

**ANNUAL ACTIVITY REPORT 2007  
OF DG REGIONAL POLICY**

Final version - 31 03 2008

# TABLE OF CONTENT

<b>1. PART 1 - POLICY RESULTS</b> .....	<b>2</b>
1.1. Level of policy area.....	2
1.2. Level of the ABB Activities .....	7
1.2.1 European Regional Development Fund and other regional interventions .....	7
1.2.2 Cohesion Fund .....	12
1.2.3 Pre-accession interventions related to structural policies (IPA and ISPA).....	14
1.2.4 Management of the Solidarity Fund .....	15
<b>2. PART 2 - MANAGEMENT AND INTERNAL CONTROL SYSTEMS</b> .....	<b>17</b>
2.1. Inherent nature and characteristics of the DG's risk and control environment .....	17
2.2. Management and control systems .....	20
2.2.1 Characteristics of budgetary execution in 2007 .....	20
2.2.2 Management and control systems in DG Regional Policy .....	21
2.2.3 Management and control systems in the Member States .....	22
2.2.4 Relations with OLAF .....	24
2.3. Follow up of audit work and previous year's reservations.....	26
2.3.1 Audit work by the Directorate General .....	26
2.3.2 Preparatory work related to the 2007-2013 period.....	29
2.3.3 Follow up of 2006 AAR reservations.....	30
2.3.4 Follow-up of other action plans .....	32
2.3.5 Other follow up actions on systems with material deficiencies reported in 2006.....	34
2.3.6 Follow-up of ECA's annual report 2006.....	36
2.3.7 Action Plan towards an Integrated Internal Control Framework: actions in 2007 .....	39
2.3.8 Follow-up of Internal Audit Service (IAS)'s recommendations .....	42
2.3.9 Follow-up of Internal Audit capability (IAC)'s recommendations.....	43
2.4. Key indicators supporting reasonable assurance .....	44
2.4.1 Key indicators on legality and regularity.....	44
2.4.2 Annual summaries of Member States – Commission's assessment.....	49
2.4.3 Internal Control Standards .....	51
2.4.4 IAC's opinion and its contribution for building the assurance.....	53
2.5. Conclusion on the effectiveness of the internal control system .....	54
2.5.1 Internal control system in DG Regional Policy .....	54
2.5.2 Assessment of management and control systems in the beneficiary countries .....	55
<b>3. PART 3 - RESERVATIONS AND THEIR IMPACT ON THE DECLARATION</b> .....	<b>67</b>
3.1. Materiality criteria used .....	67
3.2. Reservations.....	69
3.3. Overall conclusions on the combined impact of the reservations on the declaration .....	73
<b>4. PART 4 - DECLARATION OF ASSURANCE</b> .....	<b>74</b>

# 1. PART 1 - POLICY RESULTS

## 1.1. Level of policy area

In 2007, DG Regional policy pursued the following 4 mutually reinforcing strategic priorities:

1. Negotiate successfully the operational framework of the programmes 2007-2013 in support of the Growth and Jobs agenda

DG Regional policy successfully negotiated in partnership with Member States and the regions the National Strategic Reference Frameworks (NSRF) and the generation of **2007-2013 programmes**. All 27 NSRFs were finalised between December 2006 and October 2007. Following intensive preparatory work, 311<sup>1</sup> operational programmes out of 335 were adopted, representing 98% of the €347 billion to be invested in 2007-2013, which makes it the fastest ever Cohesion policy's programming exercise. The main recipients of the funding are Poland (with €67.3 billion total allocation), Spain (€35.5 billion), Italy (€28.8 billion), the Czech Republic (€26.7 billion) and Germany (€26.3 billion). Altogether, the 12 new Member States will benefit from 51.25 % of EU Cohesion policy funding during the period.

The 2007-2013 programmes are targeted on factors of **competitiveness in line with the Union's top Lisbon priority for growth and jobs**. Through the so-called "earmarking" provisions, Member States committed to allocate a major share of the funding to the investments that lie at the heart of the Lisbon strategy: research, innovation, information society, human resources and business development. The minimum share has been set at 60% of the European funds available in the case of "Convergence" regions, and 75% for the other regions under the "Regional competitiveness and employment" objective. For the less developed regions under the Convergence objective in EU-27, where the resources are heavily concentrated, 65% of the funds are programmed for Lisbon-related objectives. This represents an increase of 11 percentage points compared to the previous programming period. Regions with programmes falling under the Regional Competitiveness and Employment Objective, which account for 16% of Cohesion policy resources, plan to invest as high percentage as 82% of the funds for 2007-2013 on Lisbon-related priorities. The approved 27 NSRF have succeeded in transposing the economic and social policy of growth and jobs at regional level, as well as fostering synergies with the National Reform Programmes for the implementation of Lisbon strategy at national level.

Encouragingly, the share of the *earmarked* Cohesion policy allocation in the EU-12 Member States is 59% for the Convergence objective despite they had no legal obligation for earmarking. Poland for example, even with extensive investment needs in basic infrastructure, has decided to concentrate 64% of its resources on Lisbon-related priorities.

These results were particularly highlighted in the Commission Communication of 11 December 2007 on "Member States and regions delivering the Lisbon strategy for growth and jobs through EU Cohesion policy, 2007-2013", forming part of the "Lisbon package" prepared for the 2008 Spring Council.

DG Regional Policy increased emphasis on **innovation** approaches in negotiations of 2007-2013 operational programmes, in particular as regards shifting the investment objectives from infrastructures towards core Lisbon-related priorities. In the case of Spain for example, in spite of the 42% reduction of the financial envelope in 2007-2013, financial efforts in R&D and innovation in the new programmes adopted will be two thirds higher than for 2000-2006. The cumulative allocations to innovation (encompassing RTDI, entrepreneurship, innovative ICT and human resources) amount to €99 billion, equivalent to 29% of the total envelope.

---

<sup>1</sup> 244 Convergence and Regional Competitiveness programmes + 58 Territorial Cooperation programmes + 2 IPA cross-border programmes + 7 IPA regional development programmes

During 2007, DG Regional Policy also worked closely with other Directorates General (RTD, ENTR and AGRI) to produce guidance to national and regional authorities on how to interlink Cohesion policy's programmes with innovation and research funding under the Seventh Research Framework Programme, the Competitiveness and Innovation Programme and Rural Development Programmes (COM(2007)474 of 16/8/2007). DG Regional Policy has also launched an evaluation to examine in more detail how the new programmes will deliver the Lisbon and Gothenburg objectives as well as a study on mechanisms of regional innovation governance.

DG Regional Policy has invested notable efforts for introducing **financial engineering** in the 2007-2013 programmes. **JEREMIE** ("Joint European Resources for Micro-to-Medium Enterprises") made important steps in 2007. More than 80 ERDF operational programmes for the period 2007-2013, covering 20 Member States, include the possibility of JEREMIE type actions. Complementary to the JEREMIE initiative, the Commission has adopted in November 2007 a communication on micro-credit in the EU. This communication "A **European initiative for the development of micro-credit** in support of growth and employment" aimed to make small loans, or micro-credit, more widely available in Europe to access to finance for small businesses and for socially excluded people, also ethnic minorities, who want to become self-employed.

Regarding **JESSICA** ("Joint European Support for Sustainable Investment in City Areas"), more than 80 ERDF operational programmes include the possibility of JESSICA-type actions and investments. In April 2007, the EIB created a new JESSICA task force, to help interested Member States to implement JESSICA.

The Commission encouraged Member States to adopt the necessary national provisions to ensure that **European Groupings of Territorial Cooperation** (EGTC) can be created. The EGTC will allow for single legal frameworks for cross-border, transnational and interregional operations, thus reducing the barriers to cooperation.

## 2. Improve the implementation of the 2000-2006 programmes and projects and promote the best quality of projects and methods

DG Regional Policy continued efforts to raise the quality of programmes and projects co-financed by Cohesion policy, an objective which also covers our work to promote the **reliable financial management** of programmes, notably through the implementation of our audit strategy. Our work on financial management, control and evaluation also contributed to the promotion of good governance of the co-funded programmes and projects.

The 507 programmes managed in 2007 by DG Regional Policy for the period 2000-2006 (226 national and regional programmes, 81 INTERREG<sup>2</sup>, 71 URBAN programmes, and 128 innovative actions) and the 1029 Cohesion fund (CF)/ex ISPA projects<sup>3</sup> led to 489 Commission decisions in 2007 (approval of major projects, lifting interim payments, changes of financial amounts...). Altogether 78 Cohesion Fund projects were closed in 2007.

The **partnership model** set up between the Commission and the national and regional authorities in the Member States for the implementation of the programmes has been giving utmost quality results. The case of Ireland constitutes a good example, where the national government decided to apply the same partnership structure used for the implementation of the ERDF financed programmes in the execution of the national development funds.

In order to be able to demonstrate the **added value of European Cohesion policy**, DG Regional Policy launched during 2007 the ex post evaluation of "Objective 1 and 2" 2000-

---

<sup>2</sup> to which the PEACE programme should be added

<sup>3</sup> from both periods 2000-2006 and 1993-1999 (1018 for 2000-2006 period)

2006 programmes. The evaluation will be carried out through 12 phased and interlinked evaluations which will be completed by the end of 2009. Preparatory work was also undertaken on designing the ex post evaluations of INTERREG, URBAN and ISPA.

Under the **Regions for Economic Change Initiative**, DG Regional Policy has been active in reinforcing the identification of good practice projects in different fields of economic modernisation through network activities and encouraging dissemination to the operational programmes. The key principles of reinforcing the spread of good practice and linking the networks to the mainstream were incorporated into the texts of the INTERREG IV C and URBACT II programmes adopted in 2007. Two major conferences under this banner were organised, "Regional policy responses to demographic challenges" in January and "Fostering competitiveness" in March. The **RegioStars Awards** for Innovative Projects launched in March 2007 was very successful as it attracted applications from more than 70 regions.

Two conferences took place in 2007 for the network programmes, ERIK+ and IANIS+, which aim to gather and transfer experience on innovation in relation to technological innovation and the information society.

With more than 5500 participants from 34 countries, the **OPEN DAYS "European week of regions and cities"** with the headline "*Making it happen: regions deliver growth and jobs*", the biggest event ever organised on European Cohesion policy, was held together with the Committee of the Regions and 212 regions and cities across the EU.

The **Task Force on Northern Ireland** has been set up in May 2007 with the aim, on the basis of a stocktaking, to make recommendations on how the administration, the private sector, the universities and research institutes come become more deeply involved in the EU activities.

Finally, DG Regional policy continued to develop a **structured dialogue on Regional policy with third countries**: after the signature of a Memorandum of Understanding with China in 2006, new formal agreements have been concluded with the Russian Federation on 23 May 2007 and with Brazil on 29 November 2007.

### 3. Stimulate the debate on the future Cohesion policy

DG Regional Policy has further reinforced the policy framework of Cohesion policy and began a process of reflection about the role of European Cohesion policy. In May, the Commission adopted the **Fourth Report on economic and social cohesion**, which was followed by the **Fourth Cohesion Forum** in September, with more than 1000 participants, opening the debate on the future Cohesion policy. The **public consultation** launched in the Cohesion Forum was very well received with over 100 responses.

The Fourth Cohesion report demonstrates the capacity of European Cohesion policy to adjust to changing circumstances. Cohesion policy has supported much-needed investment in infrastructure, human resources, and the modernisation and diversification of regional economies. It has also helped to shift the policy mix of public investment in Member States towards the priorities of the Union. Cohesion programmes have helped to promote regional convergence and employment. For example, the policy has contributed to increasing GDP by 2.8% in Greece and 2.0% in Portugal in the period 2000-2006; preliminary estimates suggest that over 2007-2013, the policy will contribute to increase the GDP of Lithuania, Latvia and the Czech Republic by ca. 8.5%, of Poland by ca. 5.5%, and of Greece by ca. 3.5%.

The debate on territorial cohesion continued throughout the year and culminated in the signature of the Lisbon Treaty, which introduced the concept of **territorial cohesion**. During the German Presidency, the Ministers responsible for spatial planning and regional development adopted the **Territorial Agenda** and the **Charter on urban sustainable**

**development** in Leipzig and invited the Portuguese Presidency to prepare an Action Plan to implement it, which was adopted at an informal ministerial meeting in the Azores.

The Commission adopted a **Communication on the strategy for the Outermost regions** (achievements and future prospects) in 2007 and launched a consultation of all stakeholders.

#### 4. Help the European Union to continue to make a success of enlargement

DG Regional Policy in 2007 has ensured that sound and coherent programming strategies 2007-2013 are agreed for Bulgaria and Romania.

**JASPERS** ("Joint Assistance in Supporting Projects in European Regions") helped improving the quality of major projects prepared by the Member States which joined the EU in 2004 and 2007 and deals now with 261 projects. Three regional offices in Warsaw, Vienna and Bucharest were opened in 2007 and JASPERS expanded close to its target number of staff.

DG Regional Policy was fully involved in 2007 to help Croatia, Turkey and the Former Yugoslav Republic of Macedonia (FYROM) prepare for the introduction of the **regional development component** of the Pre-Accession Instrument and approval of three Strategic Coherence Frameworks and seven IPA-regional development component programmes (for Croatia, Turkey and the FYROM). Potential candidate countries (the Western Balkans) were assisted in preparing themselves for the absorption of Regional development funds under IPA for which they become fully eligible once they receive Candidate Status. Efforts and assistance were also provided to prepare Croatia, Turkey, the FYROM, Albania, Bosnia, Montenegro and Serbia for the introduction of the **cross-border cooperation component** of the Pre-Accession Instrument. Two IPA-CBC programmes were approved in 2007.

The **screening exercise for "chapter 22"** on Regional policy and coordination of structural instruments was completed with Croatia and Turkey and both reports were submitted by the Commission to the Council for adoption in February and March respectively.

The table below highlights some **impacts of the policy** under each of the 4 general objectives of DG Regional Policy, which are: a) to stimulate the growth potential of the least-developed Member States and regions ('**Convergence**'); b) to strengthen regions' competitiveness and attractiveness as well as their employment capacity by anticipating economic and social changes ('**Regional competitiveness and employment**'); c) to promote stronger integration of the territory of the EU to support balanced and sustainable development ('**European territorial cooperation**'); and d) to assist candidate countries as well as potential candidate countries in their progressive alignment with the standards and policies of the European Union ('**IPA**').

In the context of shared management responsibilities for Cohesion policy, the data in the table below relate to activity which is primarily the responsibility of the Member States. Furthermore, there is a time-lag to obtaining such information. Further information will be available in 2008/2009 from the ex post evaluation of Objectives 1 and 2 programmes of the 2000-2006 period. First outputs on 2007 will be reported by Member States in 2008, but it will be some years before results are known.

As of 2007, the Cohesion Fund has been brought into the programming process of Cohesion policy. Both the ERDF and the Cohesion Fund are managed and implemented by the Member States in programmes. Therefore the outputs and results often relate to both funds.

**POLICY AREA : COHESION POLICY**

**Impact indicators**

Indicators	Target (long term)	Situation at end 2007
<b>1. General objective : Stimulate the growth potential of the least-developed Member States and regions ('Convergence')</b>		
Real GDP	Level increase by some 6-12.5% (by 2013) <sup>4</sup>	Baseline = 565.3 bn € <sup>5</sup>
GDP per capita	75 % of EU27	61 % (2005) <sup>6</sup> In 2005, in 4 of the new Member States (CY, CZ, MT and SI) GDP per capita had risen to above 75% of the EU-27 average <sup>7</sup>
Employment rate	70 %	55.5 % (2004) / 58.2% (2006)
Unemployment rate	Reach EU27 average of 8.2%	13.7 % (2004) / 11.0 % (2006)
Labour productivity	Increase by some 2-7% (by 2013) <sup>8</sup>	Index 100 in 2006 for respective countries
Gross Fixed Capital Formation in% of GDP	20-25% increase on average through the period	Baseline without Cohesion policy = 100
Earmarking (for the 'Growth and Jobs' agenda) <sup>9</sup>	> 60 % (EU15 in 2007-2013)	Baseline= 53 % (EU15 in 2000-2006) 65% foreseen for EU 27 (2007-2013)
Composite regional Lisbon indicator <sup>10</sup>	Increase	Baseline (2004-2005): 0.38 <sup>11</sup> The regions with the lowest scores can be found in Romania, Poland and Slovakia, where this reflects a combination of low productivity, low employment and low expenditure on R&D.
Expected jobs created 2007-2015	1.4 million <sup>12</sup> by 2015 (net)	
<b>2. General objective : Strengthen regions' competitiveness and attractiveness as well as their employment capacity by anticipating economic and social changes ('Regional competitiveness and employment')</b>		
Earmarking (for growth and jobs agenda)	> 77 % (EU15 in 2007-2013)	Baseline = 77 % (EU15 in 2000-2006) 82% foreseen for EU 19 <sup>13</sup>
Jobs created	Increase	450,000 gross jobs were created (in ERDF Objective 2 regions in six Member States (DK, FR, SE, UK, ES and NL for the period 2000-2006) 775,000 gross jobs to be created under the Convergence Objective and Regional Competitiveness and Employment Objective, based on 100 OPs (AT, BE, BG, CY, CZ, DE, EL, FI, FR, HU, IT, MT, NL, PL, PT, RO, SE, SI, SK, UK) for the period 2007-2013
Composite regional Lisbon indicator <sup>8</sup>	Increase	Baseline (2004-2005): 0.67 Regions with a particularly high score include Denmark, most Swedish regions, Etelä-Suomi in Finland, regions in the South-East of the UK, Noord-Holland and Bayern in Germany.
<b>3. General objective : Promote stronger integration of the territory of the EU to support balanced and sustainable development ('European territorial cooperation')</b>		
Number of cooperation projects and networks	15.000 (at end of period)	Baseline (2007) : 0
<b>4. General objective : Assist candidate countries as well as potential candidate countries in their progressive alignment with the standards and policies of the European Union ('IPA')</b>		
Progress as reported in the annual progress reports of the Commission on candidate countries	Improved capacity of candidate countries	Situation of each <b>candidate country</b> as assessed in the 2007 progress reports: <b>Croatia:</b> Some progress on <i>Regional policy and co-ordination of structural instruments</i> , but continued efforts needed to set up the necessary administrative structures. <b>Turkey:</b> Progress has been made on <i>Regional policy and coordination of structural instruments</i> , particularly in designating implementing structures for the regional development components of IPA, but overall alignment remains limited (administrative capacity at central level lagging behind, process of establishing structures at regional level. <b>FYROM:</b> Progress can be reported in the area of Regional policy and co-ordination of structural instruments. But, substantial efforts are still needed to establish the necessary institutional and administrative capacity at central and local levels.
Situation for potential candidate countries		<b>Potential candidate countries:</b> National Programmes (under IPA component I) for 2007 were reviewed and adapted as appropriate to assist the countries in their efforts to become better prepared to absorb IPA regional development funds once they become available to them.

<sup>4</sup> According to HERMIN simulation for CZ, EE, LV, LT, HU, PL, SI, SK, and RO, BG

<sup>5</sup> Level in 2006 for EU-10 (CZ, EE, CY, LV, LT, HU, MT, PL, SI, SK) plus RO + BG, in 2000 market prices at 2000 exchange rates

<sup>6</sup> 75 regions were below the 75% threshold in 2005: 50 in the new Member States (PL,RO,CZ,BG,HU,SK,SI,EE,LV and LT) and 25 in the rest of the Union (EL,IT,PT,FR, DE, UK and ES)

<sup>7</sup> Source : 4th Report on Economic and Social Cohesion (2007)

<sup>8</sup> According to HERMIN simulation for CZ, EE, LV, LT, HU, PL, SI, SK, and RO, BG

<sup>9</sup> The "earmarking" of resources under Cohesion policy programmes 2007-2013 aims to support certain Lisbon-related priorities (innovation, RTD) to ensure efficient allocation of cohesion resources to make a full contribution towards growth and employment.

<sup>10</sup> To obtain a regional perspective on the Lisbon Agenda, a synthetic index has been created based on six of the short-listed Lisbon indicators relevant at the regional level. Although it is intended only to provide a rough indication of how regions are performing in relation to the Lisbon Agenda, it is nevertheless the case that, a region which scores high will be well on its way to achieving several of the Lisbon targets, while a region with a low score will be a long way off.

<sup>11</sup> On a scale ranging from 0 (far from Lisbon targets) to 1 (on way to Lisbon targets).

<sup>12</sup> Source: HERMIN simulation

<sup>13</sup> EU19= EU 27 minus BG, RO, EE, LV, LT, MT, PL, SI.

## 1.2. Level of the ABB Activities

### 1.2.1 European Regional Development Fund and other regional interventions

The European Regional Development Fund contributed to cohesion and the pursuit of competitiveness in numerous ways. It helped to lay the foundations for medium and long-term economic growth, through the co-financing of infrastructure investments. It helped increase competitiveness through co-financing of investment to create and safeguard sustainable jobs and developing endogenous potential by supporting local development and employment initiatives and the activities of small and medium-sized enterprises. It also supported cross-border, trans-national and inter-regional cooperation.

#### Launch of the 2007-2013 programming period

In 2007, DG Regional Policy conducted numerous discussions and negotiations with Member States and regions in order to pave the way for the best possible integration of the 'Growth and Jobs' objectives in the National Strategic Reference Frameworks and operational programmes for the period 2007-2013. As a result, all 27 NSRF for the period 2007-2013 and 302 operational programmes (out of the planned 316) for the Convergence, Competitiveness and Territorial Cooperation objectives were approved by the end of the year. These approved programmes are split between 244 Convergence and Regional competitiveness programmes and 58 Territorial Cooperation programmes. Only two programmes for Italy and the Czech Republic remain to be adopted in 2008 next to 12 territorial cooperation programmes. On average, the cooperation programmes have been adopted one year earlier as compared to the start of the 2000-2006 programming period.

The average ERDF support by programme is €850 million. The first instalment of the pre-financing amount has been paid on adoption of the programmes. Altogether, €3.7 billion ERDF were paid in 2007 as pre-financing for the operational programmes 2007-2013.

The new programmes 2007-2013 contain core outputs and results indicators in order to monitor the progress of the programmes against the objectives set. Some selected main expected outputs can be found in the table below.

Type of expenditure 2007-2013 (source: categorisation, as gathered from the approved Operational Programmes)	Mio € <sup>14</sup>	Some selected core output indicators (as gathered from the approved Operational Programmes)	Target (as at the end of the programming period 2007-2013)
<b>Specific objective: Redress the regional imbalances, assist the development and structural adjustment of regional economies and contribute to reducing natural, economical, social and administrative obstacles by supporting the generation of sustainable growth and jobs through investments and services, including development of financing instruments, raising productivity, competitiveness and innovation capacities of enterprises, in particular of SMEs.</b>			
Business services for SMEs to increase their competitiveness through <sup>15</sup> enhancing their research and innovation capacities (including in the field of eco-innovations) and ensuring their uptake of ICTs	24,217	Number of gross jobs to be created by research projects in AT, BE, BG, CY, DE, FI, FR, EE, IE, LT, PL, RO, SI, SK, UK	40,000
Other investment in firms <sup>16</sup>	13,623	Number of start-ups to be supported in BE, CY, DK, EL, FI, NL	10,500

<sup>14</sup> Data collected as at 6.2.2008 based on the adoption of 302 ERDF-Cohesion fund Operational programmes 2007-2013

<sup>15</sup> Code 03 - technology transfer, 04 - assistance to RTD, 06 - assistance to SME for promotion of environmentally-friendly products and processes, 09 - other measures to stimulate RTD, innovation, entrepreneurship in SMEs, 14 and 15- information society: services and applications and other measures, 68- support for self employment

<sup>16</sup> Code 08- other investment in firms

Type of expenditure 2007-2013 (source: categorisation, as gathered from the approved Operational Programmes)	Mio € <sup>17</sup>	Some selected core output indicators (as gathered from the approved Operational Programmes)	Target (as at the end of the programming period 2007-2013)
<b>Specific objective: Redress the regional imbalances, assist the development and structural adjustment of regional economies and contribute to reducing natural, economical, social and administrative obstacles by improving accessibility and attractiveness of the regions, through development of RTDI, ICT, transport, environmental and social infrastructure.</b>			
Complete and improve the transport infrastructures in the regions <sup>18</sup>	82,015 (out of which 37,740 for the TEN-T)	Km of road (new or reconstructed) in BG, CY, CZ, DE, ES, EL, LT, PL, RO, SI, SK	25,000
		Km of rail (new or reconstructed) in AT, BG, CZ, DE, ES, FR, EL, HU, IT, LT, PL, PT, RO, SK, SI, UK	7,700
Promote better accessibility of regions to ICT infrastructures and their use <sup>19</sup>	15,072	% or additional population (number of persons) covered by broadband	SI and LT = 100% PL: 6,650,000 ES: 350,000 AT: 10,000
Improve the environmental protection and risk prevention through sustainable treatment of waste, better air quality and more and better water supply and wastewater treatment <sup>20</sup>	50,160	Additional population served by water projects in CZ, EE, ES, FR, EL, HU, LV, PL, PT, RO, SI, SK	9,500,000
		Additional population served by wastewater projects in EE, ES, FR, EL, HU, PL, PT, SI, SK	31,500,000
<b>Specific objective: Redress the regional imbalances, assist the development and structural adjustment of regional economies and contribute to reducing natural, economical, social and administrative obstacles by developing regional and local potential through encouraging integrated development approach, capacity building, cross border and international cooperation and supporting networking, exchange of experience and cooperation between regions, towns and relevant social, economic and environmental actors.</b>			
Raise the level of research activities and develop centres of competences in the regions <sup>21</sup>	15,910	Number of RTD cooperation projects in AT, BE, BG, CY, CZ, DE, DK, EE, NL, PL, RO, SK	7,700

## Implementation of the 2000-2006 programming period

DG Regional Policy continued to manage programmes and projects in the eighth year of **implementation of the 2000-2006 programming period**. ERDF Objective 1 regions performed very well on the growth and convergence targets (for instance, 410,000 net jobs were created in Objective 1 regions in Greece, Spain, Portugal, Saxony and the Hainaut), while in certain ERDF Objective 2 regions (in Denmark, France, Sweden, United Kingdom, Spain and the Netherlands) accounting for some 54% of the Objective 2 allocation, an estimated some 450,000 gross jobs were created.

DG Regional Policy managed in 2007 226 **national and regional programmes** of the period 2000-2006 with an average ERDF support of €380 million per programme. Around 19% of Cohesion policy spending in EU 25 countries is devoted to transport, while 12.3% supported SMEs activities and 5.2% RTD and innovation. Between 2000 and 2006, investments from Cohesion policy amounted on average to an estimated 60% of total public capital expenditure in Portugal, 48% in Greece and 24% in Spain<sup>22</sup>. As these programmes will come to an end in 2008, DG Regional Policy issued guidelines in 2007 for their closure process which will start in 2009.

<sup>17</sup> Data collected as at 6.2.2008 based on the adoption of 302 ERDF-Cohesion fund Operational programmes 2007-2013

<sup>18</sup> Codes 16 to 32 : transport (rail, road, multimodal, ports, airports...), 52- clean urban transport

<sup>19</sup> Code 10- telephone infrastructures, including broadband networks (supply-side measures), Codes 11 to 15 – demand-side measures

<sup>20</sup> Codes 44 to 54 : "Environmental protection and risk prevention"

<sup>21</sup> Code 01- R&TD activities in research centres, Code 02- R&TD infrastructure and centres of competence in a specific technology

<sup>22</sup> Source : 4<sup>th</sup> Report on Cohesion (2007), page 145

ERDF interim payments to 2000-2006 programmes were a record of €17.6 billion in 2007. Throughout 2007, the ERDF performance of the new Member States improved remarkably; ERDF payments in the new Member States represented €2.9 billion. As at the end of 2007, EU10 countries had been reimbursed 71 % of their 2004-2006 ERDF envelopes, with around 45 % paid in 2007. As far as EU 15 countries are concerned, by the end of 2007 around 80 % of their total allocation 2000-2006 was used where 15 % was paid in 2007.

241 decisions were taken in 2007 relating to actions under the 2000-2006 period, including those approving major projects, lifting interim payments and/or suspending such lifting.

Four decisions were also taken in 2007 relating to actions under the period 1994-1999 including those to reduce or recover financial amounts. The **RAL concerning 1994-1999 programmes was further reduced** by 17.5 % to €237.7 million (0.2 % of the decided amount for the period) compared to €328 million by the end of 2006.

In 2007 active follow-up of the implementation of **81 INTERREG** programmes (of which 24 are Neighbourhood programmes) and the PEACE programme continued. This included participation in monitoring and steering committees, processing of amending decisions and modified programme complements, review of annual implementation reports and collaboration with other Commission services on the Neighbourhood programmes. Programmes have been closely monitored in order to ensure an efficient implementation, in particular as regards financial management. There have been frequent contacts with the implementing authorities, including dissemination of best practices on concrete measures to prevent losses of funds due to the n+2 de-commitment rule. In addition to this the INTERACT support programme has continued to contribute to efficient and effective implementation of INTERREG III programmes by organising a large number of best practice events and producing effective management manuals for co-operation for the benefit of bodies implementing cooperation programmes. Over the period 2000-2006, 20% of ERDF expenditure under INTERREG supported transport infrastructure, 17% environment, and 13% economic development<sup>23</sup>.

In addition, the management of the 71 operational programmes implementing **URBAN** Community Initiative has continued through the analysis of annual report, monitoring committees and annual meetings. The management of the programmes has implied not only the follow up of the financial implementation but also of ensuring the continuity of the "Urban" methodology and approach. The de-commitment (rule n+2 2005 budget allocation) concerns 5 programmes and a total amount not exceeding 5 millions euros. An active follow up of the programme URBACT I have been ensured, including the launch of two Fast Track pilot networks. The URBACT II programme, one of the main instruments for implementing the Regions for Economic Change initiative, has been approved and launched. Over the period 2000-2006, ERDF expenditure under URBAN helped to support urban planning and regeneration (33% of ERDF), SMEs and the craft sector (13%) and social inclusion (10%)<sup>24</sup>.

DG Regional Policy also managed **128 Regional Programmes of Innovative Actions** (out of which 12 were closed in 2007) which contributed to the promotion of innovation at a strategic level in the regions, by experimenting innovative methods and practices designed to improve the level of innovation and the quality of EU assistance under three themes: Technological Innovation, Information Society and Sustainable Development/Regional Identity. Eleven modification decisions were processed and 79.4 % of interim payment claims were processed within the set deadline.

---

<sup>23</sup> Source: 4<sup>th</sup> Report on Cohesion (2007)

<sup>24</sup> Source: 4<sup>th</sup> Report on Cohesion (2007)

Other than the Structural Funds, DG Regional Policy is responsible for three further areas which are related, but in a budgetary and organisational sense separate: (1) the overall co-ordination of Commission policy vis-à-vis the Outermost Regions, (2) the International Fund for Ireland, and (3) the EEA Financial Mechanism.

For the **Outermost regions**, 2007 marked the continuation of the implementation of the strategy on a strengthened partnership with these regions in line with the political priorities of the Commission of 2004 aiming at the reduction of their accessibility deficit, the improvement of their competitiveness and the strengthening of their regional insertion. The Communication on "The Strategy for the Outermost regions: Achievements and future prospects", adopted by the Commission on 12 September 2007, highlighted the achievement of the political priorities of the Commission. Inter-services meetings and partnership meetings were organised in order to ensure the coherence of Commission action for the Outermost regions.

As regards the **International Fund for Ireland**, 59 projects of total value of €20 million were approved in 2007. The payments made in 2007 were €35 million.

In line with the **EEA Financial Mechanism** and the **Norwegian Financial Mechanism** for the period 2004-2009, the Commission screened the proposed projects for their compatibility with Community objectives. By the end of 2007, DG Regional Policy had received screening requests for approximately 550 projects covering 13 Member States. 339 signed opinion letters were issued. Monthly coordination meetings took place in 2007 between DG Regional Policy and the Financial Mechanism Committee.

ACTIVITY : ERDF		
Result indicators <sup>25</sup>		
Indicators	Target (mid-term)	Situation at end 2007
<b>Specific Objectives: Redress the regional imbalances, assist the development and structural adjustment of regional economies and contribute to reducing natural, economical, social and administrative obstacles by</b>		
<b>1. Supporting the generation of sustainable growth and jobs through investments and services, including development of financing instruments, raising productivity, competitiveness and innovation capacities of enterprises, in particular of SMEs.</b>		
Volume of financing schemes to SMEs	€ 24.217 billion ERDF funds <sup>26</sup> foreseen 2007-2013 to support RTD, innovation, information society actions and entrepreneurship in SMEs	2007-13 allocations represent annually some 1.4% of gross fixed capital formation in the private sector in the EU-25 in 2004 (in current prices)
Gross Fixed Capital Formation (private sector) in% of GDP	Increase	17.4% (EU25; average 2000-2005)
<b>2. Improving accessibility and attractiveness of the regions, through development of RTDI, ICT, transport, environmental and social infrastructure.</b>		
Accessibility gain: – <b>Transport</b> Time savings for road/rail for selected countries  – <b>Environment</b> Additional population (selected countries) served by new/renovated: - Water projects - Wastewater projects  – <b>Information Society</b> Number of additional population covered by broadband access	Index of potential accessibility of peripheral regions > 40% of EU27 average	Index of potential accessibility of peripheral regions <40% of EU27 average <sup>27</sup> Spain: time savings of nearly 1.2 million hours of travel time per year Portugal: time savings (rail): 20-minute reduction by 100 km, up to 70 minutes in the principal national railway lines / International ports and airports: modernisation and a 50% increase of the capacity In Spain, 2000 km of water pipelines were renovated and 600 km of new pipelines constructed, serving some 2.6 million people. In Spain, 57 water treatment plants and 13 desalination plants were built, serving 1.8 million people. Population connected to urban waste water collection systems <sup>28</sup> : EU 25: 90% Slovakia: 55 %; Hungary: 62 %; Lithuania: 73 %; France: 82 %; Germany: 95%  2007: Broadband penetration rate of 18.2% (EU-27) <sup>27</sup>
<b>3. Developing regional and local potential through encouraging integrated development approach, capacity building, cross border and international cooperation and supporting networking, exchange of experience and cooperation between regions, towns and relevant social, economic and environmental actors.</b>		
Proportion of ERDF expenditure for Research / Innovation	Increase to average ratio of Structural Funds RTDI investment to GERD (by objective)	Structural Funds RTDI investment account for 5% to more than 18% of gross expenditure on R&D (GERD) in Objective 1 countries <sup>29</sup>
Gross Expenditure on R&D (% of GDP)	3.00 % (for EU27 in 2010)	1.89 % (for EU27 in 2003) of which 1.21% of business expenditure
<b>Main policy outputs in 2007</b>		
Finalisation of 27 National Strategic Reference Frameworks for the period 2007-2013 <sup>30</sup> Adoption of 302 national and regional operational programmes <sup>31</sup> for the period 2007-2013 Adoption of 58 European Territorial Cooperation programmes Management of 226 Structural Funds 2000-2006 national and regional operational programmes Management of 81 INTERREG 2000-2006 programmes + 1 PEACE programme Management of 71 URBAN 2000-2006 programmes Management of 128 Innovative Actions 2000-2006 programmes (out of which 12 were closed during 2007) Adoption of the 4 <sup>th</sup> Cohesion report Adoption of a communication on Delivering the Lisbon Strategy Adoption of the 18 <sup>th</sup> Report on the Structural Funds Adoption of a communication "Strategy for the Outermost regions: achievements and future prospects implementation of the 2004 strategy for the Outermost regions" Adoption of a Communication on a European Initiative for the Development of Micro-Credit		
<b>Main expenditure-related outputs in 2007</b>		
DE: Objective 1 regions: 7500 enterprises provided with investment support - IE: Nearly 9000 companies supported - EL: creation of around 1800 SMEs SE: around 30000 SMEs supported - UK: over 250 000 SMEs were supported HU: 7029 SMEs supported: 7029 (2004-2006) - 14 co-operative research centres (business-university) to be established DE: 3100 km of sewerage network built or renovated - IT: 1.524 Km of sewerage network and 3.375 Km of water network ES: around 250 000 SMEs assisted in their technology-based activities ES : 1800 km of new motorways constructed + 1200 km of roads constructed (i.e. 60% of the national increase in major roads) PT: 260 km of railway lines upgraded CZ: Length of built or enhanced roads: 332 km PT: Around 4273 R&D projects supported (period 2000-2006) - 4 centers for living science (ciencia viva) + University education centres: 4 infrastructure projects		

<sup>25</sup> The nature of the Structural Fund interventions with complex and tailor made (national, regional or sectoral) development programmes involving a wide range of stakeholders makes it difficult and sometimes irrelevant to aggregate the multiplicity of the data available. At the Commission level, core data will be gathered, organised and presented in the form of summary sheets for selected Member States on the basis of the annual reports to be submitted. The work of the Commission on this issue depends clearly on the availability of the data from the Member States and on the quality of the information provided by the Member States.

<sup>26</sup> Based on codes 03, 04, 06, 09, 14, 15 and 68 of categorisation 2007-2013

<sup>27</sup> Plus Norway and Switzerland. Source: Interim Territorial Cohesion report - DG Regional Policy - 2004

<sup>28</sup> Source: EUROSTAT

<sup>29</sup> Source: Strategic Evaluation on innovation and knowledge, DG REGIO, 2006

<sup>30</sup> The NSRF of Malta was adopted in December 2006.

<sup>31</sup> The figure includes all ERDF and ERDF/CF programmes, while it excludes the adopted 2 IPA-CBC and 7 IPA programmes. The figure includes the only programme (in Hungary) which is exclusively co-financed by the Cohesion Fund.

## 1.2.2 Cohesion Fund

The Cohesion Fund helped to lay the foundations for growth in Member States with a GDP per capita below 90% of the Community average. Expenditure under the Cohesion Fund was **equally distributed over the period 2000-2006 between environment and transport infrastructures**: 50.3 % of funds supported environment (37.5% of which for sewerage and purification and 15.9% for drinking water) and 48.8 % for transport (44.9% of which for rail and 27.2 for roads)<sup>32</sup>.

Co-financed transport projects generated substantial economic benefits in terms of improved accessibility which reduces transport costs. Environmental projects raised environmental standards in the regions, with particular regard to water supply, waste water treatment and solid waste treatment. All projects are subject to a cost-benefit analysis in order to ensure their financial and economic viability in the long run. The Commission adopted 248 decisions in 2007 on Cohesion Fund projects under the 2000-2006 period, including those on modifying the financial amounts.

DG Regional Policy continued to ensure the sound financial management of Cohesion Fund projects: commitments for the Cohesion Fund followed the progress of projects on the ground, and 99.9 % of the Cohesion Fund commitment instalment for 2007 was committed. Cohesion Fund/ex ISPA payments in the new Member States represented € 1.8 billion in 2007. As at the end of 2007, EU12 countries had been reimbursed 43% of their envelopes, with 29 % paid in 2007. As far as EU15 countries are concerned, by the end of 2007 66 % of their total allocation 2000-2006 was used where 8 % was paid in 2007.

78 Cohesion Fund projects were closed in 2007: 55 environmental, 19 transport and 4 technical assistance projects. There are still 1029 open projects, which will be closed in the coming years; 732 of these projects are in the environment sector, 249 in transport and 48 concern technical assistance. With a view to ensure a smooth closure process of the Cohesion Fund projects 2000-2006, DG Regional Policy prepared draft guidelines for the closure of the 2000-2006 Cohesion Fund projects.

As regards **the period 2007-2013**, the Cohesion Fund is integrated in the multi-annual programming with the ERDF in 24 operational programmes in the 15 eligible Member States including a specific phasing out Cohesion Fund programme in Spain. The first four major projects (all Romanian) have been analysed and are in the decisional procedure. In 2007, €1.6 billion were paid as pre-financing for the Cohesion Fund 2007-2013.

In order to harness all sources of expertise at the European level to ensure the success of the 2007-2013 programmes for 2007-2013 and the good quality of projects, DG Regional Policy created with the EIB and the EBRD a special technical assistance facility, known as JASPERS, which is intended to accelerate the approval of major projects funded within the operational programmes and to deliver better quality investments. At end 2007, JASPERS had a geographically and sectorally balanced portfolio of 261 projects, a large number of which relate to Cohesion Fund. 33% of projects are in the transport sector, 46% environment and energy, and 8% municipal.

A new framework contract for technical assistance for the preparation, appraisal and verification of the implementation of major projects under the Cohesion Fund, ERDF and IPA was signed in March 2007.

---

<sup>32</sup> Source: 4th Report on Cohesion (2007)

ACTIVITY : COHESION FUND		
Result indicators		
Indicators	Target (mid-term)	Situation at end 2007
<b>1. Specific objective: Strengthen the economic and social cohesion of the Community in the interests of promoting sustainable development by giving assistance to actions of Member States that aim to develop the trans-European transport networks and in particular priority projects of common interest as identified by Decision No 1692/96/EC</b>		
Transport: • accessibility gain	Index of potential accessibility of peripheral regions >40% of EU27 average	Index of potential accessibility of peripheral regions <40% of EU27 average <sup>33</sup> Greece: density of motorways: 9 km/surface area (2004) against 5.6 km (2001) <sup>34</sup> Portugal: density of motorways: 61.7 km/surface area (2004) against 51.2 km (2001) <sup>30</sup>
Time savings for road / rail for selected countries		Spain : time savings of nearly 1.2 million hours of travel time per year Portugal : time savings (rail): 20-minute reduction by 100 km, up to 70 minutes in the principal national railway lines
<b>2. Specific objective: Strengthen the economic and social cohesion of the Community in the interests of promoting sustainable development by giving assistance to actions of Member States related to the environment within the priorities assigned to the Community environmental protection policy under the policy and action programme on the environment.</b>		
Environment: • improvement of environmental standards	Reduce municipal solid waste production to Cohesion fund countries average (kg/yr/capita)	Municipal solid waste 240-625 kg/yr/capita <sup>35</sup>  In Ireland (programming period 2000-2006), provision of recycling capacity for 30 000 tons of waste/year and provision of green waste treatment capacity for 9 500 tons/year
• population connected to wastewater facilities	>70% <sup>36</sup>	50-100% <sup>37</sup>  In Portugal, 80% of the population covered by the waste water treatment systems (55% in 1999) as an expected result of 2000-2006 ERDF and Cohesion Fund interventions
Additional population served: - Water projects - Wastewater projects		Example of Spain: 2000 km of water pipelines renovated and 600 km of new pipelines constructed covering 2.6 million inhabitants 57 water treatment works and 13 desalination plants built, serving 1.8 million inhabitants
<b>Main policy outputs in 2007</b>		
Finalisation of 15 National Strategic Reference Frameworks (common to ERDF and the Cohesion Fund) Adoption of 24 operational programmes with Cohesion Fund contribution Adoption of the 2006 Annual Report of the Cohesion Fund Management of 1029 Cohesion Fund projects		
<b>Main expenditure-related outputs in 2007 to meet the objectives</b>		
PL: 2004-2006 36 projects in the field of transport (€ 3.8 billion) LT: 40 km new motorway; 256 km upgraded motorway; 20 km modernised railway; 405 km upgraded road EL (Athens): Metro expansion: 4 new transit stations, 17 new trains. In 2005, 17200 passengers were using them at peak hours ES : time savings of nearly 1.2 million hours of travel time per year ES : construction of 450 km of rail track for high speed train (Madrid-Zaragoza-Lleida) PL: 90 environmental projects under implementation		

The implementation of Cohesion Fund projects on the ground is quite complex (design of projects, public procurement issues); therefore, results are delivered only years after the Commission decisions approving the projects, in particular in the new Member States where administrative capacities need to be further reinforced. DG Regional Policy continued to devote important efforts to help the national authorities monitor the projects carefully and report on any issues and core problems that might endanger the completion of the project within the set deadlines of 31 December 2010.

<sup>33</sup> Plus Norway and Switzerland. Source: Interim Territorial Cohesion report - DG Regional Policy - 2004

<sup>34</sup> Source : 4th Report on Cohesion (2007)

<sup>35</sup> This information is given for illustrative purposes: the data source for both the current situation and the target levels is the Strategic Evaluation on environment and risk assessment carried out for the European Commission in 2006.

<sup>36</sup> This information is given for illustrative purposes: the data source for both the current situation and the target levels is the Strategic Evaluation on environment and risk assessment carried out for the European Commission in 2006

<sup>37</sup> This information is given for illustrative purposes: the data source for both the current situation and the target levels is the Strategic Evaluation on environment and risk assessment carried out for the European Commission in 2006

### 1.2.3 Pre-accession interventions related to structural policies (IPA and ISPA)

As regards IPA, the three candidate countries (Turkey, Croatia and the FYROM) prepared their Strategic Coherence Frameworks which were accepted by the Commission services in 2007. These strategic frameworks cover a seven years planning period and define those areas and priorities which will be implemented under different IPA Operational Programmes. They are tailored after the NSRFs, but they take account of specifics of IPA (e.g. areas of eligibility, stronger concentration, link with accession priorities, or lower aid intensities).

During 2007, the three candidate countries prepared their operational programmes, covering a three-year financial allocation (2007-2009) and focusing on infrastructure and competitiveness measures. All seven operational programmes were adopted in 2007: three in Turkey, three in Croatia and one for the FYROM.

DG Regional Policy assisted the countries in establishing adequate implementation structures: Establishing the regulatory framework (the IPA Implementing Regulation was adopted only in June 2007), the complexity of the implementation system (empowerment of line Ministries as management bodies which bridges to Structural Funds Management) and generally weak national administrations which needed time to adapt themselves to the new pre-accession instrument (strategic planning, enhanced ownership of line ministries, new financial management provisions, partnership and consultation). The conferral of management powers by Commission Decision should be achieved in 2008.

In addition to this, the Commission services received in 2007 ten proposals<sup>38</sup> for IPA Cross-Border Cooperation programmes out of 12 potential programmes<sup>39</sup>. Two of these programmes were approved by the end of the year: the cooperation programme between Bulgaria and the FYROM (€ 8.9 million of ERDF funding and an equal amount of IPA funding for the FYROM) and the cooperation programme between Bulgaria and Turkey (€13.6 Million of ERDF support with an equal amount of IPA funding for Turkey).

As regards ISPA in Croatia, implementation gained momentum with the launch of main works contracts on two of the three investment projects. However, the speed of implementation is still behind initial expectations, which is caused by bottlenecks in the public administrations and lack of adequate project management experience.

ACTIVITY : ISPA		
Result indicators		
Indicator	Target (mid-term)	Situation at end 2007
<i>Specific Objective: Provide assistance to contribute to the preparation for accession to the European Union of the beneficiary countries in the area of economic and social cohesion, concerning environment and transport policies ('ISPA')</i>		
Environment: population connected to water and wastewater networks (Croatia)	increase	Water: 76% Wastewater: 40% (2006)
Transport: railway average speed (Croatia)	Increase	48 km/h (passengers) 26 km/h (freight) (2005)
Transport: navigable inland waterways (Croatia)	Increase	287 km (2005)
<b>ISPA: Main output in 2007</b>		
Ongoing implementation of one transport project and two environmental projects		

<sup>38</sup> Adriatic, HU/SI, HU/Croatia, HU/Serbia, RO/Serbia, BG/Serbia, EL/FYROM, EL/Albania, BG/FYROM and BG/Turkey.

<sup>39</sup> The two programmes not submitted in 2007 are: EL/Turkey and CY/Turkey

ACTIVITY : IPA		
Result indicators		
Indicator <sup>40</sup>	Target (mid-term)	Situation at end 2007
<b>Specific Objective: Ensure support for the beneficiary countries to policy development as well as the preparation for the implementation and management of the Community's Cohesion policy; in particular for the preparation for the European Regional Development Fund and the Cohesion Fund (IPA)</b>		
Candidate countries become familiar with investment planning and programming approach under Cohesion policy instruments	Candidate countries draft strategic documents and operational programmes following a Cohesion policy multi-annual programming approach	Candidate countries prepared strategic coherence frameworks and multi-annual programmes of sufficient quality to meet the Commission's approval
Progress made by Turkey, Croatia and the former Yugoslav Republic of Macedonia in : <ul style="list-style-type: none"> <li>Developing long-term (2007-2013) strategic planning and in preparing and implementing multi-annual operational programmes, covering sectoral (environment and transport) and regional interventions</li> <li>Setting-up necessary decentralised management structures</li> </ul>		
The 3 candidate countries will have in place structures and capacity to receive conferral of decentralised management	Positive decision of conferral of decentralised management for the three candidate countries	The 3 candidate countries going through different steps leading to applications for decentralised management
<b>IPA: Main policy outputs in 2007</b>		
Approval of 3 strategic coherence frameworks (Croatia, Turkey and the FYROM)		
Approval of 7 operational programmes for the Regional development component		
Approval of 2 operational programmes for the Cross-border cooperation component		

#### 1.2.4 Management of the Solidarity Fund

The **European Union Solidarity Fund** has been managed by DG Regional Policy with the objective of granting financial assistance to Member States and countries negotiating their accession to the EU, in the event of major natural disasters. In 2007, altogether € 196.566 million were paid out as EUSF grants for four cases in Greece, Hungary, Germany and France. 13 decisions on the EUSF (decisions to mobilise or not, grant decisions and financial agreement decisions) have been adopted in 2007.

In 2007, the Commission concluded the processing of three applications received in 2006. Two of these applications were submitted under the exceptional 'regional criterion' of the Solidarity Fund regulation, of which one was accepted (flooding in Greece) while in the other case (forest fires in Spain) the Commission decided not to mobilise the Fund. One application (relating to a flooding in Hungary) was made under the major disaster criterion of the Solidarity Fund Regulation (i.e. damage in excess of 0.6% of GNI or € 3 billion in 2002 prices) and had already been approved by the Commission in December 2006. Following the adoption by the budget authority of an amending budget - covering the Hungarian as well as the Greek case - and the adoption by the Commission of the corresponding grant decisions and implementing agreements, the grants in both the Hungarian as well as the Greek case were paid in 2007.

A total of 19 new applications were received in the year 2007, the highest number so far in a single year. In nine of these cases, concerning forest fires in different regions in Italy, the 10-week deadline for presenting Solidarity Fund applications after the date of the first damage was not respected. Consequently, the Italian authorities were notified that their applications were not admissible. In three of the cases received in 2007 the Commission decided to propose to mobilise the Solidarity Fund: a "major disaster" application from Germany concerned a wind storm ("Kyrill"), a "major disaster" application from the United Kingdom

<sup>40</sup> There are no other indicators and outputs for 2007 as the respective interventions have just commenced.

concerning a flooding and a "regional disaster" application from France (cyclone on La Reunion). In another application concerning a "regional disaster" (flooding in Spain) the Commission decided not to mobilise the Fund.

In the case of the application from Germany (wind storm) and the application from France (cyclone on La Reunion) it was possible to pay the grant still in 2007, following the adoption by the budget authority of an amending budget and the adoption by the Commission of the corresponding grant decisions and implementing agreements. The assessment of the other seven applications was not yet completed by the end of the year.

In 2007, the Commission closed the assistance for aid which was granted to Italy in 2004 relating to an earthquake in Molise/Apulia and to the Etna eruption in Sicily (both in 2002). The assistance was equally closed for aid granted to Malta in 2004 relating to a flooding disaster. In the case of the Portuguese forest fires (2003), the assistance was closed in 2007 by initiating the recovery procedure for an unspent amount of €6.39 million. The assessments of two final reports from Spain ("Prestige" oil spill in 2002 and forest fires in 2003) were pending at the end of 2007. The Commission received five new implementation reports in 2007. These relate to a storm disaster in Slovakia in 2005 for which a grant was paid in 2005 as well as to a storm disaster in northern Europe in 2005, for which aid was paid to Sweden, Estonia, Latvia and Lithuania in 2006.

The proposal for a new Solidarity Fund Regulation that the Commission has adopted on 6 April 2005 and which received a very favourable report from the European Parliament has made no progress in the Council: in 2007, it was not put back on the agenda of the Council.

ACTIVITY : EUSF			
Result indicators			
Indicators	Target	Current situation (n-1)	Main outputs in 2007 <sup>41</sup> to meet the objective
<b><i>Specific Objective: Mobilise assistance from the European Union Solidarity Fund when a major natural disaster with serious repercussions on living conditions, the natural environment or the economy in one or more regions or one or more countries occurs on the territory of that State in order to be able to respond in an efficient and flexible manner</i></b>			
Number of population helped in overcoming a crisis situation where their living conditions have been affected	N/A	100% of population affected and eligible under the EUSF Regulation <sup>42</sup> upon the Member States' request	In 2007, altogether € 196.566 million were paid out as EUSF grants for 4 disasters in Greece (flooding), Hungary (flooding), Germany (wind storm) and France (cyclone).  The affected area concerned in Greece 180 000 inhabitants, in Hungary 1 530 904 inhabitants, in France (La Réunion) 784000 inhabitants and the whole territory of Germany (with a focus in the western part)
Number of hectares of disaster-stricken area where rehabilitation has been assisted	N/A	100% of areas affected by the disaster and eligible under the EUSF Regulation <sup>43</sup> upon the Member States' request	

41 These outputs, however, depend on the number and size of disasters for which the Commission receives applications in 2007.

42 Council Regulation (EC) No 2012/2002 of 11 November 2002 establishing the European Union Solidarity Fund

43 Council Regulation (EC) No 2012/2002 of 11 November 2002 establishing the European Union Solidarity Fund

## 2. PART 2 - MANAGEMENT AND INTERNAL CONTROL SYSTEMS

### 2.1. Inherent nature and characteristics of the DG's risk and control environment

DG Regional Policy implements the main part of its budget under a regime of shared management with Member States or decentralised management with beneficiary countries. Under shared management, in accordance with Article 53b of the Financial Regulation, the Member States have the primary responsibility to take all measures necessary to ensure that the funds are used in accordance with the applicable rules and principles and to protect the Community's financial interests. However, the Commission retains final responsibility for the implementation of the budget under Article 274 of the Treaty.

#### **ERDF and Cohesion Fund – Shared management**

**The major inherent risk** relates to the complexity of the operations and activities financed under the structural and cohesion funds, multiplicity of organisations, systems, operations and beneficiaries, many different types of projects and programmes, large number of different management organisations and beneficiaries, multi-annual framework which affects design of control systems, and detailed eligibility requirements at Community and national levels which can lead to complexity and risk of misinterpretation. Structural Fund programmes are implemented over a period of some nine years from the date of adoption of a programme to the final date of eligibility of expenditure incurred by beneficiaries. There is a further 15 months for submitting the final expenditure claim and the winding up declaration, and the actual programme. Closure by the Commission may be three or more months after that. There is no provision for annual closure, annual clearance of accounts or even partial closure for the 2000-2006 programmes.

For expenditure incurred in the execution of any given operation, there is a cycle of controls (managing authorities, paying/certifying authorities, and audit bodies) at the various levels within the Member State, and at the Commission level, designed to prevent, detect and correct irregularities. These continue until after closure in the form of closure audits by the Commission. In the event of irregularities detected by national controls, the Member State must make the necessary corrections.

Where a Member State fails to apply financial corrections required, or where there is evidence of serious systems deficiencies, the Commission may impose financial corrections. For the 2000-2006 period, the Commission is first obliged to suspend payments by Commission decision and hold a hearing with the Member State, and it is therefore an inherently lengthy procedure.

DG Regional Policy therefore takes account for its supervisory role of the principal responsibility of the Member States within the framework of shared management. It exercises its supervisory controls, mainly by audit of the Member States' management and control systems, including transactions tests at beneficiary level. The multi-annual nature of the system helps to offset the risk of national controls not functioning effectively to prevent errors, allowing corrections to be made some years after the disbursement of funds by the Member State to the beneficiaries and by the Commission to the Member State.

**For the 2007-2013 programming period**, new legislative provisions will strengthen the control environment for the Commission: (a) the clearer definition of the control responsibilities of the Member States; (b) the requirement for the Member States to provide, and the Commission to assess, the ex ante compliance assessments on systems before a first interim payment to a Member State is made; (c) the requirement on Member States to designate for each programme an audit authority working under an agreed audit strategy,

which reports audit results, and submits an annual audit opinion on the functioning of the systems to the Commission; (d) the power of the sub-delegated authorising officer to interrupt payments without a Commission decision; (e) the option of partial closure.

### **Pre-accession programmes - Decentralised management**

DG Regional Policy is in charge of a new financial instrument, IPA – Regional Development and Cross-border components. This fund is managed in a decentralised way but with strong similarities to the approach used for the structural and cohesion funds. In addition to the risks for structural actions, an additional inherent risk is related to the capacity of the candidate countries to set up and operate the systems and controls necessary for sound management of the appropriations allocated.

### **Control environment in the Directorate-General**

The Directorate General has put in place an internal control system with a developed system of financial circuits. These circuits define the roles of the various actors in the financial transaction, and thus ensure the regularity and legality of commitments and payments at the level of the Directorate General.

In order to check the internal control system functions inside the Directorate General according to the standards set, the Internal Audit and Advice Unit carries out specific audits, signals weaknesses detected in the system and gives recommendations as to the improvements that can be made.

DG Regional Policy has carried out a Risk Management Assessment exercise. In the framework of the Annual Management Plan 2007 two risks were retained: firstly, one concerns difficulties in implementation of the IT-system (SFC 2007) in some Member States. To that end an in-depth audit is currently being carried out by an independent actor under the lead of DG Regional Policy's Internal Audit and Advice to provide a reasonable assurance, that the system is sound and reliable; secondly, one concerning the policy development in order to prepare the future Cohesion policy review. A series of actions have been initiated in order to adapt the evaluation strategy, including the development of appropriate indicators and to setup different working groups with international high level experts. These actions will continue during 2008.

A very small part of the budget (0.1%) for which DG Regional Policy is responsible is utilised for contracts and grants under **direct management**. For these funds, DG Regional Policy has established controls which adequately ensure the reliability of the accounts and the legality and regularity of the underlying transactions. In order to provide a non-binding advice inside DG Regional Policy, an internal committee on public tendering and grants has been installed.

In 2007 less than 0.01% of DG Regional Policy's budget was used in management by **sub-delegation, cross-subdelegation or co-delegation**. The cross-subdelegation concerned three other Directorates General (RELEX, ESTAT and DIGIT) to cover technical assistance to IPA on budget line 13.01.04.02, database maintenance and topographical data on line 13.03.20, and the ITIC project on 13.01.04.01 and 13.01.04.03. Co-delegation applied to OPOCE. In the meantime, the sub-delegation from INFOS to manage the Programme Modinis 2004 was withdrawn in view of the programmes' closure.

In accordance with **the Code of Conduct for Commissioners** of August 2004, the working arrangements between the Commissioner and DG Regional Policy have been put in place. Monthly meetings have been held between the Commissioner and the senior management of the Directorate General (Director General and Directors). The Commissioner has been consulted on all main initiatives and strategic documents of the Directorate General. Regular meetings have been organised between the Commissioner and the Director General as well as

with the Directors in order to discuss issues of major importance. The mid-term assessment of the Annual Management Plan 2007 which was carried out in July 2007 reported on the achievement of the objectives of the year as laid down in the AMP, the follow-up of the risk assessment exercise, the implementation of the Internal Control Standards, the follow-up of the 2006 Annual Activity Report reservations and the follow-up of audit reports and actions being taken on them.

<b>Characteristics of the Directorate General's policy environment</b>	
<p><b>Summary:</b> <i>DG Regional Policy funds, mainly through the European Regional Development Fund and the Cohesion Fund, infrastructure, business investment, environmental and other projects contributing to regional development carried out by national, regional and local government bodies in the Member States.</i></p> <p><b>Key inherent risks in this environment:</b></p> <ul style="list-style-type: none"> <li>- <i>Multiplicity of organisations, systems, operations and beneficiaries;</i></li> <li>- <i>Many different types of projects and programmes;</i></li> <li>- <i>Detailed eligibility requirements at Community and national levels which can lead to complexity and risk of misinterpretation;</i></li> </ul> <p><i>Given the scope and the multi-annual nature of the structural instruments, the number of systems, and the audit resources available to the Directorate General, it is not possible to audit all significant areas each year.</i></p>	
<p><b>Management mode:</b></p> <p><i>Mainly shared management – national and regional programmes managed by Member States, which select operations for funding; Commission has supervisory role.</i></p>	
<p><b><u>2000-2006 programming period :</u></b></p> <p><b>Grant period:</b> <i>Disbursed over a 9-year period for a 7-year programme</i></p> <p><b>Grant basis:</b> <i>Co-financing with Member States (EU contribution 25% - 85%)</i></p> <p><b>Number of programmes (Operational Programmes/Single Programming Documents/Community Initiatives programmes):</b> <i>379<sup>44</sup></i></p> <p><b>Average amount of ERDF (estimate) managed by OP:</b> <i>€ 340 million</i></p> <p><b>Number of CF/ex-ISPA projects :</b> <i>1194</i></p> <p><b>Average amount (estimate) managed per CF project:</b> <i>€ 30 million</i></p> <p><b>Number of ISPA (Croatia) projects:</b> <i>6</i></p> <p><b>Average amount (estimate) managed per ISPA project:</b> <i>€ 10 million</i></p>	<p><b><u>2007-2013 programming period :</u></b></p> <p><b>Grant period:</b> <i>Disbursed over a 9-year period for a 7-year programme</i></p> <p><b>Grant basis:</b> <i>Co-financing with Member States (EU contribution 50% - 85%)</i></p> <p><b>Number of programmes (Operational Programmes, including ERDF &amp; CF):</b> <i>316</i></p> <p><b>Average amount (estimate) managed by OP:</b> <i>€ 850 million</i></p> <p><b>Number of IPA programmes<sup>45</sup> :</b> <i>7</i></p> <p><b>Average amount (estimate) managed per IPA programme:</b> <i>€ 235 million</i></p> <p><b>Number of IPA-CBC programmes:</b> <i>12</i></p> <p><b>Average amount (estimate) managed per IPA-CBC programmes:</b> <i>€ 20 million</i></p>

<sup>44</sup> In addition, there are 181 Regional Programmes of Innovative Actions managed by DG Regional Policy for the period 2000-2006, out of which 128 managed in 2007 and 53 closed in previous years.

<sup>45</sup> Regional component only

## 2.2. Management and control systems

### 2.2.1 Characteristics of budgetary execution in 2007

As far as the **financial management** of the DG Regional Policy's activities in 2007 is concerned, it can be characterised with the following performance figures:

- In terms of commitments, overall in 2007 €34.8 billion were committed by DG Regional Policy. These commitments represent 98.5% of Regional Policy's allocation on ERDF, Cohesion Fund, IPA and EUSF.
- In terms of payments, overall in 2007 €26.5 billion was paid by DG Regional Policy on ERDF, Cohesion Fund, ISPA and EUSF. It means that the performance of the Directorate General reached 99.9% for ERDF (€21.4 billion) and the Cohesion Fund (€4.3 billion), 93.8% for ISPA (€643 million), and 100% for the EUSF (€196.6 million) thereby giving an overall figure of 99.7% for all Funds together.
- The RAL concerning 1994-1999 programmes was further reduced by 17.5 % to €237.7 millions (0.2 % of the decided amount for the period).
- The payment execution within the regulatory deadline of 60 days further improved in 2007 and reached the level of 95.3 % to compare with 94 % of payment claims processed within the deadline in 2006. The further increase of rates for payment execution within deadlines for the Cohesion Fund and for ISPA indicates a better performance for 2007 ensuring a sound budget execution of the Directorate General.

The high execution rates concerning commitment credits (98.5%) and payment credits (99.7%) illustrate, beyond sound financial management in DG Regional Policy, the results of Member States' performance in the timely implementation of European Cohesion policy's programmes. These results reflect the intense cooperation efforts of the Directorate General to stimulate constant and sufficient flow of payments as illustrated by the good results in terms of amount of de-commitments – very limited – linked to the application of the n+2 rule<sup>46</sup>.

Indicator	Target	As of 31.12.2007	Comments
Commitment credits executed (programming period 2007-13)	100%	98.5%	ERDF - 98.2% (€27.2 billion) Cohesion Fund – 99.9% (€7.1 billion) IPA - 100% (€220 million)
Payment credits executed (programming period 2000-2006 & 2007-2013)	100%	99.7%	ERDF – 99.8% (€21.4 billion) Cohesion Fund – 99.9% (€4.3 billion) ISPA/IPA – 91.6% (€643 million)
Payment claims processed within the deadline of 60 days	95%	95.3%	
Impact of the n+2 rule on 2005 commitments		€157.8 million	This figure represents a maximum estimate and concerns mainly INTERREG, ES, AT, DE, FR, UK, EL, IE, IT, NL and PT.
Overall amount of EUSF grant payments in 2007	N/A	€196.5 million	Payments are related to 4 cases

<sup>46</sup> The "n+2" rule means that the Commission shall automatically decommit any part of a budget commitment in an operational programme that has not been used for payment of the pre-financing or interim payments or for which an application for payment has not been sent in conformity with Article 86 by 31 December of the second year following the year of budget commitment under the programme. There are some exceptions to this rule (please refer to article 93 of Council Regulation n° 1083/2006 of 11.7.2006).

## 2.2.2 Management and control systems in DG Regional Policy

<b>Feedback which enables control activities to be optimised</b>	
<b>Verification that processes are working as designed</b>	<p>In order to verify that the internal control processes within DG Regional Policy are working as designed, the Internal Control Coordinator of the Directorate General assesses from different sources the internal control system on a regular basis that it continues to be effective, particularly:</p> <ul style="list-style-type: none"> <li>- Management's knowledge about the state of the DG's internal control systems, receiving the information, verifying and up-dating from all services involved;</li> <li>- the audit reports prepared by the DG's Internal Audit and Advice Unit, the Internal Audit Service of the Commission (IAS), and the Court of Auditors;</li> <li>- the ICC at the end of the year has carried out a global self-assessment desk review on the implementation of the Baseline Requirements based on the questionnaire prepared by the Directorate General Budget;</li> <li>- the ICC also carried out in 2007 an analysis of the way the internal control systems have effectively worked in the Directorate General by means of the internal Control Assessment Tool (iCAT) prepared by DG Budget;</li> <li>- analysing the Risk Assessment carried out in October/November 2007 in order to ensure that critical risks related to process activities and objectives are identified and mitigated to an acceptable level.</li> </ul> <p>The evaluation of the performance of the control system in DG Regional Policy in 2007 was undertaken on the basis of the results of all the audits, advice and enquiries during the year, in particular:</p> <ul style="list-style-type: none"> <li>- the audit carried out by the Court of Auditors in the framework of the DAS 2006; which included an audit of 8 internal control standards (n°11 risk analysis and management, n°12 adequate management information, n°14 reporting improprieties, n°17 supervision, n°18 recording exceptions, n°20 recording and correction of IC weaknesses, n°21 audit reports and n°22 internal audit capability);</li> <li>- the four audits undertaken by IAS, and particularly, the Audit Report on the AAR Assurance Process</li> <li>- the audits carried out by the IAA (Internal Audit and Advice unit), including the ex-post Control on Payments, and their "Survey on Six Internal Control Standards" in the Directorate General.</li> </ul> <p>In addition, each senior manager of the Directorate General oversees the implementation of the internal control standards in his/her Directorate.</p>
<b>High level management reporting</b> (e.g. to the Director General) and its role in monitoring problem issues	<p>In addition to the general coordination provided at senior level through the weekly Directors' meetings, DG Regional Policy has on a regular basis a number of management scoreboards and management tools covering for example:</p> <ul style="list-style-type: none"> <li>- budget execution (on a bi-monthly basis);</li> <li>- adoption of Operational Programmes (on a weekly basis in 2007).</li> </ul> <p>Furthermore, an informatics database is accessible to everybody, which presents on a daily basis the state of play of procedures, delays and budgetary execution.</p> <p>Since the beginning of 2007, DG Regional Policy has developed a permanent monitoring system of fortnightly reporting of the most relevant activities in DG Regional Policy to the Director-General from each Unit and from each Directorate.</p> <p>The Director General holds quarterly meetings with the Audit Directorate on the implementation of the audit strategy, weekly meetings with the IAA on internal audit and advice matters, and with the Resource Director on human resources issues.</p> <p>A Mid-Term assessment of the implementation of the Annual Management Plan is made in the summer. Agenda planning items are being followed all over the year.</p>
<b>Monitoring of performance</b> of independent bodies, 3 <sup>rd</sup> party auditors, externally contracted auditors	<p>The Audit Directorate regularly receives the system audit reports of the national audit bodies and any important issues are followed up, including recommendations on the work of the audit bodies. The Audit Directorate also uses audit services under a framework contract. Procedures are in place so that the work of the external auditors is reviewed and the required quality is achieved before payment is made.</p>

### 2.2.3 Management and control systems in the Member States

<b>Elements of the internal control system and actors, through programme life cycle</b>	
<p><b>Preventive measures:</b></p> <p>Negotiation and approval of programmes, including main elements of management and control systems in Member States</p>	<p>For 2000-2006 programmes the Commission negotiated programme content and management arrangements which were communicated in the programme documentation sent by the Member States to the Commission. The Member States designated a managing authority per programme as the body responsible for execution of the programme and the first level controls of expenditure and a paying authority to certify payment claims to the Commission.</p> <p>For the 2007-13 programmes, establishment of a satisfactory system architecture (managing authority, certifying authority, intermediate bodies and audit authority) is a condition of programme approval. The Commission ensures that existing relevant information about weaknesses in the current systems is used to improve the systems so that the weaknesses do not recur in the new programme period.</p>
<p><b>Preventive and supervisory measures:</b></p> <p>Compliance assessment of set-up of management and control systems</p>	<p>For the 2000-06 period, the Member States sent a description of the management and control system to the Commission, including details of the organisation of the managing and paying authorities, intermediate bodies reporting to them, the audit services and the body issuing the winding-up declaration. Between 2001 and 2003 the Commission carried out a desk check of all the system descriptions and recommended changes where necessary. It also performed on-the-spot audits of a sample of systems in the Member States to verify the descriptions.</p> <p>To advance the scrutiny of systems in the 2007-2013 period, it is the Member States that will assess the compliance of their management and control systems. They will submit a description of the systems and an independent report and opinion on their compliance within 12 months of the approval of each operational programme and before the submission of the first interim application for payment.</p> <p>Where there are reservations in the opinion or the Commission itself has observations, it will ensure that corrective measures concerning key elements of the systems have been taken before confirming that interim payments can begin.</p>
<p><b>Preventive and supervisory measures:</b></p> <p>Supervisory and central checks and monitoring during the initial phases of the programme</p>	<p>Throughout the implementation period the operational units of DG Regional Policy hold regular meetings with Member States managing authorities, including the annual meetings to review the annual implementation reports; the financial unit maintains contacts with certifying authorities by accepting each payment claim; and the audit directorate with responsible audit bodies through annual bilateral and multilateral meetings. Issues in managing and controlling Community funds are also discussed with Member States in the management committees composed of representatives of the Commission and Member States.</p> <p>By these means DG Regional Policy provides advice and formal guidance on issues such as management checks and sampling for audits to establish benchmarks and spread good practices.</p>
<p><b>Detective and corrective controls:</b></p> <p>Primary level verification by managing authority of correctness of expenditure declared from financed operations and their compliance with grant conditions; reporting to the Commission on interim payments and key milestones</p>	<p>Throughout the implementation period the managing authorities in Member States are required to carry out the following actions:</p> <p>Ensure compliance of projects with selection criteria and beneficiary's understanding of the terms and conditions;</p> <p>Desk checks of all expenditure based on supporting documents, including progress reports, etc.;</p> <p>On-the-spot visits to a significant number of projects selected on the basis of a justified sampling methodology to verify delivery of the project outputs (investment, services) and reality and eligibility of expenditure declared;</p> <p>Correct irregular expenditure and recover EU funds when necessary;</p> <p>Draw up annual reports on implementation and a final report summarising the implementation of the entire programme, which are scrutinised by the Commission.</p>
<p><b>Detective and corrective controls :</b></p> <p>Secondary level verification by paying authority, including reporting of irregularities and recoveries</p>	<p>Each periodic statement of expenditure is checked and certified as correct by the paying authority/certifying authority.</p> <p>The assurance is based on its own desk checks and, if necessary, on-the-spot-verifications and the information on checks performed by the managing and audit authorities. The paying authority also monitors and reports to the Commission information on irregularities and suspected fraud and recoveries and withdrawals made.</p>

<p><b>Supervisory and corrective controls:</b></p> <p>Audits by the audit authority</p>	<p>Responsible audit body performs system audits and carries out substantive testing of projects to cover 5% of expenditure by programme closure; it transmits findings of systems weaknesses and irregular expenditure found to the managing authority and to the paying authority for correction; it issues an annual control report on the work carried out and conclusions drawn.</p> <p>For the 2007-2013 period, the audit authority for each programme will provide an annual audit opinion on the functioning of systems based on the systems audit work and audits of a sample of projects each year in accordance with an agreed audit strategy as summarised in its annual control report.</p>
<p><b>Supervisory and corrective controls:</b></p> <p>Audits by the Commission</p>	<p>Throughout the implementation period DG Regional Policy's audit directorate carries out systems audits with substantive testing to obtain assurance on the effective functioning of the systems and requires Member State to correct any system weaknesses and irregular expenditure found. This is explained in more detail in 2.2.4.1.</p>
<p><b>Supervisory and corrective controls:</b></p> <p>Audits by the European Court of Auditors</p>	<p>At any time during the implementation period, and for three years after partial or final closure, the European Court of Auditors may carry out system audits with substantive testing of a sample of transactions, as part of the audit work performed to support the annual opinion issued by the Court on the European budget (Déclaration d'Assurance), or for a special report.</p>
<p><b>Corrective controls and audit:</b></p> <p>Final payment and programme closure</p>	<p>At the end of the programme period, an independent audit body in the Member State reviews the results of the audit work and gives its opinion on the legality and regularity expenditure declared for the programme in the final statement of expenditure.</p> <p>DG Regional Policy scrutinises all such "winding-up" declarations and if necessary asks for further information or the performance of more audit work, before payment of the final balance. Financial corrections may be applied as part of the closure process.</p> <p>DG Regional Policy audits a sample of programmes after closure, which may lead to the application of financial corrections if irregularities or deficiencies are detected.</p> <p>Supporting documents have to be kept accessible for audit by the Commission and European Court of Auditors for three years after partial or final closure.</p>

#### **2.2.4. Relations with OLAF**

The main activities in 2007 were the following:

- a) Cooperation with OLAF on fraud cases concerning ERDF and Cohesion Fund;
- b) Treatment of irregularities at closure;
- c) Publication of the Annual Report 2006 concerning the protection of the financial interests of the Communities and the fight against fraud on 6 July 2007<sup>47</sup>;
- d) Commission Communication on the division of responsibilities for financial follow-up between OLAF and the authorising services<sup>48</sup>;
- e) Communication from the Commission to the Council, the European Parliament and the European Court of Auditors: "Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing"<sup>49</sup>;
- f) and IAS audit on prevention and detection of fraud.

#### **Cooperation with OLAF on fraud cases concerning ERDF and Cohesion Fund**

A reconciliation exercise was performed with OLAF in the first quarter to update the information on open potential fraud cases and the financial follow-up cases in DG Regional Policy monitoring database. The number of active (i.e. on-going) investigations currently underway by OLAF is 23 (1 BE, 1 EE, 4 EL, 2 ES, 1 HU, 10 IT, 2 LT, 1 PL and 1 UK). DG Regional Policy is currently responsible for a (financial and/or system related improvements) follow-up of 43 fraud cases which have been closed (2 BE, 2 CZ, 4 DE, 1 EL, 3 ES, 7 FR, 17 IT, 2 NL, 1 PL, 3 PT and 1 UK). An example of an on-going investigation is the enquiry which OLAF opened up following allegations which appeared in the Belgian media at the end of March 2007 that ERDF funds had been spent in a fraudulent manner by the City of Charleroi. As this is an on-going investigation the fraud allegations have not yet been confirmed and the conclusions as regards financial impact are not yet known.

#### **Treatment of irregularities at closure**

The reconciliation exercise to clear OLAF's ECR database of irregularities still open at full closure of programmes is proceeding. Some cases can be closed as there is no financial impact on the Community budget and in some cases the Member States must reimburse the Commission. Where a Member State has notified the Commission in accordance with Article 5.2 a decision is being taken as to whether the Commission accepts that the Community budget should bear the financial consequences. As regards the 1994-999 period, there are a total of some 600 cases. More than 80 % of the cases concern Germany. After a pilot exercise carried out for Denmark in early 2007, the Directorate General started in June 2007 a reconciliation exercise for all countries including obtaining information from Member States on the state of all remaining open irregularities. In 2007 the exercise was finalised for Sweden.

---

<sup>47</sup> COM(2007) 390 final (SEC(2007)930 and SEC(2007)938)

<sup>48</sup> C(2007)5709 of 27/11/2007, Communication to the Commission on the division of responsibilities between OLAF and the Authorising Officers by delegation in the Commission concerning the financial follow-up of irregularities in the domain of Community expenditure under shared management in the agricultural and structural actions areas.

<sup>49</sup> COM(2007)806 of 17.12.2007, Communication from the Commission to the Council, the European Parliament and the European Court of Auditors: "Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing"

## **Publication of the Annual Report 2006 concerning the protection of the financial interests of the Communities and the fight against fraud on 6 July 2007**

According to OLAF's Annual Report on the fight against fraud of 6 July 2007, in 2006 Member States communicated for the ERDF and the Cohesion Fund a total number of 1,225 and 228 irregularity cases amounting to €360 and €186 million respectively. As compared to 2005, even if the ERDF accounts for as much as 50% of the amounts, being also the fund with the largest resources available, its share decreased by 11% compared to 2005. The impact on the budget varies from country to country – there seems to be a correlation between the funds available and the amount of irregularities reported. Nevertheless, any statistics should be treated with caution as the reason for a higher rate of reporting in a given Member State might also relate to an increase in controls, more effective controls or better reporting.

## **Communication on the division of responsibilities for financial follow-up between OLAF and the authorising services**

The Audit Progress Committee (APC) requested in 2006 that OLAF concentrate more on its investigative function and that financial follow-up should be performed by the authorising services (including DG Regional Policy). Following this recommendation, Communication C(2007)5709 of 27/11/2007 on financial follow-up was adopted in November 2007 and is effective as from January 2008.

The key elements are that 1) the Directorate General concerned is responsible for all financial follow-up activities concerning operational cases transmitted by OLAF (final case report or relevant facts submitted by OLAF) as well as for all irregularities notified by Member States; 2) for OLAF operational cases the Directorates General will collaborate with OLAF to improve reporting and IT systems (Shared databases) to allow for a more efficient and effective follow-up and better analysis by the Directorates General; 3) as regards irregularities notified by Member States under the ECR reporting system, OLAF will remain responsible for the reporting system itself, but the operational Directorates of DG Regional Policy will have primary responsibility for the follow-up of the reported irregularities.

The Communication also foresees a more user-friendly access to the ECR database via a link to DG Regional Policy's Infoview application as well as the setting up of a common electronic platform for the follow-up of fraud cases.

## **Communication from the Commission to the Council, the European Parliament and the European Court of Auditors: "Prevention of fraud by building on operational results: a dynamic approach to fraud-proofing"**

OLAF's Communication COM(2007)806 of 17.12.2007 on fraud prevention establishes OLAF's new approach to fraud proofing of legislation and contracts as well as management and control systems. The approach is that OLAF will build on lessons learnt from its investigative activities and from the audit activities of IAS, the operational Directorates General and the European Court of Auditors. In 2008, DG Regional Policy will work together with OLAF to see how mutual benefits can be achieved from the new approach, in particular in the context of the development of the joint fraud prevention strategy.

## **IAS audit on prevention and detection of fraud**

The Internal Audit Service carried out an audit on "fraud prevention and detection in the Structural Funds" in 2007. The report was issued in December 2007. In reply to the audit findings DG Regional Policy is currently developing a joint fraud prevention strategy together with OLAF and DG EMPL. The strategy covers fraud risk assessment measures, fraud detection actions as well as internal fraud awareness raising actions in DG Regional Policy and DG Employment and in the Member States.

### **2.3. Follow up of audit work and previous year's reservations**

The audit work of the Directorate-General in the Member States and beneficiary countries is carried out in the framework of the three year audit strategy approved by DG Regional Policy and reviewed annually. The main objective of the strategy is to obtain assurance on the effective set up and functioning of the management and control systems. During 2007, the Directorate General, together with contracted auditors, carried out 87 audit missions in 30 countries.

#### ***2.3.1 Audit work by the Directorate General***

##### ***ERDF***

##### **Closure of programme period 1994-1999**

Closure audits have been completed on a sample of 56 mainstream programmes and one INTERREG programme covering all EU-15 Member States. The programmes audited give a coverage of 20-60% of the ERDF contribution in all Member States, with one exception, and an overall coverage of 35% of ERDF contribution for mainstream programmes (31% of the total ERDF allocation). All audit reports have been sent and all Member States have submitted replies. Progress on the follow up has been delayed in some cases by the prioritising of resources to deal with serious issues on the 2000-2006 programming period. At the end of 2007, 18 enquiries have been closed and corrections of an amount of €23.9 million have been applied (including a formal Commission decision of €9.6 million). Final position letters and/or hearings have already been sent or fixed for 25 programmes. For the remaining 14 cases, the final position letters are under preparation with the objective of completing all financial correction procedures in 2008.

##### **Programme period 2000-2006**

For the ERDF, an audit enquiry was started in mid-2004 to examine the effective functioning of key elements of the management and control systems in Member States for mainstream programmes. The audits comprise two phases, a systems review and audit of a sample of projects selected on a representative basis. The on-the-spot audit work initially planned was concluded by end 2006 for EU 15 and end 2007 for EU 10. Additional audits on 25 programmes were carried out in 2007 to extend coverage or address specific risks where this need had been identified from audit results, or to follow up implementation of action plans.

At the end of 2007, 214 audit missions (of which 13 INTERREG) had been carried out and 95 programmes had been audited. The programmes audited represent 41% of the number of the mainstream programmes and 61% of the planned ERDF contribution.

The risk remains that the management and control systems for the ERDF programmes are still affected by material weaknesses in certain Member States. In some cases the Directorate General does not yet have sufficient evidence that deficiencies detected have been satisfactorily remedied and expenditure at risk corrected, whilst in a limited number of cases coverage of systems is still not yet sufficient.

Based on the audit work undertaken, the main general risk identified continues to be insufficient management verifications by management authorities and/or intermediate bodies, which is not compensated by an effective certification function. The main specific risk is in the area of public procurement, where the problematic issues concern non-respect of the transparency principle, irregular complementary works, application of illegal selection criteria and problems in tender evaluation. One important reason for the deficiencies in EU 10

Member States is that staffing is still a persistent problem. Difficulties to recruit and retain sufficiently qualified staff contribute to a weak control environment.

In 2007, DG Regional Policy launched a new audit enquiry on verifying the reliability of the audit work of the winding up body. The objective is to reach conclusions as to whether the audit work of the national bodies can be relied on as a main source of assurance for the remainder of the programming period and whether the winding up declaration will be based on adequate audit work and will be a reliable source of assurance at programme closure. Under this enquiry it carried out 13 audits in 2007.

As regards INTERREG, DG Regional Policy launched a separate audit enquiry in 2006 which it has further implemented in 2007. The particular challenge is that for most of the 81 INTERREG III programmes the management and control systems are distinct. The audit approach has been to select on a risk basis from the three strands the programmes to be audited on the spot, following a similar methodology to the mainstream programmes. This has been supplemented by examining the results of a "self assessment exercise" conducted by the national bodies on the basis of a questionnaire prepared by the Directorate General and by a detailed assessment of the annual control reports in order to reach a conclusion on non-audited programmes. In 2007, 3 additional programmes were audited bringing the overall coverage to 35 % of ERDF commitments. In addition, one programme was subject to a project audit and 2 follow-up audits were carried out.

Other audit work for programming period 2000-2006 included the examination of the annual control reports received under Article 13 of Regulation No. 438/2001. By the end of 2007, 106 reports out of a total of 132 had been analysed, and replies sent to the Member States with observations and, where necessary, requests for additional information in order to be able to draw as much assurance as possible from the results of national audit work. All had been analysed by the end of March 2008. Furthermore, 231 national system audit reports were received and reviewed in 2007 of which 22% gave rise to further observations/enquiries in a letter from the Commission to the Member State.

By end of 2007, 10 annual bilateral meetings with national audit bodies had taken place, at which updated information on the implementation of audit work, progress on sample checks and follow up of findings was obtained. The remaining meetings were concluded by early February 2008.

## ***COHESION FUND***

### **1994-1999 EU 4 Member States**

The Cohesion Fund closure enquiry concerning the period 1994-99 covered 10% of Cohesion Fund projects representing 20% of the co-financed expenditure during this period. The fieldwork was finalised in 2003 and the main deficiencies found were insufficient management verifications resulting in ineligible expenditure and numerous breaches of public procurement rules. In 2007, for Spain the procedures for 3 projects were concluded by Commission decision and for Portugal the procedure for one project was concluded following acceptance by the Member State. The remaining financial correction procedures (8 projects: 4 of Spain, 1 of Greece and 3 of Portugal) resulting from this audit enquiry will be completed in 2008.

### **2000-2006 EU 16 Member States**

For EU-14 Member States, the audit work carried out in 2007 focused on follow up audits to verify the effective implementation of recommendations made on the systems in 2005 and further compliance testing of project expenditure. Special emphasis was also given to

reviewing the work of the national audit bodies including checking the quality of system audits, sample checks and other issues in relation to the work of the preparation of the winding up declaration. 20 audit missions were carried out: 7 missions under the EU14 Cohesion Fund enquiry, 2 missions under the public procurement enquiry; 3 missions under the winding up body enquiry (see ERDF 2000-06) and 8 missions concerning Romania and Bulgaria.

Financial correction procedures resulting from Cohesion Fund project audits carried out before 2007 were followed up. For Spain final position letters were sent out for all 14 projects outstanding. For Portugal, the procedures for 3 projects were concluded with acceptance of corrections by the Member State and there are procedures for 3 projects outstanding. For Greece the procedure for a flat rate correction for a horizontal issue on public procurement completed the hearing stage, and there are two further projects outstanding. All the remaining procedures will be completed in 2008.

In 2007, other audit work included examination of winding up declarations submitted for the closure of 2000-2006 Cohesion Fund projects, and the examination of the annual control reports under Article 12 of Regulation No.1386/2002, and participation in the relevant annual bilateral meetings with national audit bodies.

### ***IPA and ISPA***

#### **IPA**

In 2007, the candidate countries became eligible to the instrument for pre-accession assistance (IPA), which replaced ISPA. This instrument is accession-driven and split into five components of which 3 (regional development, human resources development and cross border co-operation) prepare for Cohesion policy.

The audit work in 2007 consisted mainly of 5 advisory and fact finding missions to the three beneficiary countries: Turkey, Croatia and the FYROM, with the principal objective to advance the national process towards accreditation by clarifying the legal requirements of the IPA regulations and explaining the expectations of the Commission services in view of the conferral of management.

#### **ISPA**

Due to slow progress of ISPA projects in Croatia in 2007, the audit work was limited to desk work in relation to outstanding issues following the Commission's decision to grant DIS to Croatia in 2006 and to an on the spot visit to review the system.

### ***SOLIDARITY FUND***

In 2007 the second phase (sample testing) of the audit on the financial grant in relation to the Portuguese forest fires of 2003 was completed.

The following validity statements which were received from the operational unit were examined relating to three Solidarity Fund grants: Slovakia (storm of 2004), Malta (storm and flooding of 2003) and Spain (Prestige oil spill of 2002).

### *2.3.2 Preparatory work related to the 2007-2013 period*

The specific objectives for the new period are to ensure that the new regulatory requirements – audit strategy, compliance assessment and audit opinion – are implemented in a correct and timely way so as to provide the Directorate General with assurance on the set up and functioning of the systems from an early date.

During 2007, DG Regional Policy and DG Employment have jointly worked on providing training workshops to the audit authorities in the Member States on the audit and control provisions of the new regulations. Workshops were provided to 24 Member States in 2007.

Guidance notes were prepared by the Directorate General in collaboration with DG Employment on the compliance assessment procedure, the audit strategy and statistical sampling, and discussed with Member States.

The first two documents were finalised in 2007. In addition the Directorate General has led a working group with DG Employment and the European Court of Auditors which has produced a new evaluation methodology on key elements of management and control systems. This document was also presented to Member States in 2007.

Detailed procedures have also been put in place in collaboration with DG Employment for the treatment of the audit strategies and compliance assessment documents. It is estimated that approximately 200 separate audit strategies and 250 separate compliance assessments will have to be dealt with in 2008 (figures include reports for the European Territorial Cooperation as well). Workflow systems have also been developed for the management of these processes. Proper preparation for the new programming period is of high importance for the Directorate General in order to ensure that assurance on the systems in the Member States is obtained at the beginning of the implementation of the programming period, and in particular that the work of the audit authority will be reliable. A significant part of the audit resources therefore have been devoted to these tasks.

### ***2.3.3 Follow up of 2006 AAR reservations***

The Annual Activity Report for 2006 concluded that there were significant deficiencies affecting the functioning of certain key elements of the management and control systems in the UK (England and Scotland) as well as for almost all INTERREG programmes. Therefore, the Directorate General had no reasonable assurance for expenditure declared on the legality and regularity of underlying transactions for the programmes concerned. In 2007 the Directorate General has ensured that required actions have been taken in the Member State concerned, and executed a targeted strategy for INTERREG.

#### **UK-England and Scotland**

##### England

The Directorate General had audited in 2006 four regions in order to verify the implementation of an agreed action plan to address deficiencies in the management checks. It was concluded that the action plan had not been effectively implemented and that there was still a high risk that irregular expenditure had been certified. As a consequence, a suspension procedure was launched in November 2006 and the Commission adopted on 4<sup>th</sup> April 2007 a decision suspending interim payments for 12 programmes in six English regions. The UK authorities were required by the decision to carry out further checks and make the financial corrections required to correct the irregularities detected. They also had to report the results to the Commission for each region concerned by the decision.

The national authorities replied to the Commission Decision in mid-2007 and the Directorate General after having examined the replies performed audit work in the six regions concerned and on the Commission basis of the positive results, lifted the suspension for 8 programmes by the end of 2007.

The Directorate General has obtained further information in the follow up to the audits for 2 programmes which has led to a decision lifting the suspension for these two programmes being adopted in February 2008. For 2 programmes in one region (North West), the Commission proposed a flat rate financial correction of the ERDF allocation. After the hearing with the English authorities on 4<sup>th</sup> December 2007, and taking into account further information provided, in particular on corrections already made on irregular expenditure, the financial correction decision was adopted on 10 March 2008 for an amount of €24,790,591 euros. This brings to a conclusion the issues which gave rise to the reservation.

##### Scotland

Following an audit mission carried out in October 2006, a reservation was made for 3 programmes (Western and Eastern Scotland and Clyde Urban Waterfront Regeneration Zone) due to serious deficiencies found in key elements of the management and control systems. The Directorate General agreed an action plan with the Scottish authorities providing for increased checks to be carried out to ensure the legality and regularity of the expenditure declared. The report on the first results of the action plan was submitted in July 2007 and a follow up audit was carried out in October 2007 to confirm the results.

The audit concluded that the progress made on the implementation of the action plan is generally satisfactory in terms of the coverage and intensity of primary level checks. A further follow up audit will be carried out in 2008 to verify the full implementation of the action plan by the established deadlines.

## **INTERREG**

Following the serious deficiencies found during the audits in 2006 (for three programmes audited) and the limited assurance on the non audited programmes, a reservation was made for INTERREG (with the exception of 2 programmes INTERREG IIIB North West Europe and Azores, Canaries and Madeira) in the 2006 AAR.

Significant audit work was carried out by DG Regional Policy through 7 audit missions in 2007, as indicated in point 2.3.1. Follow up work has been carried out on 2 programmes audited in 2006, INTERREG III-B CADSES and Spain/Portugal. For the latter an action plan was agreed, and an audit was carried out in November 2007 to make an interim assessment of its implementation. It was found that there were significant delays in implementing the actions relating in particular to the catching up of first level verifications (for example due to tendering procedures with external contractors) but that actions were generally progressing. A self-assessment questionnaire was also sent to all managing authorities of INTERREG programmes in order to identify and address potential deficiencies. This provides – together with the analysis of the annual control reports (Article 13, Reg. 438/2001) – a basis for the opinion on the non-audited programmes. As a result of the audit work and the analysis of the annual control reports received, the Directorate General launched procedures under Article 39 of Regulation 1260/1999 to suspend interim payments for 6 programmes: INTERREG III-B MEDOCC, INTERREG IIIA FR-UK, and INTERREG III A Germany-Luxemburg-Belgium in 2007, and for INTERREG III A Italy-Albania, INTERREG IIIA Greece-Italy and INTERREG IIIB Archimed in January 2008. In addition, the strategy has been updated for the non-audited INTERREG programmes in order to identify the programmes and systems at risk which should be subject of targeted audits in 2008.

### 2.3.4 Follow-up of other action plans

For other Member States where material deficiencies in management and controls systems were reported in the 2006 AAR, action plans have also been agreed as detailed below: six action plans are being closely monitored by DG Regional Policy for approximately 61 ERDF programmes. For Poland, Portugal and Spain, the action plans also cover the Cohesion Funds.

Member State	Deficiencies noted	Action plan: Start date	N° of OPs covered	Decided amounts covered in Billion €	State of play in March 2008 (Commission's analysis and conclusions)
Finland	Deficiencies in key elements of the management and control systems including lack of separation of functions, quality and reliability of the Articles 4, 9 checks and 10 audits of Reg. 438/01.	March 2007	4	0.91	<b>On-going.</b> A final verification of the implementation of the action plan was carried out end of 2007. Actions were found adequate in relation to managing authority and paying authority. Actions in relation to audit body are ongoing and will be monitored in 2008.
Italy	Deficiencies in key elements of the management and control systems including lack of separation of functions, systemic issues relating to procurement and eligibility of certain expenditure items	March 2007	1 (Puglia)	1.72	<b>On-going.</b> The action plan should have been implemented by the end of 2007. Although substantial progress was made, the work carried out is insufficient to gain reasonable assurance on the expenditure declared to date. A procedure to suspend payments has been launched in January 2008.
Netherlands	Deficiencies in the functioning of the systems of the managing authority, paying authority and audit bodies	End of 2006	5	0.94	<b>On-going.</b> The final conclusion can only be drawn after having received the final report in April 2008. The amount to be corrected will be calculated on the basis of sample checks included in the action plan.
Poland	Deficiencies in primary level checks, the certification checks and the audits, audit trail, computerised monitoring information systems and financial corrections in the area of public procurement.	August 2007	3	4.94	<b>On-going.</b> DG Regional Policy carried out an audit to review results of additional audits performed by national authorities in February 2008. As a result, the Commission will launch a procedure to suspend and correct payments if the MS fails to make the required corrections.

Portugal	Deficient first level management checks and sample controls for audit in regard to verification of public procurement rules in regard to ERDF and CF.	April 2005	23 (all)	13.25	<b>On-going:</b> Implemented for the majority of programmes/projects except for financial corrections to some projects, for which the procedures will be finalised in 2008 and follow up of remedial measures on 3 programmes. A contract of confidence was signed with Portugal on 22 January 2008, excluding the 3 programmes. Financial corrections of € 27 million (for ERDF) plus 18 million €(for CF) have been applied by the MS and DG Regional Policy has proposed to the MS additional financial corrections of about€49 million (ERDF) and about €32 million (CF).
Spain	Insufficient and inadequate quality of first level management checks. Deficiencies in work of paying authority. Important delays in systems audits and sample checks set out by Article 10.	April 2006	25 (all)	27.91	<b>On-going:</b> In view of inadequate implementation a pre-suspension procedure has been launched for suspension of payments to 14 intermediate bodies, OP <i>Sociedad de la Informacion</i> and 10 URBAN programmes.

### ***2.3.5 Other follow up actions on systems with material deficiencies reported in 2006***

#### **Ireland**

There is no formal action plan agreed for Ireland. However, in order to address deficiencies in the management and control systems identified by audits carried out by DG Regional Policy in 2006 and in 2007, the Irish Authorities initiated in 2007 a "look-back" exercise – review of all previously declared payment claims in order to identify irregular expenditure and concentrating on the areas of concern (purchases of land, overheads and public procurement, etc.). Meetings took place between the Directorate General and national authorities to discuss the principle weaknesses and requested actions.

The Commission has informed the Irish authorities of the reporting required and will examine the information provided during the first half of 2008. The Commission will carry out an audit mission to review the exercise on a sample basis in the second quarter of 2008.

#### **Czech Republic**

Audits were carried out by the Directorate General in 2007 to verify expenditure for a sample of projects for 2 programmes and extend coverage by carrying out a systems audit in OP Industry and Enterprise. These audits generally confirmed the systemic weaknesses in particular concerning first level checks on public procurement compliance and respect of rules for revenue-generating projects. The Directorate General will carry out an audit in 2008 of corrective measures by the Member State. These actions also cover deficiencies in the systems for the Cohesion Fund.

#### **Slovakia**

Audits were carried out by the Directorate General in 2007 to verify expenditure for a sample of projects for one programme and to extend coverage by carrying out a systems audit of OP Industry & Services. These amounts generally confirmed the systemic weaknesses in particular concerning first level checks on public procurement compliance. The Directorate General will carry out an audit in 2008 of corrective measures by the Member State.

These actions also cover deficiencies in the systems for the Cohesion Fund.

#### **Luxembourg**

The issues concerning the correct application of the EU public procurements directives have been followed up in 2007 through the contradictory procedure on the report of the 2006 audit, further correspondence and bilateral discussions. The national authorities have carried out further analysis of the files at risk.

The Directorate General will follow the final submissions from the national authorities, take a final position and, if justified, launch a financial correction procedure.

#### **UK – Northern Ireland**

The Directorate General followed up the outstanding issues with the national authorities and carried out a follow up audit in September 2007. Evidence was provided to close the majority of findings. The residual points will be followed up with the Member State in 2008.

#### **Belgium**

Additional audit work has been carried out in the Flanders region in 2007 to verify the systems and projects, and a follow up audit was carried out in January 2008 to check on the

implementation of corrective measures. Whilst there are some remaining weaknesses, it was confirmed that the main corrective measures had been taken.

### **Lithuania**

A follow up audit was carried out in 2007 which concluded that previously identified deficiencies concerning the control of public procurement at the primary level had been corrected. Weaknesses remain in the audit work within one Ministry which are currently the subject of corrective measures and will be verified by an audit of the Directorate General in 2008. These actions also cover the Cohesion Fund.

### **Italy** (OPs Sviluppo Locale, Ricerca, Friuli Venezia Giulia)

The Directorate General followed up the audit findings on 2 of the OPs (Ricerca and Friuli Venezia Giulia) to obtain evidence of corrections to systems deficiencies. Some outstanding issues remain, in particular regarding contested findings on projects audited, for which the follow up will be concluded in 2008. Sviluppo Locale was audited in February 2008 and the outstanding deficiencies noted, which have a limited impact, will now be followed up.

### **Germany** (OPs Saarland, Mecklenburg Vorpommern and 12 URBAN programmes)

The Directorate General has followed up the audit findings for its audit of one of the 2 mainstream programmes to obtain evidence of corrections to systems deficiencies, and in the other case for which reliance had been placed on the audit findings of another Directorate General, carried out a review of the winding up body.

There are some outstanding issues for which the follow up will be concluded in 2008.

Because of the low levels of Community financing, and as assurance on the systems is obtained through examination and follow up of the annual control report under Article 13 of Regulation 438/2001, the URBAN programmes have not been audited by the Directorate General.

### **2.3.6 Follow-up of ECA's annual report 2006**

In its Annual Report for 2006, the European Court of Auditors concluded from its audit work that there is a high risk that declared costs of Structural Policies projects are misstated or ineligible for reimbursement; control systems in Member States are either ineffective or only moderately effective and that the Commission maintains only moderately effective supervision to mitigate the risk of reimbursement of overstated or ineligible expenditure. The Court stated that at least 12% of amounts reimbursed for structural actions in 2006 should not have been reimbursed.

The error rate of a minimum 12% cited by the Court is an estimate of the risk based on the results of the Court's audit of a representative sample of 177 projects for structural actions as a whole. It indicates the order of magnitude of the risk of error of reimbursement by the Directorate General because of deficiencies in the ex ante controls by the Member States. DG Regional Policy has analysed the errors detected for ERDF and Cohesion Fund projects to identify the main sources of error. A high proportion of errors related to breaches of rules on public procurement and to missing documentation. The Directorate General has taken account of the risk concerning compliance with public procurement legislation through its targeted enquiry and through the emphasis given on this aspect in its systems audits. This is reflected in the high level of financial corrections applied by the Directorate General resulting from this type of irregularity.

The Court also analysed 10 audits carried out by DG Regional Policy in 2006. For 7 it concluded that there was adequate risk assessment, an operationally useful audit result and corresponding post-audit corrective action. For two cases of audits which had been outsourced to a private audit firm, the Court found that there are weaknesses in audit documentation making assessment of the result difficult. In one case the Court found the audit result of little operational use. Whilst the results of the Court's audit are positive, the Directorate General has further strengthened in 2007 its quality assurance procedures for its audit work.

The main recommendations of the Court are:

- ensure complete, transparent, reliable information on financial corrections and recoveries
- improve effectiveness of Commission's supervisory controls
- ensure sound closure procedures for 2000-2006
- focus on improving first level controls
- encourage use of simplification for 2007-2013 period
- increase impact of audit activity by better use of suspensions and corrections.

In October 2007, in collaboration with DG EMPL, DG Regional Policy established in response to the recommendations a common strategy to reinforce the impact of its supervisory activity.

The Commission has formalised its commitment to carry out ongoing and new actions in the "Communication on an action plan to strengthen the Commission's supervisory role under shared management of structural actions" (COM(2008) 97 final) issued on 19 February 2008 in the context of the 2006 discharge exercise. This action plan is designed to incorporate the work planned under the joint audit strategy for structural actions and in the Commission Action Plan towards the Integrated Internal Control Framework (see below in section 2.3.7) as well as the new actions referred to. The action plan to strengthen the Commission supervisory roles under shared management of structural actions includes specific outputs and

deadlines. It is composed of actions under the following headings: 1. Actions under the Structural Actions joint audit strategy 2000-2006, 2. Main ongoing actions under the Action Plan towards and Integrated Internal Control Framework, 3. Preventive actions for closure of 2000-2006 programmes and projects, 4. Preventive actions for the 2007-2013 programming period, 5. Actions to improve primary controls at national level, 6. Actions to improve reporting on financial corrections by Member States, 7. Actions to improve reporting by Commission on impact of audit activity, 8. Actions to increase impact of Commission audit activity, 9. Actions to improve assurance provided by AAR, 10. Actions to maximise value of annual summaries under Article 53b(3) of the Financial Regulation.

The Commission has shown by adopting this Communication its strong political commitment to bring about improvements to reduce the error level and to apply suspension of payments and financial corrections to show that the structural actions budget is being managed rigorously. The Commission has committed itself to provide to the European Parliament quarterly reports on the implementation of the action plan, to provide a progress report in October 2008 and a final report at end of January 2009.

### Commission actions on systems audited by the Court for 2006 DAS

A comparison between the Court of Auditors' assessment of programmes audited for the 2006 DAS and the Commission's action taken on these same programmes is set out below. The table indicates that, in all but one case, the Commission had audited the systems prior to the Court's audit and that actions had been taken. There are no significant differences between the assessments of the Court and those of the Directorate General.

Member State/Region/ Programme/ Fund	ECA assessment	Action taken by Commission	
		Action prior to Court's audit	Actions underway
ERDF- Italy/Campania, Obj. 1	Ineffective	Audit 2006, action plan agreed	Implementation of action plan being verified
ERDF- Spain/Basque Country/Obj. 2	Ineffective	Audits of system in Spain 2005-7, reservation 2005 AAR for ERDF, action plan on all programmes 2005-7	Implementation of action plan verified 2007, suspension of payments launched
ERDF- Spain/Valencia/ Obj. 1	Ineffective	Audits of system in Spain 2005-7, reservation 2005 AAR for ERDF, action plan on all programmes 2005-7	Implementation of action plan verified 2007
ERDF- Spain/Cohesion Fund/7 projects	Ineffective	Audits of sample of projects in 2004, reservation in 2005 AAR for CF, action plan 2005-07	Financial corrections applied at closure of projects
ERDF- Greece/Peloponnese/Obj. 1	Moderately effective	Audit of system in Greece in 2003-5, reservation in 2005 AAR, action plan for all of Greece 2003-5, launch of payments suspension in 2005 with financial correction of €18 million decided in 2005	Audits of further programmes carried out in 2007 and planned for 2008
ERDF- Portugal/Accessibility and Transport/Obj. 1	Moderately effective	Audits of various Portuguese programmes in 2003-5, action plan for whole of Portugal 2003-5	Signature of contract of confidence in January 2008
ERDF- Austria/INTERR	Ineffective	Audit of sample of INTERREG programmes in 2006-7, action plan for 1	National authorities have restructured the

EG/Austria-Hungary		programme, general reservation for INTERREG programmes in 2006 AAR, self-assessment exercise for non-audited programmes	administrative system and are recovering all ineligible ERDF related funds. Financial corrections of about €280.000 were applied by the Member State.
ERDF-UK/Merseyside/Obj. 1	Ineffective	Audits of system in England in 2005, reservation for England in 2005 and 2006 AARs, action plan for whole of England 2006-7, suspension of payments to 12 English programmes 2007	Implementation of action plan in this programme considered satisfactory and suspension lifted 2007. Follow-up of individual findings may lead to financial corrections.

### Cooperation with the Court of Auditors

In 2007, the cooperation between the Court of Auditors and DG Regional Policy and DG Employment on audit methodology issues was formalised through the establishment of regular inter-institutional colloquia meetings. Three meetings were held in 2007 and included topics on the agenda such as Annual Activity Reports, methodology on systems evaluation and interpretation of the regulations. Two specialist working groups were established. One has produced a common methodology for evaluating systems on the basis of defined key elements. The second has examined issues of interpretation of specific regulatory provisions to reduce the risk of divergences.

### *2.3.7 Action Plan towards an Integrated Internal Control Framework: actions in 2007*

**The Commission Action Plan towards an Integrated Internal Control Framework**, which was adopted on 17 January 2006, sets out a list of 16 concrete actions to be implemented by the Commission services which address weaknesses which have so far prevented the Court from granting the Commission a positive DAS. The implementation of the specific actions was for the most part completed by the end of 2007. A final progress report was issued on 27 February 2008 (COM(2008) 110 final). Some of the actions are still ongoing however and have effectively been taken over by the Communication on an action plan to strengthen the Commission's supervisory role under shared management of structural actions" (COM(2008) 97 final) as stated above. The Directorates General in charge of Structural Fund are key players in the process and DG Regional Policy as chef de file is participating or has participated in the following actions:

**Action 4- Tolerable risk of Error** – DG Regional Policy has been involved in the discussion on the tolerable risk of error, and participated in a seminar on risk in EU-funded programmes on 8-9 October 2007 organised by DG Budget, with representatives of national administrations, to further explore the inherent risks associated with the EU budget and the potential benefits of controls. DG Regional Policy will participate in further analysis of residual risk to be organised by DG Budget.

**Action 5 – National declarations** – DG Regional Policy supports Member States (so far, Denmark, Netherlands and UK) which have committed themselves voluntarily to provide a national political-level declaration on the use of Community funds. With regard to the annual summaries on audit activity and declarations required under the Financial Regulation, DG Regional Policy took the lead for the preparation of a guidance note which was sent to Member States at the end of 2007. Results of the submission of the first annual summaries are included under section 2.4.2.

**Action 9- Improved Coordination** – The action plan asks for increased coordination of audit work and sharing of audit results between the Commission services and between the Commission and Member States. The aim is to work towards the "single audit" concept and increase the reliance to be placed on the work of national audit bodies. For the coordination with Member States, see the text at the end of this section. Coordination between Commission services has gained greater significance with the preparations for the start of the 2007-13 period and with the closure of the 2000-06 period. A database of common bodies responsible for the management and controls systems of the Structural Funds was completed in 2007 with the winding up bodies. The Directorates General in charge of structural funds will use this database to share results of the audit enquiry on the review of the work of the winding up bodies in 2008.

**Action 10 – Cost of Controls** - To provide a basis for establishing a balance between the costs and benefits of controls, a study is being conducted on the cost of controls of the Structural Funds in Member States. DG Regional Policy assisted DG Budget in defining a common methodology for this study. The methodology was finalised with the assistance of the Member States participating in the pilot phase (Hungary, UK-Wales, Portugal and North Rhine-Westphalia in Germany). From autumn 2007 the exercise was extended to all Member States. The data has been received and will be analysed in a report to be sent to DG Budget by mid-2008. The assessment of the costs along with the assessment of the types of errors will provide an input into the discussions on defining the optimal intensity of controls assuring a tolerable risk of error – (see Action 4).

**Action 11N – Examine the reliability of national monitoring and reporting systems for recoveries and financial corrections** - The Commission included as an annex to the 2006

Annual Report on the Structural Funds information on Commission corrections and also, for the first time, provided figures for the execution of financial corrections at national level through withdrawals and recoveries by the Member States based on the communications made by Member States under the sectoral regulations. As the information provided in 2007 was incomplete, DG Regional Policy will take actions in 2008 to obtain better compliance with reporting requirements and will verify the accuracy of the data provided in a sample of Member States.

**Action 14- Guidance-** Six guidance notes were produced by DG Regional Policy in 2007 and discussed with Member States in technical meetings and/or COCOF meetings, namely guidance notes on: audit strategy requirements, compliance assessment procedure, annual summaries, financial corrections for public procurement irregularities, sampling guide and systems assessment methodology. The latter two will be presented in COCOF meetings in 2008 and a further two guidance notes, on the management verifications and the certification function, will be updated to take into account the provisions of the new regulations.

**Action 15- Contracts of Confidence** – Contracts of Confidence with UK-Wales and Austria were signed in 2006. In early 2008 contracts were signed with Denmark, Portugal, Slovenia and Estonia. As there is still relevance for the purposes of programme closure, the Directorate General will seek to sign further Contracts in 2008 where the conditions are fulfilled. Potential further candidates include Malta and Cyprus. The promotion of this initiative has driven generally the improvements in the coordination of audit work and has created a benchmarking procedure. The key elements of this initiative have been incorporated in the new regulation (Article 73).

**Action 16- Coordination of audit standards-** The aim under shared management is to operate within an integrated internal control framework and be able to rely on the work of the national audit bodies. As a result, it is necessary that all Member States perform audit work according to the same generally accepted auditing standards. The new regulations require that internationally accepted audit standards must be applied. A working group to revise the Structural Funds audit manual according to the new regulations and introduce references to international audit standards was created in 2007 and it completed sections concerning the audit strategy, the compliance assessment, sampling and systems evaluation. The remaining sections covering risk assessment, systems audits, reliance on work of other auditors and annual reports and opinions will be presented to Member States in 2008. The manual will act as a point of common reference for all Member States and the Commission services.

### **Coordination and cooperation with Member States**

A number of the actions in the Commission “Action Plan” towards an integrated internal control framework involve improving coordination with Member States and within the Commission.

The cooperation with the Member States is also stipulated in Council Regulation 1260/1999 laying down general provisions on the Structural Funds. DG Regional Policy shares information on audit issues with all Member States at least on an annual basis through the bilateral coordination meetings. These meetings provide the opportunity to exchange information on audit findings, audit strategies and methodology. During the first part of 2007, bilateral meetings were held with 16 of the Member States whereas the remaining 11 meetings had been organised at the end of 2006. For the new cycle of bilateral meetings for 2007/2008 10 bilateral meetings took place before the end of 2007 and the remaining ones in early 2008, with the last one held 8 February. DG Regional Policy also has the responsibility of centralising the planned audit missions for the Member States, the Structural Fund services and the European Court of Auditors and publishing a consolidated audit

schedule on CIRCA. For 2007 this was established in mid-January and updated and published on CIRCA every third month.

In order to promote an improved financial control culture and exchange ideas on best practices, further cooperation with the Member States is provided through the annual Homologues Group meeting, which for 2007 took place in Lemesos (Cyprus) on 15-16 October 2007. A total of 127 participants were present, representing the Member States, the Commission services and the European Court of Auditors. The main themes in 2007 were "How to obtain a higher degree of assurance", "Assessment of the key elements of the management and control systems" and "Cost of controls and tolerable risks". External guest speakers were the member of the Court responsible for the Structural Funds and the member of the budget committee of the European Parliament designated as rapporteur for the 2006 discharge.

Besides the Homologues group meeting, two multifund technical group meetings were organised in 2007 to discuss guidance notes relating to the new programming period. The first one was held on 27 March to discuss the guidance note on the compliance assessment of the systems set up under Article 71 of Council Regulation 1083/2006 and on the audit strategy under Article 62 of Council Regulation 1083/2006. The second was organised on 16 November and focused on the sampling guide (Article 62 of Council Regulation 1083/2006 and Article 16 of Commission Regulation 1828/2006), the guidance note on a common methodology for the assessment of systems and the guidance note on annual summaries under Article 53b of the Financial Regulation. This latter note was also discussed with Member States in the COCOF.

The Commission had made the commitments during the Homologues meeting held in 2006 to a) organise more frequent technical meetings, b) provide workshops on the new audit and control arrangements, c) produce more guidance notes, d) revise the Structural Funds audit manual and e) provide wider access to the Member States authorities on Commission guidance notes. In meeting these commitments, the Commission organised two technical meetings in 2007, provided workshops in all Member States (except one) on the audit and control arrangements under the new period, and produced six new guidance notes (see action 14 above). These guidance notes will be included in the revised audit manual for which work will be completed in 2008. Work is also underway and will be finalised in 2008 to provide wider access to Commission guidance notes by the Member States.

With regard to coordination between Directorates General in the Structural Fund family in the Commission, representatives from the Structural Funds Directorates General have participated in working groups such as the pool of trainers for the workshops to the Member States, the revised audit manual and the special enquiry on the reliance to be placed on the work of the winding up body launched in 2007.

### **2.3.8 FOLLOW-UP OF INTERNAL AUDIT SERVICE (IAS)'S RECOMMENDATIONS**

DG Regional Policy carries out a follow-up of the recommendations of IAS. The Directorate General provided answers to recommendations formulated by IAS in their audit reports on the In-Depth Audit of DG Regional Policy (IAS-2002-REGIO-001) on the Structural Funds (ex-post and Compliance) to assess the implementation of the financial control provisions relating to the ERDF for the 2000-2006 programming period, the process of interpreting regulation and the management reporting systems, on audit report IAS-2005-REGIO-001 to assess the suitability and the effectiveness of internal management system and the performance of the Commission departments in the implementation of article 38 of the Council Regulation 1260/1999, and on audit report IAS-2006-REGIO-003 on the Cohesion Fund (ex-post and Compliance) to assess the suitability and the effectiveness of the implementation of financial corrections provisions for Cohesion fund projects.

In 2007 the IAS has undertaken four new audits in DG Regional Policy for which recommendations are made:

- Prevention and Detection of Fraud in the Structural Funds: DG Regional Policy has produced an action plan to implement in 2008 the recommendations of the audit report. The main recommendation is the development of a fraud prevention strategy, including raising awareness in Member States on fraud prevention and detection. Many of the actions require the good collaboration between the Directorates General Regional Policy and Employment and OLAF and the utilisation of OLAF specialist services under the new working arrangements;
- Audit of the AAR Assurance Process: only one recommendation concerned DG Regional Policy directly on the reporting from the AOSD. The internal instructions launching the AAR 2007 process took account of IAS' suggestions to clearly spell out the Authorising Officers by Subdelegation's responsibilities;
- Audit on Approval of Programmes in the Member States: the actions recommended by IAS aim to proactively work with the new Member States to improve their budget absorption rates and sound financial management by contributing to their capacity building efforts. These actions are underway;
- Follow-up Audit on Article 38 of Regulation 1260/1999: the final follow-up audit report was issued on 14 December 2007. Based on the results of its follow-up audit the IAS concludes that the recommendations have been adequately and effectively implemented with the exception of three recommendations (reclassified as "Important", downgraded from "Very important"). One of the recommendations was closed by end of 2007 with a letter on the follow up to the Commission Communication C(2004)3115 sent in late December. The working groups implementing the remaining two recommendations, (a) to develop a strategy to gain more assurance on sound financial management and (b) to incorporate international audit standards in the Commission's audit procedures, will produce their working papers by mid-2008.

### **2.3.9 FOLLOW-UP OF INTERNAL AUDIT CAPABILITY (IAC)'S RECOMMENDATIONS**

IAA (Internal Audit and Advice unit) conducts its audits in adherence with the *Standards for the Professional Practice of Internal Auditing*. The audit and advice activities of the Internal Audit and Advice Unit follow a risk-based approach taking account of the risk assessment produced by management of DG Regional Policy. Their primary objective is to provide the Director-General with assurance and consulting services as to the effectiveness and efficiency of risk management, control, and internal governance processes in the Directorate General.

In accordance with the nature and the scope of the IAA work during the year in question, IAA expresses annually an opinion on the state of control within the Directorate General. The Internal Audit and Advice opinion for the year 2007 is based on the tasks carried out from the IAA Work Plan 2007 and additional ad-hoc tasks performed in the period 1 April 2007 – 31 March 2008 as well as on IAA audit and consulting work coming from the previous year contributing to the assurance.

It included the completion of the following tasks: audit of the decisional (and commitment) process, ex post controls on payments, audit of the closure of the Cohesion Fund projects, review of DG Regional Policy Accounts for the year 2007, audit of human resources, audit of the approval process of operational programmes for the programming period 2007-2013, audit of direct grants, audit of SFC2007, audit of the closure of innovative action programmes, audit of tendering and contracting procedures, audit of the process of developing guidance, follow-up audit of M+24, audit of WFS/SYSFIN, two surveys on the effectiveness of eleven internal control standards as well as advice tasks on mobility, the role of Desk Officer for the new programming period, document management and the audit strategy.

The assurance it provides to the Director General is not absolute in that it does not cover all of the DG Regional Policy activities and transactions. In particular as regards payments, IAA cannot provide assurance on the regularity and legality of the underlying transactions in the Member States. The audit of the management and control system in the Member States falls under the scope of work of the Audit Directorate of DG Regional Policy.

Further to the completion of IAA Work Plan 2007, 14 very important and 47 important recommendations were issued and all were accepted and agreed by DG Regional Policy for prompt implementation.

## 2.4. Key indicators supporting reasonable assurance

### 2.4.1 Key indicators on legality and regularity

KEY INDICATORS FOR LEGALITY AND REGULARITY - European Regional Development Fund 1994 – 1999				
INDICATORS	Cumulative information since beginning of programme period (when applicable)			
Closure programmes		Actual	As % of Programmes	As % of EU contribution
°Commission closure audits - number of audit missions		150		
°Commission closure audits - number of programmes		56	14%	35%
	Number of programmes	Estimated amount in million €		
OUTPUTS: °Pre-suspension letter issued/ Financial correction procedures launched in framework of closure <sup>50</sup>	25	473		
	Estimated amount in million €, 2007	Estimated amount in million €, cumulative		
Financial corrections resulting from procedures launched by the Commission <sup>51</sup>	39	857		

KEY INDICATORS FOR LEGALITY AND REGULARITY – ERDF 2000-2006						
INDICATORS	Year: (n) 2007			Cumulative information since beginning of programme period (when applicable)		
<b>INPUTS</b> (at DG level)	<b>Actual</b>			<b>Actual - Prior year</b>		
Human resources - Commission audit activity	55 FTE			55 FTE		
Financial resources - outsourced audits	245 days			260 days		
<b>OUTPUTS - by process</b>	<b>Intensity</b>	<b>Coverage</b>		<b>Intensity</b>	<b>Coverage</b>	
Set-up of systems		as % of		Number of Programmes	as % of	
°Compliance assessment – review of set-up of systems	System descriptions for all Member States were reviewed at the beginning of the period through desk checks and a positive assessment was given for all.					
Functioning of systems		as % of			as % of	
	Actual	Number of Programmes	EU Contribution	Actual	Number of Programmes	EU contribution
Commission audits - number of audit missions	60			214		
Commission audits - number of programmes	ERDF-25	8,4%	7,9%	ERDF-95	32%	61%
	INTERREG-3	3,7%	7,2%	INTERREG-8	10%	35%
Pre-suspension letter issued/financial correction	Number of programmes	Estimated amount in million €				

<sup>50</sup> Transmission of Article 24 letter (final position letter) to the Member State following closure audits.

<sup>51</sup> Includes corrections made by Member States, following agreement under the relevant procedure or as a result of implementation of action plans (which may cover many programmes), and corrections resulting from formal Commission decisions.

procedures launched (2000-2006)	27	1.432	
Suspension decisions issued	12	N/A	
<b>RESULTS</b>	<b>Intensity</b>	<b>Coverage</b>	
<i>Assessment of management control systems - <b>functioning of systems</b></i>	Number of Programmes	as %	
		Number of Programmes	Payments in 2007 <sup>52</sup>
Commission's assessment on ERDF (2000-2006) <sup>53</sup>			
- works well (unqualified)	147	38.8%	28.12%
- works, but needs some improvement (qualified moderate)	50	13.0%	11.16%
- works, but needs significant improvement (qualified significant)	139	36.8%	47.68%
- does not work (adverse)	43	11.4%	13.04%
	Amount (mios €) in 2007	Cumulative Amount (mios EUR) since beginning of the period	
Financial corrections resulting from procedures launched by the Commission <sup>54</sup>	179	1.561	
<b>IMPACT on Declaration of Assurance of reservation</b>	<b>Coverage</b>		
	Number of Programmes	as % of Programmes	Estimated risk for payments to programmes in question as % of total payments in 2007
<b>ERDF reservation</b>	<b>136</b>	<b>35.9%</b>	<b>2.37%</b>

<sup>52</sup> Reflects the payments disbursed by the Commission in 2007.

<sup>53</sup> Includes mainstream and Interreg programmes. Based on the management opinion of DG Regional Policy using information from results of Commission audit units, the results of Member State audits and the annual implementation reports and annual meetings.

<sup>54</sup> Includes corrections made by Member States, following agreement under the relevant procedure or as a result of implementation of action plans (which may cover many programmes), and corrections resulting from formal Commission decisions. The cumulative amount includes €8 million representing a formal Commission decision not previously reported and €1 million deduction for estimated amounts established in initial letters to Member States launching financial correction procedures.

KEY INDICATORS FOR LEGALITY AND REGULARITY - Cohesion Fund 2000-2006			
INDICATORS	Year: 2007	Cumulative information since beginning of programme period (when applicable)	
<b>OUTPUTS - by process</b>			
<i>Functioning of systems</i>	Number of Programmes	Number of Programmes	
° Commission audits - number of audit missions	20	151	
° Commission closure audits - number of audit missions	1	8	
	Number of projects	Estimated amount in million €	
Pre-suspension letter issued/financial correction procedures launched (2000-2006)	69	115	
<b>RESULTS</b>	<b>Intensity</b>	<b>Coverage</b>	
<i>Assessment of management control systems - <b>functioning of systems</b></i>	Number of Member States <sup>55</sup>	as %	
		Number of Member States	Payments in 2007 <sup>52</sup>
° <b>Commission's assessment on Cohesion Fund (2000-2006)</b>			
- works well (unqualified)	7	38.9%	23.6%
- works, but needs some improvement (qualified moderate)	6	33.3%	44.1%
- works, but needs significant improvement (qualified significant)	5	27.8%	32.3%
- does not work (adverse)	-	-	-
	Amount (mios €) in 2007	Cumulative Amount (in million €) since beginning of the period	
° Financial corrections resulting from procedures launched by the Commission <sup>56</sup>	4	103	
<b>IMPACT on Declaration of Assurance of reservation</b>	<b>Coverage</b>		
	Number of Member States	Estimated risk for payments to projects in question as % of total payments in 2007	
<b>Cohesion Fund Reservation</b>	<b>5</b>	<b>1.77%</b>	

## Financial corrections and suspensions

In order to exercise its supervisory role, the Commission has the power to suspend interim payments and to make financial corrections to ensure that only expenditure which is fully compliant with the applicable rules is co-financed. As a precautionary measure, the Authorising Officer by Sub Delegation may also in certain circumstances interrupt payments. The exercise of these powers is therefore an important indicator of the effectiveness of the Directorate General's supervision of Member States.

<sup>55</sup> The total is 18 instead of 16 as the systems for HU and BG are divided among the 2 sectors (environment and transport)

<sup>56</sup> Includes corrections made by Member States, following agreement under the relevant procedure or as a result of implementation of action plans (which may cover many programmes), and formal Commission decisions. The cumulative amount includes €17.7 million representing formal Commission decisions not previously reported and €18.7 million deduction for estimated amounts established in initial letters to Member States launching financial correction procedures.

For 2007 the Directorate General carried out the following measures:

- Suspension of interim payments by Commission decision for 12 programmes in England;
- Application of financial corrections accepted by Member States without Commission decision<sup>57</sup>.

Member State/programme	ERDF amount (2000-2006)	Member State/project	Cohesion Fund amount (2000-06)
AT2000CB160PC003	280.164,00	RO 2001RO16PPE012	35.557,00
IT 1999IT161PO006	13.933.258,00	RO 2000RO16PPT004	867.911,25
IT 1999IT161PO008	2.318.712,00	RO 2000RO16PPE008	283.843,50
IT 1999IT161PO009	14.876.063,00	RO 2001RO16PPT005	428.364,75
IT 1999IT161PO011	145.749.959,00	PT 2002PT16CPE005	1.926.163
IT 1999IT161PO007	1.788.118,00	Total	<u>3.541.839,50</u>
Total	<u>178.694.274</u>		

Member State/programme	ERDF amount (1994-1999)	Member State/project	Cohesion Fund amount (1994-1999)
BE 1997BE162DO001	187.272,63	PT 1996PT16CPE017	338.125,00
IT 1994IT162DO018	42.097,34	Total	<u>338.125,00</u>
IT 1994IT162DO019	2.733.668,37		
Total	<u>2.963.038,34</u>		

- Application of financial corrections by Commission Decision

Nine financial corrections procedures, relating to 13 OPs that were opened in previous years, were closed in 2007 through formal financial corrections decisions adopted by the Commission. These decisions relate to the programming period 1994-1999 and are listed below. There were no financial corrections by Commission decision for the 2000-2006 period in 2007.

### **ERDF**

Member State/programme	Commission Decision	ERDF amount
DE- 1994DE162DO012	C(2007)2619	5.958.401,64
GB- 1997GB162DO004	C(2007)2502	5.156.683,00
IT- 1997IT160PP002	C(2007)3893	362.789,02
IT- 1997IT161SG012	C(2007)1686	7.177.011,27
PT- 1994PT161SG001	C(2007) 3772	8.086.424,04
ES-D94110921	C(2007) 3996	9.625.375,00
Total		<u>36.366.683,97</u>

<sup>57</sup> An amount of €138 million of corrections relating to Spain have not been included, although it is likely that a large part may be linked to Commission audit work, in the sense of controls carried out under the action plan, because the link is insufficiently established by the supporting documents available.

### *Cohesion Fund*

Member State/project	Commission Decision	Cohesion Fund amount
Spain		
1995ES16CPE019	C(2007) 1279	1.924.403,00
1996ES16CPE020	C(2007) 1279	92.693,00
1997ES16CPE019	C(2007) 1279	262.177,00
1997ES16CPE038	C(2007) 1279	3.233.079,00
1998ES16CPT903	C(2007) 1168	551.121,00
1995ES16CPT911	C(2007) 1168	14.176.978,00
ES-D951161035	C(2007) 1278	2.910.962,00
Total		<u>23.151.413,00</u>

### **Financial correction procedures in-progress**

Following a Commission audit, financial corrections may be proposed in final position letters sent to the Member States. The final position letters launch the financial correction procedure under Article 39 of Council Regulation (EC) No 1260/1999 for the Structural Funds or under Article H of Annex II to Council Regulation (EC) N° 1164/1994 (as amended by Regulations (EC) N° 1264/99 and 1265/ 99) and under Commission Regulation (EC) N° 1386/2002 for the Cohesion Fund. In order to apply a financial correction for both Structural Funds and Cohesion Fund, the Council regulations require the Commission to firstly suspend payments by formal decision. During 2007, final position letters were sent for the programming period 2000-2006 covering 27 programmes for ERDF, representing an amount of approximately € 1.432 million, and 69 projects for Cohesion Fund, representing an amount of approximately € 115 million.

## 2.4.2 Annual summaries of Member States – Commission's assessment

Member State	Annual summary submitted	Compliance with minimum requirements of Financial Regulation	Has the template of the guidance note been followed	Statement on the completeness and accuracy of the information provided	Overall analysis or formal statement of assurance provided	Action by Commission <sup>58</sup>
Austria	No	Non-compliant <sup>59</sup>	N/A	N/A	N/A	Non-transmission letter
Belgium	Yes	Non-compliant <sup>59</sup>	Partially	Partially (different formats by different regions)	No	Non-compliance letter
Bulgaria	Yes	Compliant	Yes	Yes	Yes	Quality letter
Cyprus	Yes	Compliant	Yes	Yes	Yes	Quality letter
Czech Republic	Yes	Non-compliant <sup>59</sup>	Partially	Yes (2007-13)	No	Non-compliance letter
Germany	No	Non-compliant	N/A	N/A	N/A	Non-transmission letter
Denmark	Yes	Compliant	Yes	Yes	No	Quality letter
Estonia	Yes	Partially	Yes	Yes	Yes	Quality letter
Greece	Yes	Non-compliant <sup>59</sup>	No	No	No	Non-compliance letter
Spain	Yes	Non-compliant	No	No	No	Non-compliance letter
Finland	Yes	Partially	Yes	Yes	Yes	
France	Yes	Non-compliant	No	No	No	Non-compliance letter
Hungary	Yes	Compliant	Yes	Yes	Yes	
Ireland	Yes	Non-compliant <sup>59</sup>	Yes	Yes (2007-13)	No	Non-compliance letter
Italy	Yes	Non-compliant	Yes	No	No	Non-compliance letter
Latvia	Yes	Partially	Yes	No	No	Quality letter
Lithuania	Yes	Partially	Yes	No	Yes	
Luxembourg	Yes	Non-compliant <sup>59</sup>	No	No	No	Non-compliance letter
Malta	Yes	Compliant	Yes	Yes	No	Quality letter

<sup>58</sup> All Member States will receive a letter from the Commission, whether there are observations or not.

<sup>59</sup> Member State has sent further information and it is under examination by the Commission services.

Netherlands	Yes	Partially	Yes	Yes	No	Quality letter
Poland	Yes	Partially	Yes	Yes	Yes	
Portugal	Yes	Partially	Yes	No	No	Quality letter
Romania	Yes	Partially	Yes	Yes	No	Quality letter
Slovakia	Yes	Partially	Yes	Yes	No	
Slovenia	Yes	Partially	Yes	Yes	Yes	Quality letter
Sweden	Yes	Partially	Yes	Yes	Yes	
UK	Yes	Partially <sup>59</sup>	Yes	No	Incomplete (3 of 4 regions)	Quality letter

The Commission has completed its first assessment of the annual summaries submitted and has sent letters to most Member States. The letters already sent cover all cases of serious non-compliance. Where necessary, Member States which have not completely followed the recommendations in the Commission's guidance note are requested to provide revised annual summaries. Since these elements do not constitute a formal legal requirement, it cannot take further action, but it will continue to encourage Member States to follow best practice.

The majority of Member States have complied, or mainly complied, with the minimum requirements regarding information to be provided, as set out in the guidance note. The formal submission by the Member States of this information reinforces the accountability of Member States for the use of the Funds and contributes to the Commission's assurance. However, only a limited number of Member States followed the Commission recommendations to maximise the value of the annual summaries. In addition, in some cases where an overall analysis or opinion was given, the quality could still be further improved. This can be explained, at least partially, by the fact that this was the first year of application of the requirement and that many Member States decided only a few weeks before the deadline to provide information on the 2000-2006 period. Overall the results provide a good basis for motivating Member States to present annual summaries of generally better quality next year which will make a more significant contribution to the assurance for structural actions.

The results of the assessment of the annual summaries reveal no inconsistencies with the conclusions reached following the procedures for the systems evaluation set out in section 2.5.2.

### **2.4.3 Internal Control Standards**

The Commission definition of internal control covers all aspects of management procedures, from the environment in which DG Regional Policy, and the services operate to the regular reporting of the application of procedures and their impact. The framework of internal control is based on 24 Internal Control Standards and base-line requirements grouped into five components of internal control, i.e. control environment, performance and risk management, information and communication, control activities and audit, evaluation.

In line with the Internal Control Standard 24, it is necessary to assess annually the state of the Internal Control System in order to assure its effectiveness and to tackle major weaknesses, if any. This system contributes to provide support for the declaration in the Annual Activity Report, stating a reasonable assurance on respect of the principles of sound financial management and to provide guaranties concerning the legality and the regularity of the transactions. With the objective to implement and maintain an effective and reliable internal control system and monitor and report in its performance so that common understanding and ownership are ensured and risk of errors is minimized, DG Regional Policy assessed its performance with respect to the Commission's Internal Control Standards in two ways:

- firstly, the Directorate General assesses the internal control system on a regular basis to ensure that it continues to be effective from different sources, particularly, the audit reports prepared by the IAA Unit, the Internal Audit Service of the Commission and the Court of Auditors;
- secondly, it carried out a self-assessment desk review based on a questionnaire prepared by DG Budget. This questionnaire was comparable to the one used earlier.

Following our evaluation and on the basis of this questionnaire prepared by the Central Financial Service, DG Regional Policy has implemented all the baseline requirements in respect of all the 24 Internal Control Standards of the Commission.

In 2007, an iCAT exercise was carried out. iCAT (internal Control Assessment Tool) is a tool for analyzing the way the Internal Control Systems have effectively worked in the Directorate General, including suggestion for improvements. The objective of the iCAT Exercise is to assess the effectiveness rather than the compliance of the Internal Control Standards, and is structured around the 24 Internal Control Standards of the Commission. The assessment was done in 2007 at the level of the Heads of Unit. 20 Heads of Unit or their Deputies have participated in one of the preparatory meetings and have filled-in the iCAT questionnaire in January 2007. The questionnaire included 35 questions concerning the 24 Internal Control Standards presented as control objectives. The respondents could indicate whether the individual objectives in their opinion 1) were achieved, 2) needed improvement, 3) did not enable to conclude, or finally 4) were not applicable to their direct work. Globally the comments of the Heads of Units were related to the organisation structure and a demand for a clear distribution of the roles within the Directorate General. In other cases it appeared that some of the Heads of Unit were not enough informed about the functioning of some of the Baselines of the Internal Control Standards.

The "Mobility" and the way the "Sensitive Posts" have been tackled in the Directorate General were the two most controversial Internal Control Standards in 2007. For some Heads of Unit too much mobility may lead to perverse effects. The new reorganisation of the Directorate General on 01/01/2008 together with the mobility exercise at the same time took duly into consideration the worries expressed.

IAA staff surveys and/or IAA audit work show for 2007 a *very good level of effectiveness* notably for internal control standards "Mission, role and tasks" (ICS N°2), "Ethics and integrity" (ICS N°1), "Mail registration and filing systems" (ICS N°13) and a satisfactory situation (*good to medium level of effectiveness*) in relation to the standards on "Supervision" (ICS N°17), "Objective Setting" (ICS N°7), "Multi-annual programming" (ICS N°8), "Annual Management Plan" (ICS N°9), "Reporting improprieties" (ICS N°14), Delegations (ICS N°6) and Continuity of operations (ICS N°19). It also indicates some room for improvements for further efficiency and effectiveness on some aspects of the following internal control standards: "Adequacy of Management Information" (ICS N°12), "Monitoring progress against targets" (ICS N° 10), "Reporting improprieties" (ICS N°14) and "Supervision" (ICS N°17).

On the basis of this satisfactory situation, DG Regional Policy will continue to take the necessary measures in order to keep an efficient implementation of all internal control standards and to increase their ownership by all staff. It selected in particular three internal control standards for further efforts towards effectiveness in 2008: staff allocation and mobility, process and procedures and objectives and performance indicators.

### **Risk Assessment**

During the months of October and November 2007, DG Regional Policy carried out a Risk Assessment Exercise as part of the preparation of the Annual Management Plan 2008. Three critical risks for the Directorate General were identified as priorities for a particular attention, in accordance with which it also was decided that the Directorates should be in charge of the related action plans.

Three action plans have been prepared and are in progress relating to the three critical risks identified:

1. The risk, in the context of shared management, that projects and underlying transactions are not being prepared or executed in the Member States in line with the regulation;
2. The Directorate General needs to show the added value of Regional and Cohesion policy, which implies efforts to develop appropriate indicators for evaluation;
3. Risks owing to the complexity and workload involved in the closure of the 2000-2006 Cohesion Funds projects.

In addition, an internal enquiry was launched in the Directorate General and led to a series of suggestions for cutting red tape. As a result, a list of 19 proposals has been elaborated. An analysis of the proposed initiatives has shown that most of them are actions which were either already considered or which can be carried through existing internal working groups such as the "Key Users' Group" or the "Desk Officers' Group".

#### **2.4.4 IAC's opinion and its contribution for building the assurance**

Based on the results of the audit and advice assignments completed by IAA as of 31 March 2008, IAA believe that the internal control system in place adequately contributes with reasonable assurance to the achievement of the business objectives set-up for the activities/processes audited, with improvements to be done in certain areas and on which actions have been or/and are being taken.

IAA noted particular strengths of DG Regional Policy internal control system related to payments, decision-making process, approval of operational programmes, closure of Cohesion fund projects, tendering, contracting and direct grants procedures and human resources management. Implementation of WFS has also significantly improved the payment deadlines and consolidated the financial circuits and procedures. The internal control framework and control tests applied by the '*Cellule de Révision Comptable*' also contribute to the quality of accounting records in DG Regional Policy and are performed with due care.

IAA noted the following areas for improvement, on which actions has been or are being taken:

- a reinforcement in the field of gathering and consolidating information on the outcome of correction mechanisms in the Member States and DG Regional Policy for illegal and irregular expenditures. DG Regional Policy has been working on this point in 2007 and continues to work on it.
- an improvement in the field of evaluation and lessons should be drawn from 1994 - 99 ex post evaluation (complex and large-scale exercise involving a range of evaluation issues across several Member States and regions). DG Regional Policy has revised its evaluation strategy in 2007 and took consideration of these elements.
- DG Regional Policy should pursue its efforts to finalise the closure of the last open pre-2000 programmes.
- reinforcement in the field of direct grants notably for the three files JASPERS, JEREMIE and JESSICA (i.e. assessment of the agreed flat rate, level of indirect costs, grant agreement to be concluded for 2007 and audited financial statements of expenses and income to receive). Actions are on-going in that respect and a close monitoring will be devoted by DG Regional Policy in 2008 to these three initiatives.
- For the closure of Cohesion Fund projects, although control and supervision at the level of the operational units is effective, there is at this early stage no full central leadership and monitoring of the overall situation. DG Regional Policy is currently addressing these points and is introducing a central monitoring system.
- The process of approval of operational programmes is in general effective within acceptable levels, with a potential for improvements in the areas of ownership of the procedures, guidance, and supervision.

The IAA opinion and the weaknesses highlighted by IAA work were carefully examined, discussed and considered in the frame of the preparation of Declaration of assurance as well as the other information and sources of assurance at the disposal of the Director General.

## 2.5. Conclusion on the effectiveness of the internal control system

### 2.5.1 Internal control system in DG Regional Policy

On the basis of the evaluations prepared by the Internal Control Coordinator, the audits of the Court of Auditors, the Internal Audit service, and the Internal Audit and Advice Unit, it can be concluded that DG Regional Policy's internal control system is globally adequate and is working satisfactorily.

It can be mentioned that the Court of Auditors in its Report for DAS 2006 states that it has no particular observations to be reported on the ICS N° 11, 12, 14, 17, 20, 21, and 22. As regards ICS N° 18 "Recording Exceptions" the Court of Auditors made the following observation: *"For two selected cases, the auditors could verify that the exceptions from established procedures were approved by the Director-General. However, at the level of the Directorate General no written instructions or procedures for the approval and recording of exceptions exist. ICS 18 is therefore not sufficiently implemented."* A new procedure has been approved by the Directorate General on 03/09/2007, including the keeping of a centralised Register of Exceptions.

According to an analysis made in 2007 on the basis of the new Internal Control Standards, particular attention should be given to the following Internal Control Standards in order to reinforce the effectiveness of their implementation:

- N° 3 "Staff Allocation and Mobility" and N° 8 "Process and Procedures": the Directorate General will have to adapt and implement the procedures including keeping of the documentation, allowing to meet effectively the challenges of the reorganisation and the accumulation of the tasks of the next years concerning at the same time the closure of the period 2000/2006 and implementation of the period 2007/2013.
- and ICS N° 5 "Objectives and Performance Indicators", where the Directorate General will follow in 2008 the consistency between objectives and the performance indicators, including the monitoring of indicators of Cohesion policy outputs and results within the Member States.

It can be concluded that the internal control system of DG Regional Policy is functioning well although there is still room for improvement in some areas. The system set up makes it possible to have reasonable assurance of sound financial management in relation to the transactions carried out by DG Regional Policy in direct management. The financial circuits and the supervision and control bodies set up within the Directorate General and the results of the ex-post audits in direct management make it possible to support this assurance.

For shared management, the Directorate General's internal procedures and the follow-up of the problems detected in the Member states are integral to building the assurance. The provisions in place in the Directorate General for the implementation of its supervisory role within the framework of shared management set out the measures to be taken in response to the detection of deficiencies in the management and control systems of the Member States, and generally comprise: audit recommendations, bilateral meetings with the national administrations, action plans and, if necessary, suspension and financial correction procedures. The "Communication on an action plan to strengthen the Commission's supervisory role under shared management of structural actions" (COM(2008) 97 final) issued on 19 February 2008 highlights the importance attached to this supervisory role and details ways to enhance its effectiveness.

## ***2.5.2 Assessment of management and control systems in the beneficiary countries***

**For the 1994-1999 programming period**, the conclusions on the results of the closure audit enquiry related to ERDF 1994-1999 remain provisional because for 14 out of 56 programmes the contradictory procedure with Member States is not yet complete and for a further 25 programmes the financial correction procedures are not completed. The provisional conclusions are that for 11 out of 15 Member States, for 30 out of 34 programmes audited there was no material level of error, whilst for the remaining 4 Member States it is likely that there will be a material level of error for most of the 22 programmes justifying an extrapolated correction. These results indicate that for most Member States the rigorous closure procedures applied before final payments were made, and the application of corrections in the process of closure, give reasonable assurance that the residual risk of irregularities is low. For the other Member States, the completion of the follow up and correction procedures will also ensure that the main risks of irregularities are effectively addressed. A final assessment will be set out in the 2008 Annual Activity Report.

**For the 2000-2006 programming period, the process used to establish the final opinion of the DG on the assurance provided by the national systems has been reinforced. It is based on an *audit opinion* from the Audit Directorate of the Directorate General and on a *management opinion* from the Authorising Officers by Sub-delegation.**

The Audit Directorate has prepared assessment fiches and issued an *audit opinion* on the functioning of the systems for all Member States and beneficiary countries. For ERDF they cover mainstream and URBAN programmes with a separate fiche for INTERREG programmes. These fiches indicate for each system whether any deficiencies have been found (and if so whether they were significant) and give an overall audit assessment.

This assessment is based on the audit work of the Audit Directorate, the results of the analysis of the annual control reports of the Member States, information from audit reports received from the national audit bodies, and from audits of the European Court of Auditors and other Directorates General in charge of Structural Funds, up-to-date information obtained from the most recent bilateral meetings with national audit authorities, and in certain cases the results of the follow-up of action plans agreed with Member States. The Audit Directorate has taken into account in its evaluation information on error rates where available as reported by the national audit bodies or resulting from its own project audits.

The assessment methodology is aligned to that used by the European Court of Auditors in its Annual Report, but takes account of the revised approach resulting from the joint working group (European Court of Auditors and Directorates General Regional Policy and Employment) in 2007. The assessment has first been made at the level of the key control elements of the system according to the following four categories: works well – minor improvements required; works, some improvements required; works, substantial improvements required; does not work. An overall assessment of the system has then been made using the same four categories and taking account of any compensating controls or mitigating factors. There is a disclaimer (i.e. no audit opinion) in the very few cases where there is no reliable audit evidence. This concerns systems which have not been audited by DG Regional Policy, or by other audit bodies on whose work it is possible to rely. The completed fiches and audit opinions for each country were transmitted to the Authorising Officers by Sub-delegation. In certain cases an update was subsequently prepared to take account of audit

finding from audits carried out in January and February 2008 in order to ensure that the final assessment was based on the latest available information.

Each operational head of unit prepared a country fiche taking into account the examination of the annual reports from the Member States, the annual meetings, payment requests, the Monitoring Committee meetings and the contacts with regional and national programme managers. Based on the fiches from the audit directorate and audit opinions, the country fiches from the operational heads of unit, and other information from the management activities, the Authorising Officers by Sub-delegation have issued a *management opinion* for all Member States and beneficiary countries in the framework of article 4.8 of the Charter of Authorising Officers. This opinion contains their own judgement on the appropriateness of management and control systems in the Member States and any identified risk which ought to be disclosed in the Annual Activity Report or give rise to a reservation to the declaration of assurance.

The final stage of the evaluation process was a detailed review of each Member State and beneficiary country by the Annual Activity Board of the Directorate General in order to ensure the quality and consistency of the management opinions, to resolve any cases of discrepancy between the audit opinions and management opinions, to agree on any modifications required as a result of developments during the first quarter of 2008, and to identify the systems for which a reservation should be made.

**The final assessment of the systems led to the classification of all programmes in the following four categories: *unqualified, qualified with moderate impact, qualified with significant impact, and adverse.***

**An unqualified opinion** signifies that there are no material deficiencies in key elements of the systems.

**A qualified opinion** signifies the existence of material deficiencies in key elements of the systems. Where it has been concluded that the impact is **moderate**, it means that the risk for payments in 2007 is low. Where it has been concluded that the impact is **significant**, this indicates a medium risk for payments in 2007.

**An adverse opinion** signifies that there are material deficiencies in key elements of the systems so that no reasonable assurance has been obtained on the functioning of those systems, and the risk for payments in 2007 is high.

For cases where **no audit opinion** was given because of an absence of reliable audit evidence on the functioning of the systems, it has been taken into account that the set up of the systems has been considered as satisfactory, that each payment claim is certified by the paying authority as containing expenditure which is legal and regular, and that in some cases there are other sources of information on the functioning of the systems. They have therefore been classified in the final assessment under **qualified opinion** (either **significant** impact or **moderate** impact).

## ***ERDF***

The table below summarises the systems for which the different categories of opinion (unqualified, qualified with moderate impact, qualified with significant impact, adverse) are given and the percentage of payments made in 2007 for each category as a proportion of total payments for ERDF.

NO MATERIAL DEFICIENCIES – REASONABLE ASSURANCE	MATERIAL DEFICIENCIES – QUALIFIED ASSURANCE: MODERATE IMPACT	MATERIAL DEFICIENCIES – QUALIFIED ASSURANCE: SIGNIFICANT IMPACT	MATERIAL DEFICIENCIES – NO ASSURANCE
<ul style="list-style-type: none"> <li>▪ Austria (11 OPs of which 2 urban)</li> <li>▪ Belgium (6 OPs of which 2 urban)</li> <li>▪ Cyprus (1 OP)</li> <li>▪ Denmark (2 OPs of which 1 urban)</li> <li>▪ Estonia (1 OP)</li> <li>▪ Finland (2 OPs of which 1 urban)</li> <li>▪ France (40 OPs of which 9 urban)</li> <li>▪ Germany (7 OPs)</li> <li>▪ Hungary (3 OPs)</li> <li>▪ Italy (4 OPs)</li> <li>▪ Latvia (1 OP)</li> <li>▪ Malta (1 OP)</li> <li>▪ Portugal (20 OPs of which 3 urban)</li> <li>▪ Slovenia (1 OP)</li> <li>▪ Sweden (6 OPs of which 1 urban)</li> <li>▪ UK-England (7 OPs of which 3 urban)</li> <li>▪ UK-Wales (3 OPs of which 1 urban)</li> <li>▪ UK-Scotland (1 OP)</li> <li>▪ INTERREG (30 OPs)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Belgium (5 OPs of which 1 urban)</li> <li>▪ Germany (5 OPs)</li> <li>▪ Hungary (1 OP)</li> <li>▪ Italy (9 OPs)</li> <li>▪ Netherlands (8 OPs of which 3 urban)*</li> <li>▪ Spain (4 OPs)</li> <li>▪ Sweden (1 OP)</li> <li>▪ UK-England (11 OPs of which 4 urban)</li> <li>▪ UK-Scotland (4 OPs of which 1 urban)</li> <li>▪ UK-Northern Ireland (2 OPs including PEACE)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Czech Republic (4 OPs)</li> <li>▪ Finland (4 OPs)</li> <li>▪ Germany (17 OPs of which 11 urban)*</li> <li>▪ Greece (27 OPs of which 3 urban)</li> <li>▪ Ireland (6 OPs of which 1 urban)</li> <li>▪ Italy (21 OPs of which 10 urban)*</li> <li>▪ Lithuania (1 OP)</li> <li>▪ Luxembourg (1 OP)</li> <li>▪ Poland (4 OPs)*</li> <li>▪ Slovakia (3 OPs)*</li> <li>▪ Portugal (3 OPs)</li> <li>▪ UK-England (3 OPs of which 1 urban)*</li> <li>▪ UK-Northern Ireland (1 urban OP)*</li> <li>▪ URBACT (1 OP)*</li> <li>▪ INTERREG (43 OPs)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Germany (1 urban OP)</li> <li>▪ Italy (3 OPs)</li> <li>▪ Spain (11 OPs of which 10 urban + parts of 20 other OPs linked to 14 intermediate bodies)</li> <li>▪ INTERREG (8 OPs)</li> </ul>
28.12%	11.16%	47.68%	13.04%
39.28%			

\* among which 29 OPs for which there is a disclaimer: 3 urban OPs NL, 11 urban OPs DE, 3 DE OPs, 7 IT OPs, 1 OP SK, 1 OP PL, 1 urban OP UK – Northern Ireland, 1 OP UK-England and 1 URBACT programme

All cases in the categories *qualified with significant impact* or *adverse* lead to a reservation except in the cases of Lithuania (1 OP), Portugal (3 OPs) and UK – England (1 OP and 1 Urban programme) as indicated and explained below:

	Number of OPs	Estimated risk % +(M€)	Main deficiencies and justification of risk estimation	Actions to be carried out	Explanation for not issuing a reservation
LT	1	5% of €161.67 million, i.e. €8.08 million	The internal audit unit (IAU) of the ministry of economy which controls more than 40 % of the ERDF is understaffed. Its work cannot be relied on (sample checks were not done on the spot).	1) Additional auditors need to be recruited. 2) The sample checks carried out for which no visits on the spot were done, need to be re-performed.	Evidence has been provided that additional auditors have been recruited to strengthen the IAU of the Ministry of Economy and that the IAU is since mid 2007 doing its checks on the spot. The related plan for re-performing previous checks was submitted to the Commission in December 2007.
PT	3	5% of €249 million, i.e. €12.45 million	Risk of non-compliance with public procurement rules in relation to the expenditure declared from 01/01/05 onwards for 3 programmes (PRIME, POSC, POCI). Risk of lack of detection and correction of systemic irregularities by the sample controls done for PRIME	PT authorities are carrying out a specific monitoring of the situations detected in the three programmes where significant deficiencies were detected.	The Paying Authority has suspended payments in regard to 13% of the expenditure related to the measures susceptible of public procurement for PRIME, in a global amount of 213 million €(ERDF 82.5 million €). For all 3 programmes, the Directorate General has evidence that the respective action plans are being effectively implemented.

UK	2	5% €0 (no payments)	- serious deficiencies on primary controls at the level of accountable bodies - lack of effective monitoring and supervision of the managing authority	Follow up procedures for management verifications	Following a Commission decision to suspend payments in April 2007, no reimbursements have been made to the programmes in 2007. A financial correction decision has been adopted by the Commission on 11 <sup>th</sup> March 2008.
----	---	------------------------	---	---	---

For the 10 Member States and the INTERREG programmes indicated below, and in line with the criteria set out in point 3.1, in view of the material deficiencies to the systems which give rise to an unacceptable risk for payments in 2007, the Directorate General is making a reservation. The present situation for these cases is the following:

Country	Number of OPs affected (fully or partly)	Estimated risk (in million €)	State of play
<b>Czech Republic</b>	4	16.735	<p><b><u>Reason for reservation:</u></b> deficiencies in the systems, in particular as regards article 4, article 9 and article 10 of Regulation 438/2001. The deficiencies have been identified during on-spot audits of the Commission and the European Court of Auditors and through the analysis of the Member State's Annual Control reports.</p> <p><b><u>Corrective actions:</u></b> the Czech Authorities have been requested to carry out an exhaustive review of the projects supported by the OP Infrastructure in relation to the issues concerning public procurement and revenue generated projects under the programming period 2004-2006 and assess its financial impact. Actions should be taken to apply financial corrections and to prevent occurrence in the future. The same will be requested for the other programmes where relevant. The DG will closely monitor the implementation of these actions in 2008 and carry out a follow up audit if the Member State fails to carry out the required measures, a suspension procedure will be launched.</p>
<b>Finland</b>	4	6.561	<p><b><u>Reason for reservation:</u></b> deficiencies in the systems, in particular as regards article 4, article 9 and article 10 of Regulation 438/2001. The weaknesses were first identified in the Commission audit of 2004. The follow-up audit of 2006 noted that actions taken to remedy the deficiencies were inadequate.</p> <p><b><u>Corrective actions:</u></b> in December 2006, DG Regional Policy provided the Finnish Authorities with a plan of actions to correct the most important deficiencies in the management and control systems which led to an agreed action plan. The actions by the managing and paying authorities have been reported as completed. Nevertheless, these improvements have not yet been tested by the Commission. The main outstanding action is the audit by national auditors of a representative sample of projects in order to assess the error rate for payments made up until</p>

			31/12/07 and provide conclusions on the regularity of the underlying expenditure. The Finnish authorities have agreed to implement this action. DG Regional Policy will audit the implementation of the action plan in 2008.
<b>Germany</b>	4	6.977	<p><b><u>Reason for reservation:</u></b> deficiencies were found in the systems, in particular as regards article 10. For the 4 programmes concerned, a substantial amount of audit work still needs to be performed by the respective regional audit bodies. The deficiencies in OP Mecklenburg-Vorpommern referring to the lack of progress of sample checks were also identified by an audit carried out by the European Court of Auditors in November 2007 (DAS 2007).</p> <p><b><u>Corrective actions:</u></b> <u>Saarland:</u> the audit report issued in February 2008 by DG Regional Policy recommends substantial improvements in the area of system audits, sample checks and the preparation for the closure of the programmes and lists several corrective actions. The regional authorities initiated already in late 2007 mitigating measures by submitting a detailed planning of the audit work to be carried out until the winding-up of the programme as well as the related resource planning. The implementation of the on-going corrective action and further recommendations is going to be subject of close monitoring by the Commission services during 2008 through desk reviews of information received or, if necessary through further audit activities on the spot. <u>Mecklenburg-Vorpommern:</u> the Independent Audit Body in Mecklenburg-Vorpommern has been requested by letter of 20.12.2007 to present a detailed audit plan and describe the measures planned, in order to reach by the end of the programming period the obligatory 5% sample checks. DG Regional Policy will: i) follow up the completion of the 5 % checks in 2008; ii) closely monitor the reply to the 2007 DAS case and ensure the follow up actions to the recommendations; iii) follow-up the implementation of further recommendations in the context of the annual control report due on 30<sup>th</sup> of June 2008. <u>Hamburg:</u> the Commission has requested information, in the framework of follow-up of information submitted in the annual control reports on the 20<sup>th</sup> December 2007. The deadline to provide further information was end of February 2008 and this is under follow up. DG Regional Policy will audit the Independent Audit Body of Hamburg in the second half of 2008. <u>Neubrandenburg:</u> an analysis of the report received in the framework of annual control reports was sent to the Independent Audit Body in Mecklenburg-Vorpommern on 31 December 2007, in which DG Regional Policy announced its intention to propose to the Commission the formal suspension of interim payments for the programme because of the deficiencies in the audit work carried out. The national authorities have informed DG Regional Policy of the audit work in 2007 and the Commission will examine evidence of these audits in order to determine whether suspension of payments is</p>

			justified.
<b>Greece</b>	15	10.000	<p><b>Reason for reservation:</b> there is a systemic weakness concerning the control of state aid schemes through the National Development Law:</p> <ul style="list-style-type: none"> <li>- Lack of effective monitoring of accumulation of state aid, in particular on the effect of the transformation of the tax break incentive for investment into a de-minimis aid;</li> <li>- Limited supervisory role of the managing authority which relies extensively on the final beneficiaries for carrying out on the spot checks on a sample basis;</li> <li>- Weaknesses in the methodology for carrying out management checks.</li> </ul> <p>In addition, the Commission still has a limited assurance on the audit work performed by EDEL which acts as the winding up body.</p> <p><b>Corrective actions:</b> DG Regional Policy will carry out a follow up audit in 2008 to check whether remedial actions have been implemented. If the national and regional authorities fail to demonstrate that corrective actions have been taken, the Commission will launch a suspension procedure and where appropriate apply financial corrections.</p>
<b>Ireland</b>	4	3.648	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards article 4 and article 8 of Regulation 438/2001. The deficiencies have been identified during on-spot audits of Commission services.</p> <p><b>Corrective actions:</b> the Irish Authorities have taken the initiative to carry out a so-called 'look-back' exercise to recover weaknesses in the management checks and to review all previously declared payment claims in order to identify irregular expenditure. The Commission will closely monitor the implementation and results of this "look-back" exercise during 2008 and will carry out a verification audit.</p>
<b>Italy</b>	17	123.234	<p><b>Reason for reservation:</b> For 16 of the programmes audited by the DG, the main common issues are deficiencies in the systems regarding one or more key control elements (article 4, article 9 and article 10 of Regulation 438/2001). Additional issues are:</p> <ul style="list-style-type: none"> <li>--deficiencies in compliance with public procurement rules (Lazio, Sardinia);</li> <li>- high error rates in projects audited (Ricerca, Campania, Molise, Sicilia, Bolzano, Friuli Venezia Giulia);</li> <li>-non-respect of Article 8 of Regulation 438/2001.</li> </ul> <p>The three programmes where the most serious deficiencies occurring at all levels of the control system are Puglia, Lazio and Sardinia. It should be noted that the seriousness of the deficiencies should be differentiated between programmes. For the other programmes, there are weaknesses in different elements for which the follow-up of the audits is under way and which will enable a final conclusion to be reached. In the case of URBAN II</p>

			<p>Taranto, which has not been audited by the Directorate General, there is a specific risk due to the bankruptcy of the municipality.</p> <p><b>Corrective actions:</b> 16 of the 17 programmes covered by the reserve have been audited by the Directorate General. DG Regional Policy will take the necessary actions to conclude the follow up of the audit findings and, in cases where satisfactory evidence of corrective actions is not obtained, launch a procedure for suspension and correction. The follow up process is at different stages for each programme and the seriousness of the outstanding issues also varies. For one programme (Puglia) a procedure for suspension of payments has been launched already. For the programme not audited (URBAN II Taranto), the responsible authorities have been informed that they must provide evidence of sound financial procedures before further reimbursements can be made by the Commission.</p>
<b>Luxembourg</b>	1	0.372	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards article 4 and article 10 of Regulation 438/2001. The national legislation is not compliant with Directive 92/50 relating to the coordination of procedures for the award of public service contracts.</p> <p><b>Corrective actions:</b> the Commission has required the national authorities to carry out a detailed verification of the most important contracts (public works, furniture and services) by the different final beneficiaries. Following the information provided by national authorities, the Commission will verify the results and take a final position. If necessary a suspension procedure will be launched.</p>
<b>Poland</b>	3	73.335	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards Article 4 and Article 10 of Regulation 438/2001. The weaknesses were identified during the systems audits that were carried out in 2006 and 2007 by Directorate General Regional Policy. An action plan was agreed with the Polish Authorities in 2007 but has not yet been fully implemented.</p> <p><b>Corrective actions:</b> in April 2007, DG Regional Policy provided the Polish Authorities with a plan of actions aiming at correcting the most important deficiencies in the management and control systems that were identified in the audit which was agreed. DG Regional Policy carried out an audit from 18 to 22 February 2008 to verify the implementation of the main elements of the action plan. The principal outstanding issue concerns the audits by the national audit body of a sample of projects to determine the risk in past expenditure. The Directorate General is following up the findings and in the event of disagreement will proceed to suspension of payments and financial corrections.</p>
<b>Slovakia</b>	2	9.481	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards article 4 and article 10 of</p>

			<p>Regulation 438/2001. The deficiencies have been identified during on-spot audits of Commission services and through the analysis of the Member State's Annual Control reports and system audits reports.</p> <p><b>Corrective actions:</b> the Slovak Authorities have agreed in a meeting in February 2008 to carry out a review of the projects in the ERDF supported programmes for the period 2004-2007 in relation to the issues concerning public procurement, to apply financial corrections and to prevent occurrence in the future. The Commission will closely monitor the implementation of these follow-up actions and will carry out a verification audit.</p>
<b>Spain</b>	31	130.817	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards article 4, article 9 and article 10 of Regulation 438/2001. The existence of these deficiencies permitted the occurrence of irregularities such as: non compliance with public procurement law in co-financed projects, the non respect of eligibility rules, and the absence of a sufficient audit trail for declared expenditure. The responsible authorities have failed to implement fully the remedial action plan agreed in April 2006. They have also failed to take the required measures to correct systemic irregularities relating to public procurement.</p> <p><b>Corrective actions:</b> The Directorate General launched a suspension procedure on 21.12.2001 for 14 Intermediate Bodies, OP <i>Sociedad de la Información</i> and 10 URBAN programmes. It launched a second suspension procedure on the systemic issue of public procurement in February 2008, proposing to the Spanish authorities to exclude the irregular amounts from the expenditure declared to the Commission. The Spanish Authorities sent in January 2007 a circular to the Intermediate Bodies requesting them not to declare expenditure linked to the modification of public works contracts because of the risk of irregularity.</p>
<b>INTERREG</b>	51	38.347	<p><b>Reason for reservation:</b> on eight among the 81 INTERREG programmes in 2006 and 2007 have shown significant deficiencies for <u>five programmes</u> which affect key elements of the systems regarding Articles 4, 9, 10, and 19 of Regulation 438/2001. Secondly, the analysis of annual control reports received according to Article 13 of Regulation 438/2001 has shown that for the majority of programmes, the quality of the control reports is not satisfactory, as they do not provide sufficient details nor conclusions from the results of the audit work (information on error rates, amounts/percentages of checked expenditure, proper functioning of systems). In addition, they indicate that there are frequently serious delays in carrying out the audit work. Therefore, in addition to the five programmes mentioned above, it is considered that there is a potentially high risk for expenditure for <u>46 programmes</u> which have not been audited.</p> <p><b>Corrective actions:</b> 1) Additional audits will be carried</p>

			out in 2008 to check the ability of national auditors to fulfil their obligations (Review of Winding up activities). 2) For those programmes where audits have already been carried out, a detailed follow-up to the on-going action plans is being carried out to verify that outstanding problems have been corrected. 3) Actions to suspend payments and apply financial corrections will be taken when necessary. Procedures have already been launched to suspend payments for 7 programmes.
Total	136	€419.5 million	

### COHESION FUND

The table below summarises the systems for which the different categories of assessment (unqualified, qualified – moderate impact, qualified – significant impact) are given and the percentage of payments made in 2007 for each category as a proportion of total payments for the Cohesion Fund.

NO MATERIAL DEFICIENCIES – REASONABLE ASSURANCE	MATERIAL DEFICIENCIES – QUALIFIED ASSURANCE – MODERATE IMPACT	MATERIAL DEFICIENCIES – QUALIFIED ASSURANCE – SIGNIFICANT IMPACT
<ul style="list-style-type: none"> <li>▪ Cyprus</li> <li>▪ Estonia</li> <li>▪ Hungary (Transport sector)</li> <li>▪ Latvia</li> <li>▪ Malta</li> <li>▪ Portugal</li> <li>▪ Slovenia</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bulgaria (Environment sector)</li> <li>▪ Greece</li> <li>▪ Ireland</li> <li>▪ Lithuania</li> <li>▪ Romania</li> <li>▪ Spain</li> </ul>	<ul style="list-style-type: none"> <li>▪ Bulgaria (Transport sector)</li> <li>▪ Czech Republic</li> <li>▪ Hungary (Environment sector)</li> <li>▪ Poland</li> <li>▪ Slovakia</li> </ul>
23.6%	44.1%	32.3%
67.7%		

For the 5 Member States indicated below, and in line with the criteria set out in point 3.1, in view of the material deficiencies to the systems which give rise to an unacceptable risk for payments in 2007, the DG is making a reservation. The present situation for these cases is the following:

Country	Estimated risk in M€	State of play
<b>Bulgaria</b>	0.517	<p><b>Reason for reservation:</b> deficiencies were found in the systems, in particular as regards Article 4 of Regulation 1386/2002 concerning control of public procurement in the transport sector (NRIF).</p> <p>There is in addition a risk linked to the allegations of bribery concerning two officials of the NRIF being followed up at national level, and an issue of conflict of interest relating to the award of contracts.</p> <p>DG Regional Policy has taken note of the reservation made by DG ELARG in its Annual Activity Report relating to the management of PHARE funds under extended decentralised management by the CFCU and the Ministry for Regional Development and Public Works. Having regard to the differences in the management and control system for the Cohesion Fund, and the results of the extensive audit work carried out by the Directorate General, it does not consider that its assessment is affected or that the scope</p>

		<p>of its own reservation should be widened.</p> <p><b><u>Corrective actions:</u></b> Investigations have been carried out by the relevant national bodies. At the request of DG Regional Policy, an action plan to address weaknesses will be implemented and an audit by the nation audit body is to be carried out. The Paying Authority in the Ministry of Finance has agreed not to process any payment requests in respect of any of the Cohesion Fund projects being managed by the NRIF. DG Regional Policy has also notified OLAF of the abovementioned issues. If the Directorate General is not satisfied that appropriate follow up action has been taken by the national authorities, it will launch a procedure for suspension of payments to Cohesion Fund projects managed by the NRIF and financial corrections.</p>
<b>Czech Republic</b>	6.616	<p><b><u>Reason for reservation:</u></b> deficiencies were found in the systems in particular as regards article 4, article 6, article 8 and article 9 of Regulation 1386/2002.</p> <p><b><u>Corrective actions:</u></b> the Czech Authorities should evaluate the contracts supported by the Cohesion Fund in relation with the issues concerning public procurement for the period 2004-2006 and assess its financial impact. Actions should be taken to apply financial corrections and to prevent occurrence in the future. The Commission will closely monitor the implementation of these in 2008, and carry out a follow up audit.</p>
<b>Hungary</b>	10.528	<p><b><u>Reason for reservation:</u></b> deficiencies were found in the systems of these countries, in particular as regards Article 4 checks (regulation 1386/2002). Some other weaknesses were detected which concern public procurement (environment sector).</p> <p><b><u>Corrective actions:</u></b> Following the audit report of DG Regional Policy issued in February 2008, a 25% financial correction was proposed for the works contract affected by the infringements of Directive 93/37/EEC. The Government Audit Office in Hungary was requested to audit all other contracts concluded within this project to establish the potential financial risk. DG Regional Policy has interrupted payments for the project concerned until reasonable assurance is obtained that other contracts concluded within the project are not affected by similar irregularities.</p>
<b>Poland</b>	36.908	<p><b><u>Reason for reservation:</u></b> deficiencies were found in the systems, in particular as regards Article 4 and Article 9.</p> <p><b><u>Corrective actions:</u></b> in April 2007, DG Regional Policy provided the Polish Authorities with a plan of actions aiming at correcting the most important deficiencies in the management and control systems that were identified during the audit work which has been agreed. DG Regional Policy carried out an audit from 18 to 22 February 2008 to verify the implementation of the main elements of the action plan. The principal outstanding issue concerns correction of irregularities in certified expenditure which is linked to actions for ERDF.</p>
<b>Slovakia</b>	4.441	<p><b><u>Reason for reservation:</u></b> deficiencies were found in the systems in particular as regards article 4 and article 9 of Regulation 1386/2002.</p> <p><b><u>Corrective actions:</u></b> the Slovak Authorities agreed to evaluate the contracts supported by the Cohesion Fund in relation to the issues concerning public procurement for the period 2004-2007 to apply financial corrections and prevent the issue from occurring in the future. The Commission will closely monitor the implementation of these follow-up actions in 2008 and will undertake a verification audit.</p>
<b>Total</b>	<b>59.010 €</b>	

## ISPA

Since 2007, only Croatia benefits from ISPA assistance. The basis for assurance comes primarily from the audit work carried out in 2006 and the limited further audit evidence available in 2007. In particular, it was not possible to obtain any clear evidence of the actual implementation of the remedial actions announced by the national authorities following a DIS audit mission in 2007. These weaknesses as well as several uncertainties regarding the set-up of CFCU/CFCA have led to a qualified opinion. As the risk is mitigated by the ex-ante control conducted by the EC delegation, especially in relation to compliance with the applicable public procurement rules, and the fact that the payments made in 2007 represented a very low amount, the qualification is considered to have moderate impact.

### Assessment of risk

For the assessment of risk, as the DG does not for the 2000-2006 period have reliable information on representative error rates by programme or system, it has to make a judgment based on the estimated level of financial correction which would be applicable for the systems deficiencies identified. For this purpose, reference is made to the Commission guidelines on the principles, criteria and indicative scales to be applied by Commission departments in determining financial corrections under Article 39(3) of Regulation (EC) N° 1260/99 (C(2001)476), and the equivalent guidelines for the Cohesion Fund. The indicative scales of flat rate corrections are linked to the non-functioning or partial functioning of key elements of the system.

For programmes or systems where the final opinion is *unqualified*, the risk for payments made in 2007 is estimated at less than 2% (very low risk).

For programmes or systems where the final opinion is qualified with moderate impact, the risk for payments made in 2007 is estimated at less than 5% (low risk). This level of risk is considered acceptable during programme implementation since payments cannot exceed 95% of committed funds prior to programme closure (90% for Cohesion Fund) and it can be managed by the national and Commission procedures for programme closure.

For programmes or systems where the final opinion is qualified with significant impact, the risk for payments made in 2007 is estimated at 5% (medium risk).

For programmes or systems where the final opinion is no assurance, the risk for payments made in 2007 is estimated at 10% or above (high risk).

IMPACT on the Declaration of Assurance (based on functioning of systems, materiality and legality and regularity criteria)	ERDF - Coverage				Estimated impact Risk from system deficiencies (where appropriate as % of total payments in 2007)
	Number of programmes	as % of programmes	Payments to programmes in million €	as % of total payments in 2007	
<b>Reasonable assurance</b>	147	38.8 %	4.957.228	28.12 %	Risk inherent to business
<b>Qualified assurance with moderate impact</b>	50	13.0 %	1.966.701	11.16 %	Level of risk manageable due to the fact that payments cannot exceed 95 % of the committed funds before closure.
<b>Qualified assurance with significant impact</b>	139	36.8 %	8.445.346	47.68 %	2.39 %
<b>No assurance</b>	43	11.4 %	2.298.455	13.04 %	1.30 %
<b>Total</b>	379	100 %	17.667.731	100 %	3.69 %

IMPACT on the Declaration of Assurance (based on functioning of systems, materiality and legality and regularity criteria)	Cohesion Fund - Coverage				Estimated impact
	Number of countries / sectors <sup>60</sup>	as % of countries	Payments in million €	as % of total payments in 2007	Risk from system deficiencies (where appropriate as % of total payments in 2007)
Reasonable assurance	7	38.9 %	785.87	23.6 %	Risk inherent to business
Qualified assurance with moderate impact	6	33.3 %	1,470.29	44.1 %	Level of risk manageable due to the fact that payments cannot exceed 95 % of the committed funds before closure.
Qualified assurance with significant impact	5	27.8 %	1,075.09	32.3 %	1.77 %
No assurance	None	-	-	-	-
<b>Total</b>	<b>18</b>	<b>100 %</b>	<b>3,331.25</b>	<b>100 %</b>	<b>1.77 %</b>

The Commission gives the highest priority to the exercise of its responsibilities for implementing the budget under Article 274 of the EC Treaty. Over the last five years, the Commission has put in place a series of steps with the goal of improving its supervisory role for structural actions. However, these measures have not yet been sufficient to have a measurable impact on the reliability of the certification of expenditure by Member States to the Commission.

A reduction in the level of error found by the Court depends on a partnership between the Commission and the Member States to make consistent improvements in the capacity of Member States' internal control systems to prevent errors. The Action Plan to strengthen the Commission's supervisory role (COM (2008) 97 final) adopted on 19 February 2008 will mean that the Commission will contribute to these efforts through stronger supervision, more efficient correction mechanisms, and improved information. The Commission considers that the result should be a real step forward in efforts to achieve improvements and mitigate the risk of continued failures in some Member States.

At the hearing of Commissioners Hübner and Spidla before the Budgetary Control Committee of the European Parliament for the 2006 Discharge procedure, the Member of the European Court of Auditors presented the concept of a "remedy rate" in which the estimated number of programmes with ineffective control systems was compared with the estimated number of programmes subject to specific actions by the Commission.

The tables above demonstrate that for 2007 for ERDF there are 142 programmes affected by material deficiencies and that for all of these programmes the Commission has taken or is taking specific actions. The "remedy rate" is therefore 100%.

The tables demonstrate that for Cohesion Fund, there are 5 Member States for which the systems are affected by material deficiencies in at least one sector, and that in all cases the Commission is taking specific actions. The "remedy rate" is therefore also 100%.

<sup>60</sup> The total is 18 instead of 16 as the systems for HU and BG are divided among the 2 sectors (environment and transport).

### 3. PART 3 - RESERVATIONS AND THEIR IMPACT ON THE DECLARATION

#### 3.1. Materiality criteria used <sup>61</sup>

The term “significant deficiencies” as defined in the “Guidelines for assessment of materiality” of December 2005 means that deficiencies detected in the management and control systems concern key control elements and, having regard to relevant factors such as the number and duration of the deficiencies, the importance of the systems affected and whether or not there have been compensatory measures or corrective actions, it is concluded that they are systematic and wide-ranging.

**For the AAR 2007, the Directorate General has taken note of the observations of the European Court of Auditors in paragraph 2.16 of the Annual Report on 2006 concerning the compatibility with the overall assessment of the Directorate General with the qualifications made on the functioning of the management and control systems in a number of Member States. It has therefore considered that for all programmes or systems for which the opinion is qualified with significant impact or no assurance, the deficiencies should be considered as "significant deficiencies" as defined in the Guidelines, unless there is reliable audit evidence that an action plan to remedy the weaknesses and correct the risk of irregular expenditure is being implemented effectively by the national authorities and first results have been produced.**

In addition DG Regional Policy assesses whether the deficiencies give rise to special factors which put at risk the reputation of Community institutions (e.g. the fundamental incapacity of a Member State to deliver remedial measures, risk of widespread fraud).

If the assessment leads to the conclusion that a deficiency is significant, a quantification of the risk is carried out. The approach DG Regional Policy follows to ensure a consistent and defensible result is as follows:

- 1) Identify the expenditure “*population*” in which the risk occurs. For the Structural Funds and Cohesion Fund this will normally be payments made by the Directorate General in the year covered by the AAR to the programmes or projects in the Member State managed under the systems in which the deficiencies have been identified;
- 2) Estimate the maximum percentage of the expenditure in that “*population*” which might finally be determined to be irregular. This will normally be the application of the scales for flat rate corrections fixed in the Commission guidelines of 2001 (Structural Funds) and 2002 (Cohesion Fund) relevant for the seriousness of the deficiencies identified.
- 3) Quantify the actual amount of payments for the Fund and year concerned which are estimated to be at risk;
- 4) Relate the sum of such amounts for all instances of significant deficiencies to the total payments under the ABB activity for the year concerned.

In quantifying the risk DG Regional Policy also examines whether the deficiencies had an impact on previous years’ expenditure and an estimation is made of the total amount at risk, following the same procedure for the calculation. This is relevant in relation to the consideration of reputational risk for the Community institutions. For the purpose of

---

<sup>61</sup> The approach of DG Regional Policy to the disclosure of deficiencies is described in the document “*Guidelines for assessment of materiality of deficiencies in Member States’ management and control systems under shared management for the purposes of Annual Activity Reports*” which reflects the agreement reached by the four DGs responsible for implementation of the Community budget under shared management arrangements – Agriculture, Employment, Fisheries and Regional Policy – and the common basis for a more coordinated approach in the elaboration of future Annual Activity Reports.

quantification it should be noted that where the Commission has taken action to suspend payments to the Member State or has taken a financial correction decision, or where the Member State has taken actions to prevent irregular expenditure being certified to the Commission, this is taken into account in the quantification.

**Reservations should be made in respect of significant deficiencies in the systems in the Member States where the resulting risk to the Community budget is material.** Following the approach set out, this means reservations are made in the following cases:

- Where examination of the qualitative aspects leads to a finding of a significant deficiency and the sum of the amounts quantified as “*at risk*” from the cases examined exceeds 2 % of the total payments made for the year in question under the ABB activity.
- Where there are special factors in relation to the qualitative aspects of the deficiencies or a high level of risk for the budget for a number of preceding years, which give rise to a high reputational risk for the Community institutions.

### 3.2. Reservations

<b>DG</b>	<b>Regional Policy</b>
<b>Title of the reservation</b>	<p>Reservation concerning the <b>ERDF management and control systems</b> for the period 2000-2006 in:</p> <ol style="list-style-type: none"> <li>1. <b>the CZECH REPUBLIC</b> – 4 programmes</li> <li>2. <b>FINLAND</b> – 4 programmes (Operational Programmes East, North, South and West)</li> <li>3. <b>GERMANY</b> – 4 programmes (for OP Saarland (objective 2), OP Mecklenburg-Vorpommern (objective 1), OP Hamburg (objective 2) and URBAN II Neubrandenburg in Mecklenburg-Vorpommern)</li> <li>4. <b>GREECE</b> – 15 programmes (13 regional OPs, OP Competitivity and OP Information Society)</li> <li>5. <b>IRELAND</b> – 4 programmes</li> <li>6. <b>ITALY</b> – 17 programmes (Puglia, Lazio, Sardinia, Bolzano, Liguria, Piemonte, Friuli Venezia Giulia, Calabria, Campania, Molise, Sicilia, Transport, Research, Technical Assistance, and Urban II- Taranto, Mola di Bari, and Pescara)</li> <li>7. <b>LUXEMBOURG</b> – 1 programme</li> <li>8. <b>POLAND</b> – 3 programmes (Regional Operational Programme (IROP), SOP Improvement of Competitiveness of Enterprises and SOP Transport)</li> <li>9. <b>SLOVAKIA</b> – 2 programmes (OP Basic Infrastructure and OP Industry and Services)</li> <li>10. <b>SPAIN</b> (14 Intermediate Bodies (with an impact on 20 OPs), OP "<i>Sociedad de la Informacion</i>" and the 10 URBAN programmes)</li> <li>11. <b>INTERREG</b> - 51 programmes</li> </ol>
<b>Domain</b>	Structural Funds carried out under 'Shared Management Responsibility'.
<b>ABB activity</b>	13.03 ERDF and other regional interventions. Payments in 2007 linked to the period 2000-2006 (in €Mio): 17,667
<b>Reasons for the reservation</b>	<p>Deficiencies exist in the management and control systems for these programmes, in particular as regards:</p> <ul style="list-style-type: none"> <li>– Article 4 of Regulation 438/2001 (except for Germany);</li> <li>– Article 8 of Regulation 438/2001 (Italy (Puglia) and Ireland);</li> <li>– Article 9 of Regulation 438/2001 (Czech Republic, Spain, Italy (Puglia), Finland and INTERREG);</li> <li>– Article 10 of Regulation 438/2001 (except for Greece and Ireland).</li> </ul> <p>In addition, the following reasons should be mentioned for specific countries: systemic issue concerning the control of state aid schemes through the National Development Law (Greece), deficiencies in compliance with public procurement rules (Italy, Luxembourg and Spain).</p>
<b>Materiality criterion/criteria</b>	Significant deficiencies which affect key elements of the management and control systems for the programmes concerned.
<b>Quantification</b>	In accordance with the 'Guidelines on the Principles, Criteria and Indicative Scales to be Applied by Commission Departments in Determining Financial Corrections' (C(2001)476 of 2/3/2001), the risk has been quantified by applying a flat rate correction of 5 or 10% of payments made in 2007 to the programmes (or parts of programmes)

	<p>concerned.</p> <p><b>Total quantification : €419.500 million (or 2.37 % of the ABB activity)</b></p>
<b>Impact on the assurance</b>	DG Regional Policy has not been able to obtain reasonable assurance that key elements of the management and control systems of the concerned programmes functioned effectively, so as to provide reasonable assurance that statements of expenditure are correct and that the underlying transactions are legal and regular.
<b>Responsibility for the weakness and its remedy</b>	<p>The designated national and regional authorities of the programmes concerned are responsible for the deficiencies and for undertaking corrective measures.</p> <p>Execution of remedial measures will be monitored by the Commission.</p>
<b>Corrective actions</b>	<p>In each case, the DG has undertaken or planned specific actions which include follow up audits and/or monitoring of remedial action plans and/or the launch of suspension and correction procedures. The objective in all cases is either to obtain assurance that the required corrective measures have been completed or to have taken action leading to the application of financial corrections.</p> <p>Specific actions for each programme concerned are described in the table in section 2.5.</p>

<b>DG</b>	<b>Regional Policy</b>
<b>Title of the reservation</b>	Reservation concerning the management and control systems for the <b>COHESION FUND (period 2000-2006) in Bulgaria (National Roads Infrastructure Fund), the Czech Republic, Slovakia, Hungary (environmental sector) and Poland.</b>
<b>Domain</b>	Shared management of the Cohesion Fund
<b>ABB activity</b>	13.04 (Cohesion Fund) and 13.050101 and 13.050102 (ex-ISPA projects) Payments in 2007 linked to the period 2000-2006: €3,331 million
<b>Reason for the reservation</b>	Some common deficiencies were found in the systems of these Member States, in particular as regards article 4 of Regulation 1386/2002.  In addition, some other weaknesses were detected which concern: - article 9 of Regulation 1386/2002 for the Czech Republic, Poland and Slovakia - articles 6 and 8 of Regulation 1386/2002 for the Czech Republic - respect of public procurement rules for Poland and Hungary (environment sector) - risk linked to allegations of bribery of officials – Bulgaria.
<b>Materiality criterion/criteria</b>	Significant deficiencies referring to key elements of the management and control system affecting all Cohesion Fund sectors (for Poland, Slovakia and the Czech Republic), the environment sector (for Hungary) and the National Roads Infrastructure Fund (for Bulgaria).
<b>Quantification</b>	<b>Bulgaria</b> (National Roads Infrastructure Fund - NRIF): Having regard to mitigating factors of the ex-ante control function of the EC Delegation up to the end of 2006, the Paying Authority and the agreement of not to process any payment claim in respect of Cohesion Fund (ex-ISPA) projects until the outcome of an investigation and a separate audit at national level have been completed, the risk is estimated at 5% of the total payments made by the Commission in 2007 in respect of one Cohesion Fund project managed by the NRIF amounting to €0.517 million. <b>Czech Republic:</b> 5% of the payments made in 2007 (€ 132,322,965), i.e. € 6.616 million. <b>Hungary</b> (environmental sector): The payments made by the Commission in 2007 amounted to €93,727,118.54. However, the Directorate General carried out a special public procurement audit in September 2005 covering contracts signed in the environment sector, for which the opinion of the auditors is unqualified as at the end of 2007. In 2007, €777,861.50 was paid in respect of the audited contracts. Therefore, the total amount potentially at risk is € 92,949,257.04. Out of this amount, € 29,401,388.25 was paid in respect of the works contract found to contain public procurement irregularities for which it is estimated that 25% is at risk. For the remaining contracts the estimated risk is 5%, hence a total quantification of risk at € 10.528 million. <b>Slovakia:</b> 5% of the payments made in 2007 (€88,820,965), i.e. €4.441 million. <b>Poland:</b> 5% of the payments made in 2007 (€738,165,634), i.e. €36.908 million. <b>Total quantification: €59.01 million (or 1.77% of the ABB activity)</b>
<b>Impact on the assurance</b>	For all five countries, DG Regional Policy has not been able to obtain reasonable assurance that key elements of the management and control systems of the concerned sectors functioned effectively, so as to provide reasonable assurance that statements of expenditure are correct and that the underlying transactions are legal and regular.  In <b>Poland</b> , the weaknesses potentially affect all projects under the Cohesion Fund

	(including former ISPA projects). In <b>Bulgaria</b> , there are uncertainties regarding the integrity of the management and control structures for EU funding in the NRIF. For <b>Hungary</b> , DG Regional Policy has not been able to obtain reasonable assurance as regards the effective operation of the management and control systems for the Cohesion Fund in the environment sector as regards the legality and regularity of public procurement procedures. The weaknesses can potentially affect other Cohesion Fund contracts being managed by the Development Directorate (Municipality of Budapest).
<b>Responsibility for the weakness and its remedy</b>	The designated national and regional authorities of the sectors concerned are responsible for the deficiencies and for undertaking the corrective measures. Execution of remedial measures will be monitored by the Commission.
<b>Corrective actions</b>	In each case, the DG has undertaken or planned specific actions which include follow up audits and/or monitoring of remedial action plans and/or the launch of suspension and correction procedures. The objective in all cases is either to obtain assurance that the required corrective measures have been completed or to have taken action leading to the application of financial corrections. Specific actions for each programme concerned are described in the table in section 2.5.

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

For 2007, the results of the combined audit and management opinions concerning the assessment of the operation of the systems in the Member States and beneficiary countries have led to an evaluation of the risk in relation to payments made in the course of the year. Account has been taken of mitigating factors and compensatory controls. For the purposes of the declaration of the Authorising Officer by Delegation, DG Regional Policy may take account of the fact that the control arrangements for structural actions as established by the applicable regulations operate on a multi-annual basis as explained in points 2.1 and 2.2.1. The efforts of DG Regional Policy in the exercise of its supervisory functions under the shared management system aim to ensure the correction of possible irregularities in expenditure from those systems for which an unqualified opinion cannot be given. With regard to payments made in relation to those systems which are not covered by reservations, and having regard to the actions set out in the Action Plan to strengthen the Commission's supervisory role under shared management of structural actions" (COM(2008) 97 final) issued on 19 February 2008, DG Regional Policy considers that the residual risk will be reduced to an acceptable level by closure of the programmes and projects.

In application of the approach set out in point 3.1, there are two reservations concerning expenditure in 2007. There is a reservation relating to ERDF which concerns 10 Member States and INTERREG and covers 136 programmes. There is a reservation relating to the Cohesion Fund which concerns 5 Member States. The reservations concern deficiencies in systems of management and control at the national level and not within the Directorate General. The amount of expenditure considered to be at risk has been quantified using the methodology set out on point 2.5.2. The total amount quantified as "at risk" from the reservation for ERDF represents 2.37 % of ERDF payments in 2007 (related to payments for the 2000-2006 period). The total amount quantified as "at risk" from the reservation for the Cohesion Fund represents 1.77 % of Cohesion Fund payments in 2007 (related to payments for the 2000-2006 period, including payments on the ex-ISPA budget lines). The Authorising Officer by Delegation considers that the Directorate General has taken, and is continuing to take, appropriate actions to address the risk resulting from the deficiencies in the systems covered by the reservations, and that they are adequate to ensure the correction of irregularities in expenditure which has been reimbursed in order to reduce the risk to an acceptable level by closure of the programmes and projects. These actions are also covered by the Action Plan to strengthen the Commission's supervisory role under shared management of structural actions" (COM(2008) 97 final) issued on 19 February 2008.

#### 4. PART 4 - DECLARATION OF ASSURANCE

*I, the undersigned, Director-General of Regional Policy*

*In my capacity as authorising officer by delegation*

*Declare that the information contained in this report gives a true and fair view<sup>62</sup>.*

*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<sup>63</sup> and the lessons learnt from the reports of the Court of Auditors<sup>64</sup> 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.*

*However the following reservations should be noted:*

*For ERDF: there are significant deficiencies prejudicing the effective functioning of the management and control systems of certain programmes in Poland, Finland, Ireland, Slovakia, Czech Republic, Italy, Germany, Spain, Greece and Luxembourg together with 51 INTERREG programmes.*

*For Cohesion Fund: there are significant deficiencies prejudicing the effective functioning of the management and control systems for certain projects in Poland, Hungary, Bulgaria, Czech Republic and Slovakia.*

*The systems concerned have not been subject to sufficient corrective measures by the national authorities and accordingly the Directorate General does not have reasonable assurance on the legality and regularity of the underlying transactions in relation to reimbursements of expenditure declared.*

*Brussels, 31 March 2008*

*(signed)  
Dirk Ahner*

---

<sup>62</sup> True and fair in this context means a reliable, complete and correct view on the state of affairs in the service.

<sup>63</sup> Delete if not applicable

<sup>64</sup> Delete if not applicable

