



EUROPEAN COMMISSION

Directorate-General Enlargement

DG ENLARGEMENT

Annual Activity Report 2010

PART 1. POLICY ACHIEVEMENTS

The overall objective of enlargement policy is to implement Article 49 of the Treaty on European Union offering a European perspective to all European countries that respect the fundamental values of the EU and are committed to promoting them. Enlargement policy serves to promote stability, security and prosperity in Europe and to increase the influence of the EU. The enlargement process itself contributes to the objectives of the Europe 2020 strategy by extending the area of the EU's regulatory framework and creating new trade opportunities.

Progress towards this overall objective is measured through the policy's impact on those candidate countries meeting the political, economic and EU *acquis* criteria for accession and on potential candidate countries as they come closer to the standards of the EU. The applications for membership over recent years by the former Yugoslav Republic of Macedonia, Montenegro, Albania, Iceland, and Serbia, as well as the final stages of accession negotiations reached by Croatia, illustrate the overall good progress made and demonstrate the EU's power of attraction.

The specific objectives of DG Enlargement are to advance the enlargement process and develop a coherent enlargement strategy; to support candidate countries' accession processes, including financial assistance; to support the Stabilisation and Association Process in potential candidates, including financial assistance; to enhance regional cooperation; to provide support to the economic development of the Turkish Cypriot community; to complete post-accession financial assistance in the new Member States, and to implement a communication strategy aimed at ensuring public support for the enlargement agenda. It has, in this respect, met its policy objectives in 2010.

At the Sarajevo EU-Western Balkans ministerial meeting on 2 June 2010, the EU reiterated its unequivocal commitment to the European perspective of the Western Balkans: that the future of the Western Balkans lies in the European Union. The European Council of 14 December 2010 endorsed the General Affairs Council's conclusions on enlargement¹, which reaffirmed the strong support of the EU for taking the enlargement process forward on the basis of the agreed principles.

The EU has continued to improve the quality of the enlargement process, using the lessons learned from previous enlargements. DG Enlargement has, in particular, put greater focus on measures to improve the rule of law, to ensure good governance and to strengthen efforts of the candidate and potential candidate countries to fight corruption and organised crime.

The economic crisis has affected all enlargement countries. Its impact, however, varied depending on each country's economic structure. The economic crisis had a negative impact on social welfare in the enlargement countries, especially on vulnerable groups, including minorities, disadvantaged communities and people with disabilities. The EU, together with the international financial institutions, has helped to alleviate the impact of the crisis. IPA assistance was reprogrammed to support investment in infrastructure and competitiveness. Budget support and macro-financial assistance were made available to some countries. The Western Balkans Investment Framework plays an important role in mobilising funds for large infrastructure projects.

¹ 3060th General Affairs Council meeting, Brussels, 14 December 2010.

The Commission actively supported the enlargement countries' endeavours towards economic recovery, macroeconomic stabilisation and fiscal consolidation. Substantial IPA assistance is targeted at improving public finance management, increasing the quality of statistics, and strengthening banking sector supervision. Many enlargement countries stated their intention to reflect the Europe 2020 strategy in their national reform priorities.

Overall, the Western Balkans have moved closer to the EU over the past year, as the region made progress, albeit unevenly, in reforms and in meeting established criteria and conditions. The progress of Croatia confirms that the Stabilisation and Association Process for the Western Balkans is a policy leading to EU accession. The December 2010 European Council agreed to give Montenegro the status of candidate country. Progress of the other countries of the Western Balkans towards EU membership depends, similarly, on the pace of their political and economic reforms.

Substantial progress was made towards visa liberalisation. Over the past year the EU has lifted visa requirements for Bosnia and Herzegovina, and Albania when they demonstrated their capacity to meet the benchmarks which had been set in the areas of security of travel documents, border management, migration, asylum, public order and security, as well as respect for human rights. It is important that these countries intensify their efforts to inform their citizens about the scope and limits of the visa-free regime. Steps have also been taken to reinforce post visa-liberalisation monitoring mechanisms.

Progress of the candidate countries, and the potential candidates, towards meeting the conditions for accession and the terms of the Stabilisation and Association Agreements, respectively, was carefully monitored and assessed. The findings were published in November 2010 in the document "Enlargement Strategy and main challenges 2010-2011" and the accompanying progress reports². The findings and recommendations of this Commission Communication were broadly endorsed by the General Affairs Council in December 2010.

On a country-by-country basis, the following developments can be reported:

EU accession negotiations, which began with **Croatia** in October 2005, have reached the final phase. Croatia has continued to make good progress towards meeting the criteria for membership. Out of 35 negotiating chapters, 28 have been provisionally closed.

EU accession negotiations with **Turkey**, which began on 3 October 2005, have moved forward, albeit at an uneven pace. Negotiations are now in a more demanding phase, requiring a new impetus for reform. Thirteen out of 33 negotiation chapters have been opened so far, while one chapter has been provisionally closed. Benchmarks conditional for opening negotiations on 14 chapters have been set.

The Commission, in November 2010, reiterated its recommendation that EU accession negotiations be opened with the **former Yugoslav Republic of Macedonia**. The Council has not yet taken a position on the matter. The Commission, in its annual progress report, noted progress in key reforms although at an uneven pace. The former Yugoslav Republic of Macedonia has been a candidate country since December 2005.

Conferral of Management powers for IPA pre-accession funds to national agencies of the former Yugoslav Republic of Macedonia was granted for the regional development, social development and rural development components in 2009 and for the technical assistance and institution building component in December 2010.

² See in http://ec.europa.eu/enlargement/press_corner/key-documents/reports_nov_2010_en.htm.

Following **Albania's** application for EU membership, and the subsequent request from Council, the Commission issued its Opinion on Albania's application, in line with Article 49 of the Treaty on the European Union, on 9 November 2010. The Opinion concluded that Albania has made progress towards meeting both the political and economic criteria set by the Copenhagen European Council and the conditions of the Stabilisation and Association Process and that Albania would be in a position to take on the obligations of membership in the medium term in most of the *acquis* fields. The Commission considers that negotiations for accession to the European Union should be opened with Albania once the country has achieved the necessary degree of compliance with the membership criteria. The Opinion identified key priorities and other challenges which remain to be addressed in order for the country to achieve the necessary degree of compliance with the membership criteria and, in particular, the Copenhagen political criteria in view of opening EU accession negotiations.

The Stabilisation and Association Agreement (SAA) between the EU and Albania, which entered into force in April 2009, was, on the whole, implemented smoothly in 2010. In the framework of a visa liberalisation dialogue, the Council lifted the visa requirement for Albania's citizens for travel to the Schengen area in November 2010.

Bosnia and Herzegovina made little progress in 2010. The domestic political climate did not improve and the lack of a shared vision by political leaders on the direction of the country continued to block key reforms and further progress towards the EU. Some progress related to the rule of law, notably in areas such as border management and migration policy, was made through reforms aimed at meeting visa liberalisation requirements. The visa requirement for Bosnia and Herzegovina's citizens for travel to the Schengen area was lifted by Council in November 2010.

Bosnia and Herzegovina has made little further progress towards a functioning market economy. Considerable reform efforts must be pursued with determination to enable the country to cope over the long term with competitive pressure and market forces within the Union. As far as European standards are concerned, the country needs to intensify its efforts in many areas.

EU-**Montenegro** relations developed further during 2010. The Stabilisation and Association Agreement (SAA) entered into force in May 2010 and the country's track-record in implementing its obligations under the SAA is positive.

Following Montenegro's application, in December 2008, for EU membership and the subsequent request from Council, the Commission issued its Opinion on Montenegro's application in November 2010. The Commission Opinion concluded that Montenegro has made progress towards meeting the political and economic criteria set by the Copenhagen European Council and the conditions of the Stabilisation and Association Process. Montenegro should be in a position to take on the obligations of membership in the medium term in most of the *acquis* fields. The Commission considered that negotiations for accession to the European Union should be opened with Montenegro once the country had achieved the necessary degree of compliance with the membership criteria. The Commission Opinion identified key priorities and other challenges which need to be addressed in order for the country to achieve the necessary degree of compliance with the membership criteria and, in particular, the Copenhagen political criteria in view of opening EU accession negotiations. In recognition of the country's progress, the European Council granted candidate country status to Montenegro in December 2010.

Serbia has made progress in 2010 in meeting the political criteria. The Interim Agreement entered into force in February 2010 and Serbia progressed in complying with the Stabilisation

and Association Agreement (SAA) requirements. The ratification process of the SAA was launched in June 2010. Despite the active on-going cooperation of Serbia with the International Criminal Tribunal for the former Yugoslavia (ICTY), the two remaining ICTY fugitives, Ratko Mladić and Goran Hadžić, remain at large.

The Council, in 2010, requested the Commission to prepare an Opinion on Serbia's EU membership application (of December 2009).

Kosovo³ strengthened its commitment to the European agenda in 2010. However, the capacity of the public administration remains weak and rule of law remains a serious concern. The Commission has, in 2010, taken forward the initiatives outlined in its October 2009 Communication on Kosovo. In 2010, the International Court of Justice (ICJ) issued an advisory opinion which concluded that Kosovo's declaration of independence did not violate general international law or Security Council Resolution 1244/1999. Following up on this opinion, the UN General Assembly adopted a resolution aiming to open the way for a process of dialogue between Pristina and Belgrade to promote cooperation, achieve progress on the path to the European Union and improve the lives of the people.

Following **Iceland's** application for membership and a request from Council, the Commission issued its Opinion in February 2010 recommending that EU accession negotiations should be opened. Following the Commission's opinion, the Council decided in June 2010 to open accession negotiations with Iceland. In July 2010, the Negotiating Framework was adopted and accession negotiations were formally opened at the first intergovernmental conference on the accession of Iceland to the European Union. The Commission's Progress Report in November 2010 reaffirmed that Iceland meets the political criteria and that the country has strong institutions and deeply rooted traditions of representative democracy.

Over the last decade, there has been substantial progress in the Western Balkans towards stability and **regional cooperation**. However, a number of issues stemming from conflicts in the region remain open. Regional cooperation has, in particular, been held back by differences over Kosovo. The EU is working with parties in the region to overcome this legacy of the past. Progress on reconciliation is a key element for stability in most countries and requires efforts at all levels – governments, judiciary and civil society. There have recently been a number of positive signals: the Serbian parliament adopted a declaration condemning the crime in Srebrenica, referring to the International Court of Justice ruling on Srebrenica; NGOs have launched an initiative to establish a regional commission for truth-seeking and truth-telling, supported by the Presidents of Croatia and Serbia, by the Montenegrin parliament and religious communities; there have been positive developments on the refugee return issue initiated by the Sarajevo Process. A ministerial conference, held in March in Belgrade, reopened the dialogue between the governments concerned.

The region has taken steps to strengthen regionally owned structures. The Regional Cooperation Council (RCC) has a key role in guiding and monitoring regional cooperation. The RCC adopted an ambitious strategy and work programme for 2011-2013. The Regional School of Public Administration (ReSPA) officially opened its premises in Danilovgrad (Montenegro) on 11 November 2010. It is fully operational and currently delivering around 2,500 training days per year.

There have also been positive developments recently on judicial cooperation in several Western Balkan countries. New bilateral agreements on police cooperation, notably between Serbia and Albania, on mutual legal assistance and mutual enforcement of sentences in penal matters have been concluded. Croatia and Serbia went further, signing an agreement enabling

³ Under United Nations Security Council Resolution 1244/1999.

them to extradite their nationals to each other for criminal proceedings or enforcement of prison sentences in cases of organised crime and corruption. The Regional Cooperation Council strives to enhance cooperation between the police, prosecution services and the judiciary.

The financial dimension of regional cooperation has made progress. The Western Balkans Investment Framework (WBIF), the European Fund for South-East Europe (EFSE) and the Green for Growth Fund (GGF) are good examples of leveraging a high level of capital inflow with limited public resources. The WBIF was set up in December 2009 as a joint initiative of the Commission and partner IFIs to channel investments into infrastructure in the region. It leverages significant loans from the IFIs with IPA grants. €136 million of grants have been attributed that could leverage investments for an estimated value of €6.6 billion in areas such as water and waste water projects, energy efficiency, the European core transport network, the development of SMEs, and mechanisms to encourage economic growth in the aftermath of the financial crisis.

With regard to the **Cyprus issue**, the leaders of the Greek Cypriot and of the Turkish Cypriot communities continued negotiations on a comprehensive settlement under the auspices of the United Nations. The Commission supported their efforts and provided technical advice on issues within EU competence, calling on both leaders to strengthen their efforts to bring the settlement talks to a successful conclusion as soon as possible and reiterating its call on Turkey to contribute in concrete terms to a comprehensive settlement of the Cyprus issue. DG Enlargement continued to implement the specific programme aimed at promoting the economic development of the Turkish Cypriot community and bringing it closer to the EU. The “Direct Trade” Regulation remained blocked in Council.

The implementation of old **PHARE** programmes and Transition Facilities in the 12 new Member States is drawing to a close, and final payments are expected to be made in early 2011. Nevertheless, following the reservations it filed in the 2007 and 2008 AARs concerning weaknesses found in two Bulgarian implementing agencies, DG Enlargement continues to devote significant management effort to the careful processing of final declarations still outstanding, including the issuance of major recovery orders.

DG Enlargement successfully implemented its information and communication strategy aimed at ensuring public support for the enlargement agenda in the candidate countries, and potential candidates, as well as in the current Member States.

Information and communication initiatives included various events in major cities in the more enlargement-sceptical countries. These gathered several thousand participants and generated significant media coverage. Two large pan-European projects enabled students and young journalists from across the EU and the region to exchange their views on enlargement.

To publicise the adoption of the enlargement package in November 2010, Commission Representations in the Member States and Delegations in the candidate countries and potential candidate countries organised events, conferences or debates with stakeholders and the general public. “Enlargement Ambassadors” travelled to 13 member states. Travelling exhibitions on the region were displayed in five cities. An article by Commissioner Füle was placed in 19 leading newspapers across 16 EU member states and in all enlargement countries. The achievements of pre-accession assistance under IPA were emphasised through the release of 33 case studies on selected projects, fact sheets on the WBIF, and the production of a video clip on IPA. The annual IPA conference in December 2010, which gathered 400 participants from EU Member States, IFIs and other donors, IPA beneficiary

countries and civil society organisations, was also used to highlight the benefits of the EU's assistance.

Management of financial assistance to candidate countries and potential candidate countries progressed largely as planned. In 2010, DG Enlargement committed funds totalling **€976.1 million** and made payments for a total of **€1,034.5 million**. This represents 99% of the total commitment appropriations and 98.5% of the total payment appropriations available to the DG in 2010⁴.

Difficulties experienced in different areas of implementation led DG Enlargement to return €77.5 million in payment credits to the global budget. Measures and tools designed to ensure more accurate forecasts and an earlier reaction to events affecting them continued to be deployed and pursued at the highest management level.

Outstanding commitments from the current and previous years amounted to **€2,734.1 million** at the end of 2010 (compared with €3,203.4 million at the end of 2009). Decommitments reached €314.3 million (against a target of €80 million minimum). 'Potentially abnormal' outstanding commitments⁵ were reduced by €182 million, and reached the comparatively low value of €113.8 million.

The EU Delegations in the Western Balkans, some of which had earlier taken over financial assistance duties from the European Agency for Reconstruction (EAR), stabilised their resources and structures. The contracting performance was satisfactory and limited the build-up of backlogs across Western Balkan beneficiaries. Nevertheless, the challenges posed by the weakness of some national administrations endure. DG Enlargement continues to implement measures designed to tighten the monitoring of financial implementation and simplify the delivery of assistance.

Pre-accession financial assistance is designed to prepare the beneficiary countries for the requirements of EU accession and bring tangible benefits to their citizens. Successful examples of this in 2010 include the completion of the civil registry in Albania, a pre-condition for visa liberalisation and for the organisation of elections. In Bosnia and Herzegovina, projects which delivered tangible benefits included mine clearance, the establishment of an agriculture information system, and the efficiency of prison management. The closure of a lead-contaminated Roma camp in Kosovo and the relocation of families concerned was a significant success after years of controversy. In Montenegro an important by-pass was completed which will greatly reduce traffic jams and pollution in Podgorica. In Serbia, further support to refugees and internally displaced people provided accommodation and employment to families in four different municipalities.

The European Fund for Southeast Europe (EFSE), established by the European Commission and partner IFIs, was awarded the first prize in a competition for best models for sustainable SME financing at the G-20 summit in Seoul. The Instrument for Pre-accession Assistance (IPA) contributes approximately €10 million annually to the fund, generating on average €70 million loans to SMEs in the Western Balkans, where the fund has the bulk of its operations.

⁴ Comprising the appropriations voted by the Budgetary Authority for the year (appropriations of type C1), but also assigned revenue (appropriations of type C4 and C5) arising, for example, from amounts of pre-financing recovered.

⁵ Estimate of the value of the outstanding commitments which have not been de-committed, but almost certainly should have been. It comprises commitments for which the final date of implementation expired more than 6 months ago, and commitments for which no payment has been made in the last two years.

The average micro-loan is €4,000, and since 2005 over 100,000 companies or entrepreneurs have received its loans.

The implementation of projects in the context of the €259 million aid programme for the Turkish Cypriot community has continued at a good pace, however, the legal and practical problems stemming from the particular situation on the island continue to represent a significant challenge and source of risk.

Demand for the institution building instrument TAIEX has increased, notably in neighbourhood countries (particularly Ukraine) and in support of the Turkish Cypriot community programme. TAIEX organised 1,958 events (15% more than in 2009). The largest user is now the Turkish Cypriot community, followed by Turkey and the former Yugoslav Republic of Macedonia. Workshops remain the most important type of TAIEX assistance, representing almost half of all events.

In the candidate countries where the implementation of pre-accession assistance is decentralised to national authorities (Turkey and Croatia), the progress made by these national systems continued to be mixed. In Croatia, the authorities have continued to strengthen the management and control systems for IPA funds, and the rate of rejection of files prepared by these systems has fallen significantly. By the end of 2010, Croatia has taken over responsibilities for the whole project cycle in the IPA Component for Technical Assistance and Institution Building except for the closure of decentralised programmes, which will be inaugurated in 2011. In nearly all components where *ex ante* controls are still applied, the line Directorates General concerned have entered into dialogue with the Croatian authorities based on roadmaps on the conditions for the waiver of *ex ante* controls for their respective IPA component.

In Turkey, some progress was recorded in key decentralised bodies as regards major weaknesses noted earlier. Nevertheless, some conditionalities remain unmet, and rejection rates, albeit declining slightly, remain too high. Weaknesses remain in major sections of the decentralised system, in particular concerning programming, monitoring of implementation, and general absorption capacity. The EUD conducts its own monitoring plans, mitigating the risk.

In 2010, DG Enlargement conducted programme-level 'Country Programme interim Evaluations' (CPiE) in Croatia, Turkey and the former Yugoslav Republic of Macedonia. In connection with the conferral of management authority, these evaluations also assessed beneficiaries' own capacity building in the fields of monitoring and evaluation.

The evaluations found the programming of financial assistance to be of mixed quality. Findings included a need to strengthen the intervention logic in Multi-annual Indicative Planning Documents (MIPDs), National Programmes and projects, to improve and further develop indicators to measure results and impacts, and to enhance beneficiaries' own programming and assessment capacity.

Interventions were assessed as generally relevant; but there was a need to develop mechanisms for furthering cost-effectiveness and prioritising project proposals. Overall, evaluations reported that the delivery of outputs and attainment of immediate results and impacts were effective. *Acquis* related interventions were seen as generally effective, and their mid-term impact prospects were positive. However, sustainability was uncertain, mainly owing to a short supply of appropriately qualified personnel, high staff turnover, and insufficient ownership and political support in specific policy areas.

An evaluation covering all intra-Western Balkan cross-border programmes (CBC) was concluded in 2010. It found CBC programming documents to reflect well the objectives of the pre-accession national strategies. Needs assessment, strategy, and indicators and objectives were generally coherent. While the selection process for interventions worked well, shorter, simpler procedures were needed. Regarding the performance of assistance, the report found established, working management structures, but with differences between programmes and some weaknesses (mostly relating to Joint Monitoring Committees) liable to undermine the efficiency of the delivery of assistance.

Furthermore, in 2010, DG Enlargement contracted a mid-term meta-evaluation of IPA, designed to provide a consolidated, comprehensive and comparative assessment of the intervention logic used in planning, programming and managing IPA assistance, as well as to evaluate its overall performance. This overarching exercise is based on evaluations carried out earlier: CPiEs, specific strategic and interim country evaluations of potential candidates, and evaluations of regional and multi-beneficiary programmes, as well as additional evaluations under Components II to V. The report is expected in 2011.

In light of lessons learnt, in 2010 DG Enlargement pursued efforts to move pre-accession assistance increasingly from a project-based to a more strategic approach in order to leverage its overall impact further.

In March 2010, a mid-term assessment of the strategic documents of pre-accession assistance (MIPDs) concluded that the policy priorities for assistance remained valid: the MIPDs were consequently not modified in 2010. In parallel, steps were taken to prepare for a sector-based approach to be introduced in the MIPDs for the period 2011-2013. The aim is to enhance the link between financial assistance and country strategies, the EU Enlargement Strategy, and EU overarching policies such as the EU 2020 Strategy.

As an intermediate step, in 2010 IPA programming was streamlined, with fewer, larger projects designed to make implementation easier to manage and increase its effectiveness and visibility. In line with the enlargement strategy, the main focus continued to lie on Institution Building, in particular for areas related to rule of law. Socio-economic development remained an important priority in the light of the continued impact of the economic crisis on the budgets of IPA beneficiaries, particularly in the Western Balkans.

The IPA Council Regulation (EC) 1085/2006 of 17 July 2006 was amended in June 2010 in order to include Iceland as a beneficiary of IPA assistance. The Multi-Annual Financial Framework (MIFF) was revised in November 2010 as part of the Enlargement Strategy: the main changes reflect the inclusion of Iceland in IPA, and the transfer to DG REGIO of the management of the funds for the participation of the Western Balkans in the transnational programmes Mediterranean Region and South East Europe, complementary to ERDF funding.

The December 2010 IPA Conference, organised in partnership with the World Bank, highlighted the need for further work for an inclusive approach to socio-economic development and preparation for future EU membership in close coordination between the EU, the IPA beneficiary countries, and the international donor community. The conference confirmed the importance of cross-border cooperation as a tool for regional cooperation and good neighbourly relations in the Western Balkans.

PART 2. MANAGEMENT AND INTERNAL CONTROL SYSTEMS

2.1 Introduction to DG Enlargement

DG Enlargement is both a political and a spending department. It has the responsibility for defining and implementing the accession strategy and for managing pre- and post-accession assistance in (currently) five candidate countries, four potential candidates and (residually) 12 post-accession Member States. Both types of activities are closely interlinked.

DG Enlargement's political objectives are linked to the preparation for accession (in candidate countries and potential candidates) or to the successful completion of the reform and transformation process after accession (in the new Member States). DG Enlargement has the overall responsibility for EU pre- and post-accession assistance.

Pre-accession assistance is delivered through the Instrument for Pre-Accession Assistance (IPA) which came into force on 1 January 2007. Under this instrument, the link between the political priorities and the programming of financial assistance in support of these priorities is detailed in the Multi-Annual Indicative Planning Documents (one per country, one for the multi-beneficiary programme and, from 2011, a separate one for cross border cooperation) which give a three year strategic perspective and are reviewed annually.

IPA is split into five components. DG Enlargement leads in the coordination of the instrument as a whole and manages component I (Transition Assistance and Institution Building) and part of component II (Cross-Border Cooperation). DG REGIO manages the part of component II under shared management with Member States and is responsible for component III (Regional Development). DG EMPL is responsible for component IV (Human Resources Development); and DG AGRI has responsibility for component V (Rural Development).

Assistance to the northern part of Cyprus is delivered through the Turkish Cypriot community aid regulation. During 2011 DG Enlargement will continue to manage other assistance programmes under previous legal arrangements.

DG Enlargement implements its budget in complex circumstances which create specific risks and require a broad variety of controls and audits. Risk factors are *inter alia*:

- different levels of intervention (national, regional, bilateral);
- a multitude of sectors and line ministries involved in the beneficiary countries;
- an implementation environment which is constantly changing in line with the progress made by the candidate countries and potential candidates;
- many different modes of implementation (including the use of many different award / procurement rules).

Pre- and post-accession assistance is implemented through a variety of management modes which take into account the different levels of preparedness of the beneficiary countries. The following management modes and sub-modes can be distinguished:

- Centralised direct – central: funds are managed by DG Enlargement at headquarters.
- Centralised direct – de-concentrated: funds are managed by EU Delegations under the supervision of DG Enlargement.
- Centralised direct – cross-delegated: funds are managed by another service of the Commission through cross sub-delegation.
- Centralised indirect – funds are managed by executive agencies (in the case of DG Enlargement funds, the Executive Agency for Education, Culture and Audiovisual -

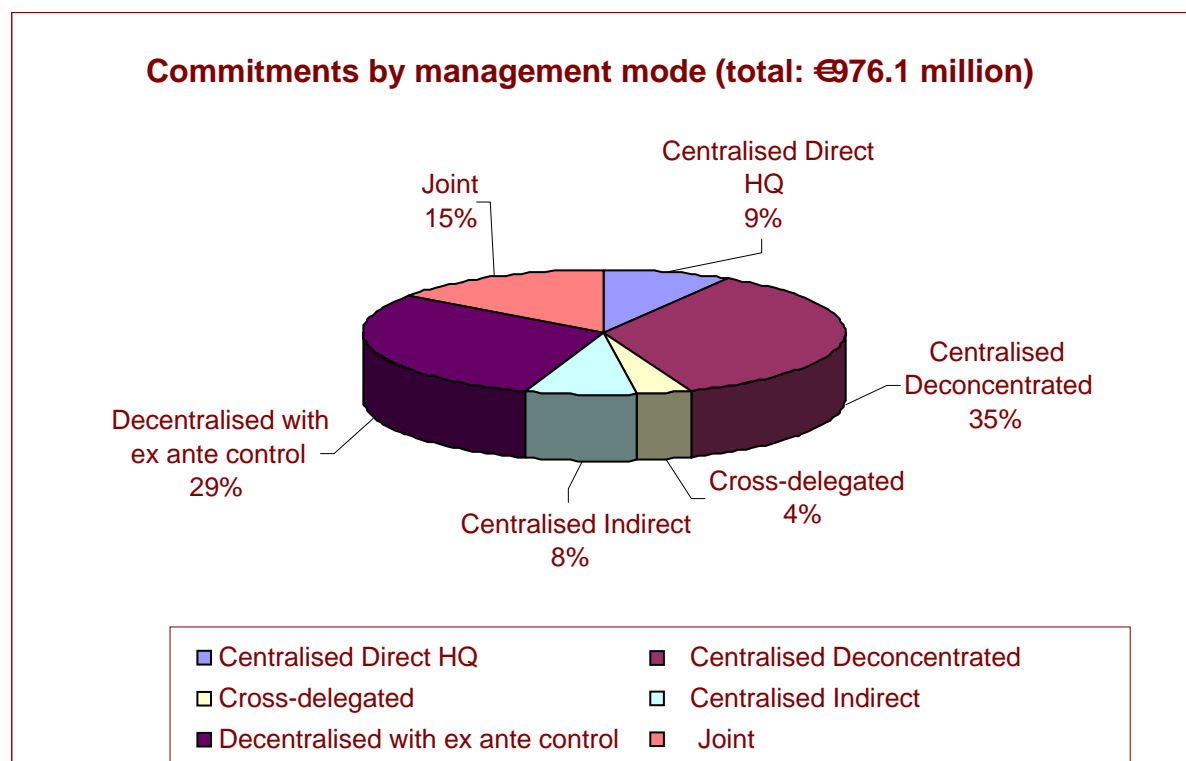
EACEA), specialised Community bodies (such as the European Investment Bank or the European Investment Fund), and national or international public-sector bodies or bodies governed by private law with a public-service mission (such as GIZ and KfW).

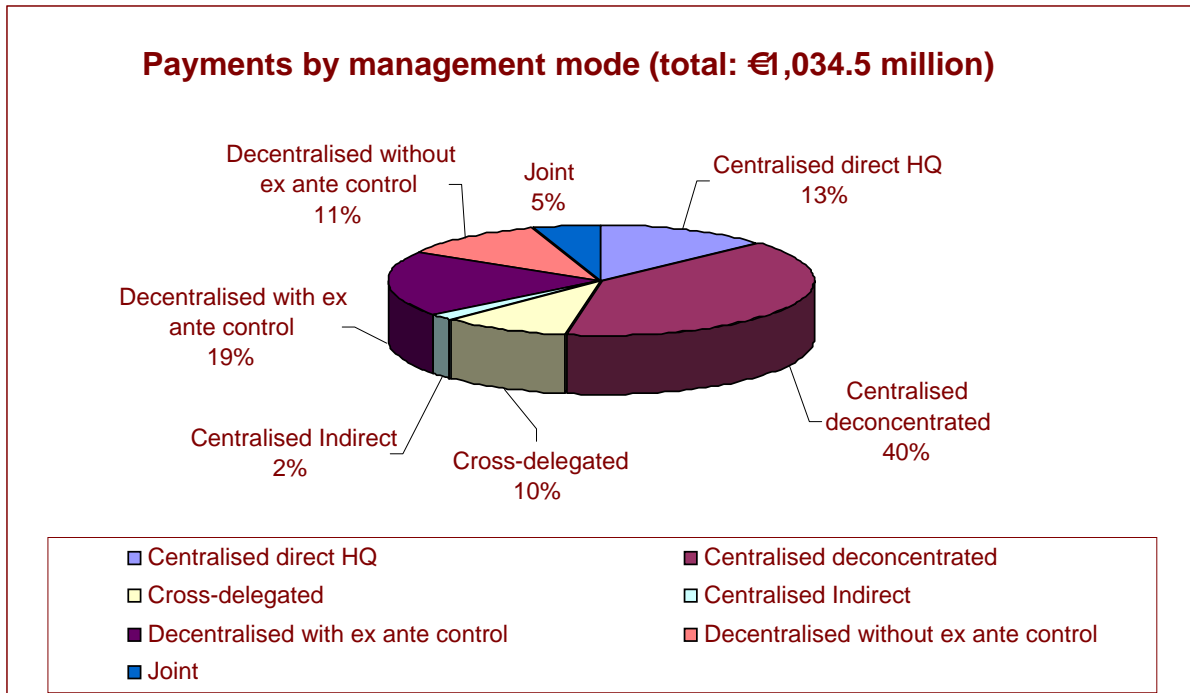
- Decentralised with *ex ante* control: funds are managed by accredited national authorities of the beneficiary country, but procurement is subject to *ex ante* control by the EC Delegation.
- Decentralised without *ex ante* control: funds are managed by accredited national authorities of the beneficiary country and are not subject to *ex ante* controls by an EC Delegation.
- Joint: funds are jointly managed with International Organisations (EBRD, EIB, Sigma, UN agencies, etc.)

Assistance under IPA is designed to prepare the beneficiary countries to assume full responsibility for the management of financial assistance granted by the EU. Implementation of two components of IPA that fall under the responsibility of DG Enlargement (components I and II) starts under a centralised management mode, with a view to transferring implementation management powers to the beneficiary countries as soon as their administrative capacities are considered sufficiently developed to ensure sound financial management.

EU Delegations play a major role in the delivery of IPA, in particular under the deconcentrated and decentralised management modes. Following the entry into force of the Treaty of Lisbon, Delegations have become part of the European External Action Service rather than the EU Commission, with effect from 1 December 2010. The Council adopted changes to the financial and staff regulations which allow the Delegations' role in the delivery of assistance entrusted to the Commission to continue. In particular, Heads of EU Delegation remain sub-delegated authorising officers for the Commission authorising officers. Some detailed arrangements are still being finalised.

Table: Management mode shares in commitments and payments executed by DG Enlargement, 2010





DG Enlargement has complied with the working arrangements agreed with Commissioner Füle. Regular management meetings were held between the Commissioner and his Cabinet and the DG's senior management. Financial and control matters were on the agenda of some of these meetings⁶. The DG has issued two notes on financial management and control issues in the year 2010, one to Commissioner Rehn in January, and one to Commissioner Füle in July⁷.

2.2 The functioning of the entire internal control system

2.2.1 Compliance with the requirements of the control standards

Directorate and Unit authorising officers' management reports, issued twice per year, include a section on compliance with the Commission's internal control standards (ICS).

In 2010 very good progress was made in meeting recommendations issued by the IAC following audit assignments carried out in the second half of 2009 specifically to assess compliance with internal control standards in four Western Balkan Delegations⁸. This had followed the devolution of management responsibilities to these Delegations and the phasing-out of the European Agency for Reconstruction (EAR) in 2008/09. The process of phasing-in the Delegations had been accompanied by detailed policies, instructions, and supervisory visits by headquarters designed to guide Delegations in setting up internal control standard compliant arrangements, structures and operations.

⁶ Management meetings of 15 July, and 3 December 2010.

⁷ Note [Ares\(2010\)535083](#) of 12 July 2010.

⁸ EUDs to Serbia, to the former Yugoslav Republic of Macedonia, and to Montenegro, and the EC Liaison Office in Kosovo. The IAC audits' recommendations, none ranked higher than 'important', addressed outstanding issues concerning ICS 1, 7, 8, and 11, as well as the implementation of specific management policy guidelines regarding payment claim validation. For the latter, see section 2.2.2 on ICS effectiveness.

One area where very good progress was made in 2010 was document management and filing. All recommendations relating to internal control standards in these Delegations have now been completed⁹.

Furthermore, the EUD to Serbia held a training session on ethical behaviour in June. The EUD to Bosnia and Herzegovina organised two training sessions on internal control standards in February and March, attended by a total of 70 staff.

In the following areas some difficulties to achieving full compliance remain:

- ▶ ICS 3, staff allocation and mobility: the adoption of a common methodology for a regular workload assessment in Delegations (and operational Units) is delayed;
- ▶ ICS 7, operational structure: not all Delegations have reported their policies for managing sensitive posts and mobility in the case of local agents.

In both cases, the actions requested will be finalised in 2011.

In addition, concerning the staff development part of ICS 4, several Delegations reported persistent tension between training needs and very high workload, with an impact on formal training targets¹⁰.

These difficulties relate at least partly to the transition to the new European External Action Service in the second half of 2010. The process created particular challenges to DG Enlargement. Enlargement zone EUDs' policy and assistance missions remain largely in the Commission's policy remit. However, since 1 December 2010, EU Delegations and their Heads no longer report to the Commission while the majority of enlargement zone EUD staff remain Commission staff, now formally assigned to DG Enlargement (formerly they were attached to DG RELEX). New rules and agreements have been established to secure the continuity of the service and detail division of tasks between Commission and EEAS, as well as sub-delegation and reporting lines. Nevertheless, some disruption is inevitable, and further adjustments will be necessary. Some of the new rules pose problems and risks of their own. This is notably the case of the impossibility for Deputy Heads of Delegation, now EEAS staff, to continue to be sub-delegated authorising officers for the Commission (in enlargement area Delegations, these posts had often been specifically created to supervise financial implementation issues).

No other issues of compliance with the 16 internal control standards arose.

2.2.2 Effectiveness of implementation of the prioritised control standards

In its Management Plan for 2010 DG Enlargement identified three internal control standards as particularly relevant for the challenges the DG faced as both a policy and spending department: ICS 6, Risk Management Process; ICS 8, Processes and Procedures; and ICS 9, Management Supervision.

The emphasis on these standards was based on the effort underway to consolidate the DG's internal control system, adjust it to the increased weight of centralised management, and improve the quality of the Director-General's assurance process.

The key new building blocks planned to come into fruition from 2010 included:

⁹ A follow-up IAC audit concerning ICS 9 and 11 in the Kosovo Liaison Office will take place in 2011.

¹⁰ Note on DG Enlargement's overall training targets: in 2010 Delegation staff were accounted for in DG RELEX.

- Annual Assurance Strategies were defined and designed by each AOSD to inform their assurance on the capacity of the systems under their responsibility to ensure the legality and regularity of underlying transactions. These strategies were based on specific, risk-based plans for the deployment of the available control tools (self-evaluations, on-the-spot controls, audits supporting financial circuit visas);
- AOSD reports to refer back to the targets set in those plans *inter alia* through appropriate indicators, and to highlight key developments and risks, and provide substantiated assurance regarding financial management;
- implementing a policy of ex post controls in centralised management;
- updating the policy of clearance of accounts in decentralised management *inter alia* adding a flat-rate correction tool;
- rolling out a harmonised Management Information System (MIS) to support all Delegations and implementing HQ Units and to provide more accurate reporting tools.

Action taken:

Delegations and implementing Units issued for the first time annual assurance strategies (AAS) for 2010 based on internal instructions. The IAC was mandated to audit two of these documents in early 2010. These audits, as well as feedback provided by the supervising Directorates, led to the adoption of revised AASs in some cases. On the basis of lessons learnt in this first exercise, the circular for the 2011 AASs was improved and streamlined. Delegations and implementing Units issued much improved AASs for 2011 including detailed risk-based plans for their control actions.

Assurance strategies have become a key building block of authorising officers' risk management process, and are now central to the DG's overall internal control strategy. AOSD reports refer back to them and have gained focus as a consequence. In its audit on public procurement under IPA in DG Enlargement, the IAS referred to this process as a particular strength of DG ELARG.

Furthermore, on top of existing assurance strategies the DG has started to implement *ex post* controls in centralised management to provide even further assurance. For resource reasons, only one of the foreseen reports could be finalised in 2010, the remainder will follow in 2011. The updated clearance of accounts policy was adopted and is now being implemented as appropriate. The development of the first release of the MIS was finalised and will be progressively deployed in Delegations in 2011.

Management survey on the effectiveness of the implementation of the selected standards

In the context of preparing this annual activity report, a survey on the effectiveness of the implementation of the three Internal Control Standards selected in AMP 2010 was carried out. The survey queried senior, middle and sector managers.

The results of the survey indicate a positive self-perception of the effectiveness of the selected control standards. Depending on the standard, 50 to 62% of respondents thought the standards to be effectively implemented, whereas 33 to 42% thought some improvements were still needed (the rest opting for 'a lot of improvement needed' or 'not effectively implemented'). Management Supervision is deemed to be the best addressed of the three standards, with 95% of replies 'implemented' or 'some improvement needed'. Processes and Procedures appeared as the relatively least well addressed, with 91% of replies 'implemented' or 'some improvement needed'.

The replies to the questionnaire are, on balance, very positive. Nevertheless, the survey suggests that the need for further improvements is more keenly felt in the following areas: the effectiveness and efficiency of main processes and procedures used for implementation and control; the user-friendliness of the risk and assurance management process; and the supervision of external implementing bodies in decentralised management.

A similar survey carried out in 2009 had yielded broadly similar results. In the 2010 survey there was further improvement under 'risk management' and a slightly negative fluctuation for 'processes and procedures'¹¹.

2.2.3 Conclusion

In 2010 DG Enlargement continued to strengthen its internal control systems on the basis of its current control strategy.

The results of the internal survey conducted on the effectiveness of selected control standards reflect this perception by the DG's managers at all levels.

The planning and reporting process was significantly strengthened, with the implementation of the first assurance strategies issued by AOSDs, in some cases revised following reviews by senior management and auditors. The new assurance strategies for 2011 issued at the end of 2010 comprise significant quality improvements and now provide for comprehensive, risk-based monitoring and audit plans across the board. Two Internal Control Reports provided top management with regular updates of progress on all key risks, on major weaknesses and issues of compliance with the standards, and on the implementation of audit recommendations.

Procedures and controls used in financial management were also further strengthened.

The DG issued IPA Instructions for the EU Delegations jointly with DGs REGIO and EMPL. A draft overall policy for the validation of payment claims in decentralised management¹² has been finalised and should be adopted soon.

Checklists used for the operational visa for payments and for requests for funds in decentralised management were reviewed with the emphasis on providing for a solid audit trail and a robust assurance assessment and statement.

New guidance was issued for the process of conferral of management powers (decentralisation). The methodology for the calculation of rejection rates was harmonised. A revised clearance of accounts policy was brought in, providing for a flat rate correction tool to correct for possible systems weaknesses demonstrated in the implementation by decentralised agencies.

Following an IAC audit on the DG's financial circuits, the DG decided in early 2011 to optimise its control and organisational approach to decentralised and centralised direct management. The AOSD responsibilities for commitments and payments, formerly split, are to be brought together under the Director responsible for operations in a given country or area.

DG Enlargement made significant efforts to obtain effective remedial measures from the decentralised institutions in Turkey concerning high risk findings made by both the DG's

¹¹ Note that in 2009 there were two further selected ICSs, # 2 and 5.

¹² Following on the adoption of a policy for the validation of payment claims in centralised management in 2009.

systems auditors and the supervising Directorate¹³. The DG also took mitigating action to manage the specific high risk environment in which the assistance programme for the Turkish Cypriot community is implemented¹².

All these actions addressed not only a number of internal audit recommendations (both IAC and IAS, see also section 3.1.2 and 3.1.3.3 on follow-up to audits), but also weaknesses pointed out in the Court of Auditors' 2009 annual report in respect of decentralised agencies in Turkey and Croatia and in the EU Delegations' *ex ante* controls over their procurement (see also section 3.1.2, on "results from audits during the reporting year"). These weaknesses had led the Court to qualify the effectiveness of the DG's *ex ante* control system.

Some relatively minor issues of compliance remain to be addressed as the setup of the European External Action Service has created new internal control challenges to the DG. The new operating procedures now being phased in with respect to EU Delegations involve different actors (EEAS, DG ELARG, DG DEVCO, PMO) and changes to reporting lines and sub-delegations. They will be tested in the months to come and may put some strain on compliance with some of the internal control standards.

2.3 Information to the Commissioner

The main elements of this report and assurance declaration have been brought to the attention of Commissioner Štefan Füle.

¹³ See also section 3.1.3.1 on follow-up to the DG's major risks, and section 3.1.1.2 on results of key legality and regularity indicators, sub-section ii) *Indicators of legality and regularity in assistance managed by decentralised agencies*, specifically the indicator on systems audits findings.

PART 3.

BUILDING BLOCKS TOWARDS THE DECLARATION OF ASSURANCE (AND POSSIBLE RESERVATIONS TO IT)

3.1 Building blocks towards reasonable assurance

3.1.1 Assessment by management

3.1.1.1 Overview of the control strategy

DG Enlargement's control strategy is set out in a comprehensive control strategy document adopted in 2009¹⁴. Internal Control Templates in Annex 5 of this AAR provide detailed information on the DG's internal control framework. A short summary follows.

DG Enlargement's financial circuits detail the steps to follow for financial transactions under different implementation modes (see 2.1 for the overview of management modes used). The Authorising Officer by Delegation (AOD) has given sub-delegation to the operational Directors who in turn have given sub-delegation to the Heads of Unit (at headquarters) and the Heads of EU Delegations (in the candidate countries and potential candidates), respectively.

The Heads of Delegation play an important role as Authorising Officers by Sub-Delegation (AOSD) in both centralised-deconcentrated and decentralised management. With the entry into force of the Treaty of Lisbon Delegations no longer work under the authority of the Commission; nevertheless, changes to the financial and staff regulations and working arrangements agreed between the European External Action Service (EEAS) and the Commission ensure that Heads of EU Delegations remain Authorising Officers sub-delegated by the Director General for Enlargement for pre-accession funds.

The inherent risks are relatively limited in the centralised direct management mode. DG Enlargement has direct access to all relevant information and can ensure appropriate *ex ante* controls and subsequent checks through its financial circuits. A similar risk level is present where DG Enlargement grants cross-delegations to another Commission service (such as DG ECFIN or DG ESTAT). DG Enlargement can rely on the fact that these other Commission services apply similar controls and checks.

In the de-concentrated management mode, inherent risks are determined by the reliability of the control environment put in place in the Delegation. Staffing and staffing levels, general training and information systems are additional factors that may affect the efficiency and effectiveness of the control systems in the Delegations.

With the entry into force of the Treaty of Lisbon and the establishment of the EEAS, the related institutional and organisational changes have affected, and will continue to affect, the DG's control strategy, in particular as regards the role of EU Delegations (see above). Although Delegations are in the EEAS, staff managing pre-accession assistance remain Commission staff, and are now assigned to DG Enlargement¹⁵. In addition, DG DEVCO performs general administration duties for Commission staff in all Delegations. The transitional period will continue to require further adjustments and necessarily brings with it some additional risk as the new arrangements settle in.

¹⁴ D(2009) REP 200626 of 15 April.

¹⁵ Formerly to DG RELEX.

The inherent risks in the decentralised management modes are greater than in other management modes. Primary and secondary controls ensuring the legality and regularity of individual tenders, contracts and payments are carried out by accredited national authorities of the beneficiary countries. However, the Delegation retains the powers to carry out *ex ante* controls on procurement until these are waived following an agreed roadmap, which requires the national systems to meet certain demanding benchmarks and conditions.

Funds are transferred to the national authorities only when assurance is reached that the implementation of the assistance is conducted according to approved management and control systems and is in line with the provisions of the financing agreements and other relevant legal bases, and that expenditure is legal and regular. DG Enlargement's assurance is mainly based on conferral of management and follow-up audits of the national systems or parts of these systems; on national audit authorities' reporting on their own audits of national systems; on national authorising officers' management and monitoring reports; on joint monitoring arrangements; on the DG's and Delegations' own regular monitoring (including sample checks of documents and on-the-spot checks); and on *ex post* controls. Control tools include follow-up audits of the national systems, general monitoring and targeted on-the-spot checks. Detective control tools include risk-based audits of sub-systems and *ex post* controls based on representative samples of projects and contracts.

With effect from 2010, the DG adopted a streamlined process for planning and demonstrating authorising officers' assurance which is fully integrated with the management plan and annual activity report processes. Authorising officers by sub-delegation (Heads of EU Delegation, and Heads of Unit and Directors at headquarters) are required to submit Annual Assurance Strategies early in the year. The assurance strategies set out the AOSDs' implementation targets, as well as their risk-assessed plans for the mix of control and monitoring tools they intend to use. Assurance strategies comprise an explanation of the operational risks foreseen in the implementation of the funds; control work plans, including a monitoring plan, a plan for project level evaluations, and an audit plan for audits supporting in-circuit visas. In addition, AOSDs contribute to the DG's central evaluation and systems audits plans. Quarterly financial reports and twice-a-year AOSD management reports take stock of the implementation of the annual assurance strategies.

3.1.1.2 Results of key legality and regularity indicators

Indicators of legality and regularity in centrally managed assistance

Corrections to centralised payments

This indicator measures the financial impact of *ex ante* controls of centralised payments (i.e. payments under centralised direct HQ or deconcentrated, joint, and indirect centralised management).

In 2010, a total of **350 corrections** (deductions or recoveries) were made to centralised payments as a result of detection of error, irregularity, or suspected fraud¹⁶, for a total value of approx. **€6.0 million**. Two thirds (55% by value) concerned procurement contracts and one third (45% by value) concerned grants.

All but three corrections affected contracts managed under the centralised direct mode either at headquarters or in Delegations. Total corrections to payments made in this management mode amounted to €5.9 million, or approx. **1%** of total centralised direct payments. This

¹⁶ Excluding corrections made to recover bank balances or unused advance payments.

meets the management plan target of between 0.5% and 1.5%. For joint management, the ratio is only 0.1%, and for centralised indirect 0%.

Finally, of the total, €132,021 was corrected as a direct consequence of on-the-spot checks carried out by EU Delegations or headquarters' Units.

Intensity of *ex ante* on-the-spot controls in centralised management

This indicator establishes the ratio of the value of contracts controlled on-the-spot in 2010 to the value of contracts ongoing on 1 November 2009. It is a measure of the coverage of additional controls conducted on-the-spot before payments are validated.

In 2010, contracts to the value of €733,180,284, out of a total value of contracts ongoing on 1 November 2009 of €2,094,789,502, were *ex ante* controlled on-the-spot. This leads to a coverage ratio of **35%**, and meets the management plan target of >20%.

Derogations, prior approvals and other exceptions authorised

Internal guidance issued in March 2010 modified the internal reporting of derogations. The new arrangements distinguish derogations, mandatory prior approvals and other exceptions¹⁷. As a consequence, figures for the first quarter are presented separately from the values for the three other quarters of 2010. In the first quarter 16 derogations following the old instructions and definitions were reported, for a value of €9.48 million. During the three other quarters of 2010, 30 derogations and other exceptions were reported for a total value of €4.93 million, and 67 prior approvals were sought and granted for a value of €77.85 million. For methodological reasons, the figures should not be aggregated; nevertheless, added together they would represent approximately 10% of commitment appropriations, well within the management plan target of maximum 20%.

Number of complaints received regarding procurement or contract awards

Twelve complaints have been escalated to the DG's headquarters legal team in 2010.

Two further indicators for centralised management included in the Management Plan concern *ex post* controls (coverage and error rate). The policy for *ex post* controls of centrally managed contracts was designed as an ancillary, rather than fundamental, source of the AOD's assurance for contracts implemented by sub-delegated authorising officers. The policy was adopted in December 2009 and initiated in 2010. However, delays caused by resource bottlenecks allowed for only two assignments to be carried out and one report¹⁸ to be issued in the reporting period. No quantitative results or statistical extrapolation of an error rate can therefore be presented in this AAR. Full results will be presented in AAR 2011.

ii) Indicators of legality and regularity in assistance managed by decentralised agencies

The indicators listed here have varying scope depending both on the stage of the implementation of the pre-accession programmes and on the stage reached by countries in their roadmaps for decentralisation of management powers (see section 2.1 on DG Enlargement's general implementation setup). Each individual indicator's specific scope is mentioned in the text.

¹⁷ Director General's note ARES (2010)179782 of 26 March. See technical appendix for the definitions.

¹⁸ Report on *ex post* controls in the EC Liaison Office in Kosovo. Eleven reports were originally planned for 2010.

Error rate

Scope: pre-IPA programmes already finalised (EU-12 + Turkey, Croatia)

This indicator measures the recovery rate from *ex post* controls of finalised programmes in decentralised management as a proxy for the level of error¹⁹. Meeting the management plan target (< 2%) means that the level of errors in transactions *not* controlled *ex post* is unlikely to be material. The overall error rate across all audited programme years remains below materiality at **0.82%**. For the audits accrued during 2010, the specific rate found was **0.5%** (see detailed tables in the technical appendix).

Predicted residual error rate

Scope: pre-IPA programmes already finalised (EU-12 + Turkey, Croatia)

This indicator predicts the most likely trend of the residual error rate. It is itself not a direct indicator of error. The “residual error rate” represents the percentage of unknown errors per programming year which remain after the recovery of the known errors. It is computed statistically for each programming year by extrapolating the errors found in a representative sample of transactions. These errors are obtained from the audit findings raised by external auditors (potential errors). It is expected that, after the contradictory procedure laid down in the regulations for the pre-accession instruments, some of these findings will lead to confirmed errors subject to recovery. The historic average of the ratio between recoverable errors and financial findings is approx. 1 to 5.

The value of the residual error rate for the programme year 2004 is 5.8% of financial findings (potential residual errors) in the unaudited population. Based on the historic average of the ratio between recoverable errors and financial findings, this value in turn predicts a true residual error rate of **1.16%** for the programme year 2004²⁰ which would be below the 2% materiality threshold. Nevertheless, this figure represents a significant increase compared to prior programme years, reflecting the increased weight in the population and in the audited sample of transactions concerning Bulgaria and Romania. The risk of error in transactions in these two countries can be considered as high. This is consistent with the risk and reservation reports and action taken by DG Enlargement as reported in AARs from 2007 to 2009.

Total recoveries

Scope: pre-IPA and IPA programmes, finalised or ongoing (EU-12 + Turkey, Croatia)

This indicator shows total recoveries from *ex post* controls and irregularity reports in the reporting period. They include those reported by the national authorities and recovered by the Commission.

In 2010, 62 recovery orders were issued as a result of *ex post* controls and irregularity or OLAF reports for a total amount of €28.5 million (2.7% of 2010 payments). This represents a 6% decrease relative to 2009.

Irregularities reported by National Authorities

Scope: countries with decentralised management (EU-12 + Turkey, Croatia)

Irregularities may concern contracts from any programme year. By the end of 2010, 582 suspected and reported irregularities were open, mainly in Bulgaria (233) and Romania (260), of which most are likely to be subject to recovery. These figures include all cases reported by

¹⁹ Error rate = Recoveries issued as % of funds audited in *ex post* controls up to 2009. Only closed *ex post* controls are counted toward the error rates.

²⁰ Based on the 20% historic average ratio of recoverable errors to financial findings. See detailed tables in the technical appendix.

the national authorities as well as irregularities identified through the DG's internal and external on the spot monitoring, press news, audit findings, etc.

204 irregularities were reported in the period²¹, in contracts totalling approx. €11.2 million. The value of reported irregularities was 0.4% of the value of financing memoranda under implementation in 2010 (see tables in the technical appendix).

124 irregularities (over 60% of the total number, and 32% of total value concerned) reported in the period have been reported by the Bulgarian authorities. This is evidence of a sustained change of approach regarding the reporting of irregularities following the action plan that led to the reservation being lifted in AAR 2009. However, the high value of irregularities reported (roughly 5% of financial agreements running in Bulgaria) bears out the DG's justification in having filed those reservations in the past. Romania also shows a high number of irregularities (35 by number, for a value concerned of €4.9 million). However, this represents less than 1% of the financing memoranda running in the period. No major frauds have been reported to the Commission services; most irregularities concern small contracts and incorrect expenditure, especially regarding grants at the local level. The Romanian authorities, in particular the Anti-Fraud Service (DNA), continue to be proactive in tackling all irregularities regardless of the amount involved.

By the end of 2010, OLAF had overall reported 133 cases to DG Enlargement (2009: 177), 16 of which were still at the stage of internal evaluation.

Rejection rates in decentralised implementation

Scope: countries with decentralised management with ex ante controls (Turkey, Croatia)

This indicator is only applied to countries where assistance is decentralised to national systems and EU Delegations control procurement files *ex ante*. Rejected files are returned to the national authorities and re-submitted until they are found to be fully legal and regular and compliant with the principles of sound financial management.

This indicator shows, for each Delegation, the ratio between the number of rejections of tender, evaluation, and contracts documents submitted by national Implementing Agencies (IAs) for the Commission's *ex ante* control²² and the absolute number of submissions of such documents for approval in the reporting year (see tables in the technical appendix). A sustained reduction of rejection rate levels is an important condition for the Commission to waive *ex ante* controls on procurement files.

In 2010, rejection rates overall improved slightly in Turkey after having deteriorated in earlier years. However, rejections remained at a high level, particularly for tender files (64.7%). Almost all targets set in the roadmap to the waiver of *ex ante* controls were missed. This means that extended decentralisation (waiver of *ex ante* controls by the EU Delegation) cannot be envisaged in the near future. National authorities need to undertake further efforts with the EU Delegation's support. This is further elaborated in section 3.1.3.1 on follow-up to the inherent risk in decentralised management.

In the case of Croatia, rejection rates decreased across the board. Encouragingly, the reduction was particularly sharp in the last quarter of 2010. Nevertheless, rejection rates remained relatively high for more complex files (public works, in some cases also supplies), reflecting inadequate quality of the technical control expertise. Further sustained efforts by the national

²¹ Irregularities reported from October 2009 to September 2010 for financing agreements running in 2010.

²² This indicator therefore does not by definition apply to countries where *ex ante* controls have been waived by the Commission. However, no country for which *ex ante* controls had been waived is contracting anymore.

authorities with the support of the EU Delegation could pave the way for the waiving of *ex ante* controls in the foreseeable future.

Systems audits findings

Scope: countries with decentralised management (EU-12 + Turkey, Croatia) and countries which have initiated the decentralisation process

This indicator shows, for each country where management is decentralised or conferral of management powers is planned, the number of high risk (red flag) and medium risk (yellow flag) findings reported in systems audits carried out by DG Enlargement (see tables in the technical appendix).

The impact of the weaknesses underlying these findings varies with the stage of decentralisation of the individual country. In countries where EU Delegations control procurement files *ex ante* (currently, Turkey, and Croatia, as well as the former Yugoslav Republic of Macedonia since end 2010), these controls largely offset the potential negative impact of weaknesses in the national systems. In countries where such *ex ante* controls have been waived (currently, the twelve newer Member States for the funds remaining under implementation), systems weaknesses are more likely to have a direct impact on legality and regularity of underlying transactions, and may lead to corrective measures (see next indicator). In countries which are preparing for decentralisation, but where the national systems are not yet managing funds (currently Montenegro and Serbia), such weaknesses may lead only to delays in the process leading to conferring management powers upon national agencies.

Three high risk findings were reported for both Romania and Bulgaria, and seven for Turkey in 2010. No high risk findings were reported for Croatia and the former Yugoslav Republic of Macedonia.

The trend relative to earlier years' remains generally toward fewer high-risk findings (see table in appendix). Nevertheless, the management plan target of no red flags and a maximum of 10 yellow flags was reached only in the case of the former Yugoslav Republic of Macedonia, and narrowly missed in Croatia by one yellow flag. In the case of Turkey, the high number of high risk findings bears out the concerns highlighted in section 3.1.3.1, "Follow-up to significant risks flagged in the management plan for 2010", bullet point on "Inherent risk in decentralised management", subsection ii).

The following corrective actions were taken in 2010 to tackle the high risk findings:

- In Romania, high risks were found in a sub-system audit on twinning. The findings included: deficient substantiation of chosen twinning partners; inconsistency about the Romanian contracting party in twinning contracts; and overreliance on audit certificates and documentary checks in the verification of expenditure claims. The Romanian authorities were requested to address the auditors' finding and report on the measures taken. In addition, DG Enlargement undertook to revise the Twinning Manual with a view to ensure stricter compliance in practice with the principles of transparency and fair competition. This revision is underway. All contracts under implementation were reviewed by the Romanian CFCU and the inconsistencies regarding the Romanian contracting party were corrected; in addition, the NAO modified the relevant procedures in order to ensure that the verification of expenditure claims also include additional verifications and on-the-spot checks. NAO also certified that the choice of twinning partners was done in strict accordance with the applicable rules.
- In Bulgaria, high risks were also found in a sub-system audit on the management of twinning. The findings included deficiencies in the appointment of the selection

committee; lack of substantiation of the twinning partner; and weak monitoring and verification controls by the CFCU/AO. In July 2010, DG Enlargement requested the NAO to report on all the corrective actions taken or planned to address the findings, as well as to provide a justification for his own assurance concerning the eligibility of the twinning contracts managed by the CFCU. In August 2010, the NAO provided a list of specific measures introduced for twinning contracts in 2009 and 2010 in connection with the audit findings and submitted evidence of the official nomination of the selection committees by the PAO for 3 twinning projects. In addition, the NAO reported improvements in the justification and substantiation of the selection of twinning partners and the introduction of additional controls through checklists for review and approval of side letters and reports. The administrative capacity of CFCU was reported to have been strengthened, and additional training was provided to the staff involved in twinning contracts management.

- In Turkey, four high risk findings were raised in a conferral of management follow-up audit, and three in a sub-system audit on the management of irregularities. The former report was finalised in December 2010. Its findings include incomplete procedures for managing and reporting irregularities; incomplete workload assessments at the EUSG; incomplete training and recruitment of staff at EUSG; and lack of evidence of segregation of duties.

The March 2010 report on the management of irregularities had found the NAO's supervision to be weak; irregularity registers to be incomplete; and the criteria for classification of irregularities and suspected fraud to be unclear. In April 2010 DG Enlargement requested the submission of an action plan by the NAO. This was submitted in August, and immediate corrective action was taken. The NAO improved the quarterly irregularity reporting with new formats and information requirements. The CFCU developed an electronic irregularity database with all key elements concerning irregularities found. Nevertheless, the findings have not yet been fully and sustainably addressed. Half of the 76 cases of irregularity reported by the NAO (17 in 2010) remain open without recovery. The EU contribution recovery rate remains very low, at 6% of the amount to be recovered. The EU Delegation has requested from the NAO clarifications and corrective action on these issues as well as the improvement of the EU contribution recovery.

A further sub-system audit report on the management of payment claims has not delivered the final report, but preliminary findings point to significant weaknesses concerning the reliability of certified correct visas given by the Senior Programme Officer.

Corrective measures applied in decentralised management

Scope: all countries with decentralised management (EU-12 + Turkey, Croatia)

This is an indicator of the reliability of national systems. It indicates whether corrective measures had to be taken by the Commission against decentralised agencies upon significant transaction, co-financing or systems findings. These measures may include flat-rate corrections, suspensions of payments and withdrawals of accreditation.

Following the lifting of the suspension of payments to Bulgaria in November 2009 (see AAR 2009), payments were resumed in 2010 and reduced by financial corrections suggested by the Bulgarian authorities. Final corrections will be calculated and applied at the occasion of the clearance of accounts procedure after submission of final declarations.

No suspensions of payments or withdrawals of management powers were enforced in 2010.

3.1.1.3 Other information relevant to legality and regularity

- Exception register

Nine specific exceptions were filed to the DG's exception register in 2010. The more significant exception by value of the transactions concerned related to a decision on the extension of deadlines in Contribution Agreements between the Commission and the IFIs (EIB, EBRD and CEB/KfW) under the PHARE programme. The preparation time for the addenda to the Contribution Agreements further to the amendments to the Commission decisions in some cases led to their technical validation occurring after the expiry of certain dates in the Contribution Agreements, and therefore to a technical retroactivity.

- Statements of assurance of National Authorising Officers (NAO) and National Audit Authority Reports and Opinions

The **Croatian NAO's** Annual Statement of Assurance (SoA) for 2010 includes *inter alia* a confirmation of the effective functioning of the management and control systems; a confirmation of the legality and regularity of the underlying transactions and a statement that there have been no incidences of non-compliance with Community rules that could have a material effect on the expenditure declared.

An audit on conferral of management for IPA component I had issued one recommendation relating to the issuance of the Statement of Assurance. Croatia subsequently prepared a new methodology for the Statement of Assurance which it has incorporated in the Manuals of Procedures submitted as evidence to the Commission. Thereupon the DG's auditors brought the level of underlying risk down to low. DG Enlargement will verify the fulfilment of the recommendation through a management mission in the course of 2011.

The **Croatian Audit Authority for IPA** delivered its Annual Audit Activity Report and Audit Opinion for 2010. It presented an unqualified audit opinion. In line with the model provided by the Framework Agreement, the Annual Audit Opinion concluded, "*without expressing an opinion on the overall reliability of the Statement of Assurance*", that "*the Statement of Assurance issued by the NAO did not contain any representations that would be materially inconsistent with our audit findings and which would therefore provide any reason to doubt that the Statement of Assurance has been correctly drawn up in accordance with the applicable legislation*". During 2010, the Audit Authority performed several systems audits within the Operating Structure established for the TAIB (transition assistance and institution building) component of IPA. It also performed operational audits for selected projects of the 2007 IPA TAIB programme. The main findings were of intermediate level of importance and related primarily to management and control standards for effective controls of CODEF, CFCA²³, and National Fund. Other findings include an insufficient segregation of duties in the IPA Management Information System and lack of adequate controls in selected IPA 2007 projects.

In March 2011, DG Enlargement auditors will conduct a sub-systems audit designed to assess the work of the Audit Authority on the basis of their 2010 Annual Audit Activity Report and Opinion for both Components I and II.

The **Turkish NAO's** Annual Statement of Assurance for 2010 includes a confirmation of the effective functioning of the management and control systems; a confirmation of the legality

²³ CODEF: Central office for development strategy and coordination of EU funds. CFCA: Central Finance and Contracting Agency of the Republic of Croatia.

and regularity of the underlying transactions and a statement that there have been no incidences of non-compliance with Community rules that could have a material effect on the expenditure declared. The Statement of Assurance includes a report by the NAO Support Department, which lists the follow-up given, in 2010, to various audit findings and control missions. The report shows the quantitative progress made; however, it lacks a qualitative assessment of the remaining weaknesses. The NAO agreed at the JMC of 2 February 2011 to prepare a more comprehensive action plan on outstanding audit and control findings; it is expected that this action plan will help to address the weaknesses which remain with the NAO supervision and strengthen the reliability of the Statement of Assurance.

The **Turkish Audit Authority** submitted its annual audit opinion and activity report for the period October 2009 to September 2010, in which it reported several critical findings, including, in regard of components I and II of IPA: lack of supervision (on-the-spot controls) by the National Fund; payments executed by the CFCU²⁴ lacking a certified correct visa of the programme officer; the CFCU's lack of a plan for on-the-spot checks of supply and service contracts and the execution of few such checks; high staff turnover and low awareness concerning irregularities.

These findings bear out the DG's own findings and remarks²⁵ and the corrective measures are followed up closely by the EU Delegation and the supervising Director.

Management powers were conferred upon the **former Yugoslav Republic of Macedonia's** institutions only in December 2010; no expenditure, contracts or payments were declared to the Commission in 2010²⁶. Therefore, the Statement of Assurance received is not yet relevant for the assurance on underlying transactions. On systems issues, the NAO reports lack of staff and high turnover of employees in the National Fund and the Central Financing and Contracting Department (CFCD). A number of remedial actions are being taken in recruitment processes which will be closely monitor this year by the EU Delegation and HQ.

3.1.2 Results from audits during the reporting year

Internal Audit Capability (IAC)

In 2010, DG Enlargement's IAC launched 13 out of the 15 planned engagements and delivered 9 reports (3 full audits, 3 follow-up audits, and 3 consulting engagements).

The level of acceptance of IAC recommendations in 2010 was 100%. The IAC's assurance work covered 13% of DG ELARG commitments and 18% of DG ELARG payments. The combined IAC-IAS coverage in 2010 was 45% of commitments and 46% of payments²⁷.

In 2010, the IAC issued no critical recommendation and 6 recommendations ranked 'very important'. The areas needing improvement included i) for TAIEX operations: the quality of the assurance underlying the operational visa on invoices; and the documentation of decisions to finance specific events (actions tackling these recommendations fully have subsequently been reported by management); ii) for decentralised management: the account taken, in providing the operational visa on requests for funds, of the assurance component relying on the accredited systems; and the adequacy of the DG's current financial circuit model; iii)

²⁴ Central Finance and Contracts Unit.

²⁵ See section 3.1.3.1, bullet point on inherent risk in decentralised management, item ii).

²⁶ i.e., in 2010 pre-accession assistance to the former Yugoslav Republic of Macedonia was still entirely implemented under the centralised management mode.

²⁷ However, audit coverage does not entirely overlap with this report's scope: cross sub-delegated funds are not part of the internal auditors' audit universe; conversely funds cross sub-delegated to DG Enlargement are.

internal rules on reporting of exceptions and derogations which lacked clarity²⁸; iv) and issues about the regularity of one specific contract in the area of information and communication.

An audit on financial circuits in decentralised and centralised (at HQ) management was concluded in early 2011. Some of its conclusions are mentioned in this report as they have a direct bearing on the DG's control strategy²⁹.

Another five 'very important' recommendations from previous years are still outstanding or were reopened by the IAC (see 3.1.3).

Overall, the IAC issued a qualified opinion, considering that the internal control system provided reasonable assurance regarding the achievement of DG Enlargement's business objectives except for the 11 issues mentioned above.

Internal Audit Service (IAS)

In 2010, the IAS delivered two full audit reports on DG Enlargement, one on public procurement under IPA, and another on the management of IPA grants. Furthermore, DG Enlargement is one of two operational DGs audited within the framework of a further IAS engagement on the management of guarantees in the Commission.

Further to these two audits, the IAS issued no critical recommendation. It issued three 'very important' recommendations, one in the audit on procurement, and two in the audit on grants. These recommendations remain outstanding³⁰. The former concerns minimum requirements for check lists used in *ex ante* controls of procurement in centralised and decentralised management. The latter concern guidance and procedures for *ex ante* assessments of institutions involved in indirect centralised and joint management schemes; and the strengthening of guidance and controls for the evaluation process in calls for proposals.

Court of Auditors

In its Annual Report on the Implementation of the 2009 Budget, the Court of Auditors estimated the most likely error for the audited policy group which encompasses the enlargement policy area (the group of DGs executing heading 4 of the budget) to lie between 2 % and 5 %. The methodology used by the Court does not allow for a separate estimate of the error in the enlargement policy area. In 2009, enlargement made up 17.5% of the payments in the 'policy group'. Only one quantifiable error (out of 6) found by the Court concerned enlargement.

Concerning the effectiveness of systems, the Court found the DG's monitoring and supervision arrangements, as well as *ex post* controls and internal audit to work effectively. It found the DG's *ex ante* controls to be partially effective. This qualification was based on material levels of error found in tender procedures managed by national agencies under decentralised management which had been subject to *ex ante* control by EU Delegations. The Court noted weaknesses in the definition of the roles of Commission actors in the conferral of management powers, and recommended updated guidance. It also found fault with the documentation of Delegations' checks underlying operational visas to requests for funds.

Both issues have been addressed. New check lists have been issued for the operational visa in decentralised management requiring the documentation of each check and a reasoned

²⁸ A problem noted Commission wide. DG Budget is currently developing draft new guidance on this matter.

²⁹ See e.g. section 2.2.3, conclusions on internal control standards.

³⁰ The audit report on IPA grants was issued in late December 2010. The DG's action plan was issued in early February 2011.

statement on the overall assurance drawn from the checks. A guidance note on conferral of management powers under IPA was adopted in December 2010³¹, clarifying the stages of the process and the actors within DG ELARG and EU Delegations involved. This guidance note is now the document of reference for the preparation of new Commission decisions on conferral of management powers and for monitoring the decisions in force.

The Court agreed with the assessment made by the Director General for DG Enlargement in filing no reservation in AAR 2009.

The Court's special report on the Commission's management of pre-accession assistance to Turkey was published early in 2010³². The report sought to establish the added value of projects for meeting strategic priorities, the effectiveness of the decentralised management system of the programmes, and the effectiveness of the monitoring and evaluation of performance. The report "*found weaknesses in the Commission's management of pre-accession assistance to Turkey*" in the period examined, adding that "*since then, the Commission has taken action to improve procedures for the IPA, although the effectiveness of the changes can only be assessed in the future. Improvements are still required in establishing priorities for and assessing the effectiveness of the funding.*" It recommended improvements in the determination of strategic and specific objectives for the assistance, the selection and design of projects and the setting of measurable objectives and indicators to allow for adequate effectiveness assessment and evaluation. It found that the decentralised management setup "*ensured that the audited projects mostly achieved their planned outputs and the results were likely to be sustained*", even though the DIS institutions had many weaknesses, which the Commission was addressing.

In the IPA instrument in use since 2007, many of the issues raised by the Court have been addressed. Needs assessments, as well as SMART project objectives and indicators, have become mandatory requirements. The DG is currently implementing further significant changes to its programming approach, moving to sector-based, more strategically targeted programmes. The monitoring of performance has also been significantly improved, with higher monitoring and reporting standards and requirements, results-oriented monitoring and interim and thematic evaluations. The Commission acknowledges the weaknesses remaining in the DIS bodies, whose capacity has since accreditation not been raised in line with funding increases. These issues are dealt with elsewhere in this report³³.

3.1.3 Follow-up of previous years' reservations and action plans for audits from previous years

A reservation filed in AARs 2007 and 2008 concerning critical weaknesses in two implementing agencies in Bulgaria was lifted in AAR 2009 following the implementation of an action plan, and downgraded to a 'significant risk'. Further follow-up action in this regard is reported in section 3.13.1, which follows up on the DG's major risks. DG Enlargement made no reservation in AAR 2009.

³¹ Note Ares 992622 of 22 December 2010.

³² "[The European Commission's Management of Pre-Accession Assistance to Turkey](#)", European Court of Auditors Special Report No. 16/2009. The report examined a sample of 11 (out of 82) projects carried out under Turkey pre-accession programmes between 2002 and 2004.

³³ See in particular further below section 3.1.3.1, "Follow-up to significant risks flagged in the management plan for 2010", subsection ii) of bullet point on "Inherent risk in decentralised management", and, under section 3.1.1.2 *Results of key legality and regularity indicators*, sub-section ii) *Indicators of legality and regularity in assistance managed by decentralised agencies*, heading 'Systems audits findings'.

3.1.3.1 Significant risks and follow up

This section reports on the risks identified in the risk register of the 2010 Management Plan for the DG. The plan for 2010 did not include any risks ranked 'critical'. Risks that were classed as 'significant', and their evolution and follow up are detailed below.

- ***Regularity of implementation of PHARE programmes and Transition Facilities in Bulgaria and Romania***

The critical risk which led to a reservation on Bulgaria in AAR 2008 was downgraded to significant after the Bulgarian authorities fulfilled the conditions for lifting the suspension of payments. AAR 2009 no longer filed a reservation over this issue.

Throughout 2010 the DG has maintained a high level of supervision, monitoring and auditing in order to manage the risk in both Bulgaria and Romania.

Upon lifting the suspension of payments in November 2009 DG ELARG resumed the assessment of requests for funds and final declarations. For programmes contracted under DIS (with *ex ante* control on procurement), irregular contracts and ineligible expenditures are in the process of recovery. For programmes under EDIS (where there was no *ex ante* control on contract procurement), the system weaknesses found earlier are being corrected by applying flat rate corrections to requests for funds and on clearing the accounts after the final declaration is provided by the national authorities.

In the case of Romania, particularly careful analysis of the eligibility of the expenditures will be required in assessing final declarations due to the significant number of irregularities detected and reported and to the delays in both procurement and implementation.

48 final declarations concerning programmes in Bulgaria and Romania are under assessment or in review by DG Enlargement. A further 17 remain to be received.

- ***Inherent risk in decentralised management***

This inherent risk is based on the fact that the Commission lacks direct authority over the implementation structure of the decentralised managers (see section 3.1.1.1 for an overview of the control strategy). The risk is mitigated by the strict conditionality and handling of the conferral of management process, by a system of *ex ante* controls through EU Delegations (waived after a stringent roadmap is fulfilled), and through various monitoring tools. The residual risk is accepted as an integral part of the institution building process in candidate countries and is monitored by the DG.

The problems encountered in 2007 and 2008 with two implementing agencies in Bulgaria (see above) illustrate the need for this risk to be managed carefully. The action taken by the DG to tackle these problems has also provided evidence of the effectiveness of DG Enlargement's overall control system.

Two pre-eminent issues in connection with this risk arose in 2009 (see AAR 2009) and have been further addressed throughout 2010:

i) IAC and IAS audit reports pointed out **a weakness regarding the robustness of the operational certification of requests for funds** (and final declarations). In addition, the quality of the documentation of this operational visa was found insufficient. The Court of Auditors took up the same point in its 2009 Annual Report.

The perceived weakness of the operational visa stemmed from an unclear split of responsibility between Delegations and Headquarters and between AOSDs for commitments

and AOSDs for payments. This affected the consistency of elements of assurance drawn from the national implementing systems on the one hand and those drawn from direct verifications of transactions by the EU Delegation on the other. The former rely on systems audits carried out both by the Commission and by local audit authorities and on general monitoring and supervision of national authorising officers by the responsible Directorate in DG Enlargement. The latter rely on monitoring and on the spot checks carried out by the EU Delegation on an *ad hoc* or sample basis.

Following an action plan adopted in early 2010, the check lists used for the operational visa on requests for funds have been revised. The update includes a requirement to indicate, for each check, the sources providing the assurance, as well as a concluding statement on whether reasonable assurance is reached overall and whether corrections may be needed. The updated checklist also clarifies division of labour between Delegations and Headquarters.

In addition, the DG streamlined the internal control planning and reporting system. Risk-based assurance strategies are now followed by AOSD and management reports and an overall internal control report, see also section 2.2.3. This provides a consistent, integrated framework for the detection, assessment, and follow-up of weaknesses.

Finally, an IAC audit on the DG's financial circuits³⁴ recommended revising the DG's break down of responsibilities between AOSDs for commitments and payments. In February 2011 the DG's management agreed in principle that the AOSD for payments should be in the relevant operational Directorate rather than in Directorate E, and consequently one of the decentralised financial circuit models should be adopted.

ii) Persistent *weaknesses in Turkey's national management and control systems* for financial assistance remain a cause for concern. These weaknesses are reflected in high rejection rates of procurement files submitted for the EU Delegation's ex ante control (see also section 3.1.1.2 on indicators of legality and regularity, rejection rates).

Weaknesses affecting the EUSG, NAO and CFCU³⁵ continued to be reported in 2010 both in management reports and in a follow up report on the conferral of management issued by the DG's systems auditors. The weaknesses include delays in deploying new EUSG staff, with general coordination remaining insufficient; insufficient supervision activity by the NAO; lack of capacity in the CFCU, despite improvements in performance; and insufficient operational controls before (local) payments by the CFCU (see also section 3.1.1.2 on indicators of legality and regularity, systems audits). The national Audit Authority's annual report issued in January 2011 also highlighted such weaknesses.

If left unremedied, these weaknesses could have negative consequences on Turkey's capacity to absorb pre-accession funds as programmed; they could also weaken the assurance drawn from the local systems, and, by implication, the operational assurance on requests for funds (see i) above). This is a matter of concern for the overall functioning of the decentralised implementation system.

DG Enlargement issued two letters to the NAO in August and November 2010 summarising its concerns and recommendations. In February 2011, the DG and the Turkish authorities held a Joint Monitoring Committee for IPA components I and II. There was agreement regarding the remaining weaknesses in the programming and implementation of IPA. The NAO agreed to prepare a comprehensive action plan by end of March 2011 to address all outstanding weaknesses, including the capacity problems at the CFCU. In addition, several measures were

³⁴ Final Audit Report AU6/9/2010, Financial Circuits – Part I (Centralised HQ and Decentralised) delivered on 21 February 2011, Ares(2011)192854.

³⁵ EUSG: Secretariat General for EU Affairs of the Republic of Turkey; NAO: National Authorising Officer; CFCU: Central Finance and Contracts Unit.

agreed to improve programming, and a working group was tasked with making monitoring more effective. The implementation of the agreed measures will allow improving the management and control systems and the implementation of IPA in Turkey.

In relation to the problems in implementation and absorption of funds, the Turkish authorities will be encouraged to swiftly address outstanding weaknesses, implement the comprehensive action plan and in particular address capacity issues at the CFCU and speed up the accreditation of the line Ministries for IPA component III, IV and V, to avoid any loss of funds.

Concerning programming of IPA component I, the Commission supports the move towards fewer, larger, and more strategic sector-based projects based on an appropriate methodology to be developed in line with the new MIPD 2011-2013. Specific measures need to be taken as soon as possible to strengthen the capacity of the EUSG and beneficiaries to move in this direction.

The current risk to the overall legality and regularity of underlying transactions remains limited owing to the strong mitigation provided by the *ex ante* controls performed by the EU Delegation on all procurement and by the Delegation's own risk-based monitoring and audit plans on selected transactions.

- ***Delays in implementation of aid programme to the Turkish Cypriot community***

Despite the DG's and Commissioner's sustained efforts, the implementation of a number of projects is at significant risk with regard to sustainability or achievement of objectives. In the 2011 Management Plan this risk has been reclassified to a risk of deficient implementation, rather than delayed implementation as registered in 2010.

Implementation of the aid programme to the Turkish Cypriot community takes place in a unique legal, political and diplomatic context. The achievement of its objectives is based on the fundamental political assumption that the two communities on the island continue to work towards a comprehensive settlement. The European Commission is responsible for administering the assistance on the basis of a specific regulation³⁶. The programme is implemented by a DG Enlargement team in an EU Member State but in an area that is not under the effective control of that Member State's government and where the application of the EU *acquis* is suspended. The risk implicit in the Commission's decision to carry out this programme is therefore significantly higher than the risk usually inherent in centrally managed assistance programmes.

Implementing this programme, while respecting the principles of sound financial management, requires *ad hoc* arrangements. There is no Financing Agreement with the "government" of the beneficiary to establish the legal framework under which the assistance is implemented. The Commission has to rely on unilateral declarations from the beneficiary. These are not legally enforceable and may change during the lifetime of a contract. The lack of a Financing Agreement also means that the Commission, in entering into contractual arrangements with its contractors, takes on potential liabilities that it would not normally encounter. In addition, because of the political context and non-recognition, legal enforcement of recovery orders for amounts to be recovered from Turkish Cypriot entities is impossible. Co-financing and other conditionality set out in project fiches also face enforcement problems.

³⁶ Council Regulation (EC) No 389/2006 establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community, adopted on 27 February 2006. On the basis of this regulation, €259 million was allocated from the 2006 EU budget.

All these risks have been extensively discussed at IRM³⁷ meetings since 2009. The Commission has adopted mitigating measures including intensive monitoring and support, revised payment conditions, gaining assurance from the beneficiary on access rights and other issues, suspensive clauses in contracts and, in the case of one large project for €27 million, dividing the contract into two to limit the Commission's financial liability if access restrictions are not lifted.

2011 will be a critical year in terms of sustainability of results. A number of large-scale EU funded works and supplies investments will be completed and handed over to the Turkish Cypriot beneficiaries. They need to allocate the necessary well trained staff to operate and maintain these new assets and the budgets for their operation and maintenance. They will also need to undertake the reforms and structural changes necessary to make them work in a sustainable manner in line with EU standards. On all these fronts, considerable challenges still remain for the beneficiaries to catch up in time.

A further risk, internal to the Commission, is linked to the precarious budgetary basis under which the programme team, largely made up of contract agents, is funded. DG Enlargement is seeking a more solid arrangement in the 2012 draft budget currently under preparation.

The Court of Auditors is currently carrying out a performance audit of this assistance.

- ***Impact of the establishment of the European External Action Service on the control systems for implementing pre-accession assistance (Relex family cross-cutting risk)***

Heads of Delegation, now EEAS staff, will continue to be sub-delegated authorising officers implementing DG Enlargement's assistance programmes. It is, however, a matter of concern that Deputy Heads of Delegation, who in the enlargement area were usually entrusted with the executive role in the management of assistance, can no longer perform that role as sub-delegated authorising officers. Furthermore, DG Enlargement has become involved in the management of some additional 500 staff serving in the Delegations of its zone (formerly managed by DG RELEX). It is too early to assess reliably what impact this may have on workloads. Discussion of the respective roles of the institutions concerned is still underway. Significant risks will remain in this area until new arrangements are fully and satisfactorily implemented.

- ***Poor absorption of aid in Croatia, Turkey***

In Croatia, contracting activity improved, with a rate of 92% achieved for the IPA 2007 national programme at expiry. Nevertheless, there are delays in contracting the IPA 2008 programme, and an extension of the contracting deadline is sought by the Croatian authorities. In the case of Turkey, absorption lagged considerably behind the expected targets, and the national implementing authorities are building a contracting backlog which reached over €800 million by the end of 2010. The contracting authority, the CFCU, has a professional approach, yet its capacity appears to be insufficient to manage components I and II of IPA. The measures proposed by the Commission in this respect have not been sufficiently addressed, and this matter remains under close scrutiny (see also item ii) under '*Inherent risk in decentralised management*' above).

³⁷ Interim Review Mechanism, a mechanism akin to a Joint Monitoring Committee. It acts as a forum to discuss in detail the implementation of the aid programme with the beneficiaries.

- ***Backlog in IPA implementation by the EU Delegation to the Former Yugoslav Republic of Macedonia***

This risk was linked to the capacity problems of the EU Delegation, which was one of the recently devolved Delegations following the phasing out of the EAR. In 2010, the contracting performance was satisfactory. Concerns about absorption capacity in the future remain, but the focus is on the capacity of the local administrations upon which contracting and management powers were conferred at the end of 2010.

- ***Limited implementation of earlier IFI co-operation***

In 2010, efforts continued to speed up implementation and disbursement of various IFI facilities created under the PHARE programme. The total value of these facilities is about €435 million. Amendments to the 2005 and 2006 Phare Municipal Finance Facility and SME Finance Facility (with the Council of Europe Development Bank in cooperation with KfW) made the resources available to the Green for Growth Fund and the European Fund for South East Europe and triggered payments by DG ECFIN in the last quarter of the year for a total of more than €53 million. Further amendments of other IFI facilities (with EIB) were initiated by the end of 2010 that should further increase performance and absorption of these programmes.

- ***Shortfalls in co-financing***

No major issues have arisen in this area thanks to regular contacts with national authorities and close monitoring (other than those linked to the TCc assistance programme risk above).

- ***Policy related risks***

In its AMP for 2010, the DG flagged a number of significant risks of a political nature with potential impact on the pre-accession processes in the Western Balkans and Turkey, and on the issue of the Turkish Cypriot community. They included the risk of

- ▶ slowdown of Turkey's accession process, particularly in connection with the progress of the settlement talks in Cyprus and Turkey's failure to implement the Additional Protocol;
- ▶ failure to reach a settlement and unification in Cyprus;
- ▶ deadlock on central political issues in the former Yugoslav Republic of Macedonia, and, for this country, of blockage of the start of accession negotiations;
- ▶ the process of conferral of management for IPA component I to the Former Yugoslav Republic of Macedonia being delayed;
- ▶ insufficient progress on key political reforms in Albania, Bosnia and Herzegovina, and Montenegro;
- ▶ insufficient cooperation by Serbia with the ICTY;
- ▶ the stalling of regional co-operation in the Western Balkans.

All these 'environmental' risks for the enlargement policy area remained present throughout 2010. Specific developments are reported in Part 1 of this AAR.

3.1.3.3 Follow-up to audit recommendations issued in previous years (IAC, IAS, Court of Auditors)

Internal Audit Capability (IAC)

No 'critical' recommendation issued by IAC in previous years is still outstanding. However, three 'very important' recommendations were still to be addressed. They cover the need for a

workload assessment methodology, the quality of the “certified correct” visa on requests for payments in decentralised management, and the development of a harmonised management information system for Delegations. All risks associated with these points are covered elsewhere in this report³⁸. With one exception, the IAC in its annual report assessed the residual risk and impact associated with the outstanding recommendations as moderate or limited taking into account the follow-up work already undertaken by management. The exception concerned the need for a safeguard ensuring the handover of liability for infrastructure installations completed under the Turkish Cypriot community assistance programme. In this case, the IAC had assessed the residual risk as still significant (see also section 3.1.3.1 above on follow-up to risks). The issue has in the meantime been addressed through the issuance of a specially designed handover instrument, and an IAC follow-up audit³⁹ considered the recommendation implemented. However, the follow-up audit also noted that the underlying risk remained. The unilateral acceptance certificates for completed infrastructure projects may not fully absolve the EC of legal liability for damages caused in connection with these installations. The auditors recognised, however, that this was an inherent risk associated with providing financial assistance to the Turkish Cypriot Community for infrastructure projects in the northern part of Cyprus. The Commission would need to decide whether to accept this significant residual risk.

Internal Audit Service (IAS)

All ‘critical’ and ‘very important’ recommendations issued by the IAS in previous years have been completed by management⁴⁰ with the exception of a recommendation on the implementation of a common management information system for Delegations, which is in the process of being completed (see e.g. section 2.2.2 on this).

Court of Auditors

Concerning its earlier recommendations the Court noted that DG Enlargement had duly addressed the recommendation on developing the multiannual programme of the IAC. It further welcomed the DG’s initiative to develop a strategy for *ex post* controls of centrally managed projects, but noted that the new strategy would be put in practice in 2010 and still needed to prove its effectiveness. Finally the Court noted that DG Enlargement still needed to devote special attention to the follow-up of the implementation of the post-accession funds in Bulgaria, where fundamental weaknesses remained concerning potential irregularities in the management of PHARE funds by two agencies in Bulgaria. This weakness was met by a reservation by DG Enlargement in AAR 2007 and 2008, followed by the implementation of a strict action plan. As reported elsewhere⁴¹, the DG remains focussed on conducting rigorous clearance of accounts procedures for all programmes still outstanding.

3.1.4 Assurance received from other Authorising Officers in cases of crossed sub-delegation

In 2010, cross-delegations from DG enlargement amounted to approx. €35.7 million in commitments and €101.1 million in payments. These funds were managed through centralised direct implementation.

³⁸ E.g. section 2 on internal control standards, section 3.1.3.1 on follow-up to risks.

³⁹ Ares(2011)205212 of 23 February 2011.

⁴⁰ However, in some cases the IAS has not yet validated this completion through follow-up audits.

⁴¹ See section 3.1.3.1 “Follow-up to significant risks flagged in the management plan for 2010”, bullet point “Regularity of implementation of PHARE programmes and Transition Facilities in Bulgaria and Romania”.

Cross-delegated implementation 2010, in €		
To DG	Commitments	Payments
RELEX	31,416,007	31,855,567
ECFIN	0	57,809,428
ESTAT	1,000,000	7,397,978
ENV	70,000	2,145,577
EAC	2,000,000	0
SCIC	10,000	9,897
TAXUD	705,000	191,929
ENTR	300,000	0
JRC	30,000	12,651
PMO	0	449,458
EMPL	24,900	0
DGT	50,000	0
MOVE	69,000	52,110
ECHO	8,000	1,198,896
Total	35,682,907	101,123,491

Cross sub-delegations are based on written agreements setting out the conditions and rules of management and control, including frequency of reports and controls to be carried out.

In particular, cross-delegated Directors General commit themselves to inform DG Enlargement in writing of any management problems or irregularities encountered and action taken.

Examples of significant activities carried out under sub-delegation included the management of staff serving in EU Delegations in the enlargement zone (by DG RELEX); a DG EAC project to provide support to the former Yugoslav Republic of Macedonia's national agency monitoring the Lifelong Learning and Youth in Action Programmes; a project to enable the Turkish Customs Administration to fully implement the Common Communication Network and Common System (CCN/CSI) in line with EU requirements of interconnectivity and interoperability (by DG TAXUD); SME Finance Facilities with the EBRD and CEB/KfW⁴², and Energy Efficiency programmes with CEB/KfW (by DG ECFIN); and multi-beneficiary statistical cooperation programmes (by DG ESTAT).

DG Enlargement has received appropriate assurance from most relevant services. Some reports still outstanding have no material impact on 2010 payments. Cross-delegated services operate under the Financial Regulation and have internal control systems responding to the same standards as DG Enlargement. DG Enlargement fully relies on their reporting.

3.1.5 Completeness and reliability of the information reported in the building blocks

The information reported in sections 3.1.1 to 3.1.4 above covers the totality of the budget delegated to DG Enlargement.

Concerning the audit reassurance activity, two IAC audits and two IAS audits contributed to the IAS overall audit opinion in 2010. These four audits covered €480 million in commitments and €436 million in payments, which represents respectively 46% and 45% of total DG ELARG commitments and payments⁴³.

⁴² Council of Europe Development Bank and Kreditanstalt für Wiederaufbau.

⁴³ See note 27 concerning differences between audit coverage and this report's scope.

Risks pointed out by auditors, and recommendations issued upon them, have been systematically followed up. No critical recommendation is outstanding.

In 2010, DG Enlargement intensified its efforts to further strengthen its control framework and internal guidance. The DG further strengthened its planning and reporting mechanisms and further tightened the monitoring of budget implementation, with positive results.

In 2010, weaknesses and risk developments have been detected and monitored early and discussed at senior management level, leading to swift corrective action. Following the weaknesses that had led to a reservation on two Bulgarian implementing agencies in 2007 and 2008 and the successful implementation of an action plan in 2009, the DG continued to focus on ensuring that financial corrections and recoveries are applied where appropriate when processing final declarations and clearing accounts.

Overall, the indicators for legality and regularity confirm the robustness of the DG's control systems.

In centralised management, additional on the spot controls have been applied to a substantial share (over one third) of ongoing contracts. Corrections to centralised payments on grounds of error, irregularity, or suspected fraud detected through different types of controls amounted to approximately 1% of total relevant payments, which falls in the expected range.

In decentralised management of pre-IPA programmes, the error rates, including the predicted residual rate of error, remain below materiality.

Indicators of the quality and effectiveness of decentralised systems (rejection rates, red flags from systems audits, irregularities reported) show progress, albeit at varying pace. Weaknesses in decentralised systems are systematically followed up with the relevant national authorities. In particular, the Turkish NAO will shortly present an action plan to remedy the systems weaknesses noted by the DG's and national auditors. The impact of local systems weaknesses remains strongly mitigated by the EU Delegations' *ex ante* controls on procurement and own additional monitoring of implementation. Where *ex ante* controls no longer apply (finalisation of pre-IPA programmes in new Member States), financial corrections are applied to contracts affected by detected system weaknesses.

This provides a reliable basis for the assurance that the principles of sound financial management have been respected in all areas and that no major weaknesses persist for which no remedial action has been taken yet.

Taken together, these results underpin the declaration of reasonable assurance without reservations provided in part 4.

3.2 Reservations

N.a.

3.3 Overall conclusions on the combined impact of the reservations on the declaration as a whole

N.a.

PART 4. DECLARATION OF ASSURANCE

I, the undersigned,

Director-General of DG Enlargement

In my capacity as authorising officer by delegation

*Declare that the information contained in this report gives a true and fair view*⁴⁴.

State that I have reasonable assurance that the resources assigned to the activities described in this report have been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions.

This reasonable assurance is based on my own judgement and on the information at my disposal, such as the results of the self-assessment, ex-post controls, the work of the internal audit capability, the observations of the Internal Audit Service and the lessons learnt from the reports of the Court of Auditors for years prior to the year of this declaration.

Confirm that I am not aware of anything not reported here which could harm the interests of the institution.

Brussels, 31 March 2011

[Signed]

Michael Leigh

⁴⁴ True and fair in this context means a reliable, complete and correct view on the state of affairs in the service.

TECHNICAL APPENDIX

General financial performance indicators

Indicator	2005	2006	2007	2008	2009	Annual target	2010
Total commitment credits available (M€)	2,047.4	2,358.2	1,083.7	1,156.2	1,084.3		986.1
Total commitment credits executed (M€)	1,882.2	2,302.8	1,004.5	1,120	1,074		976.1
Commitment execution rate (%)	91.9	97.6	92.7 (C1: 98.5)	96.9 (C1: 99.3)	99.1 (C1: 99.8)	≥ 90	99 (C1: 99.9)
De-commitments (M€)	131	245	186	296.1	476	≥ 80	314.3
Total payment credits available (M€)	2,495.3	2,110	1,729.2	1,579.1	1,343.1		1,050.6
Total payment credits executed (M€)	1,861.7	2,062.5	1,696	1,499.2	1,224.6		1,034.5
Payment execution rate (%)	74.6	98.1	98.1	95 (C1: 97.4)	91.2 (C1: 91.4)	≥ 90	98.5 (C1: 99.2)

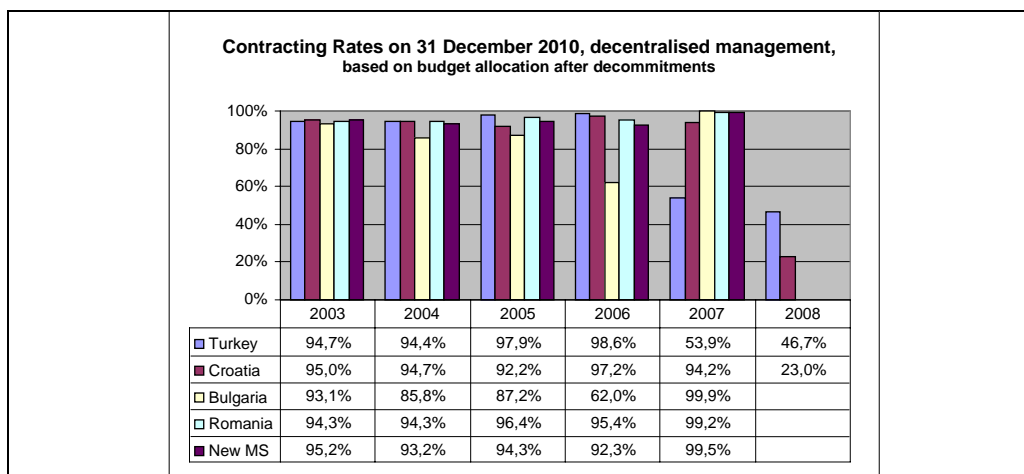
# of payments	5,147	3,652	3,021	2,395	3,188		3,325
# of times interests on late payment are paid				4	13	≤ 100	17
Amount of interests paid on delay (€)				23,056.5	18,034	≤ 200.000	12,417
Amount of RAL end year (M€)	5,521.3	5,495.6	4,612.8	3,910	3,203.4		2,734.1
Variation of abnormal RAL versus y-1 (M€) (incl. Cards)	+160	+85.6	-177.96	-175.5	-117.6	≤ 50	-182.3
# of recovery orders	229	261	331	367	288		241
Recovery orders (M€)	72.2	38.9	218	153.8	60.7		66.8
# of negative recovery orders: tech. adjustments, cancellations, waivers	12	31	7	4	15		0
Negative recovery orders issued (M€)	0.17	8.7	2.98	0.2	0.4		0
Total recoveries from ex-post controls and irregularity/OLAF reports (M€) in 2010*					20.8		30.7
# of programmes audited so far**	107	206	311	374	446		484
Programmes audited, accumulated (M€)		1,739.3	2,772.8	3,342.2	3,810.9		4,164.9
Programmes audited, closed, accumulated (M€)		783.2	1,191.1	2,023	3,038.9		3,533.3
# of ex-post controls closed in 2010**				80	110		58
Error rate for ex-post controls closed (%)				0.72	0.81	≤ 2%	0.82
# number of contracts closed			2,139	1,408	2,324	≥ 1,000	1,891

* In addition 49 invoices were reduced by a total of € 12 million of non-eligible amounts plus 110 credit notes issued to reduce the eligible amounts by € 1.1 million.

** The figure represents the amount of entries in the audit register. The entries are created on the basis of audit reports received on the basis of one entry per audit report per Financing Memorandum per implementing agency.

Contracting rates by end 2010

Contracting rate for all countries reported end of December 2010 based on budget allocation after de-commitments						
(E)DIS implementation (%)						
Reporting year	2005	2006	2007	2008	2009	2010
Programme year 2001	93.1					
Programme year 2002	98.4	96.93				
Programme year 2003	84.8	98.6	94.9			
Programme year 2004	17.9	84.1	94.2	95.5		
Programme year 2005		11.2	61.5	86.8	89.8	
Programme year 2006			5.8	58.4	70.1	94.7
Programme year 2007					13.7	65.8
Programme year 2008						43.2



Note: The contracting period for most programmes from programme year 2008 on have not yet expired.

Legality and Regularity Indicators

• Corrections to centralised payments

This indicator measures the financial impact of *ex ante* controls of payments relating to centrally and jointly managed contracts. It counts **corrections** (deductions or recoveries) made to centralised payments as a result of detection of error, irregularity, or suspected fraud⁴⁵. The AMP 2010 target range was between 0.5% and 1.5%.

Value for 2010

CORRECTIONS TO CENTRALISED PAYMENTS						
by management mode and reason for correction						
Mode / Reason	Grants		Procurement		All Contracts	
	Amount	N°	Amount	N°	Amount	N°
<i>Centralised Direct</i>	2,625,795	121	3,296,810	226	5,922,605	347
Error	1,720,988	53	1,740,430	98	3,461,418	151
Irregularity	904,807	68	1,373,955	126	2,278,762	194
OLAF notified	0.00	0	182,425	2	182,425	2
<i>Joint</i>	82,760	3	NA	NA	82,760	3
Error	72,699	2			72,699	2
Irregularity	10,061	1			10,061	1
OLAF notified	0	0			0	0
<i>Centralised Indirect</i>	0	0	NA	NA	0	0
Error	0	0			0	0
Irregularity	0	0			0	0
OLAF notified	0	0			0	0
Total	2,708,555	124	3,296,810	226	6,005,365	350

In 2010, a total of **350 corrections** (deductions or recoveries) were made to centralised payments for a total value of approx. **€6.0 million**. Two thirds (55% by value) concerned procurement contracts and one third (45% by value) concerned grants.

All but three corrections affected contracts managed under the centralised direct mode either at headquarters or in Delegations. Total corrections to payments amounted to €5.9 million, or approx. **1%** of total centralised direct payments. This meets the management plan target of

⁴⁵ Excluding corrections made to recover bank balances or unused advance payments.

between 0.5% and 1.5%. For joint management, the ratio is only 0.1%, and for centralised indirect 0% (counting only corrections triggered at Commission level). Of total corrections, €132,021 was corrected as a direct consequence of on the spot checks carried out by EU Delegations or headquarters Units.

- Derogations, prior approvals and other exceptions authorised

Internal guidance⁴⁶ issued in March 2010 modified the internal reporting of derogations. The new arrangements distinguish derogations, mandatory prior approvals and other exceptions⁴⁷. As a consequence, figures for the 1st quarter are presented separately from the values for the three other quarters of 2010.

DEROGATIONS, PRIOR APPROVALS AND OTHER EXCEPTIONS value in €mio	1 st quarter		Final 3 quarters	
	Number	Value	Number	Value
Derogations	16	9.48	n.a.	n.a.
Derogations and other exceptions	n.a.	n.a.	30	4.93
Prior approvals	n.a.	n.a.	67	77.85

The target set in the Management Plan was <20% of commitment appropriations. All values in the table put together reach just under 10%.

- Error rate in decentralised management

This indicator measures the recovery rate⁴⁸ from *ex post* controls in decentralised management as a proxy for the level of error in the transaction population. It is a key building block for the quantitative assessment of the materiality of error in funds under decentralised management in the annual declaration.

The AMP 2010 target was < 2%. Meeting this target means that the level of errors in transactions not controlled *ex post* is unlikely to be material.

Value for 2010

The overall error rate across all audited programme years remains below materiality, at **0.82%**. For the audits accrued during 2010 (ie, closed in 2010 irrespective of year of programming), the specific rate found was **0.5%**.

With the exception of programme year 1992, all programme year error rates for which almost all audits have been processed (up to 2002) are below materiality.

⁴⁶ Director General's note ARES (2010)179782 of 26 March.

⁴⁷ **Derogation:** waiver from a specific rule applicable to a procedure or contract foreseen in the applicable legal instruments. **Prior approval:** exception to a general rule which, while specifically permitted or not explicitly prohibited by the applicable rules, requires adequate justification from the AOSD. **Other exceptions: regularisations and/or any deviation from policies and procedures established in legal instruments issued by an authority hierarchically higher than the Director General** (e.g. the Council, the European Parliament or the College) under exceptional circumstances.

⁴⁸ Error rates = Recoveries issued as % of funds audited in *ex post* controls up to 2010. Only closed *ex post* controls are counted toward the error rates.

ERROR RATES IN <i>EX POST</i> CONTROLS UP TO DEC 2010						
Error rates = Recoveries issued as % of funds audited in the <i>ex post</i> controls up to 2010. Only closed <i>ex post</i> controls are counted toward the error rates.						
	Amount audited total (M€)	Recoveries (M€)	Error rate (%)	Amount audited for audits closed in 2010 (M€)	Recoveries 2010 (M€)	Error rate (%)
Total	3,533.3	29	0.82	517.2	2.6	0.5

Breakdown by country, all audits closed to date

Bulgaria	355.3	1.1	0.30	75.2	0.2	0.27
Cyprus	10.2	0.03	0.26	6.5	0.03	0.41
Czech Republic	594.4	1.2	0.2	54.6	0	0
Estonia	73.7	2.7	3.6	2	0	0
Hungary	344.9	4.3	1.25	56.5	0.7	1.22
Latvia	44.1	0.004	0.01	3.8	0	0
Lithuania	95.7	1.5	1.55	18.6	0.2	0.9
Malta	9.1	0.02	0.23	0.8	0.02	2.54
Poland	1,093.6	11	1.01	123.2	1	0.81
Romania	568.5	5.5	0.97	138.4	0	0
Slovenia	99.7	0.7	0.71	20.6	0.3	1.67
Slovakia	244.1	1	0.41	17	0.2	0.97

Breakdown by programming year

	Amount Audited (M€) total	Recoveries (M€)	Error rate (%)
1990	1	0.003	0.33
1991	47.1	0.007	0.01
1992	95.5	8.3	8.64
1993	114.8	1.4	1.26
1994	154.6	0.4	0.26
1995	200.3	0.7	0.33
1996	205.2	2.1	1.03
1997	275.2	0.4	0.14
1998	275	3.7	1.33
1999	386.4	2.2	0.57
2000	657.4	1.8	0.27
2001	266.2	4.1	1.52
2002	582.7	2.6	0.45
2003	142.2	0.5	0.36
2004	61.5	0.8	1.31
2005	67.2	0.03	0.05
2006	0.8	0	0

Country specific error rates are shown only indicatively and are not statistically representative. The sampling methodology is designed for a materiality statement by programming year across all countries (see tables above)⁴⁹.

• Predicted residual error rate

The “residual error rate” represents the percentage of unknown errors per programming year which remain after the recovery of the known errors. It is computed statistically for each programming year by extrapolating the errors found in a statistically representative sample of

⁴⁹ Not all audits for all programming years have been closed. In some cases quite lengthy contradictory procedures may occur. From programme year 2003 onwards, most audits are still in contradictory procedure or under AOSD review. However, there are still open audits also for years 1993, 1995, 1998, 1999, 2000 and 2002. The share of open audits is minor, except for 1998 (16.9%) and 1999 (7.8%).

transactions. These errors are obtained from the audit findings (potential errors) raised by external auditors. It is expected that after the contradictory procedure laid down in the IPA regulation, some of these findings will lead to confirmed errors subject to recovery. The historic ratio of findings to confirmed errors is approximately 5 to 1.

The added value of this indicator consists in providing a preliminary indication of the error rate in programme years more recent than those for which the recovery-based error rate has reached a stable value (see error rate above).

Value for 2010

The value of findings for the programme year 2004 was 5.64% of the value of the audited sample. With the preliminary audit findings now available for all the contracts relevant to the 2004 programme year sample, it can be statistically extrapolated⁵⁰ that the unaudited 2004 population would yield 5.8% financial findings or potential residual errors. This in turn predicts a true residual error rate of **1.16%** based on the historic average of the ratio between recoverable errors and financial findings (1 : 5)⁵¹.

EXTRAPOLATION OF RESIDUAL ERROR RATE	Predicted error rate based on historic share of findings confirmed as recoverable error (20%)	
	TARGET	PREDICTED RESIDUAL ERROR RATE
2004 PROGRAMME YEAR	<2%	1.16%
2003 PROGRAMME YEAR	<2%	0.44%
2002 PROGRAMME YEAR	<2%	[0.64% PREDICTED]
		[0.45% REAL]

The significant increase in the predicted residual error rate for programme year 2004 reflects the higher weight of transactions in Bulgaria and Romania⁵² in the population and in the audited sample further to the decrease of the assistance provided to the EU-10 after accession. The risk of error in transactions in these two countries can be considered as high. Contracts in Romania represent 37% of the sample but account for almost 50% of the value of all identified findings. This is consistent with the risk and reservation reports and action taken by DG Enlargement as reported in AARs from 2007 to 2009.

• Irregularities reported by National Authorities

Where pre- or post-accession assistance is implemented by the beneficiary countries the national authorities are required to report regularly on detected irregularities and suspected fraud cases. Where appropriate, OLAF launches its own investigations after evaluating the case.

This indicator shows the number and value of irregularities reported by NAOs in 2010. It sets the total value of reported irregularities against the total value of financing memoranda under implementation in the same period (under implementation = final payment not effected). Note that the irregularities may concern contracts from any programme year. The ratio of value of

⁵⁰ At a 95% confidence level and 2% materiality level.

⁵¹ For reference, the predicted error rate for 2002 under the same assumptions was 0.64%. The error rate for the sampled 2002 transactions is 0.45% (see error rates in decentralised management above).

⁵² They represented 60% of the value of the population (66% of number of transactions) for programme year 2004, compared with 21% of the value of the population (18% of number of transactions) for programme year 2003.

reported irregularities to value of running financing memoranda is therefore designed to provide a contextual order of magnitude rather than a precise rate of irregularity.

Value for 2010

During the last quarter of 2009 and first three quarters of 2010 Bulgaria, the Czech Republic, Poland, Romania, Slovakia, Latvia and Hungary have reported new irregularities as follows:

IRREGULARITIES REPORTED				
Country reporting	Number	Amounts concerned, €		
Bulgaria	124	3,524,124		
Czech Republic	1	67,490		
Poland	1	10,565		
Romania	35	4,169,817		
Slovakia	2	4,836		
Latvia	1	1,474,200		
Hungary	1	43,576		
Turkey	18	1,499,137		
Croatia	21	378,883		
Total	204	11,172,628	Financing Memoranda running	%
			€2,827,509,654	0.4

Over 60% by number (32% by value) of the irregularities reported in the period have been reported by the Bulgarian authorities. This is evidence of a sustained change of approach regarding the reporting of irregularities following the action plan that led to the reservation being lifted in AAR 2009. However, the high ratio of irregularities reported (roughly 5% of financial agreements running in Bulgaria) also bears out the DG's justification in having filed those reservations in the past. Romania shows an even higher number of irregularities by value, but this represents less than 1% of the financing memoranda running in the period.

As a whole approx. 582 suspected and reported irregularities are open, mainly in Romania and Bulgaria under the PHARE programme, most of which are likely to be subject to recovery. The figure below includes all cases reported by the national authorities as well as irregularities identified through the DG's internal and external on the spot monitoring, press news, audit findings, etc.

Country	Open reported irregularities likely to be subject to recovery	Open OLAF cases likely to be subject to recovery
Bulgaria	233	12
Cyprus	0	0
Czech Republic	16	5
Estonia	0	0
Hungary	8	2
Latvia	0	1
Lithuania	1	2
Malta	0	0
Poland	6	9
Romania	260	47

Country	Open reported irregularities likely to be subject to recovery	Open OLAF cases likely to be subject to recovery
Slovakia	2	4
Slovenia	4	1
Turkey	52	12
Croatia	n.a.	2
Total	582	97

OLAF cases reported, end of year					
Countries	2007	2008	2009	2010	under evaluation*
EU-10	27	26	28	23	4
Bulgaria	22	34	30	16	0
Romania	86	59	64	47	5
Turkey	22	21	27	15	2
W. Balkans	24	23	30	32	5
Total	181	163	177	133	16

* Cases under internal evaluation: suspicion of irregularity or fraud not yet confirmed.

By the end of 2010, OLAF had reported 133 cases to DG Enlargement, of which 16 were still at the stage of internal evaluation.

Concerning the New Member States of the fifth enlargement, the total number of cases communicated to and followed-up by OLAF (23) is decreasing.

The number of irregularities reported by Romania continues on a downward trend. No major frauds have been reported to the Commission. Most irregularities concern small contracts and amounts that have been incorrectly spent, especially for grants at local level. The impression is that Romanian authorities, in particular the Anti-Fraud Service (DNA), continue to be quite proactive in tackling all irregularities, regardless of the amount involved.

Concerning Bulgaria, there are 16 OLAF cases in the various stages of investigation; no new cases have been filed in the last months and 8 are under active investigation, which compares to 22 cases last year. In Turkey, (15 cases of which 2 new ones in evaluation) it is worth noting that the EU Delegation is the source for more than half the listed cases reported to OLAF.

• Rejection rates

This indicator shows, for each Delegation, the ratio between the number of rejections of tender, evaluation, and contracts documents submitted by national Implementing Agencies (IAs) for the Commission's *ex ante* control⁵³ and the absolute number of submissions of documents for approval in the reporting year.

A sustained reduction of rejection rate levels is an important condition for the Commission to waive *ex ante* controls on procurement files⁵⁴.

⁵³ This indicator therefore does not by definition apply to countries where *ex ante* controls have been waived by the Commission. However, no country for which *ex ante* controls had been waived is contracting anymore.

⁵⁴ Rejection rates reflect both the skills and effectiveness of the IA and national administration staff and systems in delivering sound and efficient procurement, and the effectiveness of the *ex ante* controls by the EU

Value for 2010

Rejection Rates							
Country	Stage	2010	2009	2008	2007	2006	2005
Turkey	Tender dossiers	64.7	85.3	72.1	51.9	19.9	20.2
	Evaluation reports	30.7	27.4	29.2	19.7		
	Contracts	19.3	54.2	23.3	14.1		

Croatia*	Evaluation reports	1 st submission	14	20	22	60	35/45.8	n.a.
		further submissions	20	67	35	34		
	Contracts	1 st submission	20	21	20	60	2/12.5	
		further submissions	10	33	37.5	34		

*In Croatia rates are recorded on first and later submissions. The DIS system started in early 2006 only. In 2006, rates for PHARE (1st) and CARDS (2nd) are presented separately. In 2007, Croatia figures were not reported separately for evaluation reports and contracts.

The figures for rejection rates, and especially their comparability over time and across countries, need, however, to be viewed with caution. A number of factors qualify their value, including methodological changes over the years, and weaknesses in the compilation of data based on the current information systems. In mid-2010, DG Enlargement adopted a standardised approach to rejections and the calculation of rejection rates.

• Systems audits findings

Shows the number of critical and significant findings reported in 2010 in systems audits performed by the Commission for countries with decentralised management⁵⁵.

Results of systems audits (including follow-up audits) are a very important indicator of the reliability of national administrations in decentralised management. Systems audits are carried out: a) before management powers are conferred upon the national authorities; b) before systematic *ex ante* controls by the EU Delegation in the beneficiary country are waived; c) after conferral of management powers, in order to assess the continued compliance of national procedures with EU rules. Romania and Bulgaria are in stage c), Croatia and Turkey in stage b), and the former Yugoslav Republic of Macedonia has recently moved to stage b).

The target is that no country shows any red flags and a maximum of 10 yellow flags.

Delegation. However, they do not directly assess errors, since ‘rejections’ take place prior to the execution of the underlying contracts by the decentralised manager. They rather denote *avoided* error.

⁵⁵ Auditors rate their findings as high risk, or ‘red flags’, and medium risk, or yellow flags. High risk means auditors consider that legal or operational risks arising from the weakness may put in doubt the reasonable assurance derived from National Authority systems for the Commission’s certification of expenditure claims; medium risk means the related weakness requires remedying but is less likely to have an immediate impact, and the Commission may therefore allow some time for the remedial action to be undertaken by the decentralised administration before it takes specific action.

Value for 2010

Systems Audits Findings, by Rating										
Country	High risk (red flags)					Medium risk (yellow flags)				
	2010	2009	2008	2007	2006	2010	2009	2008	2007	2006

COUNTRIES WITH DIS WITHOUT *EX ANTE* CONTROL (EDIS)

Romania	3	2	8	n.a.	1	0	4	12	n.a.	25
Bulgaria	3	n.a.	11	3	n.a.	1	n.a.	9	21	n.a.

COUNTRIES WITH DIS WITH *EX ANTE* CONTROL

Turkey	7 ⁵⁶	3	13	12	11	16	4	24	14	29
Croatia	0	n.a.	10	1	n.a.	11 ⁵⁷	n.a.	20	10	n.a.
Fyrom	0	12	n.a.	n.a.	n.a.	7 ⁵⁸	16	n.a.	n.a.	n.a.

The trend is generally toward fewer high risk findings. Nevertheless, the management plan target was reached only for the former Yugoslav Republic of Macedonia. It was narrowly missed for Croatia (by one yellow flag).

⁵⁶ 3 in a subsystems audit on management of irregularities, 4 in a conferral of management follow-up audit for components I and II.

⁵⁷ 4 in a component II conferral of management audit on modification of implementing agency, 7 in a component I conferral of management follow-up audit.

⁵⁸ Second conferral of management audit on high risk findings detected during the 2009 audit. Conferral of management powers to former Yugoslav Republic of Macedonia agencies occurred only in late 2010.