

Foreign Assistance Funds Provided to the Czech Republic

The audit was included in the Plan of Audits of the Supreme Audit Office for the year 2000 under File No. 00/20. The audit was managed and its conclusions prepared by JUDr. František Bárta, a member of the Supreme Audit Office.

The purpose of the audit was to evaluate actual benefits of the use of foreign assistance funds and to verify the system of, and preparedness for, the disbursement of foreign assistance funds in the Czech Republic following the establishment of the National Fund.

The audit was conducted between January and May 2001 by SAO's audit teams from the Department of Transportation, Industry and Economy, Department of Environment and Agriculture, and SAO's regional departments from Northwest Bohemia, South Bohemia, and South Moravia.

The audited entities are listed below:

- A. central state administration institutions - Ministry of Finance (hereinafter "MoF"), Ministry for Regional Development (hereinafter "MoRD"), Ministry of Agriculture (hereinafter "MoA"), and Ministry of Environment (hereinafter "MoE");
- B. implementation agency - Centre for Regional Development of the Czech Republic (hereinafter "CRD");
- C. recipients and beneficiaries of foreign assistance - Severočeská vodárenská společnost a.s., Teplice; Jihočeská plynárenská a.s., České Budějovice; Hospodářský park České Velenice, akciová společnost, České Velenice; Statutory City of České Budějovice; Municipality of Znojmo; Municipality of Telč; Municipality of Frymburk; Municipality of Dyjákovičky; Municipality of Hřensko; Association of Municipalities Vodovody a kanalizace Znojemsko.

Complaints against the Audit Protocol were lodged by MoA, and dealt with in a decision of the Head of the Audit Team.

At its XIVth meeting held on August 28, 2001, and in its Resolution No. 13/XIV/2001, the Collegium of the Supreme Audit Office *approved conclusions of the audit, which read as follows:*

I. Introduction

Since 1990, the European Communities (hereinafter "EC") have been providing assistance to the Czech Republic in the framework of the PHARE programme, a relatively independent part of which is a so-called Cross-Border Cooperation Programme (hereinafter "CBC PHARE") launched in 1994. In 2000, the EC expanded the scope of assistance and divided it into three programmes, namely PHARE, SAPARD and ISPA. The manner in which the assistance is provided under each of the programmes is governed by Directives of the EC Council. The central state administration body of the Czech Republic responsible for coordinating the reception of the foreign assistance is the Ministry of Finance, to which these responsibilities were transferred from the former Ministry of Economy as of November 1, 1996; as to CBC PHARE programmes, relevant responsibilities were transferred from the former Ministry of Economy to MoRD.

1. The implementation of the **PHARE programme** is governed by a manual issued by the European Commission (hereinafter “the Manual”). Implementation structures were bound to observe and comply with the Manual by Financial Memoranda signed by and between the Czech Republic and the European Commission at the ministerial level as a legal document pertaining to and a financial commitment for a given programme. The Financial Memoranda established deadlines with respect to the completion of contracting procedures (generally within two years from the signature of the Memorandum) and the final date of disbursements of funds (generally within a year from the date of completion of contracting procedures).

A general legal and administrative framework of the implementation of the PHARE programme in the Czech Republic was only established by the Framework Agreement between the Government of the Czech Republic and the European Commission, on the participation of the Czech Republic in the Programme of Assistance of the EC, signed on March 12 and July 12, 1996, in Prague and Brussels, respectively, and promulgated in the Collection of Legal Acts dated August 21, 1997, as Act No. 207/1997 Coll. (hereinafter “the Framework Agreement”), becoming valid and effective as of August 6, 1997. On October 12, 1998, the Czech Republic and the European Commission signed a Memorandum of Understanding on the establishment of the National Fund (published in the Collection of Legal Acts under No. 18/2001), which has changed the institutional arrangements of the implementation, starting with the PHARE 1998 programme.

- (a) The responsibility for coordinating, creating and monitoring PHARE programmes lies with the National Assistance Coordinator (hereinafter “NAC”), while the National Approving Officer (hereinafter “NAO”), who is the Head of the National Fund, is responsible for managing and controlling financial flows. In its Resolution No. 865, dated August 25, 1999, the Government acknowledged the fact that the above positions were held by Deputy Ministers of Finance.

Pursuant to provisions of Section 37 of Act No. 218/2000 Coll., on budgetary rules and changes of some other related legal acts (Budgetary Rules Act), the National Fund comprises aggregate financial funds entrusted by the EC to the Czech Republic for the purpose of implementing joint programmes. Decisions concerning the funds kept in the National Fund are made by MoF in accordance with commitments related to their acceptance. The Ministry of Finance has exercised these responsibilities through various organizational units (hereinafter “National Fund units”) within its organizational structure.

Since the PHARE 1998 programme, all funds provided by the EC have come through the National Fund’s accounts at the Czech National Bank (as to the 1995 - 1997 period, all PHARE funds were credited directly to accounts of implementation agencies opened at any bank of their choice).

- (b) Implementation agencies are responsible for the technical, financial and administrative implementation of PHARE programmes, including organizing and conducting tenders and signing contracts. Between 1995 and 1997, the programmes were implemented by 14 so-called “central servicing units” the organizational forms of which differed (contributory organizations in the case of the Ministry of Industry and Trade or MoRD, departments at MoF and MoE, Czech Railway Company etc.). Since the PHARE 1998 programme, the implementation authorities within the state administration structure have been so-called **implementation agencies** (hereinafter “IA”) and the **Central Financing and Contracting**

Unit (hereinafter “CFCU”) established at the Ministry of Finance. As to the PHARE 1998 and 1999 programmes, the NAO signed financial agreements with CFCU and just three implementation agencies, namely CRR, CzechInvest (contributory organizations of the Ministry for Regional Development and the Ministry of Industry and Trade, respectively) and Nadace pro rozvoj občanské společnosti (Civic Society Development Foundation). Outstanding PHARE programmes falling into the 1995 - 1997 period will either be completed by the servicing units that started them, or have been taken over by CRR and CFCU operating in the framework of the Ministry for Regional Development and the Ministry of Finance, respectively.

- (c) The Programme Approving Officer (hereinafter “PAO”) is responsible for proper management of funds in PHARE programmes being implemented and for activities of implementation agencies; between 1995 and 1997, the PAO was appointed by the relevant minister, and since the PHARE 1998 programme by the NAO. If the administrative and financial implementation of PHARE programmes is done by CFCU, responsibilities for the technical implementation lie with a so-called Chief Programme Officer, who is appointed by the relevant ministry (for example by the Ministry of Agriculture for the CZ 9809 “Agriculture” programme, or by the Ministry of Environment for the CZ 9811 “Environment” programme).
 - (d) The monitoring and evaluation of PHARE programmes from the viewpoint of meeting all goals and objectives set forth in the Financial Memoranda are done by the Joint Monitoring Committee the chairman of which is the NAC and the members of which include, *inter alia*, the NAO and representatives of the Delegation of the European Commission in Prague (hereinafter “DEC”).
2. Support of the EC provided under the **SAPARD programme** is related especially to the adoption of *acquis communautaire* (EC law) in the field of common agricultural policy and to resolving pressing or specific difficulties and problems arising in connection with the long-term adaptation of candidate countries in the field of agriculture and rural regions. The European Commission decided to entrust the administration of the assistance provided under the SAPARD programme to an agency. The agency in question is Agentura SAPARD (SAPARD Agency), established by the Ministry of Agriculture as its organizational unit as of August 1, 2000. On February 5, 2001, the Czech Republic and the EC signed a Long-Term Financial Agreement on the SAPARD programme, under which funds come to the Czech Republic via the National Fund.

Projects will be selected by SAPARD National Selection Commissions and Regional Selection Commissions. Applications for support will be submitted to the SAPARD Agency and MoRD, to which responsibilities concerning priorities related to the development of rural regions have been delegated. The monitoring and evaluation of SAPARD programmes will be carried out by the SAPARD National Monitoring Committee, in which the NAC and eight regional monitoring committees at the NUTS II (regional-level statistical units) level will be represented.

3. In the framework of the **ISPA programme**, the EC will provide assistance with a particular focus on measures enabling to achieve compliance with requirements laid down in the EC’s environmental legislation, as well as measures and actions to ensure an interconnection, interoperability and functionality of national networks and links to trans-European systems in the field of transportation. On December 13, 2000, the Minister of

Finance and the European Commission signed a Memorandum of Understanding on the use of the National Fund for the ISPA Programme (published in the Collection of Legal Acts under No. 19/2001), which defines essential structures needed to make use of the programme. In its Resolution No. 149, dated February 14, 2001, the Government acknowledged coordination and implementation structures of the ISPA programme.

- (a) Responsible for the programming, implementation and monitoring of projects is the ISPA National Coordinator the job of whom was amalgamated with that of the NAC by Resolution of the Government No. 1109, dated November 8, 2000. In this respect, he is supported by the ISPA Coordination Committee, which is responsible for an overall coordination insofar as project preparations are concerned. The chairman of the ISPA Coordination Committee is the Deputy Minister for Regional Development, the other members are the NAC and the NAO. Projects are selected by two ISPA Working Groups, one dealing with environmental matters (applications are submitted to the State Environmental Fund), the other with transportation-related projects. The ISPA National Coordinator submits proposed projects to the European Commission. The principal monitoring body is the ISPA Monitoring Committee, headed by the NAC.
 - (b) The NAO is responsible for the management of funds provided under the ISPA programme. A Sectoral Approving Officer, appointed by the NAO, is responsible for activities of the IA and proper financial management. As to the transportation sector, the IA's job has been entrusted to the Ministry of Transportation. On February 8, 2001, the NAO appointed the Deputy Minister of Transportation the Sectoral Approving Officer; at the same time, he appointed two Deputy Sectoral Approving Officers at the end beneficiaries of the assistance, namely České dráhy (Czech Railway Company) and Ředitelství silnic a dálnic ČR (Directorate of Roads and Motorways of the Czech Republic). Insofar as ISPA 2000 environmental projects are concerned, the IA's job were performed by CRR. Since 2001, the State Environmental Fund should take over. By the time the audit was completed, the NAO had not appointed either the Sectoral Approving Officer (Environment) or his deputy.
4. Responsibilities related to the disbursement and use of the foreign aid were elaborated in the "Guidelines for the Management of Funds in the Implementation of EC Pre-Accession Assistance Programmes (PHARE, SAPARD, ISPA) in the Czech Republic", approved by Resolution of the Government No. 274, dated March 15, 2000 (hereinafter "Government Guidelines"), and the "Principles of Coordination Concerning the Use of EC Aid (PHARE, SAPARD, ISPA) Funds in the Czech Republic", approved by Resolution of the Government No. 275, dated March 15, 2000. Insofar as the disbursement and allocation of the funds mentioned above is concerned, the coordination is provided by the Management and Coordination Committee, responsible for coordinating the EC assistance at the nationwide level. Its statutes and order of procedure were approved by Resolution of the Government No. 273, dated March 21, 2001. Its members include the NAC and NAO, Chairman of the ISPA Coordination Committee, and Chairman of the SAPARD National Monitoring Committee.

II. Findings Regarding PHARE Programmes between 1995 and 1999

Between 1995 and 1999, the EC provided funds for the PHARE programme under the 1995 – 1999 Long-Term Indicative Programme (hereinafter "LTIP"), signed by the Czech Republic and the European Commission on July 7, 1995. An overview of allocations set forth in

Financial Memoranda for all PHARE programmes accepted and approved in each year, as well as the overall amount of contracted and actually disbursed funds as of December 31, 2000 (based on MoF data) is shown in the table below.

(EUR 1,000)

Year	Allocated	Contracted	% of Allocation	Disbursed	% of Allocation
1995	114,600.0	109,688.8	95.71	105,987.6	92.48
1996	58,050.0	53,034.1	91.36	44,712.0	77.02
1997	62,200.0	60,614.9	97.45	57,433.9	92.34
1998*	46,000.0	43,434.5	84.42	20,058.4	43.61
1999**	86,600.0	35,951.3	41.49	2,405.0	2.78
Total	367,450.0	302,703.6	82.38	230,596.9	62.76

*) The disbursement deadline has not expired yet.

***) Both the contracting and the disbursement deadlines have not expired yet.

Assuming an exchange rate of CZK 37 to 1 EUR, the aggregate allocation of EUR 367.45 million amounted to CZK 13.6 billion. The audit focused on programmes implemented by CRR, CFCU and MoE, representing an aggregate budget of EUR 33.009 million (CRR – EUR 13.491 million, CFCU – EUR 18.595 million, MoE – EUR 0.923 million).

1. Goals and Priorities of PHARE Programmes

(a) **Starting with the 1998 National PHARE Programme, the EC have reprioritized the programmes in favour of those speeding up the Czech Republic's preparations for its accession to the European Union** (hereinafter "EU"). In accordance with requirements presented by relevant ministries and priorities laid down in the Long-Term Indicative Programme, the 1995 to 1997 National PHARE Programmes were focusing mainly on strengthening the Czech economy, railway infrastructure, development of the road network, regional investments, investments into the development of institutions etc. Since the 1998 National PHARE Programme, the focus of the programmes has been based on the "Partnership for Accession" and "National Programme of the Czech Republic's Preparations for the Membership in the EU" documents, whose priorities included establishing institutional and administrative structures needed to introduce and implement the EC legislation and ensuring investments permitting the Czech infrastructure to be adapted to the EC law (particularly in the field of finances, agriculture, environment, justice and internal affairs). A new form of the assistance, the so-called twinning, has been introduced, in the framework of which central state administration institutions and authorities were receiving consultants from EU member nations, or arranging training and educational visits of their employees in EU countries.

(b) As to the CBC PHARE programme, the European Commission approved the Long-Term Indicative Programme in July and November 1995, with allocations of EUR 125.0 million and EUR 30.0 million for cross-border cooperation with Germany and Austria, respectively, its aim being to foster cooperation of border regions, especially in transportation, environmental matters, agriculture, forestry etc. Beneficiaries of the aid included mainly municipalities or joint-stock companies in which the state or municipalities were majority owners. Starting with the 1997 CBC PHARE programme, the European Commission stopped approving every project, delegating the decision-making power to target regions through funds (Fund of Small Projects, Forest

Revitalization Fund, Fund for Supporting Small and Medium-Sized Enterprises, Countryside Rehabilitation Programme). On the other hand, it set the minimum support limit at EUR 2.0 million, starting with the 1999 CBC PHARE programme; while this move increased the importance of individual projects, it also reduced the number of potential eligible candidates. Compared to the Long-Term Indicative Programme, the actual allocation was EUR 13.6 million less in the case of Germany, and EUR 7.6 million higher in the case of Austria. Since 1998, the scope of the EC's assistance has been expanded to include Poland (EUR 3.0 million) and Slovakia (EUR 2.0 million).

- (c) As to the 1995 and 1996 PHARE programmes, the European Commission agreed with a re-allocation of EUR 8.63 million for the reconstruction of regions affected by floods, of which a sum of EUR 4.63 million was re-allocated from the CBC PHARE programme and used to mitigate damage with a cross-border impact, while a sum of EUR 4.0 million came from the CZ 9507 (Technical Assistance) and CZ 9603 (Regional Development) programmes and distributed in the regions of Ostrava and Olomouc.
- (d) **Between 1995 and 1999, the EC allocated to PHARE programmes in Financial Memoranda a sum which was EUR 37.45 million higher than that envisaged in the Long-Term Indicative Programme.** While the Long-Term Indicative Programme anticipated to allocate an aggregate sum of EUR 330.0 million, the actual amounts stipulated in the Financial Memoranda dealing with national programmes and cross-border cooperation were EUR 182.0 million and EUR 154.0 million, respectively. Furthermore, the EC allocated, in separate Financial Memoranda for the 1995 and 1996 PHARE programmes, a sum of EUR 10.85 million for tri-lateral cross-border cooperation programmes and multi-national programmes focusing on border crossings and checkpoints; as to the 1999 PHARE programme, an additional EUR 20.6 million was allocated to projects related to the Partnership for Accession (especially to large infrastructure capital investment projects and the implementation of the EC legislation in the social sphere).

2. Disbursement of Allocated PHARE Funds

- (a) **The Czech Republic failed to make full use of funds allocated under the 1995 to 1998 PHARE programmes, in respect whereof the contracting deadline has already expired, falling EUR 14.1 short of the planned figure mainly as a result of overestimated financial requirements and insufficient preparations of projects.**

The highest differences between allocations and aggregate contracted amounts existed in the following projects:

- CZ 9504 (Infrastructure Integration) programme, implemented by the Czech railway Company – EUR 4.8 million;
- CBC PHARE programmes implemented by CRR, especially the CZ 9604 (CBC Germany) programme – EUR 4.2 million;
- 1997 and 1998 PHARE National Programmes implemented by CFCU – EUR 2.7 million.

The failure to disburse and spend all allocated funds is attributable particularly to capital requirements of projects having been overestimated by beneficiaries of foreign aid; the overestimated requirements were in turn reflected in amounts allocated in Financial Memoranda. Another factor affecting the level of disbursements was represented by lower prices offered by bidders in public tenders organized in accordance with the Manual. For

example, the aggregate contracted amount for the "Vranovice Railway Station" and "Choceň – Ústí nad Orlicí Line Railway Bridge" projects (CZ 9504 programme) was just EUR 10.2 million compared to the allocated EUR 14.0 million; as to the "Cheb – Railway Station Reconstruction" project (CZ 9604 programme), the allocated and contracted amounts were EUR 4.0 million and EUR 2.1 million, respectively.

As to the PHARE National Programmes, the failure to disburse allocated funds in full was attributable to lower bids in public tenders and particularly to

- failed contracts because of unclear requirements on the part of the end user; for example, technical assistance offered under the CZ 9809 (Agriculture) programme, for which a sum of EUR 200,000 had been allocated, was no longer required;
- unsuccessful tenders (no bids at all, formally incorrect bids, bids exceeding the planned budget);
- failure to meet the contract signature deadline;
- insufficient coordination with the Delegation of the European Commission; for example, the latter cancelled a tender for a project with an allocation of EUR 200,000 in the framework of the CZ 9809 programme, as it had been initiated without its approval.

Under the PHARE system, unallocated funds could be transferred to other projects only to a limited extent.

(b) **Actual disbursements were lower than contracted amounts.** The difference cannot be determined in an objective manner, as some of the funds will be disbursed only after relevant warranties have expired. Furthermore, CRR was paying invoices even after the expiry of disbursement deadlines laid down in Financial Memoranda (for example, invoices related to the 1995 to 1997 CBC PHARE programmes and amounting to more than EUR 1.0 million were paid as late as in 2001).

As far as capital investment projects are concerned, the non-disbursement of a whole contracted sum is also affected by a so-called "retention fee", which amounts to roughly 10 percent of the contract value and is paid only after the warranty has expired. In other cases, the difference was attributable to the unsuccessful implementation of the CZ 9602 programme, referred to in Paragraph 3(a) of this part of the Audit Conclusions, or to a lower-than-planned scope of work, or a cancellation of contracted projects. For example, the CFCU-run CZ 9703 (Building of Institutions) programme did not spend EUR 971,500, as its actual costs of services and technical assistance (e.g. air tickets, costs of organizing seminars, rents etc.) were lower than those envisaged in the contract. The difference was identified only in the final invoicing, and PHARE rules did not permit to use the remaining funds for a different purpose.

3. Achievement of Anticipated Benefits in Audited PHARE Programmes (Projects)

The audit focused on benefits of PHARE National Programmes concerning environmental matters (CZ 9602, CZ 9705, CZ 9811) for the Ministry of Environment, and of PHARE National Programmes dealing with agriculture and preparations for the SAPARD Programme (CZ 9807, CZ 9809) for the Ministry of Agriculture; the aggregate allocation for these programmes amounted to EUR 12.35 million. As to the Ministry for Regional Development and the Ministry of Finance, the audit checked the use of fixed assets purchased under the institution-building programme. At ten beneficiaries, the implementation of ten 1996 to 1998 CBC PHARE projects with an aggregate allocation of EUR 15.01 million was audited. The

ten projects, plus an additional five projects of Severočeská vodárenská společnost (North Bohemian Waterworks Company), were assessed and evaluated from the viewpoint of meeting predetermined criteria. The selected projects comprised only those which had been completed and whose outputs were measurable/quantifiable.

(a) The CZ 9602 programme was unsuccessful because of its wrong orientation, the European Commission being too slow in releasing necessary funds, and its delayed start. Of the allocated sum of EUR 5.0 million, 4.1 million remained unused.

The Ministry of Environment managed the CZ 9602 programme, its objective being to provide favourable interest rates for projects focusing on the introduction of environmentally efficient technologies at small- and medium-sized businesses and enterprises in the Czech Republic. To this end, the ministry established the Entrepreneurial Environmental Fund; based on the outcome of a public tender it had organized and in which only one bidder had taken part, it entrusted the management and administration of the Fund to Investiční a poštovní banka (hereinafter "IPB"). In March 1998, the MoE, IPB and DEC signed an agreement for EUR 5.0 million, divided into two tranches. Following the signature of the agreement, the European Commission was supposed to send the first tranche of EUR 2.9 million within 15 days, while IPB was to sign credit agreements with selected applicants for an aggregate sum of EUR 2.5 million (the balance of EUR 0.4 million was to be used to cover costs of a technical consultant, advertising in the media, and preparations of an accession strategy for the Ministry of Environment) within 15 months.

The agreement provisions and a request of the Ministry of Environment of August 1998 notwithstanding, the European Commission sent the sum of EUR 2.9 million as late as in April 1999. In April 2000, it warned the Ministry of Environment that IPB had not yet disbursed all of the funds earmarked for credits, and set the final deadline in this respect at the end of June 2000. In the same month, IPB was placed under receivership. Subsequently, the European Commission suspended the project as of June 30, 2000, rejecting a request of the Ministry of Environment to extend the deadline by two months in December 2000.

By the end of the year 2000, IPB had provided credit lines in an aggregate amount of EUR 616,100 to only five clients. When determining the objective of the programme, the Ministry of Environment failed to make a survey to establish the level of interest in this type of credits. Given their difficult financial situation, small- and medium-sized enterprises did not regard environmental capital investments as their top priority. Furthermore, the European Commission set too stringent eligibility criteria, and IPB, in cooperation with the technical assistant, was forced to reject 122 projects because of their non-compliance. There were long delays in the implementation of the programme, due to which some of the applicants finally completed their projects without actually making use of the foreign aid.

(b) Most of the planned objectives and goals of other audited programmes (projects) in which MoE and MoA were responsible for the technical side were met. These programmes (projects) were represented mainly by the introduction and implementation of information systems, implementation of guidelines and directives, training courses etc. Only the project the purpose of which was to estimate economic costs of a reduction of glass-house gases in the Czech Republic (in the framework of the CZ9705.05 sub-programme) was of a somewhat lower usability for end users, as the subcontractor failed to translate its final report into Czech and to send it to parties concerned. As to the Ministry of Agriculture, a project in the framework of the CZ 9809 programme with an allocation of EUR 0.2

million, the purpose of which was to develop a system of registration and identification of animals, was cancelled, as the end user had lost interest in the assistance because his application had been evaluated too long.

- (c) The Ministry of Finance and the Ministry for Regional Development were using assets purchased with funds provided under the PHARE programme, but failed to enter them into their accounting books and ledgers, rectifying the shortfall only during the audit.**

In the framework of the CZ 9503, CZ 9703 and CZ 9812 programmes, CFCU transferred assets valued at EUR 70,400 to the Ministry of Finance between March 1998 and November 2000. Five transactions of this type, involving computer hardware, copiers and software, which occurred between September and November 2000 and whose aggregate value was EUR 36,300, were not entered into the accounting system of the Ministry of Finance, finding their way into it not earlier than in May 2001.

The Ministry for Regional Development failed to enter assets valued at EUR 137,500 (cars, IT equipment, printers, copiers, mobile phones etc.) transferred in 16 transactions from the CZ 9503 and CZ 9705 programmes between August 1997 and December 2000 into its accounting system, rectifying its omission only in March 2001. Before doing so, it transferred some of the assets on a temporary basis to regional development agencies in Most, Olomouc and Ostrava. However, the protocols on the acceptance of the passenger cars by the regional development agencies in Most and Ostrava, dated November 2000, do not contain stamps of these agencies. The Ministry corrected the situation only in March 2001.

- (d) Nine completed and quantifiable projects focusing on sewage collection systems and waste water treatment plants achieved and met their respective planned criteria, and their implementation has had a positive effect on the quality of the environment in the areas and municipalities concerned. Six other projects dealing with the construction of waste water treatment plants, sewage collection systems, a gas pipeline, a railway siding and paths for bikers could not be evaluated because of a too short time of operation since their completion.

For all the ten projects which have been audited, the Ministry for Regional Development signed co-financing agreements with the beneficiaries with a delay of 6 to 31 months from the date of signature of the relevant Financial Memorandum, which in turn delayed the implementation of the projects by one to three years. The delayed contracts resulted from a lengthy approval process in which some steps were approved directly by the European Commission in Brussels. For example, the Ministry for Regional Development signed a co-financing agreement for the “Děčín Waste Water Treatment Plant” project as late as 24 months after the Financial Memorandum had been signed. Aid beneficiaries completed a total of seven projects 10 to 23 months later compared to planned dates laid down in relevant Project Fiches (forms).

In its co-financing agreements, the Ministry for Regional Development divided eight of the ten audited projects into a PHARE-funded part and a part financed from own funds of the beneficiary. The reason was that, for the Czech-funded part of the project, the beneficiaries were able to

- implement the project as soon as they had secured funds needed to co-finance the project (e.g. a subsidy provided by the State Environmental Fund). Budgetary rules did not permit

government-provided funds to be carried over to the next year, while the release of PHARE funds took as long as several years, depending on the length of the approval process;

- start the tender process for the implementation of Czech-funded part of the project. Before the Framework Agreement took effect (i.e. before August 6, 1997), the tender process for PHARE-funded public contracts had not been governed by the Manual, but by Act No. 199/1994 Coll., on placing orders for public contracts, as amended.
- 4. Neither the Ministry of Finance nor the other audited central state administration bodies were conducting continuous assessments of PHARE programmes from the viewpoint of whether planned goals had been achieved. These activities should be provided only from the year 2001.**

The monitoring and assessment of programmes financed from structural funds is one of the key principles applied by the European Union. Since 1996, the European Commission had been monitoring and evaluating selected projects through a consortium named OMAS. The Ministry of Finance prepared a new Czech programme evaluation system, the implementation of which was expected to start only in 2001. According to the Memorandum of Understanding, the monitoring and assessment of programmes from the viewpoint of the achievement of goals and targets laid down in relevant Financial Memoranda is to be carried out by a Joint Monitoring Committee. Monitoring reports are to be prepared by implementation agencies (IAs) or CFCU in cooperation with relevant ministries.

In the framework of the CBC PHARE programme, the Ministry for Regional Development evaluated individual projects through its (or CRR's) participation at meetings of Joint Programme and Monitoring Committees. It has been developing a new monitoring system of the Structural Funds pursuant to Resolution of the Government No. 40, dated January 11, 1999, whereby it has been delegated responsibilities in this area; judging from a document the Ministry submitted to the Government in January 2001, it should implement the first version of the system at two to three sites. This is expected to provide prerequisites for a central monitoring of the PHARE, ISPA and SAPARD programmes. In the year 2002, the system scope should be expanded to include sectoral and regional operational programmes and financial flows of the National Fund.

- 5. Neither the Ministry of Finance nor the other audited central state administration bodies were conducting continuous checks/audits of the disbursement of PHARE funds.**

Only the Ministry of Finance conducted an audit focused on the management of PHARE funds at all implementation agencies. The audit covered the January 2000 - September 2000 period, and was conducted pursuant to Resolution of the Government No. 1249, dated November 29, 1999, which was in turn based on a discussion of conclusions of Audit No. 96/42 - Audit of the Management of Funds Provided to the Czech Republic in the Framework of Foreign Assistance - conducted by the Supreme Audit Office. Control mechanisms were also provided by the European Commission (acting through DEC), which approved in writing some procedures employed by the implementation agencies (in particular tenders and contracting). In addition, EC used independent auditors as well, and carried out a final audit upon the completion of each programme.

III. Findings Related to the Implementation of the PHARE Programme

1. The Ministry of Finance failed to ensure adequate human resources in the early stage of the operation of the National Fund.

To ensure a timely and proper fulfillment of tasks, the Ministry of Finance, according to Article 10 of the Memorandum of Understanding, was to provide adequate human resources for the National Fund at its own expense. Since the establishment of the National Fund on December 31, 1998, till January 1, 2000, the National Fund's functions were performed by several cooperating departments of the Ministry; since January 1, 2000, the National Fund's role was assumed by a section of the National Budget Department of the Ministry of Finance, with five job slots/positions. An independent department handling the National Fund was established not earlier than on February 1, 2001; it comprises 17 planned job slots/positions, of which 13 were occupied as of April 30, 2001.

2. Early into their operation, organizational units of the National Fund were showing shortfalls when submitting requests for PHARE funds to the European Commission. This fact combined with a delayed release of the funds by the European Commission was causing temporary shortages of these funds at CFCU.

The European Commission rejected the first two requests, dated June 16, 1999, and August 11, 1999, for the release of funds under the Financial Memorandum of the 1998 National PHARE Programme, which was signed on October 12, 1998. One of the requests was rejected because it did not mention persons authorized to handle account transactions, the other because no accounts having been opened for CFCU sub-programmes (but this omission was also present in the first request). Only the third request, dated September 29, 1999, was approved by the European Commission, and an up-front payment, amounting to EUR 3.6 million, was credited to the source account of the National Fund on November 8, 1999, i.e. five months since the submission of the first request and twelve months from the signature of the Financial Memorandum.

According to Article 4, Paragraph 2, of the Memorandum of Understanding, the European Commission may be asked to supply additional funds if the overall balance of available funds drops below 10 percent of the total budget of the programme. Insofar as the 1998 National PHARE Programme is concerned, organizational units of the National Fund submitted requests to this effect too late (two of them as late as three months since the amount of available funds had dropped below 10 percent) and/or with mistakes (one of the requests did not contain information on the amount of accrued interests, which was a mandatory data item). The result was CFCU's insolvency; in August 2000 and January 2001, it did not have any funds to settle outstanding invoices in the aggregate amount of EUR 0.3 million and 2.0 million, respectively.

The lack of funds at CFCU affected the 1999 National PHARE Programme as well. While organizational units of the National Fund required additional funds to be supplied on January 18, 2001 (shortly after a drop of available funds to 7.2 percent as of December 31, 2000), the European Commission approved the request not earlier than in April 2001. By that time, the aggregate sum of outstanding invoices had climbed to EUR 3.2 million.

In the light of the difficulties outlined above, DEC extended the disbursement deadlines of the 1998 National PHARE Programme and the 1999 National PHARE Programme from June 30, 2001, to March 31, 2002, and from December 31, 2001, to September 30, 2002, respectively.

3. The Ministry of Finance failed to introduce a double-entry book-keeping system for foreign assistance funds.

Provisions of Article 20 of the Instruction of the Government stipulate that the Ministry of Finance maintains a double-entry book-keeping system and analytical records capturing all financial transactions of the National Fund. So far, no double-entry book-keeping system has been introduced with respect to financial transactions of the National Fund or implementing agencies. The Ministry of Finance was developing a methodology and a system of maintaining analytical records based on double-entry book-keeping principles, expecting the work to be completed by mid-2001.

4. Regulations governing the PHARE programme were translated by the Ministry of Finance into Czech either too late, or not at all. When making use or disbursing the foreign assistance, organizational units of the National Fund and implementing agencies have been using English not just in communication with the European Commission, but also with respect to Czech entities.

Provisions of Article 32 of the Instruction of the Government stipulate that documents submitted to the European Commission should be executed in English or Czech. Unless an organizational unit of the National Fund says otherwise, all other documents are in Czech. Organizational units of the National Fund did not issue any instruction to use English. Yet even Czech entities and institutions have maintained relevant documentation in English only. Although the Manual is a keynote regulatory document of the European Commission governing the implementation of the PHARE programme, the Ministry of Finance had it translated as late as in the year 2000. It has not yet translated the PERSEUS record-keeping system, or has had it translated.

5. Relevant ministries have not yet applied for an accreditation of implementation agencies falling into their respective purviews.

Provisions of Article 26 of the Instruction of the Government stipulate that the ministries establishing IAs should ask the NAO to verify/certify their accounts. As soon as that has been done, they should have applied for an accreditation, pursuant to provisions of Article 26 of the Instruction of the Government, but have not done so.

6. The Ministry of Finance relieved interests accrued on foreign assistance funds of the income only in 2001. The payment of the income tax resulted in a difference between the amount which the European Commission asked to be returned, and the actual balance on accounts of completed PHARE programmes.

The European Commission required the balance on the accounts of the completed CZ 9503 (Integration of Institutions) and CZ 9507 (Technical Assistance) to be returned. However, the required amounts differed from the actual balances by EUR 45,500 in the case of the former programme and EUR 4,800 in the case of the latter programme, the difference having been caused mainly by the taxation of interests in the Czech Republic. The Ministry of Finance arranged the foreign assistance funds to be relieved of the income tax only as of January 1, 2001 (by provisions of Section 19, Paragraph 1, Subparagraph (y), of Act No. 586/1992 Coll., on income taxes, as amended by Act No. 492/2000 Coll.

7. The Ministry of Finance has not yet provided prerequisites for the operation of CRR, although tasked to do so by the Government.

Between 1998 and 2000, activities of CRR were co-financed by the European Commission. Since 2001, they have been fully financed by the Czech side. In its Resolution No. 826, dated August 23, 2000, the Government tasked the Ministry for Regional Development to provide personnel, material and financial prerequisites needed for the operation of CRR. However, the Ministry is only now drafting a proposed solution of the human resources aspect of the implementation of programmes by CRR, which is to be submitted to the Government and which constitutes a part of the proposed human resources policy of the whole sector.

IV. Findings Related to the Provision of the EC Assistance since 2000

Since 2000, the European Communities have been providing the assistance on the basis of conclusions of the meeting of the European Council held in March 1999 in Berlin, where financial outlooks of the structural policy of the European Union for the 2000 - 2006 planning period were approved. The European Council approved an annual assistance amounting to EUR 3,120 million for the ten EU candidate countries, including the Czech Republic (EUR 1,560 million - PHARE, EUR 520 million - SAPARD, EUR 1,040 million - ISPA); as of the date of its accession, the relevant candidate country would stop receiving it. The European Communities determine the amount of assistance allocated to each candidate country taking into account its specific situation and conditions (e.g. its population, per capita GDP, area of agricultural land etc.).

As to the PHARE programme, the EC allocated an average sum of EUR 79 million per year to the Czech Republic. As far as the SAPARD programme is concerned, the Czech Republic and the European Commission signed an Annual Financial Agreement on February 5, 2001, according to which the financial commitment of the European Communities vis-a-vis the Czech Republic should be up to EUR 22.4 million in the year 2000. The above sum represents 4.2 percent of the total amount allocated to all the candidate countries; compared to the other candidates, it is the lowest amount in terms of per capita assistance (for example, the amounts allocated to Poland and Rumania are more than twice or three times larger, respectively), and the second lowest amount if converted to unit of area of the national territory. As to the ISPA programme, the EC made an allocation of 5.5 to 8 percent of the total to the Czech Republic, which translates into EUR 57.2 - 83.2 million a year. The actual amount depends on whether the Czech Republic is able to submit a sufficient number of projects to the European Commission for approval and to furnish the required proportion of its own funds for co-financing.

The PHARE and SAPARD programmes constitute pre-stages for the use of standard structural funds, while the ISPA programme serves as a preparatory stage for the use of the Cohesion Fund. According to the Council Directive (EC) No. 1260/99, dated June 21, 1999, which deals with the use and disbursement of structural funds between 2000 and 2006, every region requiring assistance should draft a Regional Development Plan setting forth relevant priorities. Once the Plan has been discussed, the European Commission will prepare a document called "Community Support Framework", on the basis of which countries will prepare operational plans - either sectoral, with a nationwide effect, or regional, at the NUTS II level. The Czech Republic prepared a so-called National Development Plan (hereinafter "NDP") covering its whole territory and serving as a basic programme document; the NDP sets forth, *inter alia*, reasons justifying and explaining the need of EC assistance, including

goals and targets which should be achieved. The institution responsible for drafting the NDP was the Ministry for Regional Development. In its Resolutions No. 1140, dated October 27, 1999, and No. 14, dated January 5, 2000, the Government took note of the draft NDP, which contained the following six essential priorities:

- strengthening the competitive ability of the industry and business services;
- development of basic infrastructure;
- development of human resources;
- protection and improvement of the environment;
- development of rural regions and multi-functional agriculture; and
- development of tourism, spas and resorts.

As the European Commission will sign the Community Support Framework document with the Czech Republic only after the accession of the latter to the European Union, the Czech Republic is elaborating in advance six sectoral operational plans and eight regional operational plans at the NUTS II level, using the priorities outlined above as guidelines. Since 2000, the National Development Plan and the sectoral and regional plans have become another set of source documents for the utilization of the pre-accession PHARE, SAPARD and ISPA programmes, in addition to the Partnership for Accession and the National Programme of the Czech Republic's Preparations for the Membership in the EU.

- According to Financial Memoranda of the PHARE 2000 programme, the European Commission allocated EUR 101.5 million to the Czech Republic, of which the National Programme accounted for EUR 59.0 million. Related to the National Development Plan are, for example, two regional development programmes at the NUTS II level, "Northwest" and "Ostrava Region", to which the EC has allocated a sum of EUR 8.0 million. The Government took note of these programmes in its Resolution No. 650, dated June 26, 2000.
- Based on the fifth of the NDP's priorities listed above, the Ministry for Regional Development and the Ministry of Agriculture elaborated a "Plan of the Development of Agriculture and Rural Areas for the 2000 - 2006 Period - SAPARD Programme", which the Government took note of in its Resolution No. 769, dated July 28, 1999, and which was approved by the European Commission on October 29, 1999. The Plan sets three basic priorities (improving the competitive ability of agriculture, permanently sustainable development of rural regions and areas, professional assistance), which are further elaborated into nine measures.

1. Preparations for the SAPARD Programme have been considerably delayed. The SAPARD Agency and the Ministry for Regional Development launch the programme for the year 2000 in the second half of 2001 at the earliest.

The Ministry of Agriculture established the SAPARD Agency only as of August 1, 2000, i.e. almost a year since the SAPARD Plan had been approved. The Agency is an organizational unit of the Ministry and its Managing Director is a subordinate of the Deputy Minister of Agriculture, although in the opinion of the person responsible for the PHARE CZ 9807.03.01 (Preparations for the Participation in the SAPARD Programme) it would have been better if the agency had been an independent legal entity, like its counterparts in Sweden, Austria or Ireland.

The SAPARD Agency cannot start working without an accreditation granted by the National Fund. The latter has entrusted the accreditation process to the auditing firm CAAC s.r.o.,

selected in a tender. The SAPARD Agency carried out a self-evaluation the results of which were submitted to the auditing firm mentioned above on March 15, 2001, whereupon the National Approving Officer initiated the accreditation process on March 26, 2001. CAAC is to prepare an auditor's report which the National Fund will use as a basis for granting the national accreditation. As the SAPARD Agency is a new institution, the National Fund expects to grant a so-called temporary accreditation. The SAPARD Agency and the Ministry for Regional Development will assess applications for support under the SAPARD 2000 programme only after the completion of the accreditation process, i.e. in the second half of 2001 at the earliest. Article 3 of the Annual Financial Agreement sets December 31, 2002, as the deadline for the submission of applications.

2. As to ISPA projects, the EC did not accept some of the costs claimed by the Czech Republic, and thus provided a lower financial contribution. This fact put the launching of environmental projects in the year 2001 in considerable jeopardy.

- (a) As far as environmental issues are concerned, the Ministry of Environment submitted a total of 14 projects to the European Commission in May 1999, in respect whereof it required co-financing under the ISPA Programme. Following their analysis and evaluation, the Ministry arranged preparations for four of the projects together with the EC's Framework Contractor, the firm Carl Bro of Denmark. In January 2000, the DEC notified the Ministry that it had prepared its own proposals which it had discussed with Carl Bro.

In December 2000, the ISPA National Coordinator and a representative of the European Commission signed two Financial Memoranda related to environmental projects, namely "Extension of the Sewage Collection System in Ostrava", with an allocation of EUR 16.6 million, and "Extension of the Sewage Collection System in Brno", with an allocation of EUR 17.8 million. Of the aggregate costs of both projects, which amounted to EUR 80.0 million, the European Commission did not accept EUR 26.8 million; the latter sum represented a crucial part of the costs (80 percent and 60 percent, respectively, for the construction of a multi-purpose utility trunk conduit, in which power and telecommunication lines, gas pipelines and cable TV were to be laid in addition to sewage collection piping). Had the claimed costs been accepted in full and assuming the same percentage of assistance, the ISPA contribution would have been EUR 17.5 million higher. Because of the non-acceptance, both municipalities are now struggling to raise enough funds to complete the two projects. At the same time, the tender documents presented by both cities to potential bidders anticipated the projects would commence in August and June 2001, respectively. The financing of the two projects in the year 2001 is in jeopardy.

- (b) As to the transportation sector, the Ministry of Transportation and Communications sent a total of eight projects to the European Commission in the end of 1999, in respect whereof it required co-financing under the ISPA Programme. Based on Financial Memoranda of December 2000, the EC will provide a contribution for the following projects:

- Section # 48 of the Frýdek-Místek - Dobruška high-speed motorway;
- Optimization of a railway section Ústí nad Orlicí - Česká Třebová;
- Reconstruction and upgrading of a railway section between Zábřeh and Přelouč with a total allocation of EUR 65.6 million. With respect to these projects, the European Commission did not accept claimed costs amounting to EUR 8.0 million.

3. The Ministry of Environment cannot find any practical use for another ISPA project (Technical Assistance).

The Czech Republic and the European Commission also signed a Financial Memorandum for technical assistance related to the preparation of environmental projects (water supply, sewage collection systems), with an allocation of EUR 285,000. However, the Ministry of Environment cannot find any practical use for such assistance, as relevant projects either have already been submitted to the European Commission (Municipality of Jihlava), for which an application has already been drafted (Municipality of Karviná), or whose implementation has been suspended because of unclear ownership relations (Municipality of Vrchlabí).