units or the technical assistance units without the Commission having delegated authority to these various units to do this. In addition, these amendments took place without any written explanation which would have allowed checks to be carried out to see whether they were really justified.

#### Major amendments

73. Within the framework of the project concerning the loan operations in favour of small and medium-sized agricultural enterprises in Tunisia (*SEM/03/212/015*), the type of the products to be imported, as stipulated in the FA, was ignored and essential products of a different type, to a value of almost 11 Mio ECU, were imported. The Delegation also accepted a substantial increase in the rates of interest on the medium-term and long-term loans, raising them from 7,50 to 10 % and from 8 to 11 %. This last amendment increased the farmers' debt burden considerably and a number of them were not able to support it (see paragraph 97).

74. Within the framework of the agricultural development project to the south-west of Kef in Tunisia (*SEM/03/212/004*), the management powers delegated by the FA to a body with legal personality and budgetary autonomy were transferred to a decentralised

administration which was not at liberty to invest liquid assets.

75. In Morocco, the Agricultural Development Fund project (*SEM/03/204/002*) for which the Commission has paid, within the framework of the Third Protocols, 30 Mio ECU, was, according to the terms of the FA, to have been subjected to an audit by the Moroccan General Inspectorate of Finances for each of the three years of its implementation. The Delegation allowed this inspection to be replaced by an audit conducted by an external company which only partly covered the period of Community financing. This being the case, the correct use of 10 Mio ECU was not audited.

#### Authorisation of transfers between headings

76. During the implementation of the training project in Morocco in the textile and leather industries (*SEM/03/204/012*), the Delegation agreed an increase of 37 % for the 'training network' component, which thereby increased from 1,09 Mio ECU to 1,5 Mio ECU.

77. Transfers of appropriations between the budget headings of the FA were frequently approved. In the case of the «Rjim Maatoug» project (*SEM/03/212/010*), the changes observed also concerned the origin of the funds and the acceptance of the fact that the approved limits under certain headings were to be exceeded.

78. Finally, in respect of the Helwan Waste Water project (*SEM/03/220/005A*) and, generally, all the infrastructure projects financed for the benefit of Egypt, the Delegation charged payments as long as appropriations remained available under the FA without concerning themselves with the specific amounts made available under each budgetary heading.

79. These examples show that the managing departments too often tend to overlook the restrictions imposed by the amounts entered in the FA and only consider the overall budget. They are, however, largely unaware of the rules restricting expenditure to the appropriations allocated to each expenditure heading<sup>(25)</sup>.

80. Apart from the irregular nature of this situation, it raises questions about the initial allocation of appropriations which were intended to cover the requirements identified during the preparatory studies. A

<sup>(25)</sup> See also paragraph 15.29 of the Annual Report on the financial year 1991 (OJ C 330, 15.12.1992).

need to amend the amounts under the budget headings for a project indicates a need to amend its implementation. This is an important management decision, which should only be taken by those authorities which have received a proper mandate to do so (see paragraph 39). In future the FAs should stipulate that all applications for amendments to the initial decisions, such as those described above, must be justified and be approved by the authority responsible.

#### Services provided by the technical assistance units

81. An examination of the sample revealed the generally high quality of the services provided by the technical assistance. Excessive invoices for ineligible expenditure (NVRP — see paragraph 64) or incorrect attitudes (Helwan Waste Water — see paragraph 92) were nevertheless observed. The following comments should moreover be made.

82. In Morocco the services provided by the TA units for the implementation of the pedagogical and technical components of the project for the improvement of the teaching of science and technology (SEM/03/204/006) were judged to be inadequate by the Minister of Education and by the Commission.

83. In Jordan, in the case of the Economic Geology project (SEM/03/628/013), the TA, due to its inability to work in close collaboration with the local authorities, did not lead to any strengthening of the institutions, which constituted one of the project's important goals. In contrast, good cooperation between the technical assistant and the local authorities was decisive for the success of the National Soil Map and Land Use project (SEM/03/628/005).

84. In addition, it was noted that when the technical assistance replaces the local authorities responsible for the administration and financial management of the project, the project's survival is in doubt if it is expected to continue beyond the duration of the consultants' contracts.

#### *Management by those responsible for the projects and results obtained*

#### Observations in respect of the accounts and finances

85. Two of the four projects audited in Jordan did not have separate accounts while for two others the only

accounts kept were those of the technical assistance unit. It should be added that in the case of the National Soil Map and Land Use project (SEM/03/628/005), the accounts, which were kept by the TA, did not present the appropriations under the budgetary headings stipulated in the FA, thus making it impossible to monitor their utilisation.

86. In the case of the Nile Valley Regional Project in Egypt (SEM/03/220/008A), the only accounts were kept by the technical assistance. Neither the national coordinators for the various research programmes nor the local research centres kept accounts.

87. In spite of the generally high quality of the management of the «Rjim Maatoug» project (SEM/03/212/010), the checks carried out showed that the managers of the project did not award a local contract for the purchase of tractors to the lowest bidder and the files do not supply a satisfactory explanation for this decision, which contravenes the public tendering regulations.

#### The results recorded and the survival of the projects

88. The projects' success depends on the partners fulfilling their commitments and on an adequate system of management, the definition of which is a result, or should be a result, of feasibility studies. Bearing in mind these two criteria, the controls conducted by the Court revealed contrasting situations. The shortfall in the results achieved compared to the objectives set out in the FAs, and doubts about the ability of the following projects to survive, should be emphasised.

89. The Helwan Waste Water project (SEM/03/220/005A), which has received, commencing with the first protocol, almost 87 Mio ECU, can still not be taken over by the local institutions. Two administrations share responsibility for the project. Responsibility for the execution of the work lies with the *Cairo Waste Water Organisation* (CWO) which, after its final inspection of the work done, hands it over to the *General Organisation For Sanitary Drainage* (GOSD), which is responsible for the management of installations and the distribution of water. Checks carried out on the spot have shown that neither of these two institutions is in a position to perform its tasks in an acceptable fashion and that the project as a whole only works thanks to the technical assistance.

90. There are two basic reasons which explain this situation. Firstly, the GOSD was not authorised to set the

price of water at an adequate level to allow it to achieve the real budgetary autonomy which would guarantee its financial viability without the aid of international donors. Secondly, the poor remuneration paid by these two institutions to their officials has led to a number of them leaving: after having received qualifications through vocational training from the technical assistance, they joined the private sector as soon as they had the opportunity, where they obtained higher salaries.

91. Such a situation robs the administrations concerned of their capacity to fulfil their responsibilities and they then depend completely on the technical assistance for the smooth running of the waste water treatment system and, ten years after the launch of the project, are themselves still incapable of assuring its maintenance and continuation.

92. This situation has given the technical assistance a position of such strength that they have taken the liberty, with the active support of GOSD, of continuing to work, in spite of the Commission's refusal to prolong their contract once it had ended. At the time of the Court's mission to Egypt, this situation had continued for 17 months. Following the Court's visit, the Egyptian authorities agreed to take responsibility for the costs arising from the extension of this contract.

93. In addition, at the time of the Court's audit, stocks of spare parts were inadequate for an operation of this scale. According to the technical assistance, numerous disappearances of equipment had occurred and the standard of maintenance of the installations was not adequate.

94. Constraints of the same kind inhibited the Food Development Sector Programme project (SEM/03/220/020A), the survival of which will be doubtful once the European technical assistants responsible for its management depart.

95. The Court visited the Ras Mohamed National Park project (SEM/03/220/025A) some weeks before the deadline set by the FA for the completion of the work. At that time the buildings required to carry out the project had still not been constructed because the government had only just made the land required available.

96. As in the case of the Helwan Waste Water project, the park created as part of the Ras Mohamed project was not able to generate the financial resources necessary to assure its survival.

97. The project involving loan operations in favour of small and medium-sized enterprises in Tunisia (SEM/03/212/015) has had an unwanted effect. The farmers' level of indebtedness increased considerably when rates were raised (see paragraph 73). The controls carried out revealed that more than 80 % of the farmers were not able to support the burden of their debts. As national legislation forbids access to new financing if there are delays in repayments, the result is that even the continued existence of some agricultural holdings has been jeopardised.

98. Two of the four projects in the sample which were financed in Jordan only partially achieved the desired objectives and their survival also appears fraught with difficulties. On the other hand, the National Soil Map and Land Use project (SEM/03/628/005) may be considered a success as it has allowed a real transfer of know-how to the benefit of the local departments. Two aspects in particular account for this success: the project was well defined from the beginning by Jordanian technicians and the technical assistance worked in close cooperation with them.

#### *Conclusions in respect of the management of the projects*

99. An examination of the management of the projects shows that the main weaknesses pointed out in the Court's Special Report No 3/91 still persist in spite of the commitments to remedy them given by the Commission.

100. The inadequacy of the human resources, the lack of clarity in the division of responsibilities between the various departments and of competences between the Commission's headquarters in Brussels and its Delegations in the field — all these aspects have contributed to the Commission's failure, on the whole, to cope with the management of the projects.

101. The limitations of the management tools aggravate this situation:

- (a) the computer software that the Commission has at its disposal does not enable it to keep real auxiliary accounts for projects which are directly linked to the implementation of the budget, or even accounts giving a comprehensive view of the financial situation of these projects;
- (b) the wording of the financing agreements is not precise enough when specifying the nature of contractual obligations, the management framework and the instruments for monitoring operations;
- (c) the audit contracts do not define clearly the information that the Commission expects from external controls.

102. The tangible increase planned for Community aid to the NMCs, practically doubling, every year, the amounts committed, will only aggravate the present situation. While it is scarcely likely that the increase in appropriations foreseen under MEDA will increase the number of projects by the same proportion, the amounts allocated to each of them will undoubtedly be increased quite considerably. The first application decisions for the MEDA Regulation tend to confirm this analysis. These actually concern structural adjustment programme support operations and involve amounts of between 100 and 159 Mio ECU.

103. The management systems for the projects must be set out in the FAs on the basis of knowledge of the administrative realities in the recipient States. Where the administrative structures are of good quality, as is the case in the Maghreb, the Commission ought to use them and not attempt to impose a standard, pre-established model which runs counter to local traditions. An attempt to impose such a model can only lead to conflicts with the local authorities. The audit revealed that, while the Commission has, on the whole, avoided this error when implementing the Protocols, certain NMCs fear that, with the implementation of MEDA, the management of the projects will no longer be entrusted to the responsible local institutions but will lie with ad hoc management units headed by co-directorates made up of European technical assistance units and local managers.

**THE MANAGEMENT OF OPERATIONS ADMINISTERED BY THE EIB ON BEHALF OF THE COMMISSION AND THE AUDIT OF THESE OPERATIONS**

*General presentation of the audit*

104. The Mediterranean Protocols include financing which, although it originates within the budget, is

managed by the EIB. This financing consists of non-reimbursable aid which takes the form of interest subsidies on loans granted by the EIB from its own resources and of refundable aid earmarked for risk capital operations.

105. Within the framework of the Third Protocols, 37 Mio ECU was made available for risk capital. This amount rose to 80 Mio ECU, i.e. an increase of 216 %, in the Fourth Protocols, underlining the growing interest of the Euro-Mediterranean partners in this financial instrument<sup>(26)</sup>. *Tables 2a and 2b* give the corresponding amounts for the seven countries concerned. The Protocols do not fix an overall budget for the financing of interest subsidies (see paragraphs 137 – 138).

106. The management of interest subsidies was mainly audited on the basis of an examination of the Commission's files. For the management of risk capital, the controls were complemented by an analysis of a sample of projects, most of which were the subject of inspections on the spot (see *Table 7*). These checks covered:

- (a) whether the use of these resources was consistent with the objectives assigned to them in the protocols;
- (b) the quality of the management by the mandated body by means of an examination of the structures employed and the results obtained;
- (c) the monitoring of these various operations by the Commission.

<sup>(26)</sup> NB: 25 Mio ECU are added to this amount outside the protocols.

TABLE 7

## PROJECTS MANAGED BY THE EIB AND EXAMINED/VISITED BY THE COURT

(Mio ECU)

Ref.	Economic sector	Number of jobs created	Total project cost (Mio ECU)	EIB resources (Mio ECU)	Risk capital (Mio ECU)	Interest rate subsidy (Mio ECU)
<b>EGYPT</b>						
SEM/03/220/012E SEM/04/220/033E	Industry	750/800	140,0	25,0	5,5	2,1
SEM/03/220/013E Global loan via the Export Develop. Bank of Egypt	Tourism Carpet ind. Synthetic fibres Tourism	400	5,2 9,7 1,3 6,2	2,1 4,0 0,7 0,8	0,5	0,6
SEM/03/220/030E SEM/04/220/029E	Industry	600	77,7	15,0	9,0	1,9
SEM/03/220/036E SEM/03/220/037B	Horticulture	480 permanent 800 seasonal	21,4	6,0	1,5	0,8
		<b>Total Egypt</b>	<b>262</b>	<b>54</b>	<b>17</b>	<b>5</b>
<b>MOROCCO</b>						
Global loans via the Treasury	Electronics Pesticides Paper Textile Marble Steel Electronics Fish meal, fish oil Leather goods Clothing Rm Concrete Exp. polystyrene Textile	26 29 26 perm. + 10 occ. 120  not available 180 35 perm + 20 seas. 40 150 25 30 155	1,4 1,2 1,9 1,1  1,6 1,1 1,3 0,1 2,0 1,4 0,6 1,5		0,1 0,1 0,2 0,2  0,3 0,1 0,1 0,0 0,2 0,1 0,1 0,2	
Financing through the SPPP	Biotechnology Food Copper industry	40  45	0,7 2,8 2,7		0,3 0,2 0,3	
		<b>Total Morocco</b>	<b>21,4</b>		<b>2,5</b>	
<b>TUNISIA</b>						
Global loans via Banque Nationale de Développement Protocols II, III and IV	Ceramics Textile Tyre industry Rubber components Shoes Tourism Mining Enamel industry	40  500 65 104 not available 250 60	1,8 17,0 3,5 2,0 0,1 2,5 56,0 4,5		0,3 0,7 0,7 0,1 0,1 0,1 0,9 0,2	
	<b>TOTAL RISK CAPITAL TUNISIA</b>		<b>87,3</b>		<b>3,0</b>	
SEM/03/212/016	Chemical pollution	—	70,4	35,4		5,4
		<b>Total Tunisia</b>	<b>157,7</b>	<b>35,4</b>	<b>3,0</b>	<b>5,4</b>

Source: Court of Auditors.

107. Taking into account the number of financial instruments, on the one hand, which the Commission has entrusted to EIB management and, on the other, the constraints experienced in connection with the organisation of the external audit of the EIB, the obligation to organise, systematically, a joint audit with the EIB, represents a real constraint on the Court. For this reason, it was materially impossible to carry out controls, on the spot, on a large number of projects which had benefited from budget finance in the form of interest-rate subsidies.

### *The system of risk capital management*

#### **The purpose of risk capital and conditions of eligibility**

108. Risk capital is, according to the terms of the Protocols, intended primarily to help in making equity capital or the like available to private and public undertakings, in particular those in which natural or legal persons from Member States of the Community have participations. They are available to all sectors of the economies of the NMCs.

109. The extremely broad formulation of the Protocols led the EIB to define three conditions for the eligibility of projects for risk capital. Two of these conditions concern the actual qualities of the projects, i.e. their economic value and their financial viability. The third concerns the decisive role which risk capital must play in the execution of the project.

110. The EIB, however, interprets this final condition very generously. It is considered to be fulfilled when the absence of this financing would lead to delays in the operation, to an upset in the balance of the relationship between the local and European partners or would influence other hesitant donors unfavourably.

#### **Description of the management system**

111. This system is built around financing procedures within a contractual framework and procedures for the launching and monitoring of the projects which are adapted to suit each one of them.

#### *Financing procedures and contractual framework*

112. The EIB took care to adapt the means of intervention employed to the realities of the NMCs. Five methods were therefore tried out, as single alternatives or together, one after the other, in order to achieve the best possible adaptation to local realities.

113. These procedures, presented by the EIB in an information note dated 24 June 1992, are:

- (a) a global loan to a selected financial institution intermediary (IFI) (Tunisia, Egypt, Jordan);
- (b) a global loan to the national exchequer working in cooperation with several IFIs (Morocco);
- (c) creation of special financial companies;
- (d) direct intervention in the projects (Egypt);
- (e) the financing of feasibility studies.

114. The legal framework put in place by the Bank was different for each procedure, in order to adapt it to their particular characteristics. Notwithstanding this diversity, the management of risk capital is generally characterised by the following factors:

- (a) financing is always granted at more advantageous rates than those obtained on the local market;
- (b) the risk of exchange losses is not borne by the beneficiary, but is charged to the Community initially then subsequently to the NMC concerned;
- (c) the definitive granting of finance to the final beneficiary may not take place without the EIB's express agreement.

115. As in the case of its own operations, the EIB ensures that the clauses of the contract are incorporated harmoniously into local law.

#### *Appraisal and monitoring of projects*

116. When the EIB uses its own resources to finance a project jointly with risk capital, its departments appraise the file, which is drawn up according to its usual internal procedures, directly.

117. In contrast, when the management of the operations takes place within the framework of the implementation of a global line of credit, the appraisal of the project follows a decentralised procedure. The IFI must first submit an application.

118. Nevertheless, the IFI does not have autonomous powers of decision in respect of the allocation of risk capital. It must send the file relating to the project and the result of its appraisal to the EIB to obtain its approval. This file contains, at the least, according to the terms of the contract, a standardised information sheet.

119. After examination of the forwarded file, the EIB takes an allocation decision by which the IFI is authorised to conclude the financing contract with the final beneficiary.

120. The monitoring of the operations is conducted according to two complementary procedures. Contracts signed with the IFI provide for monitoring of documentation, whereby information on the state of their risk capital portfolio and on the financial situation of each beneficiary is sent to the EIB on a regular basis. This information is collated in standardised sheets, a specimen of which is attached to the contract. This monitoring is complemented by inspections on the spot which the EIB carries out directly or by despatching consultants recruited specifically for this purpose.

121. In the case of the global lines of credit granted to the State of Morocco, its Treasury ensures, prior to the release of the funds, that the contractual conditions have been fulfilled by the beneficiary. In parallel with this, it monitors the projects by examining the financial balance sheets which are sent to it.

#### **The Court's observations at the conclusion of the audit**

##### *The appraisal of the projects*

122. The most commonly encountered weakness concerned the information collated on the European companies associated with the joint enterprise, whose exact situation and the extent of whose commitment cannot be assessed on the basis of the material contained in the appraisal files forwarded to the Court. The controls carried out demonstrated the close connection between the quality of the partners involved and the success or, on the contrary, failure of the projects financed.

123. The second weakness demonstrated by an analysis of the projects in the sample and by an examination of the available documents, concerns the relative frequency of under-estimation of the investment budgets and, in particular, of the working capital requirements.

124. Apart from these two weaknesses, the quality of the appraisal files varies. An examination of files appraised by the EIB's offices directly, or by the Tunisian IFI, or by the investment company created in Morocco, shows the high quality of the appraisal work. In contrast, the poor quality of the files forwarded in support of applications for the allocation of funds by the other IFIs visited as part of the inquiry, reflects, depending on the individual case, the absence or lack of experience on the part of these institutions in the management of this type of operation.

##### *Concentration of aid*

125. Of the eight projects selected in Tunisia, the IFI was itself the beneficiary for half of them, receiving an amount in excess of more than 60 % of the total allocation.

126. In Morocco, according to information received from the supervisory authorities, the beneficiaries of the risk capital came mainly from amongst the usual customers of the IFIs.

127. In Egypt, three projects absorbed 16,5 Mio ECU of the 27 Mio made available under the Third and Fourth Protocols. This concentration of allocations is also special because of the size of the projects financed, one of them representing a total investment of 140 Mio ECU, of the size of the European partners involved, the majority of which are multinational companies, and of the commitment by the EIB of its own resources in these operations.

128. Such concentrations are questionable, in spite of the undeniable economic importance of the projects financed in Egypt in the light of the objectives laid down for risk capital by the Protocols and indicative programmes concluded with these countries. The fact is that, according to the terms of the latter, small and medium-sized enterprises constitute the favoured target group for risk capital. However, the only operations aimed at benefiting these enterprises were financed by two global loans, of which the first, under the Third Protocol, was only partially used and the second, under the Fourth Protocol, had not been the subject of any allocation at the time of the Court's audit.

129. According to the EIB, the portfolio of projects financed in Egypt is sound and reflects its concern to manage the resources entrusted to it by the Commission as well as possible, taking into account the possibilities offered by the local market. Without disputing this claim, the Court notes a contradiction with the commitments made in the indicative programmes.

130. One NMC's responsible authorities underlined, moreover, that the basic value of this financial instrument was to allow the implementation of quality projects which, however, were difficult to finance by conventional bank loans because of the impossibility on the part of their sponsors of offering sufficient guarantees. The purpose of the risk capital, therefore, is to encourage the creation of a new generation of entrepreneurs, which was not really the case for the projects financed in Egypt and was only partly the case for those financed in Morocco and Tunisia.

*Overall monitoring of the operations by the EIB*

131. As far as the monitoring of documents is concerned, it was observed that, in general, the IFIs did not fulfil their contractual obligations in respect of forwarding to the EIB, on a regular basis, information sheets on the state of their risk capital portfolio or on the financial situation of each beneficiary.

132. In May 1993 the EIB employed a consultant, at its own expense, to evaluate operations financed in Morocco on the basis of a large sample covering 37 projects. Several of the projects examined as part of the Court's audit had also been evaluated by this consultant or had been audited by the EIB. The Court found similarities in the findings of these audits.

*The results achieved*

133. The management of risk capital within the framework of the implementation of the Third Protocols is characterised by:

- (a) an even distribution of the loans to the beneficiaries in the various sectors of activity in the NMCs, particularly in Morocco and Tunisia, where seven and nine sectors of activity respectively have benefited from this financial instrument;
- (b) a leverage effect on investments, whereby the priority given to the creation of joint enterprises has encouraged an inflow of foreign capital;

- (c) the creation of 5 200 jobs, directly, in Morocco and more than 1 900 in Tunisia and Egypt. In addition, in these latter two countries, two other audited operations were able to save respectively 400 and 500 jobs which were under threat;
- (d) a selection of projects designed to improve the balance of foreign trade.

*The implementation of the Fourth Protocols*

134. Within the framework of the Third Protocols, the finance granted through the global loans, with the exception of the finance granted to the IFIs themselves, had taken the form of long-term loans offered at rates of interest below those on the local market. It was clear, at the time of the audits, that this was the main reason for their success.

135. The conditions for the allocation of finance within the framework of the Fourth Protocols demonstrate the determination to emphasise the risk capital component by encouraging participations which yield dividends, and the determination to increase the priority given to the formation of joint ventures with European partners. There were difficulties in the application of these new procedures in Morocco and Tunisia and this explains the poor utilisation of the credit lines agreed within the framework of the Fourth Protocols (see *Table 8*).



TABLE 8  
THIRD & FOURTH PROTOCOLS – RISK CAPITAL AS AT 31.12.96

(Mio ECU)

Country	Ref.	Loan Definition	Committed	Disbursed	Cancelled	Balance
ALGERIA	SEM/03/208/025/E	Direct	3,0	0,9	0,0	2,2
	SEM/03/208/026/E	Direct	1,0	0,2	0,0	0,8
TOTAL ALGERIA 3rd PROTOCOLS			4,0	1,0	0,0	3,0
MOROCCO	SEM/03/204/008/C	Global loan	9,0	9,0	0,0	0,0
	SEM/03/204/010/E	Venture capital	0,5	0,5	0,0	0,0
	SEM/03/204/011/E	Venture capital	1,5	1,2	0,0	0,3
TOTAL MOROCCO 3rd PROTOCOLS			11,0	10,7	0,0	0,3
	SEM/04/204/006/E	Global loan	20,0	10,0	0,0	10,0
TOTAL MOROCCO 4th PROTOCOLS			20,0	10,0	0,0	10,0
TOTAL MOROCCO 3rd & 4th PROTOCOLS			31,0	20,7	0,0	10,3
TUNISIA	SEM/03/212/008/E	Global loan	3,0	2,9	0,0	0,1
	SEM/03/212/013/E	Global loan	3,0	2,5	0,0	0,5
TOTAL TUNISIA 3rd PROTOCOLS			6,0	5,4	0,0	0,6
	SEM/04/212/005/E	Global loan	7,0	3,0	0,0	4,0
	SEM/04/212/016/E	Global loan	8,0	1,5	0,0	6,5
TOTAL TUNISIA 4th PROTOCOLS			15,0	4,5	0,0	10,5
TOTAL TUNISIA 3rd & 4th PROTOCOLS			21,0	9,8	0,0	11,2
EGYPT	SEM/03/220/012/E	Direct	3,0	3,0	0,0	0,0
	SEM/03/220/013/E	Global loan	3,0	0,5	2,5	0,0
	SEM/03/220/022/E	Direct	2,0	2,0	0,0	0,0
	SEM/03/220/030/E	Direct	3,0	3,0	0,0	0,0
	SEM/03/220/036/E	Direct	1,5	1,5	0,0	0,0
TOTAL EGYPT 3rd PROTOCOLS			12,5	10,0	2,5	0,0
	SEM/04/220/013/E	Global loan	6,0	0,0	0,0	6,0
	SEM/04/220/029/E	Direct	6,0	6,0	0,0	0,0
	SEM/04/220/033/E	Direct	2,5	0,0	0,0	2,5
TOTAL EGYPT 4th PROTOCOLS			14,5	6,0	0,0	8,5
TOTAL EGYPT 3rd & 4th PROTOCOLS			27,0	16,0	2,5	8,5
JORDAN	SEM/03/628/011/E	Global loan	1,0	1,0	0,0	0,0
	SEM/03/628/037/E	Global loan	1,0	1,0	0,0	0,0
TOTAL JORDAN 3rd PROTOCOLS			2,0	2,0	0,0	0,0
	SEM/04/628/012/E	Global loan	2,0	1,0	0,0	1,0
TOTAL JORDAN 4th PROTOCOLS			2,0	1,0	0,0	1,0
TOTAL JORDAN 3rd & 4th PROTOCOLS			4,0	3,0	0,0	1,0
LEBANON	SEM/03/604/009/E	Global loan	1,0	0,0	0,0	1,0
TOTAL LEBANON 3rd PROTOCOLS			1,0	0,0	0,0	1,0
	SEM/04/604/007/E	Global loan	2,0	0,0	0,0	2,0
TOTAL LEBANON 4th PROTOCOLS			2,0	0,0	0,0	2,0
TOTAL LEBANON 3rd & 4th PROTOCOLS			3,0	0,0	0,0	3,0
3rd PROTOCOLS		Venture capital	2,0	1,7	0,0	0,3
		Direct loans	13,5	10,5	0,0	3,0
		Global loans	21,0	16,9	2,5	1,6
TOTAL 3rd PROTOCOLS			36,5	29,0	2,5	5,0
4th PROTOCOLS		Direct loans	8,5	6,0	0,0	2,5
		Global loans	45,0	15,4	0,0	29,5
TOTAL 4th PROTOCOLS			53,5	21,4	0,0	32,0
		VENTURE CAPITAL	2,0	1,7	0,0	0,3
		DIRECT LOANS	22,0	16,5	0,0	5,5
		GLOBAL LOANS	66,0	32,3	2,5	31,2
GRAND TOTAL 3rd & 4th PROTOCOLS			90,0	50,5	2,5	37,0

Source: Court of Auditors.

136. In addition, because of the structure of the local SMEs, which are often family enterprises, the twin objectives of helping to increase their capital funds while encouraging the creation of joint ventures, are often difficult to reconcile with the diffidence shown towards acceptance of a foreign partner. The local authorities recommend dividing the credit lines into two parts so that some of the funds will be reserved for local sponsors who do not wish to participate in joint ventures.

### *The management of interest-rate subsidies*

#### **Introduction**

137. Non-reimbursable aid charged to the general budget of the Community as stipulated in the Protocols may be used to subsidise, up to a limit of 2 %, the rates of interest applied by the EIB to the loans it grants from its own resources. In contrast to the situation regarding risk capital, the Protocols do not mention the amounts which may be allocated in the form of interest subsidies.

138. In its Special Report No 3/91 the Court criticised the powers conferred on the EIB by the Regulation of

1986 in respect of financing decisions relating to interest subsidies. For this reason, non-reimbursable budgetary resources were mainly allocated according to the EIB's requirements. Council Regulation No 1762/92 corrected this but was not applied until the implementation of the Fourth Protocols.

#### **Audit findings**

#### *Budgetary data*

139. The implementation of the Third and Fourth Protocols in favour of the seven countries concerned by this audit resulted in total commitments, as at 31 December 1996, of 114,7 Mio ECU in commitment appropriations, of which 58,2 Mio ECU had been paid. In addition, 5,3 Mio ECU in committed appropriations, had lapsed. At the close of the accounts for the financial year 1996, the balance of appropriations committed and not paid in interest-rate subsidies for the overall budgets of the Third and Fourth Protocols came to 51,1 Mio ECU, i. e. 44,5 % of the total committed (*Table 9*).

TABLE 9  
THIRD & FOURTH PROTOCOLS — INTEREST RATE SUBSIDIES AS AT 31.12.96

(Mio ECU)

Country	Ref.	Interest Rate Subsidy			
		Committed	Disbursed	Cancelled	Balance
ALGERIA	—	—	—	—	—
EGYPT	SEM/03/220/011/B	3,0	2,8	0,2	0,0
	SEM/03/220/014/E	6,4	5,3	1,1	0,0
	SEM/03/220/015/B	0,9	0,8	0,2	0,0
	SEM/03/220/016/B	5,6	3,3	2,3	0,0
	SEM/03/220/017/B	2,8	2,1	0,7	0,0
	SEM/03/220/027/B	3,8	3,5	0,0	0,3
	SEM/03/220/029/B	1,9	1,7	0,0	0,3
	SEM/03/220/037/B	0,8	0,0	0,0	0,8
	SEM/03/220/038/B	7,9	6,3	0,0	1,5
	SEM/03/220/041/B	2,7	0,0		2,7
	TOTAL EGYPT 3rd PROTOCOLS	35,8	25,7	4,5	5,6
	SEM/04/220/001/B	1,7	0,0	0,0	1,7
	SEM/04/220/007/B	4,9	4,9	0,0	0,0
	SEM/04/220/009/B	7,4	0,9	0,0	6,5
	SEM/04/220/012/B	3,4	0,0	0,0	3,4
	SEM/04/220/023/B	5,4	2,7	0,0	2,7
	SEM/04/220/032/B	7,6	0,0	0,0	7,6
	TOTAL EGYPT 4th PROTOCOLS	30,4	8,5	0,0	21,9
	TOTAL EGYPT 3rd & 4th PROTOCOLS	66,2	34,2	4,6	27,4

(Mio ECU)

Country	Ref.	Interest Rate Subsidy			
		Committed	Disbursed	Cancelled	Balance
<b>JORDAN</b>	SEM/03/628/008/B	2,1	1,5	0,6	0,0
	SEM/03/628/009/B	1,2	1,2	0,0	0,0
	SEM/03/628/010/B	1,1	1,0	0,0	0,1
	SEM/03/628/018/B	0,3	0,1	0,0	0,3
	SEM/03/628/030/B	1,4	1,3	0,1	0,0
	SEM/03/628/034/B	0,3	0,3	0,0	0,0
	SEM/03/628/036/B	0,4	0,4	0,0	0,0
	SEM/03/628/039/B	1,0	0,9	0,0	0,1
	SEM/03/628/040/B	0,8	0,8	0,0	0,0
	<b>TOTAL JORDAN 3rd PROTOCOLS</b>	<b>8,7</b>	<b>7,5</b>	<b>0,7</b>	<b>0,5</b>
	SEM/04/628/002/B	2,3	0,4	0,0	1,9
	SEM/04/628/003/B	0,6	0,4	0,0	0,2
	SEM/04/628/004/B	0,7	0,6	0,0	0,1
	SEM/04/628/010/B	1,2	1,1	0,0	0,0
	SEM/04/628/014/B	2,0	1,0	0,0	1,0
	SEM/04/628/018/B	0,0	0,0	0,0	0,0
	SEM/04/628/020/B	2,7	1,0	0,0	1,7
	SEM/04/628/021/B	0,9	0,4	0,0	0,5
	SEM/04/628/026/B	1,5	0,0	0,0	1,5
	<b>TOTAL JORDAN 4th PROTOCOLS</b>	<b>11,9</b>	<b>5,0</b>	<b>0,0</b>	<b>6,9</b>
	<b>TOTAL JORDAN 3rd &amp; 4th PROTOCOLS</b>	<b>20,6</b>	<b>12,5</b>	<b>0,7</b>	<b>7,3</b>
<b>LEBANON</b>	—	—	—	—	—
<b>MOROCCO</b>	—	—	—	—	—
<b>SYRIA</b>	SEM/03/608/013/B	6,1	0,0	0,0	6,1
	<b>TOTAL SYRIA 3rd PROTOCOLS</b>	<b>6,1</b>	<b>0,0</b>	<b>0,0</b>	<b>6,1</b>
	SEM/04/608/001/B	6,9	0,0	0,0	6,9
	<b>TOTAL SYRIA 4th PROTOCOLS</b>	<b>6,9</b>	<b>0,0</b>	<b>0,0</b>	<b>6,9</b>
	<b>TOTAL SYRIA 3rd &amp; 4th PROTOCOLS</b>	<b>13,0</b>	<b>0,0</b>	<b>0,0</b>	<b>13,0</b>
<b>TUNISIA</b>	SEM/03/212/005/B	1,4	1,2	0,0	0,2
	SEM/03/212/006/B	1,4	1,4	0,0	0,0
	SEM/03/212/011/B	2,4	2,2	0,0	0,2
	SEM/03/212/016/B	5,4	5,1	0,0	0,3
	SEM/03/212/018/B	4,4	1,7	0,0	2,7
	<b>TOTAL TUNISIA 3rd PROTOCOLS</b>	<b>14,9</b>	<b>11,6</b>	<b>0,0</b>	<b>3,3</b>
	<b>GRAND TOTAL 3rd PROTOCOLS</b>	<b>65,5</b>	<b>44,8</b>	<b>5,3</b>	<b>15,4</b>
	<b>GRAND TOTAL 4th PROTOCOLS</b>	<b>49,2</b>	<b>13,6</b>	<b>0,0</b>	<b>35,6</b>
	<b>GRAND TOTAL 3rd &amp; 4th PROTOCOLS</b>	<b>114,7</b>	<b>58,3</b>	<b>5,3</b>	<b>51,1</b>

Source: Court of Auditors.

*Dormant commitments and monitoring*

140. An examination of the Commission's files revealed the existence of a large volume of commitment appropriations which were either tied up prematurely or represented an amount in excess of the requirements of the operations concerned.

141. This phenomenon demonstrates the weakness of the Commission's monitoring: it did not carry out the necessary controls to check whether the amount committed was justified and did not set up a procedure for the closure of completed projects at the end of each year.

*Premature tying-up of commitment appropriations*

142. Overall, the Court's examination of the Commission's accounts showed that appropriations committed and amounting to 27,5 Mio ECU remained unused over periods exceeding two years. These amounts, as *Table 10b* shows, derived from seven projects, in respect of four of which, at the time of the audit, no payments had been made.

## INTEREST-RATE SUBSIDIES – DORMANT COMMITMENTS

TABLE 10a

## Residual amounts to be decommitted

Country	2nd Protocols		3rd Protocols		4th Protocols	
	Ref.	Amount (Mio ECU)	Ref.	Amount (Mio ECU)	Ref.	Amount (Mio ECU)
Egypt			SEM/03/220/029	0,25	SEM/04/220/007	0,01
Jordan	SEM/628/02/034 SEM/628/02/035	0,10 0,07	SEM/03/628/010 SEM/03/628/018 SEM/03/628/034 SEM/03/628/036 SEM/03/628/039	0,08 0,28 0,01 0,03 0,07		
Tunisia			SEM/03/212/005 SEM/03/212/011	0,19 0,16		
Total		0,17		1,07		0,01
Grand total						1,25

TABLE 10b

## Delayed utilisation of appropriations committed

Country	3rd Protocols				4th Protocols			
	Ref.	Amount (Mio ECU)	Commitment date	First payment	Ref.	Amount (Mio ECU)	Date of commitment	First payment
Egypt	SEM/03/220/037	0,75	24.11.1992	—	SEM/04/220/009 SEM/04/220/012	7,40 3,39	1.12.1993 28.7.1994	11.7.1996 —
Jordan					SEM/04/628/002 SEM/04/628/003	2,31 0,65	29.12.1992 23.3.1993	13.2.1996 10.8.1996
Syria	SEM/03/608/013	6,10	3.5.1995	—	SEM/04/608/001	6,87	3.5.1995	—
Total		6,85				20,61		
Grand total								27,46

Source: Court of Auditors.

### Unexpended balances to be decommitted

143. The Court's review of the operations financed with interest-rate subsidies within the framework of the Third and Fourth Protocols, and also of the Second, showed that appropriations corresponding to projects for which the EIB had made the final payment and informed the Commission were still open in the Commission's accounts with unexpended balances of very long standing. In one case, the last payment was made in 1990.

144. *Table 10a* shows that eleven projects, accounting for almost 1,25 Mio ECU, fall within this category, one unexpended balance of 168 320 ECU even deriving from two commitments made under the Second Protocols with Jordan. The setting-up of a systematic procedure for the annual closure of operations would enable such a situation, where appropriations are frozen to no useful purpose and merely congest the accounts, to be avoided.

145. Audits carried out in Egypt confirmed this analysis. In two of the three projects concerned, the amount committed was, for one of them, over 700 000 ECU, or 25 % too high, and for the other it was over 250 000 ECU, or 13 % too high. In the first case the unused and unneeded funds remained blocked from March 1994 onwards, in the second, from December 1992 onwards. In both cases the funds in question were still in the account as 'restant à liquider' (still outstanding) at the end of 1995, and were carried over until 1996 and decommitted in July only in the first case.

146. In the third case, the initial EIB own resources loan was fixed at 35 Mio ECU, with an estimated interest rate subsidy of 5,6 Mio ECU. At the end of 1993, the bank decided to reduce the size of its loan to 28 Mio ECU, as the promoter had reduced the scale of the project, but did not inform the Commission of this until June 1994. The Commission, however, failed to take action at this point to reduce the funds committed for the interest rate subsidy. A balance of over 3 Mio ECU remained committed throughout 1994 and 1995, with a final payment being made in December 1995. It was not until July 1996 that the remaining funds were decommitted. Again, this project provides evidence of a lack of sufficiently close management of budgetary funds by the Commission's services. The bank should also have informed the Commission more promptly of its decision to reduce the size of its loan.

### Observations relating to the management of interest-rate subsidies

147. The findings described above demonstrate the poor quality of the controls of the justification for the amounts

requested by the EIB for interest-rate subsidies. The Commission did not ask for any explanation of the initial amount, of the reasons for the existence of an unexpended balance at the end of an operation, or, on the other hand, of the reasons which led the EIB to request an increase in the appropriations initially committed. The weakness of the Commission's monitoring is confirmed by the number of unexpended balances to be decommitted and the length of time they have been in existence.

148. Council Regulation (EEC) No 1762/92 restored to the Commission control over financing decisions relating to interest-rate subsidies. It is for the Commission to use it to ensure that the application file submitted by the EIB allows the Commission to check whether the appropriations requested are justified in principle and in terms of the amount.

149. Furthermore, the Commission should set up a procedure for the annual closure of projects and the cancellation of unexpended balances, as the Court has regularly recommended both in this and other fields<sup>(27)</sup>.

### GENERAL CONCLUSIONS

#### *Considerations relating to the system of Protocols*

150. The considerations produced by the Court on examining the implementation of the first two series of Protocols in its Special Report No 3/91, are still valid<sup>(28)</sup>.

151. The right acquired by the recipient countries to the amounts set out in the Protocols for an unlimited period has meant that a smooth progression from one Protocol to the next has not been possible and that budgetary resources have been tied up which could have been used for other purposes. At the same time, the Commission found itself obliged to manage all four series of Protocols as from 1992. This situation will persist until the appropriations allocated to the various Protocols are exhausted and will run parallel to the management of the aid governed by the MEDA Regulation. In view of this situation, the Commission plans, on the basis of the Third and Fourth Protocols, annual payments of approximately 200 Mio ECU up to 1999, with payments of smaller amounts in the years following until the appropriations are exhausted<sup>(29)</sup>.

<sup>(27)</sup> See, in particular, paragraph 3.18 onwards of the Special Report accompanying the Statement of Assurance for the financial year 1994 (OJ C 252, 30.12.1995).

<sup>(28)</sup> See Special Report No 3/91, and particularly paragraph 3.23 onwards (OJ C 252, 26.9.1991).

<sup>(29)</sup> See the remarks on Item B7-4051, general budget of the European Union for the financial year 1997 (OJ L 44, 14.2.1997).

152. The MEDA Regulation tackles the problem of the use of funds by adopting a procedure which can respond flexibly to the absorptive capacity of the recipient non-Member countries while respecting their priorities. In fact, the terms of this Regulation are such that the NMCs will no longer acquire a right to an amount from the budget but will negotiate a plan, the indicative nature of which is underlined, to run for a period of three years.

*Considerations relating to the Commission's system of management*

153. DG IB's management suffers from the inadequacy of its human resources, a lack of clarity in the division of tasks between the departments and of competences between the Commission's headquarters in Brussels and the Delegations. The powers of the Delegations should be increased to allow them to take, in good time, decisions which may prove necessary for the management of the projects. These increased powers should go hand in hand with the obligation to justify these decisions.

154. The quality of the financing agreements must be improved from a legal point of view by making provision for penalties when obligations are not fulfilled by the beneficiary, and from a technical point of view by a better description of the management bodies and of the contents of the implementation reports and the automatic inclusion of a clause providing for an evaluation when the project is 50 % complete, for a final evaluation on completion and also for an external audit.

155. The computer tools at the Commission's disposal do not allow auxiliary accounts to be kept for the projects which are directly linked to the implementation of the budget, or detailed monitoring of the projects to be carried out. The secondary commitments, which the contracts concluded when applying the FA represent, must still be subjected to manual monitoring. The Management Information System (MIS) was installed in a simplified version in 1997.

156. The cumulative effect of these various shortcomings has led to insufficient control, on the part

of the Commission, over the overall cycle of management of the projects and particularly their implementation. The rationalisation of the Commission's system of management, which began with the application of the Management Cycle Project, must be intensified and completed.

157. This situation is particularly worrying at a time when, with the adoption of the MEDA Regulation, the Commission's departments are confronted with a perceptible increase in the volume of the budget which they have to manage and which, in commitment appropriations, is approximately double that of the Protocols. To this end, amending budget No 1/96 provided for the possibility of using up to 3 % of MEDA appropriations for administrative and technical support. In addition, the change of approach under MEDA could completely upset the pattern of relations between the Community and the NMCs and exacerbate competition between the latter.

158. From the experience gained from the implementation of the Protocols (see paragraph 103), it appears that for the management of finances after the MEDA Regulation, the Commission should base its work, whenever possible, on the administrative structures in place in the NMCs and not seek to impose a preconceived standard model.

*Considerations relating to the operations managed by the EIB on behalf of the Commission*

159. The controls carried out showed clearly, in spite of the weaknesses in the set-up procedures of certain IFIs, the quality of the system established for the management of risk capital and could be awarded full marks for the results obtained. The implementation of risk capital gave rise, however, to an excessive concentration of finances.

160. The Commission's monitoring of those operations entrusted to EIB management was poor. This poor quality is displayed in the minimal use made of the informative documents sent by the EIB and, in the case of interest-rate subsidies, by the volume of dormant commitments.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 29 January 1998.

*For the Court of Auditors*

Bernhard FRIEDMANN

*President*

## COMMISSION REPLIES

## THE SYSTEM OF PROTOCOLS

*Implementation of protocols***Budgetary presentation**

21. The Commission and the Budget Authority have in preparing and establishing the annual budget, sought to maintain a balance between the proliferation and the consolidation of budget lines whilst maintaining the transparency of the objectives of actions funded.

**Community legality**

23. With respect to decisions regarding interest rate subsidies, while there is a theoretical possibility for the Commission opinion to be overruled, in fact this has never happened.

As the Court notes Regulation 1762/92 has rectified the situation.

24. Pursuant to Article 209 of the Treaty, the opinion of the Court must be obtained by the Council in three specific cases. The Commission does not consider that the MEDA Regulation comes directly under any of these headings.

However, under the terms of an agreement concluded in 1980, the Commission has the possibility of consulting the Court on any proposals involving significant changes to the techniques of financial and/or budgetary mechanisms.

In future the Commission will more systematically recommend the Council to obtain the Court's prior opinion.

*Conclusions on the system of protocols*

28. See paragraph 24.

## OPERATIONS MANAGED DIRECTLY BY THE COMMISSION

*Management and monitoring instruments***Financing agreements**

31.-33. The Commission will examine the Court's recommendations. The Commission agrees that the

financing agreements in general could have been improved and the introduction of Project Cycle Management (PCM) has led to a better definition and follow-up of the project.

Project Cycle Management training courses were organised with the assistance of outside consultants from 1992 to 1997. Project leaders have gradually learned this method of project management.

**Information technology**

34.-36. Further efforts are being undertaken to continue to develop financial management and information tools for project monitoring and control.

**Organisation and available tools**

37.-43. In the period covered by the Court's audit, the Commission's administrative structures relating to bilateral aid have changed greatly. The division of responsibilities between the headquarters and its delegations is under constant review. For tendering, contracts and local payments, the revised rules have allowed the delegations to maintain their flexibility. With the creation of MEDA teams, the delegations' ability to monitor projects will be enhanced. Within the headquarters the separation of responsibilities covering conception, resourcing, management, and evaluation of projects, has been inspired by the SEM 2000 initiative and the principles underlying project cycle management. The review of bilateral aid has led to securing extra resources for the implementation and follow-up of projects under the MEDA Regulation. Where appropriate, Commission staff have been reminded of and been provided with guidelines relating to their obligations in the management of contracts and financing agreements. The effect of the consequences alluded by the Court in its paragraph 42 will be reduced as the culture of financial discipline created by the SEM 2000 initiative gains ground.

The distribution of tasks between the geographical and technical units and the delegations is consistent with the work carried out in Directorate-General IB, which seeks to draw up new rules to establish as precisely as possible

the mode of cooperation between headquarters' departments and Commission delegations in the field of economic cooperation and development aid.

#### Schedule for the completion of projects

44.-47. With respect to the Economic Geology Project: the Commission Decision was taken on 23/3/89 and following preparatory work the Financing Agreement was sent for signature on 14/11/89 and eventually countersigned on 23.4.90. The delay of 13 months was accounted for in equal part by the need to complete administrative procedures in both the Commission and the beneficiary country.

The Commission is aware of the problem identified by the Court and has included in the proposal to amend the financial regulation that financing agreements be signed at least within the year following the year in which the Commission Decision is taken. This measure is designed to encourage the recipients to ensure their national procedures are completed within a set time-limit, when agreeing to the conditions governing the grant of aid.

46. The 'administrative technical provisions' (DTA) which are a part of a financing agreement, are often subject of difficult and sensitive negotiations with the beneficiary states notably to ensure the transparency of rules and security of Community funds.

The financing agreements which the Court refers to, were drafted in the late 80's and early 90's.

With the creation in July 1995, of the Finance and Resources Directorate, as the counter-weight required by the SEM 2000 initiative, progress has been made to standardise and complete the financing agreements and these now include most of the suggestions made by the Court.

Concerning the rules relating to tendering and contractual procedures, the Commission has issued detailed rules and guidelines to staff dealing with Community projects. These rules are updated regularly as well as when the circumstances demand.

48.-49. The Commission is aware that major construction and social infrastructure projects often have a tendency to overshoot their original cost estimates. In

the field of cooperation aid covered by preferential agreement, the project is managed primarily by the country and the Commission has taken appropriate measures to ensure that projects proceed correctly in the light of changing circumstances — economic, social and technical. Now, concerning the financing agreements, the Commission has measures in place to ensure that the expiry date is monitored with greater care, and changed to reflect the circumstances.

#### Financial management and monitoring of projects

51.-53. The Commission agrees that the progress reports should be followed with fuller effect. In keeping with the principles of mutual trust underlying the provision of external aid, the Commission endeavours to ensure that the recipient state or the financial institution monitors the amounts contributed by the recipient.

The Commission through its representative ensures that monitoring systems are updated to reflect changing requirements. Nevertheless, the Commission headquarters receives regular reports on the projects' progress. With the increased resources available under the MEDA Regulation, the Commission foresees the improvement in the follow-up of project progress reports.

52. Wherever possible, the Commission aims to use national structures to promote the concept of ownership. The introduction of six-monthly inspection visits currently planned under the MEDA programme, should considerably reinforce the monitoring of projects.

#### *Administrative and financial management*

##### Monitoring the accounts of the paying agencies

54. The Commission is aware of the problem cited by the Court and, following the creation of DG IB, has reallocated personnel to reconcile the Paying Agent accounts. Furthermore, the Commission has procedures in place to ensure that the reconciliation will, in future, be made on a quarter basis. The process to ensure that the backlog is cleared is well advanced, except for those countries where the access to information is difficult notably due to political difficulties.



### Selection of technical assistance

55. The responsibility for selection of technical assistance has now been passed to the recently created Finance and Resources Directorate of DG IB.

In separating the initiation, selection, implementation and evaluation functions, the Commission has reinforced internal control thereby ensuring procedures are not only transparent but also effective. Furthermore, new tendering procedures with revised limits have been issued to staff dealing with projects.

56.-57. See remarks for paragraph 55.

### Cash management

59. Generally, such projects are often implemented under difficult circumstances and it is essential that the project management adopts a prudent but positive approach. The work programme and cost estimates reflected this approach. During the implementation of the work programme and cost estimate, the PMU is obliged to closely control the achievements and expenditures.

60. The interest generated by loan operations could be re-used on the basis of an agreement with the administration inspired by the findings/conclusions of the six-monthly inspection visits.

### Payment of ineligible expenditure

61.-62. The Commission is sensitive to the fact that payments are made for costs which are eligible. The eligibility is determined, inter alia, by the fact that the expenditure falls due after the commitment of appropriations has been finalised. The financing agreement could therefore allow costs which were incurred between the commitment of appropriations and the operative date of the financing agreement.

The Commission agrees that for the project SEM/03/204/212, the ECU 212 000 portion of a total payment of ECU 452 488 was for aid to the section of the project which predated the signature date of the Financing Agreement. When the training, for which the grant was destined, started (September 1990), the Commission (6 July 1990) had decided to support the project and the appropriations required to fund the project had been committed already.

63. The unforeseen activity noted by the Court relates to the urgent need to control the spread of vector through the distribution, in Libya, of live but sterilised

screw worms imported from America. This activity had the agreement of the Member States and Egypt. The Commission provided ECU 700 000 from the Food Sector Development Programme (FSDP) to purchase urgently needed insecticides for the preventive control of animals along the Libyan/Egyptian border. The amount advanced was to be reimbursed by the Food Aid Counterpart Funds (FACF). The FACF Committee has authorised ECU 705 010 to be paid in Egyptian pounds into the FSDP revolving fund account.

64. The Financing Agreement has foreseen amounts of ECU 350 700 (15 % of project total less contingencies) for services provided by an international organisation and ECU 1 067 500 for the organisation's personnel and office costs. These costs have now been spread over the five projects in which the international organisation participates. With regard to the allocation of office costs, the Commission is in the process of obtaining clarification from the international organisation.

### Payment periods

65. The interest paid for late payment noted by the Court was due to the late payment of an advance due in 1991. The 158 days delay was caused by events outside the control of the Commission headquarters, which was nevertheless obliged to release the penalty in the interests of the project.

66. With regard to the 'Ground Water Investigation' in Azraq (SEM/030628/006) it has to be noted that delays in payments resulted from the payment procedure through the banking system, which issued payments to the sub-contractor in general currencies when the contract clearly stated that payments should be made in ECU.

68. With regard to the late payment referred to by the Court, following the internal procedures of the Commission it took between 42 and 53 days to process the payment request received from the National Authorising Officer.

### Evaluation and external audits

69.-71. Since the inception of the projects covered by the Court's audit, improvements have been made in the number of projects evaluated. In-depth monitoring of audit reports and mid-term and ex post evaluations of projects should now be possible, following the establishment of an evaluation unit in the departments concerned and the reinforcement of the financial unit.

Concerning audits, the Commission, faced by a constraint on personnel resources, has resorted to the use of external auditors. A systematic programme of audits, combining internal resources, project resources and external auditors, is being prepared for 1998.

In addition, the Commission is increasingly trying to include in the FA the obligation to accept external audits.

#### **Amendments to initial decisions**

72.-80. The project officers, both at the Commission's headquarters and the delegations, had adopted a pragmatic approach to implementing the financing agreement. This resulted, as the Court has noted, in them varying the conditions attached to financing agreements.

The responsibility for ensuring the appropriate approval of contractual and legal matters has been separated from the technical units and, to a substantial degree, from the delegations and handed to the Finance and Resources Directorate. In doing so, the internal control over changes to financing agreements has been strengthened. Therefore, any modification of the financing agreements must be authorised in accordance with the rules.

#### **Services provided by the technical assistance units**

81. The Commission shares the Court's opinion concerning the overall quality of the technical assistance provided to the projects.

82.-84. In one case, the consultant was replaced and, in another, the consultant was allowed to continue the contract and the matter is being closed.

#### ***Management by project leaders and the results obtained***

#### **Observations in respect of the accounts and finances**

85.-87. A programme for audit of projects for 1998 will include the points identified by the Court.

#### **The results recorded and the survival of the projects**

88. The Court has recognised the dangers inherent in development projects which require a balance between technical assistance and the creation of a culture of

dependency. The examples given in paragraphs 89-98 are a confirmation of this dilemma.

89. When the plant was due to be handed over to GOSD it became evident that GOSD needed institutional support for a limited time in order to build up its capacities to manage a plant at this point of the Helwan scheme. This was approved by the Commission and a complementary financing of ECU 3 million was made available for this task. The shortcomings of GOSD noted by the auditors were recognised at the time and measures were taken to improve their management capacity.

90. It is not unusual that the staff (mainly paid by the contractors) running and maintaining the plant during the testing period are unwilling to become government employees. This is the reason why GOSD needed technical assistance (TA) support for an intermediate period after withdrawal of the contractors and change of responsibility from government level to municipal level. Such a transition period is critical and the Court's auditors visited the project just at this moment. The situation has settled down since then, and the controlled phasing out until 1998 of TA support is in progress. The question of water pricing is highly sensitive politically and could not be addressed specifically within the project. However the EC, together with other major donors have raised it with the GOE.

93. The Commission will follow up to ensure that control over stocks and equipment is improved.

94.-96. See general reply for 88.

#### ***Conclusions in respect of the management of projects***

99. The special report 3/91 and the replies to it have formed the basis of a major revision of the Commission procedures in dealing with aid given to the Mediterranean countries. All the undertakings given by the Commission could not be fully implemented on projects that are funded by the third and fourth protocols, because they were already in progress when the report was drafted; they have nevertheless been followed for the MEDA projects.

100.-102. The shortage of human resources, underlined by the Court have, to an extent, been made good by the budgetary provisions accompanying the MEDA programme. The revised Commission structures' impulse by SEM 2000, has led to a clarification of responsibilities, the separation of duties and the establishment of clearer rules on the management of projects.

The necessary improvements will be continued by increasing the Commission's capacity to evaluate and audit projects, further developing the computer systems permitting the accounting and financial monitoring of projects as well as devoting appropriate resources to the expansion of the technical follow-up of projects.

101. See paragraphs 34-36 and 37-43.

103. The Commission notes the Court's observations regarding the definition of the management systems. This has now become an essential point to be treated in detail in the examination of projects phase and should also be included in the FA.

The Commission generally seeks to use national administrations to implement projects, adapting the proposed system to the capacities of the administration.

As part of the process of setting up Meda, the Commission is establishing the necessary instruments to facilitate project management and negotiating framework agreements with each Mediterranean partner, which determine the statutory framework and the administrative arrangements for implementing projects and programmes. Starting from a common base, they will take account of various proposals and specific situations of the non-member Mediterranean countries.

#### THE MANAGEMENT OF OPERATIONS ADMINISTERED BY THE EIB ON BEHALF OF THE COMMISSION AND THEIR AUDIT

##### *General presentation of the audit*

107. The Commission and the EIB are careful to follow up the Court's requests.

At the time of the annual planning discussions with the representative of the Court responsible for coordinating the audits of projects administered by the EIB, the EIB Audit Committee expressed the wish that there should be a balanced distribution of visits throughout the year and that the programme should take account of local administrative differences and public holidays. Such planning is quite usual for two audit bodies.

The Audit Committee is always willing to organise visits jointly when requested in accordance with the Tripartite Agreement between the institutions, sometimes at very short notice, depending on the country.

In addition, to enable the Court to draw the maximum benefit from on-the-spot visits, information meetings are always organised in advance.

##### *The system of risk capital management*

##### **The purpose of risk capital and conditions of eligibility**

110. The interpretation of the terms for granting risk capital is compatible with the objectives of this type of assistance. The terms for each project are submitted for approval to the Article 9 Committee (representatives of Member States' governments and a representative of the Commission), in accordance with the regulations.

##### **Description of the management system**

##### *Financing procedures and contractual framework*

114. a) Although the observation may be true of certain operations under the third protocol, it does not apply to most of the operations under the fourth protocol.
- b) In general, the risk of exchange losses is charged to the Community (see second subparagraph of Article 3(1) of the management agreement between the Commission and the EIB of 16 June 1987 and 17 December 1992). It is inherent in the nature of capital acquisition transactions.

##### *Appraisal and monitoring of projects*

117. Another usual method is a global loan for which appraisal is delegated and the EIB retains the powers of decision, whether own resources or risk capital are involved.

##### **The Court's observations at the conclusion of the audit**

##### *Appraisal of the projects*

122. The weakness was identified by the EIB, which reacted by giving more weight to the companies' technological or commercial contribution than to their straightforward capital injection, which has too often proved to have little impact in the medium term.

123. The EIB is familiar with the problem, which demonstrates the importance of boosting own funds with risk capital.

124. The EIB carries out regular inspections and notes the progress made by the IFIs in this respect.

*Concentration of aid*

126. It should be noted that in Morocco nearly all the banks use the credit line. Given the great demand for project funds in Morocco, it is efficient and normal that the IFF's own clients introduce suitable projects. This does not preclude others from introducing their projects.

127.-130. When launched by the Community and the EIB, the availability of global loans for the SME sector had been an innovative activity. In the development context, it has not been easy to identify suitable projects presented by financially stable SMEs wishing to borrow in foreign exchange. At the time, some of the IFF's did not have the experience to extend funds under the credit line to SMEs, though this appears to be changing over time.

A further reason why the take-up rate of global loans has been low has been the exposure to exchange risks and vagaries of export markets, together with conditions prevailing in the local environment which was characterised by a low growth of GDP and abundance of other funds.

The Mediterranean companies normally receive revenues in local currency. The loans offered at very favourable rates have been counterbalanced by the exposure to exchange risk and business risk inherent to the SME sector.

In light of the above experience, the EIB cancelled ECU 17,4 million of the own resources loan. Of the ECU 3 million risk capital, only ECU 0,52 million was disbursed and the remaining ECU 2,48 million cancelled. The Community financial interest was therefore safeguarded.

*Overall monitoring of the operations by the EIB*

131. It has been confirmed that monitoring is being stepped up.

*Implementation of the fourth protocols*

135. It is now clear that the concept of joint ventures needs to be more flexible. The definition has been extended to include all forms of cooperation without necessarily entailing joint participation in capital, thus speeding up the utilisation of credit lines.

Clearly under the new procedures the loans are less open-ended: this reflects the normal evolution of the financial market which is becoming more mature and

open to the gradual introduction of new instruments. The EIB considers that its role is to encourage the expansion of the range of financial products on offer for SMEs.

136. Support for promoters without foreign partners is included in the new guidelines for the Euro-Mediterranean partnership policy, designed to make SMEs in non-member Mediterranean countries more competitive following the elimination of customs protection planned in the new association agreements.

*Management of interest rate subsidies**Audit findings**Dormant commitments and monitoring*

140.-142. The recent installation of a systematic information system will lead to improved information about interest rate subsidies.

As part of its periodic review of sleeping and slow moving commitments, the Commission has re-examined projects covered by the Court's audit to determine their continued financial needs. Following its review, the Commission has closed off or revised the projects examined by the Court and decommitted the funds surplus to requirements.

*Observations on the management of interest rate subsidies*

147.-148. See reply in paragraphs 140 to 142 above.

**GENERAL CONCLUSIONS***Considerations relating to the system of protocols*

150.-152. The Court correctly notes that experience in implementing the Mediterranean protocols was taken into account in Council Regulation No 1488/96 MEDA. The framework for the Euro-Mediterranean partnership provides for financial and technical measures relating to reforms of the economic and social structures of its Mediterranean partners.

*Considerations relating to the Commission's system of management*

153.-158. With the rapid development of the Mediterranean policy, the shortage of human resources has become felt. Nevertheless, the Commission has, through reorganisation, redeployment and reinforcement

of project management, sought to use its resources effectively and efficiently.

This process will be refined further through the creation of a joint administrative service which was decided by the Commission on 15 October 1997. The division of responsibilities and separation of tasks between the headquarters and delegations and within Brussels between the technical and service units, is being reappraised.

These developments have been accompanied with a clarification of rules and procedures on contract and financial management. Finally, the resources available to evaluation and audit activities are being increased both quantitatively and qualitatively.

Following experience from the conception and implementation of the protocols, the Commission has

taken necessary measures to ensure that the follow-up of MEDA projects is not constrained but carried out with care.

*Considerations relating to the operations managed by the EIB on behalf of the Commission*

159. Over 200 beneficiaries have profited from the third and fourth protocols, except for the situation outlined in replies to paragraphs 127-136, where the Community's financial interest needed safeguarding, there has not been an excessive concentration of funds awarded.

160. The Commission is reviewing its procedures with the EIB and has, in the meanwhile, reinforced the resources available to ensure closer monitoring of the flow of information between the two institutions.

---