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COUR DES COMPTES EUROPÉENNE



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Report on the annual accounts of
the European Agency for Reconstruction
for the financial year 2004

together with the Agency's replies

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INTRODUCTION

1. The European Agency for Reconstruction (hereinafter called “the Agency”) was established pursuant to Council Regulation (EC) No 1628/96¹. This Regulation was replaced by Council Regulation (EC) No 2068/2004². The Agency, which was actually set up in February 2000, was initially responsible for managing the EU’s aid programmes in Kosovo. Following three extensions to its mandate in 2001, 2002 and 2004, its operations now also cover Serbia-and-Montenegro and the Former Yugoslav Republic of Macedonia. The Agency’s head office is in Thessaloniki and it has operational centres in Belgrade, Podgorica, Pristina and Skopje. It implements programmes to foster institution-building and good governance, to promote the development of a market economy and essential infrastructure and to consolidate civil society. **Table 1** summarises the Agency’s powers and activities based on information provided by the Agency itself.

2. For information purposes the annual accounts drawn up by the Agency for the financial year 2004 are summarised in **Tables 2, 3 and 4.**

THE COURT’S OPINION

3. The Court’s opinion is addressed to the European Parliament and the Council in accordance with Article 185(2) of Council Regulation (EC, Euratom) No 1605/2002³; it was drawn up following an examination of the Agency’s accounts, as required by Article 248 of the Treaty establishing the European Community.

¹ OJ L 204, 14.8.1996, p. 1

² OJ L 358, 3.12.2004, p. 2

³ OJL 248, 16.9.2002, p. 1.

4. The Agency's accounts for the financial year ended 31 December 2004⁴ were drawn up by its Director, pursuant to Article 8(2) of Regulation (EC) No 2667/2000⁵, and sent to the Court, which is required to give its opinion on their reliability and on the legality and regularity of the underlying transactions.

5. The Court conducted an audit in accordance with its policies and standards, which are based on international auditing standards that have been adapted to the Community context. The audit was planned and performed to obtain reasonable assurance that the accounts are reliable and the underlying transactions are legal and regular.

6. The Court has obtained a reasonable basis for the opinion expressed below.

Reliability of the accounts

Except for the issue mentioned in paragraph 9, the Agency's accounts for the financial year ended 31 December 2004, in all material respects, are reliable.

Legality and regularity of underlying transactions

Except for the issue mentioned in paragraph 11, the transactions underlying the Agency's accounts, taken as a whole, are legal and regular.

⁴ These accounts were drawn up on 13 October 2005 and received by the Court on 18 October 2005.

⁵ OJ L 306, 7.12.2000, p. 7.

OBSERVATIONS

7. Although significant funds were maintained throughout the year⁶, the Agency has no active treasury management policy in place; considerable amounts are maintained on current bank accounts without their earnings being checked by the Agency.

8. Reconciliations between bank accounts and the Agency's accounting records are not regularly carried out. With the introduction of accruals accounting in 2005, it is even more relevant that bank accounts be reconciled with the accounting records on a monthly basis.

9. In the absence of effective internal control procedures for long-term receivables the Court cannot be certain that the transactions relating to counterpart funds, credit line schemes and special funds have been completely recorded.

10. One of the main problems the Agency faces is the difficulty in recruiting agents capable of carrying out the difficult tasks with which it is entrusted. The policy of renewing the mandate of the Agency for short periods of time increases this problem as very few individuals with the required profile will relocate under these circumstances.

11. In its 2003 report⁷, the Court noted anomalies which had affected decisions in awarding contracts. In 2004 this situation was again observed. Tenders are the subject of formal procedures which constitute the main guarantee against unequal treatment between tenderers. It is therefore essential to ensure that procedures are strictly applied. Many of the difficulties encountered were due to the fact that criteria set in calls for tender were open to interpretation because

⁶ The bank account balance at 31 December 2004 was 158 million euro - see Table 4.

⁷ Issued on 10 December 2004.

they were unsuited to the practical situation. The Agency should thus be particularly attentive when setting selection criteria to avoid unrealistic requirements which would later lead to interpretation and ineffective procedures.

12. A review of operations entrusted to the United Nations Mission in Kosovo (UNMIK) was carried out. It has covered all 16 operations still open in the Agency's accounts totalling 30,7 million euro (2004 payments 2,5 million euro). In those cases where UNMIK is directly managing the contracts the Agency made payments without exercising adequate financial control. The frequent absence of audit trail requires an in-depth review of the applicability of the agreement⁸ signed between the Commission and the United Nations.

13. In the cases of funds where UNMIK was acting on behalf of the local government departments, the management of these operations was entirely left to these departments. The Agency has not paid sufficient attention to the proper financial organisation of the beneficiaries because it assumed this was the legal responsibility of UNMIK and was then faced with serious difficulties in closing the operations mainly due to an absence of adequate accounts for the projects and of sufficient justification for the expenditure.

14. Concerning supporting documentation for payments, a standardised system of dealing with payment requests needs to be adopted and criteria set on the kind of supporting evidence that is necessary for a payment to be made.

⁸ Financial and Administrative Framework Agreement (FAFA) signed between the European Commission and the United Nations on 29.4.2003.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 10 november 2005.

For the Court of Auditors

Hubert Weber
President

Table 1 – European Agency for Reconstruction (Thessaloniki)

Areas of EU responsibility according to the Treaty	The Agency's powers as defined in Council Regulation (EC) No 2667/2000 of 5 December 2000			Governance	Resources made available to the Agency (data for 2003)	Activities and services provided in 2004
	<u>Objectives</u>	<u>Application</u>	<u>Tasks</u>	<u>Governing Board</u>	<u>Final budget</u>	<u>Overall figures</u>
<p>The Community shall carry out, within its spheres of competence, economic, financial and technical cooperation measures with third countries. Such measures shall be complementary to those carried out by the Member States and consistent with the development policy of the Community.</p> <p>(Article 181 A)</p>	<p>To provide EU assistance (i) for reconstruction, the return of refugees and displaced persons ; (ii) to promote sound administration, stronger institutions and the rule of law ; (iii) to support the development of a market economy and investment in physical infrastructure and environmental measures ; (iv) to support social development and consolidate civil society.</p>	<p>The Agency manages the principal aid programmes in Serbia-and-Montenegro (Republic of Serbia, Kosovo and Republic of Montenegro) and in the former Yugoslav Republic of Macedonia (FYROM). Beneficiaries may include States, bodies under administration, federated, regional and local bodies, public and semi-public bodies, both sides of industry, business support organisations, cooperatives, mutual companies, charities, foundations and NGOs</p>	<ul style="list-style-type: none"> - To advise the Commission of priority needs ; - To devise programmes for reconstruction and the return of refugees and displaced persons, - To take every possible step to implement EU assistance. 	<p>Comprises one representative from each Member State, two representatives from the Commission and an observer from the European Investment Bank.</p> <p>Director Appointed by the Governing Board on a proposal from the Commission</p> <p>Operational centres in Belgrade, Pristina, Podgorica and Skopje with a high level of management autonomy.</p> <p>External control Court of Auditors</p> <p>Discharge authority the Parliament following a recommendation from the Council.</p>	<p>Staff as at 31 December 2004:</p> <p>114 (120) posts listed in the establishment plan</p> <p>posts occupied: 88 (94)</p> <p>other posts – local staff: 195 (201) posts of which 173 (173) were occupied</p> <p>Total staff: 261 (267)</p> <p>Responsible for operational tasks: 184 administrative tasks: 77</p>	<p>Appropriations : 374,6 million euro Contracted: 299 million euro Paid: 292,8 million euro</p> <p>By operational centre: KOSOVO: a) start-up grants, loans, training and business advice to small businesses; b) legal assistance to vulnerable persons; c) loans provided from the EAR credit schemes; d) substantial and complex repairs to the fire damaged thermal power plant Kosovo B; e) rehabilitation of the 'Sunny Hill' district heating sub-station in Pristina; f) six bridges reopened between Pristina and the border crossing with FYROM SERBIA: a) draft laws in Public Administration Reform; b) training programmes for special Police bodies; c) rehabilitation programme for hospitals; d) new jobs created due to loans from the Revolving Credit Fund; e) training support to enterprises; f) overhaul of thermal power plants; g) regional training centres for adults; pilot schools rehabilitated and supplied with IT equipment; h) works on the Sloboda bridge and the Horgos border crossing point with Hungary. MONTENEGRO: a) specialised training to border police and to civil servants; b) central IT data base of the Ministry of Interior; c) Agency for Human Resources Management, regional centres for vocational education and training; d) veterinary laboratory; e) new Roads Directorate and transport laws; f) master plans for wastewater and solid waste; g) Electric Utility unbundling/restructuring, energy efficiency strategy. FYROM: a) 90 % of Internally Displaced Persons returned to their pre-conflict homes; b) training of mainly ethnic Albanians to become public servants; c) new jobs created and jobs preserved due to loans to SMEs from the Revolving Credit Fund; Agency for Entrepreneurship Promotion and SME Observatory set up; d) three new institutes developed and their staff trained.</p>

Source: Information supplied by the Agency

Table 2 - European Agency for Reconstruction - Implementation of the budget for the financial year 2004

(million euro)

Revenue			Expenditure										
Source of revenue	Revenue entered in the final budget for the financial year	Revenue received	Allocation of expenditure	Available appropriations					Appropriations carried over from the previous financial year				
				entered	committed	paid	carried over	cancelled	balance for commitment	commitments carried over	paid	cancelled	outstanding commitments
Community grants	362,3	232,3	Title I Staff	18,8	17,6	17,3	0,3	1,3	-	0,3	0,2	0,1	-
Other grants and counterpart funds	0,4	5,6	Title II Administration	7,1	6,2	5,1	1,1	0,9	-	1,2	1,1	0,1	-
Re-use credits (C5) from previous years	0,0	0,0	Re-use credits (C5) from previous years	0,4	0,1	0,1	0,0	0,2	0,0	-	-	-	-
Remaining funds	11,9	0,0	Title III Operating activities	348,7	139,4	23,2	116,2	0,0	209,2	345,4	200,3	6,7	138,4
Miscellaneous revenues (re-use)	p.m.	1,1	Sub-total	375,0	163,3	45,7	117,6	2,4	209,2	346,9	201,6	6,8	138,4
Total	374,6	239,0	Appropriations carried over from 2003	239,1	135,7	45,5	90,3	4,1	99,4	-	-	-	-
			Total	614,1	299,0	91,2	207,9	6,5	308,6	346,9	201,6	6,8	138,4

NB: Discrepancies in totals are due to the effects of rounding.

Source: The Agency's data - This table summarises the data provided by the Agency in its annual accounts.

Table 3 - European Agency for Reconstruction - Revenue and expenditure account for the financial years 2004 and 2003⁽¹⁾

	2004	2003
Revenue		
EC subsidy	231 909	274 221
Recovery of expenses (re-use Title III)	1 229	1 318
Revenues from administrative operations (re-use Titles I and II)	181	199
Other operating revenue	6 113	28 413
Total operating revenue	239 432	304 151
Expenditure		
Administrative expenses		
- Staff expenses	17 575	17 333
- Other administrative expenses	6 290	6 475
Operational expenses		
- Centralised direct management	268 965	297 168
Total administrative and operational expenditure	292 830	320 976
Surplus/(Deficit) from operating activities	-53 398	-16 825
Extraordinary gains	738	0
Extraordinary losses	-1 269	-4 118
Economic result of the year	-53 929	-20 943

NB: Any discrepancies in totals are due to the effects of rounding.

⁽¹⁾ The figures for 2003 have been adjusted from those previously presented to reflect a change in accounting practices.

Source: The Agency's data - This table summarises the data provided by the Agency in its annual accounts.

Table 4 - European Agency for Reconstruction - Balance Sheet as at 31 December 2004 and 31 December 2003⁽¹⁾

ASSETS		2004	2003	LIABILITIES		2004	2003
Fixed assets				Fixed capital			
Fixed assets at net book value		1 652	1 771	Own capital ⁽²⁾		63 270	1 771
Subtotal		1 652	1 771	Accumulated surplus		150 332	204 261
				Subtotal		213 602	206 032
Long-term receivables							
Counterpart funds, credit line schemes and special funds		61 619	0	Current liabilities			
Subtotal		61 619	0	Employee benefits		28	0
				Current payables		9 619	6 067
Current receivables				Other accounts payable		37	515
Current receivables		1 761	135	Subtotal		9 684	6 582
Subtotal		1 761	135				
Cash accounts							
Cash and cash equivalents		158 254	210 708	Subtotal		9 684	6 582
Subtotal		158 254	210 708				
TOTAL		223 286	212 614	TOTAL		223 286	212 614

(1 000 euro)

NB: Any discrepancies in totals are due to the effects of rounding.

⁽¹⁾ The figures for 2003 have been adjusted from those previously presented to reflect a change in accounting practices.

⁽²⁾ Own capital is calculated as the sum of Fixed assets and Long-term receivables.

Source: -The Agency's data - This table summarises the data provided by the Agency in its annual accounts.

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Replies of the Agency

Paragraph 7

The funds available in the Agency's bank accounts are commensurate to its disbursement needs, taking into account that payments may reach peaks of 45M€ in a single month and that there was in December 2004 a total outstanding amount of 345M€ to be paid on contracted funds. Disruption in treasury due to delays in receiving the requested tranches of the EC subsidy also needs to be avoided. The Agency follows a treasury policy in line with the Commission's practice. Following the Court's observation, guidance from DG Budget will be sought. Recovery orders are issued to ensure proper recording in the accounts. In 2004, 2,9 million euro was earned on the EAR bank accounts.

Paragraph 8

Bank reconciliations were frequently carried out by the Agency before the introduction of the new double entry computerised accounting tool in mid-2004. The Agency agrees to perform them on a monthly basis.

Paragraph 9

In accordance with its commitments taken in the context of the 2003 discharge procedure, the Agency has entered in the final 2004 accounts the original value of the investment less a provision for bad debts for all counterpart funds and credit line schemes and the unspent amount for special funds. All of these activities have undergone or are undergoing external audits in 2005. The Agency considers that the accounts provide a fair and complete view of the EAR long term receivables. Any minor adaptation needed will be made in the 2005 balance.

Paragraph 11

The Agency operates under difficult circumstances in a demanding environment and is fully aware of the risk involved in managing substantial amounts of assistance under such conditions. It therefore established an elaborated procurement system with clear division of tasks amongst its operational, procurement and finance staff. The EAR has taken appropriate measures to address the issues raised by the Court in its annual report for 2003 finalised and published end of 2004; thus the improvements could not be visible in

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2004 but will be appreciated in the context of the audit for the 2005 exercise. The EAR in particular provided central guidance to the actors involved in calls for tenders across the Agency and improved the coherence of applicable standards and approaches. Such efforts will continue in order to ensure that the relevant recommendations of the Court are complied with.

Paragraph 12

The Agency attempts by all means to ensure that UNMIK respects its relevant obligations. The EAR's policy is to insist in particular on receiving in due time and form the reports provided for in the contracts, and to reject them if inappropriate. No further payments are made without checking the financial data and documents required. The EAR also funds audits at the most appropriate stage of implementation, normally in view of, or immediately after, the closure of a contract. These audits are "subject to the internal and external auditing procedures laid down in the Financial Regulations, rules and directives of the United Nations" as stipulated in Article 1.(a) of the FAFA.

Paragraph 13

The terms of the EAR grant agreements with UNMIK are clear on the respective shares of responsibility. UNMIK is the responsible organisation regarding government departments. Conscious of the difficulties mentioned, the Agency provided technical and financial advice in the framework of certain grant agreements. This practice will be further extended in future. The Agency's final payments to UNMIK are conditional to the respect of financial requirements, based on reports by independent auditors.

Paragraph 14

The Agency uses a workflow (financial circuit) with two verifications prior to authorisation and standard checklists. An Instruction Note with the detailed procedure for processing invoices was updated in mid-2004. Efforts to further strengthen and standardise these rules will continue.