EU REPORT 2010

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Report on the EU Financial Management in the CR

Supreme Audit Office
Jankovcova 2
170 04 Prague 7
tel.: +420 233 045 111
fax: +420 220 808 094
www.nku.cz

Content:

Introduction

The *EU Report 2010*, in other words the third edition of the *Report on the EU Financial Management in the Czech Republic*, is a reflection of the endeavour of the SAO to present comprehensive information about financial relations in the context of the management of the EU budget from the point of view of an independent audit authority. This endeavour, grounded in the SAO's strategic goals regarding audit of finances provided to the Czech Republic from abroad, seeks to assess audit findings made at national level in the context of equivalent findings concerning the entire European Union. The main expected benefit is therefore the concentration of audit findings, statements and recommendations of the European Commission, the European Court of Auditors, and the SAO, while simultaneously assessing whether they conform or how they differ; in other words, providing objective feedback about the strengths and weaknesses of the management of EU finances in the Czech Republic.

The structure of the *EU Report 2010* is based on the model chosen for the *EU Report 2009* and therefore consists of three main chapters. The general information chapter is devoted to the EU budget and its relation to the Czech Republic. The chapter focusing on sector matters analyses the issue of revenues flowing into the EU budget from the Czech Republic and expenditure on EU policies in the Czech Republic. This chapter also contains a list of the most serious findings mentioned in approved SAO's audit conclusions and an analysis of the audit findings of the European Court of Auditors and the European Commission, which are compared to the SAO's findings. The final chapter describes SAO's activities related to the development of the legal environment as regards the EU budget and to international cooperation with bodies of the EU and Member States' Supreme Audit Institutions. The *EU Report 2010*'s content also responds to some current developments and past situations. It mentions the measures being adopted at various levels to mitigate the consequences of the economic crisis that emerged in 2009 and regarding drawdown of EU support, as well as the results of the Czech Presidency of the Council of the EU in the first half of 2009.

All relevant data contained in the *EU Report 2010* come from official sources: on the one hand from SAO's audit conclusions published quarterly in the *SAO Bulletin*, from special reports and the Annual Report of the European Court of Auditors, and from an analysis of the European Commission's findings via the National Co-ordination Authority; on the other hand, detailed data were provided by the relevant sections of the Ministry of Finance and the Ministry for Regional Development, with which the SAO has cooperated very successfully. Information concerning the implementation of the EU budget is also derived from the European Commission's official sources. The data on which the *EU Report 2010* is based apply to 2009, or to 2008 where data for the current year are not yet available. In addition, other data are presented that provide a summary picture of the past programming period (for the Czech Republic the shortened period of 2004–2006), as well as findings from the current programming period 2007–2013.

The *EU Report 2010* is intended in general for concerned experts in the Czech Republic and abroad as well as for the institutions responsible for the management of EU finances.

A. General information

A.1 Current development in the EU budget implementation and control

This chapter provides concise information about current developments in the implementation and control of the EU budget. Particular attention is paid to those matters that affect the issue of shared management of the EU budget (i.e., a budget management method under which budget implementation tasks are delegated to Member States).

A.1.1 Lisbon Treaty

The Treaty of Lisbon[1], which fundamentally amends funding treaties and thus creates a new legal framework for the working of the European Union ("EU")[2], entered into force on 1 December 2009. The Lisbon Treaty's main aims are to reform EU's institutions and decision-making procedures, strengthen its democratic legitimacy and boost the EU's role on the global stage.

The Lisbon Treaty also brings a number of changes in the area of the budget, financial management, and control. The following examples of some of the changes contained in the re-formulated *Treaty on the Functioning of the European Union* ("TFEU")[3] are:

- TFEU explicitly establishes a principle by which budget expenditure requires the prior adoption of a legally binding EU act; furthermore, it lays down a requirement that the budget must be implemented in line with sound financial management principles and that Member States and the EU cooperate to use budget finances in line with this principle.

1 Full name: "*Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community*". The Treaty of Lisbon amends three founding treaties, namely the *Treaty on European Union*, the *Treaty establishing the European Community*, and the *Treaty establishing the European Atomic Energy Community*.

2 The amended wording of the *Treaty on European Union* states that the EU replaces and succeeds the European Community. For this reason the *EU Report 2010* uses the term *European Union*, including when dealing with issues that in the past came under the competence of the European Community. The term *European Community* is only retained where it is used in the official names of older documents (e.g., legal regulations or financial statements).

3 The *Treaty on the Functioning of the European Union* is the new name for the original *Treaty establishing the European Community*.

- TFEU lays down new rules on the institute of the multi-annual financial framework, which shall take the form of a regulation in the future and not an inter-institutional agreement, as the case had previously been.
- The EU annual budget shall be approved by the European Parliament ("EP") and the Council in a special legislative procedure that affords essentially the same status to the two participating bodies; the previous system by which the EP had the last word in approving non-compulsory expenditure and the Council had the last word in approving compulsory expenditure no longer applies.
- Regular meetings between the heads of the EP, the Council, and the European Commission ("Commission") are to be convened as part of the budget process. The principal purpose of these meetings is to reach agreement between the bodies on matters concerning the EU budget.
- TFEU explicitly requires that the Financial Regulation[4] lay down for Member States a control and audit duty in implementation of the budget as well as the responsibilities that stem from this duty.
- Together with the final accounts, the Commission is obliged to submit to the EP and the Council an evaluation report on the EU finances based on the results achieved, with particular regard for the tasks the EP and the Council mentioned in connection with the granting of discharge.

Some of the above changes to the EU financial management are significant changes from the practice applied to date. In other cases, however, the Lisbon Treaty merely explicitly lays down instruments and measures that were already applied in practice but were not regulated in the founding treaties (e.g., the multi-annual financial framework or the "trialogue"[5]).

The changes to the EU's founding treaties will necessitate corresponding changes in EU legislation concerning the issue of financial management. In the future, it can therefore be expected that further changes to the EU financial management will follow on from the new rules contained in the Lisbon Treaty.

A.1.2 European Commission initiatives designed to improve financial management

A.1.2.1 Commission Action Plan towards an Integrated Internal Control Framework

The *Commission Action Plan towards an Integrated Internal Control Framework*[6] ("Action Plan") was adopted in January 2006 in response to the fact that the European Court of Auditors ("ECA") had in previous years not issued an unqualified Statement of Assurance ("DAS")[7] in respect of payments in the majority of budget areas. The Action Plan's main objective was to improve the EU budget funds' management and control system, not only at EU level but at Member State level as well.

After adopting the Action Plan the Commission began to initiate the adoption of the individual measures proposed therein. The Commission also continuously monitored the progress in the execution of these measures and their impacts. The last report on the impact of the Action Plan was issued in February 2009[8]. This report declares that the last six measures have already been completed, thus completing the implementation of the Action Plan per se[9].

A number of the measures introduced on the basis of the Action Plan have a direct impact on the financial management and control carried out at Member State level. Above all, these measures are:

- simplification of the regulatory framework in the 2007–2013 period;
- submission of annual summaries of audits and declarations;
- communication between the Commission and Member States' Supreme Audit Institutions ("SAIs");
- widening of the scope of sanctions in the EU legislation and a more vigorous approach by the Commission to recovering amounts unduly paid and imposing sanctions;
- improving the legislation on control within the framework of the shared management for the 2007–2013 period;
- issuing new instructions with regard to the management of the risk of errors in the Structural Funds.

4 The regulation lays down the details of the compilation and implementation of the budget, the submission of accounts, audit and responsibilities of participants in financial transactions.
5 Regular meetings of the Presidents of the EP, the Council, and the Commission that are convened at the Commission's instigation as part of the budget process.
6 Communication from the Commission to the Council, the European Parliament and the European Court of Auditors: *Commission Action Plan towards an Integrated Internal Control Framework*, COM(2006) 9 of 17 January 2006.
7 From the French *declaration d'assurance*.
8 Communication from the Commission to the European Parliament, the Council and the European Court of Auditors: *Impact Report on the Commission Action Plan towards an Integrated Internal Control Framework,* COM(2009) 43 of 4 February 2009.
9 The only exception is three measures that were abandoned.

The implementation of individual measures in the Action Plan and their actual impact on management and control systems was also monitored by the ECA. In this context, the ECA performed an assessment of the aforementioned Commission report on the Action Plan's impact and included the results of this analysis in its Annual Reports concerning the financial year 2008 ("ECA's Annual Report")[10]. The ECA's analysis reveals that it is too early to determine whether the Action Plan has had a measurable impact on supervisory and control systems and thus ultimately on the regularity of transactions[11].

A.1.2.2 Action Plan to strengthen the European Commission's supervisory role under shared management of structural actions

In February 2008, the Commission adopted the *Action Plan to strengthen the European Commission's supervisory role under shared management of structural actions*[12] ("Action Plan to strengthen the Commission's supervisory role"). This action plan follows up the *Action Plan towards an Integrated Internal Control System* and devotes heightened attention to the Structural Funds and the *Cohesion Fund*, as this is an area in which the ECA has repeatedly drawn attention to a high error rate. The Plan's principal objective was to strengthen the Commission's supervisory role to ensure that Member States reduce error rates in payment claims sent to the Commission. If Member States do not manage to reduce error rates in expenditure, the Commission will prevent losses in the EU budget by means of financial corrections.

The Action Plan to strengthen the Commission's supervisory role set out a total of 37 actions that were divided into 10 main areas. The actions ought to have been implemented by the end of 2008.

In February 2009, the Commission issued a report[13] on the implementation of the said action plan, stating that 28 actions had been completed by the end of 2008. The remaining nine actions therefore had to be completed during 2009. Appendix No. 2 gives an overview of the actions, along with information about whether they have been completed or have an extended deadline for completion.

Overall, the Commission states that effective implementation of the Action Plan to strengthen the Commission's supervisory role made it possible to achieve fundamental progress towards its principal objective, i.e., strengthening its supervisory role in the management of structural actions. However, the Commission simultaneously draws attention to the fact that it is still too early to measure action plan's impact on reducing the level of errors in expenditure. The impossibility of assessing its impact results from the fact that errors that have already occurred will continue to influence payments which were based on expenditure declared by the Member States and which the Commission will make up to 2010 (up to 2012 in the case of the *Cohesion Fund*).

The main consequences of the Action Plan to strengthen the Commission's supervisory role that will significantly impact on Member States included the increased intensity of the Commission's audit work and the increase in the number of financial corrections regarding past programming periods. The Commission has conducted audits of the highest-risk Managing Authorities and also completed procedures for payment suspension and financial corrections. The following Graph 1 shows the increase in the volume of financial corrections affecting the 2000–2006 programming period and applied on the basis of a Commission's or ECA's audit.

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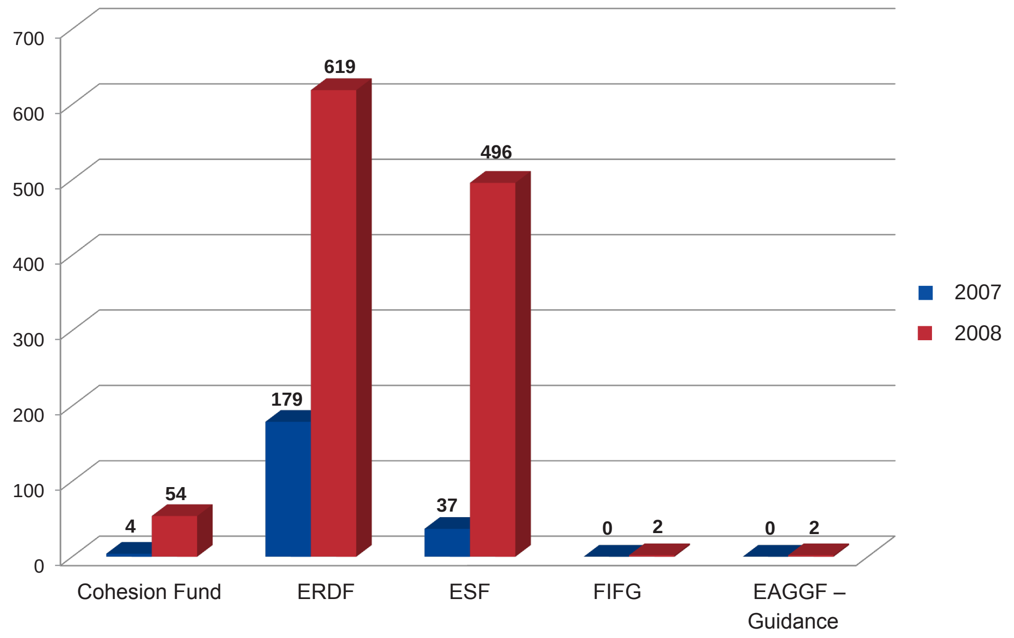
10 Annual Reports concerning the financial year 2008, ECA, 2009/C 269/1.

11 Point 2.28, ECA's Annual Reports concerning the financial year 2008.

12 Communication from the Commission to the European Parliament, the Council and the European Court of Auditors: *An action plan to strengthen the European Commission's supervisory role under shared management of structural actions,* COM(2008) 97 of 19 February 2008.

13 Communication from the Commission to the European Parliament, the Council and the European Court of Auditors: *Report on the implementation of the action plan to strengthen the European Commission's supervisory role under shared management of structural actions,* COM(2009) 42 of 3 February 2009.

Graph 1: Financial corrections made in 2007 and 2008 resulting from audits by the Commission or ECA (EUR million)



Source: Point 6.4.1.2, Annual accounts of the European Communities, Financial year 2007; Point 6.4.1.2, Annual accounts of the European Communities, Financial year 2008.

The Action Plan to strengthen the Commission's supervisory role and the progress report in respect of the Czech Republic ("CR") show that one of the Czech Managing Authorities was included in the group of audited high-risk Managing Authorities. However, the procedures for suspensions and financial corrections being completed under this action plan do not concern any of the Czech Managing Authorities. Consequently, none of the Commission's decisions regarding suspension of payments or the application of financial corrections in the context of this action plan concern the Czech Republic[14].

A.1.3 Measures adopted by the EU and the Czech Republic in response to the financial and economic crisis

During 2009, the EU authorities adopted a number of measures in response to the current financial and economic crisis. The measures to combat the crisis stem primarily from the *European Economic Recovery Plan*[15] approved by the European Council in December 2008. These measures are being implemented in various areas of the EU's competences (e.g., financial market, budget policy) and a number of them directly affect the EU budget. Examples of the adopted measures that had the biggest impact on the management of EU budget finances in Member States during 2009 are shown below. These measures mainly concerned the following areas:

New financial instruments – In July 2009, a financial instrument called the *European Energy Programme for Recovery* with a total budget of €3,980 million was launched. Projects designed to support gas and electricity infrastructure, the use of wind energy and carbon capture and storage will be financed under this instrument during 2009 and 2010. In addition, a *European 2020 Fund for Energy, Climate Change and Infrastructure* (known as the Marguerite Fund) was founded by certain public institutions (including the European Investment Bank). This fund's goal is to finance strategically important objectives of European policy and projects in the area of transport, energy, climate change, and renewables.

14 Annex 1b to the Communication from the Commission to the European Parliament, the Council and the European Court of Auditors: *Report on the implementation of the action plan to strengthen the European Commission's supervisory role under shared management of structural actions,* COM(2009) 42 of 3 February 2009.

15 Communication from the Commission to the European Council: *A European Economic Recovery Plan*, COM(2008) 800 of 26 November 2008.

Structural Funds and the *Cohesion Fund* – The EP and the Council made several changes to the legal framework of the Structural Funds and the *Cohesion Fund* designed to accelerate the implementation of Operational Programmes and the impact of investments on the economy. For example, advance payments to Member States were increased, eligible expenditure were changed, and the possibilities for reporting costs on a flat rate basis or as a lump sum were expanded. In addition, all Member States may use up to 4% of the allocation from the *European Regional Development Fund* ("ERDF") for energy-efficiency improvements and renewable energy measures in existing buildings.

European Rural Development Fund – Under the *European Economic Recovery Plan*, €1,020 million is to be released to all Member States during 2009 and 2010 for the development of broadband internet access in rural areas and to reinforce activities linked to the European Communities' ("EC") strategic objectives such as climate change and supporting use of renewables.

Changes to other financial instruments – During 2009, changes were made to existing financial instruments with a view to ensuring that they contribute more effectively towards tackling the crisis. For example, the *European Globalisation Adjustment Fund* will now provide support to workers made redundant in direct consequence of the financial and economic crisis. Furthermore, a TEN-T[16] call for proposals for trans-European transport projects with a value of €500 million has been announced.

Rules for State aid – In response to the economic crisis, the Commission defined conditions under which certain new State aid regimes could be deemed compatible with the single market, provided their aim is to remedy a serious disturbance in a Member State's economy. The Commission also introduced a simplified procedure for assessing certain types of State aid.

In the Czech context, measures to address the crisis are based mainly on the *National Anti-crisis Plan* approved by the Czech Government in February 2009[17]. This plan comprises a set of measures adopted as a response to the global economic downturn's impacts on the Czech economy. The measures deal with both public budgets expenditure and a whole series of other areas (e.g., changes in tax legislation or reducing the burden of bureaucracy on entrepreneurs). The following measures affect the management of EU finances in the Czech Republic:

- increasing sources for financing the *Rural Development Programme* and co-financing direct payments;
- fiscal impulses in support of research and development;
- support for credit for small and medium-sized enterprises;
- accelerating the drawdown of finances from the Structural Funds and the *Cohesion Fund*.

A.1.4 Summaries of audits and declarations

Member States are obliged to draw up, at an appropriate national level, summaries of audits and declarations for submission to the Commission by 15 February of the following year. These documents are drawn up both for agricultural expenditure and for expenditure on structural and other measures. The section devoted to audit summaries should summarise the main results of audits undertaken by audit or certifying bodies. The part devoted to summaries of declarations should then contain a summary declaration on behalf of the Member State regarding whether management and control systems provide adequate assurance of the regularity of expenditure. The aim of these documents is to increase Member States' responsibility for sound management of EU budget finances.

The 2008 budget year was the second year for which these summaries were drawn up. During 2009, the Commission performed an assessment of the summaries of audits and declarations issued in respect of expenditure on structural measures. This assessment shows that the majority of Member States satisfied the minimum requirements for these documents' content as laid down by the Financial Regulation.[18] However, a number of Member States failed to provide a summary declaration about the regularity of the EU financial management. Issuing this declaration is not expressly required by the Financial Regulation, but the Commission encourages Member States to do so.

16 Contraction of Trans-European Network – Transport. This instrument is intended to support the development of the trans-European transport network.

17 Government Resolution No. 204 of 16 February 2009, on *National Anti-crisis Plan*.

18 Council Regulation (EC, EURATOM) No. 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities.

For the Czech Republic, the Ministry of Finance ("MoF") sent a summary of audits and declarations regarding the Structural Funds. According to the MoF, the management and control systems satisfied *the regulatory requirements applying to them and work effectively, thus providing reasonable assurance that the reported expenditures confirmed to the Commission are correct, and consequently providing reasonable assurance that the related transactions are lawful and regular*[19]*.* The Commission's analysis indicates that this summary of audits and declarations contained all the required particulars (including a summary analysis of audit findings and a summary Statement of Assurance) and was accepted by the Commission. However, the Commission drew attention to the fact that certain discrepancies exist between the MoF conclusions and the conclusions stemming from the assessment of the management and control systems conducted by the Commission in the Czech Republic.[20]

As far as agriculture is concerned, all the Paying Agencies - including the Czech Paying Agency, i.e., the State Agricultural Intervention Fund ("SAIF") – submitted declarations that the management and control systems provide reasonable assurance regarding the legality and regularity of underlying transactions. These declarations are complemented by certificates by certifying bodies that attest to their truthfulness, completeness and accuracy. The vast majority of certifying bodies provided unqualified certification reports, thus confirming the Paying Agencies' declarations. If a Member State has more than one Paying Agency, a coordinating body[21] has to draw up annual summaries of statements of assurance and certifications. The Commission's analysis indicates that these summaries too essentially possessed all the required particulars.[22]

A.1.5 Annual Reports of the European Court of Auditors concerning the financial year 2008

The ECA is the body responsible for conducting external audit of the management of EU budget finances. Results of audits designed to verify the reliability of the European Commission's accounts and the legality and regularity of the transactions underlying the accounts are published every year in the ECA's Annual Reports. These Annual Reports contain both a Statement of Assurance and the ECA's detailed comments on individual areas of the budget. The DAS includes two types of opinions: an opinion on the reliability of the annual accounts and an opinion on the legality and regularity of the transactions underlying them.

This passage of the *EU Report 2010* focuses on the ECA's conclusions as summarised in the Statement of Assurance contained in the latest Annual Report concerning the 2008 budget year. Particular attention is paid to links between the DAS and the ECA's findings in respect of the Czech Republic. Section B of the *EU Report 2010* deals with the detailed comments on individual budget areas.

For the second year running, the ECA issued an unqualified opinion on the accounts. According to the ECA, *the Annual Accounts of the European Communities present fairly, in all material respects, the financial position of the Communities as of 31 December 2008, and the results of their operations and cash flows for the year then ended.*[23] In this context, the ECA also draws attention to the fact that weaknesses in the accounting systems, which are partly due to the complex legal and accounting framework, still put at risk the quality of financial information.

As regards the opinion on the legality and regularity of the transactions underlying the accounts, the ECA issued an unqualified opinion as regards the area of revenues and commitments for all policy groups. However, the situation in the area of payments from the EU budget remains complicated, as payments in various areas are affected by differing rates of error.

The following table summarises the results of the DAS for 2008 regarding the legality and regularity of underlying transactions by individual areas of the budget.

19 Annual summary of audits and declarations for the year 2008, MoF.
20 Annual Activity Report for the year 2008. Directorate General Regional Policy, 2009.
21 If more than one Paying Agency is accredited in a Member State, the Member State must establish a coordinating authority. This body gathers the information that is to be submitted to the Commission, presents this information to the Commission, and also supports the harmonised implementation of EU rules in the Member State.
22 Annual Activity Report 2008. Directorate General for Agriculture and Rural Development, 2009.
23 Point VII DAS, ECA's Annual Reports concerning the financial year 2008.

Table 1: The summary of 2008 DAS results on the legality and regularity of underlying transactions

Heading	Functioning of supervisory and control systems	Error range	Opinion
Revenue	green	green	green
Agriculture and natural resources	yellow	green	yellow
Cohesion	yellow	red	red
Research, energy and transport	yellow	yellow	red
External aid, development and enlargement	yellow	yellow	red
Education and citizenship	yellow	green	green
Economic and financial affairs	yellow	yellow	yellow
Administrative and other expenditure	green	green	green

Legend:

Supervisory and control system		Error range		Opinion	
green	effective	green	less than 2%	green	unqualified
yellow	partially effective	yellow	between 2% and 5%	yellow	qualified
red	not effective	red	more than 5%	red	adverse

Source: Annual Reports concerning the financial year 2008, ECA 2009, Table 1.3 and points IX-XI DAS.

A year-on-year comparison of the error rate shows that it is gradually being reduced in the individual areas of the EU budget. However, more than 50% of the EU budget continues to show an error rate exceeding 2% (i.e., the materiality threshold)[24].

The ECA findings are addressed first and foremost to the Commission, which is the principal auditee. It is above all the ECA's conclusions related to traditional own resources and areas of the EU budget subject to shared management that concern the Member States. This management method is used primarily in the *Cohesion* and *Agriculture and Natural Resources* areas. These areas account for more than 80% of EU budgetary expenditure. For the first time, the ECA issued a qualified opinion and not an adverse opinion for *Agriculture and Natural Resources*, as the error rate had fallen below 2%[25]. By contrast, the *Cohesion* remains the area that contains the most errors of all areas of the budget.

The conclusions in the *Revenue* and *Agriculture and Natural Resources* chapters of the ECA's Annual Report are based partly on findings made in audit missions undertaken in the Czech Republic[26]. The audit mission regarding budget revenues concerned traditional own resources; the audit mission regarding agricultural expenditure concerned the rural development[27].

As far as the ECA's adverse opinion in respect of the *Cohesion* is concerned, this is not based on the results of the audit missions conducted in the Czech Republic, as for the purposes of the preparation of the DAS 2008 the results of audit missions were not reflected in the passage of the ECA's Annual Report devoted to Cohesion Policy. Nevertheless, the results of ECA's audits conducted in the Czech Republic in previous years, as well as the results of audit work done by the Supreme Audit Office ("SAO"), indicate that the situation in the Czech Republic is not different from that in other Member States and that there is still room for improvement in this area (for more details see Chapter B.3 of the *EU Report 2010*).

24 For audits done for the purposes of the DAS, the materiality threshold is generally fixed at 2% of the total expenditure or total revenues of the EU budget.
25 The qualified opinion was issued mainly because of rural development expenditure, where the error rate remained above the 2% threshold.
26 Letter by Director-General for Budget of 10 November 2009, Ref. Ares(2009) 314580.
27 The audit mission concerned expenditure under the *Rural Development and Multifunctional Agriculture Operational Programme*. The outputs from this mission were reflected in the ECA's Annual Report chapter dealing with agriculture and not in the chapter on Cohesion Policy.

A.1.6 Current development in the protection of the EU's financial interests

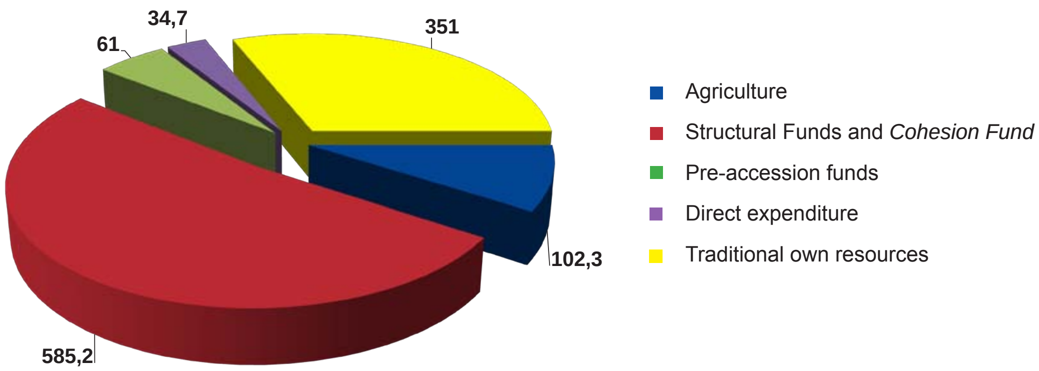
The European Union and its Member States jointly combat fraud and other illegal activities that affecting the EU's financial interests[28]. To this end, the Member States and the Commission have an obligation to prevent, detect, report, and remedy irregularities[29], including fraud[30].

There were several significant changes at the European level during 2008 and 2009 designed to contribute to more effective protection of the EU's financial interests. Above all, the following measures affect the management and control of EU budget finances involving the Member States:

- continuing preparation of institutional reform of the European Anti-Fraud Office ("OLAF")[31];
- entry into force of the Second Protocol to the Convention on the Protection of the European Communities' Financial Interests;
- launch of information databases designed to provide bodies administering EU budget finances with relevant information enabling more effective protection of the EU's financial interests[32];
- implementation of various measures of Action Plans designed to contribute to obtaining a positive DAS;
- elaboration of a joint strategy for preventing fraud in the context of structural actions.

The Commission submits an annual report on the protection of financial interests to the European Parliament and the Council every year. This report primarily contains statistics on reported irregularities and information about the quality and speed of information exchange regarding irregularities. The report for 2008[33] shows that a total of 11,939 cases of irregularities was reported in the areas of budget expenditure and traditional own resources; their estimated financial impact was €1,134 million. A year-on-year comparison shows that there was a fall in the number of communicated irregularities from 2007 and a reduction in the estimated financial impact[34]. Graph 2 shows the estimated financial impact of irregularities by areas of the EU budget.

Graph 2: Total estimated financial impact of irregularities in 2008 (EUR million)



Source: Commission Report to the European Parliament and to the Council: *Protection of the Communities' financial interests - Fight against fraud - Annual Report 2008*, COM(2009) 372 final of 15.7.2009.

28 Article 325 (1) of TFEU.
29 Irregularity means any infringement of Community law resulting from an act or omission by an economic operator which has or would have the effect of prejudicing the general budget of the Communities or budgets administered by the Communities, either in a reduction or loss of revenues from own resources collected directly for the Communities or in the form of wrongful expenditure.
30 Fraud means an intentional irregularity displaying the features of the conduct described in the *Convention on the Protection of the Financial Interests of the European Communities.*
31 From the French *L'Office européen de lutte antifraude*.
32 Above all, the exclusion database used in public procurement or the award of grants from the EU budget and the customs files identification database designed to help Member States coordinate their controls better and to detect suspicious movements of goods.
33 Commission Report to the European Parliament and the Council: *Protection of the Communities' financial interests – Fight against fraud – Annual Report 2008*, COM(2009) 372 of 15 July 2009.
34 12,144 cases of irregularities were reported for 2007, with an estimated financial impact of €1,425 million.

The Czech authorities reported a total of 185 cases of irregularities for 2008; their financial impact was estimated at a sum exceeding €20 million[35]. The highest numbers of irregularities with the biggest estimated financial impact were reported in the areas of the Structural Funds and traditional own resources. More detailed information on irregularities in the individual areas of the EU budget is given in Chapter B of the *EU Report 2010*.

A.2 The EU budget structure and its relation to the Czech Republic

A.2.1 Revenues

EU expenditure is financed mainly from "own resources". These resources are collected by Member States in the EU's name and are subsequently transferred into the EU budget.

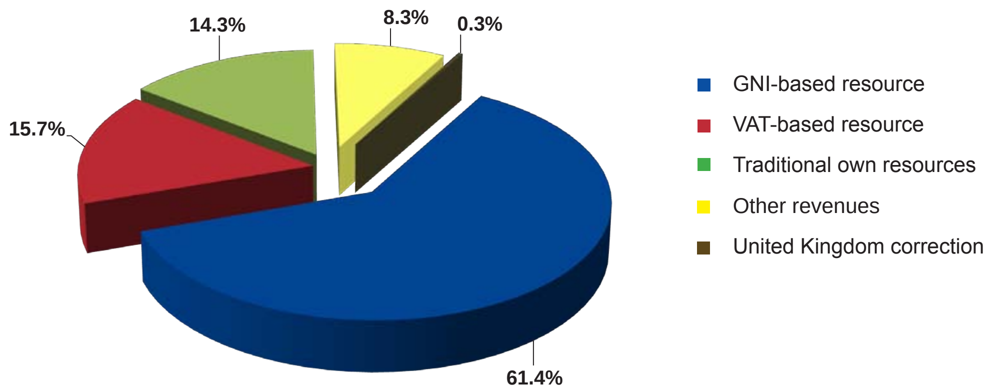
EU budget revenues include:

- **Traditional own resources** – customs duty levied on imports of goods from third countries, agricultural and sugar levies;
- **Resource based on Value Added Tax** – the same percentage rate for all Member States levied on a harmonised Value Added Tax ("VAT") base;
- **Resource based on Gross National Income** – as part of the budgetary process, the same percentage rate is levied on each Member State's Gross National Income ("GNI");
- **Other revenues** – e.g., surpluses from previous years, penalties imposed for breach of the rules of economic competition or other regulations, income tax of EU employees or contributions from third countries to EU programmes.

The level of individual Member States' contributions is also influenced by the Correction Mechanism, under which part of the United Kingdom's contribution to the EU budget is returned to it in order to correct the imbalance between the UK's share of payments to the EU budget and its share in Community expenditure. The costs of this correction is shared between other Member States.

Graph 3 shows the share of the different resources in total EU budget revenues, which amounted to €121.2 billion in 2008[36].

Graph 3: Share of the EU budget revenue in 2008



Source: European Commission – *EU budget 2008 – Financial Report*.

35 This figure includes irregularities concerning expenditure on agriculture, the Structural Funds, the *Cohesion Fund*, traditional own resources and pre-accession instruments. The figure does not include irregularities detected by the Commission among Czech beneficiaries under direct centralised management. Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15.7.2009.

36 Here we present data for the 2008 financial year, as the final figures for 2009 were not available at the time of writing.

For the 2007–2013 period, lower payments of the VAT-based resource were introduced for Germany, Austria, the Netherlands, and Sweden. In addition, a reduction of annual contributions based on the GNI was accepted for the Netherlands and Sweden; this reduction will be financed by all Member States according to their share of the Communities' GNI.[37]

A.2.2 Expenditure

The budget for 2008 adopted by the European Parliament on 18 December 2007 was compiled on the basis of the financial framework for 2007–2013. The expenditure side of the budget consists of the following six chapters:

1) **Sustainable growth** – consists of two subchapters. The first subchapter, *Competitiveness for Growth and Employment*, finances activities such as education, science and research, and the development of trans-European networks. The second subchapter, *Cohesion for Growth and Employment*, consists of finances earmarked for enhancing economic, social, and territorial cohesion. In 2008, expenditure in this chapter accounted for a total of 44% of all EU expenditure, making it for the first time the biggest single expenditure item in the EU budget.

2) **Preservation and management of natural resources** – composed of finances earmarked for agriculture, rural development, fisheries, and the environment.

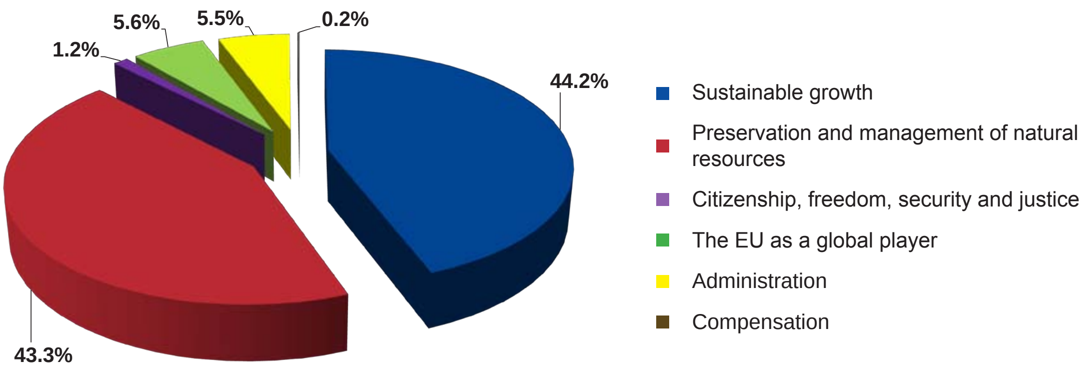
3) **Citizenship, freedom, security and justice** – also divided into two subchapters, *Freedom, Security and Justice* and *Citizenship*. The first subchapter includes expenditure on migration management, the fight against terrorism, protection of fundamental human rights, and cooperation between justice authorities. The second subchapter covers expenditure on the EU culture, consumer protection, and/or health protection.

4) **EU as a global player** – covers expenditure earmarked for EU cross-border activities (including enlargement), bilateral relations, humanitarian aid, and/or development assistance.

5) The last two chapters include expenditure on administration and temporary compensations[38].

Graph 4 below shows the structure of EU budgetary expenditure in the 2008 financial year by chapters. Total expenditure in 2008 amounted to €130.9 billion.

Graph 4: Expenditure headings of the EU budget in 2008



Source: European Commission – *EU budget 2008 – Financial Report.*

A.2.3 The EU budget in relation to the Czech Republic

Membership of the EU allows the Czech Republic to draw down funds from the EU budget and obliges it to contribute to this budget.

37 Council Decision No. 2007/436/EC, Euratom on the system of the European Communities' own resources.

38 This is temporary expenditure for the new Member States Bulgaria and Romania. These compensations are intended to ensure that these countries have a positive revenue and expenditure balance vis-à-vis the EU.

A.2.3.1 Czech contributions to the EU budget

The following table lists the contributions the Czech Republic made to the EU budget in the years 2004 to 2008.

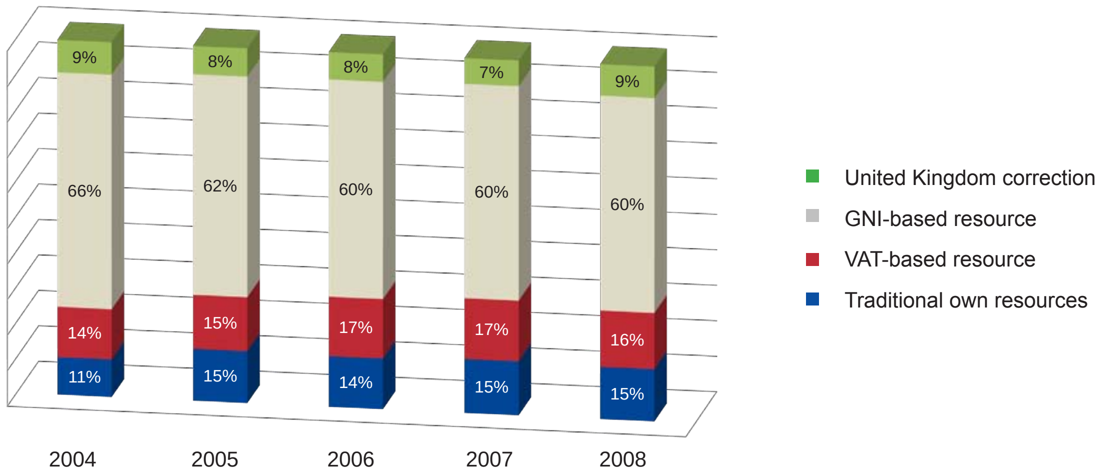
Table 2: Overview of EU budget revenues originating from the CR in 2004–2008 (EUR million)

	2004[39]	2005	2006	2007	2008	2004–2008
Traditional own resources	60.4	146.1	149.0	178.8	206.9	741.2
VAT-based resource	80.1	150.6	173.7	199.9	221.4	825.7
GNI-based resource	373.0	614.6	632.5	703.8	843.9	3,167.8
United Kingdom correction	51.6	78.8	80.1	84.4	123.7	418.6
Total	**565.1**	**990.1**	**1,035.3**	**1,166.9**	**1,395.9**	**5,153.3**

Source: European Commission – *EU budget 2008 – Financial Report.*

These contributions increase every year; in 2008, the payment amounted to more than €1,395 million, which is almost 20% more than in 2007. However, the share of the total structure of payments accounted for by the individual resources has continued to remain practically unchanged, as demonstrated by the following Graph 5.

Graph 5: Share of EU budget revenues originating from the CR in 2004–2008



Source: European Commission – *EU budget 2008 – Financial Report.*

A.2.3.2 EU budget expenditure for the Czech Republic

In 2008, the Czech Republic obtained its highest sum yet from the EU budget, specifically €2,441.1 million. The rate of growth is also very high, amounting to more than 12% compared to 2007, see Table 3 below. This fact is mainly linked to the end of the 2004–2006 programming period and the receipt of advance payments for the 2007–2013 programming period.

Table 3: Finances provided to the CR from the EU budget in 2004–2008 (EUR million)

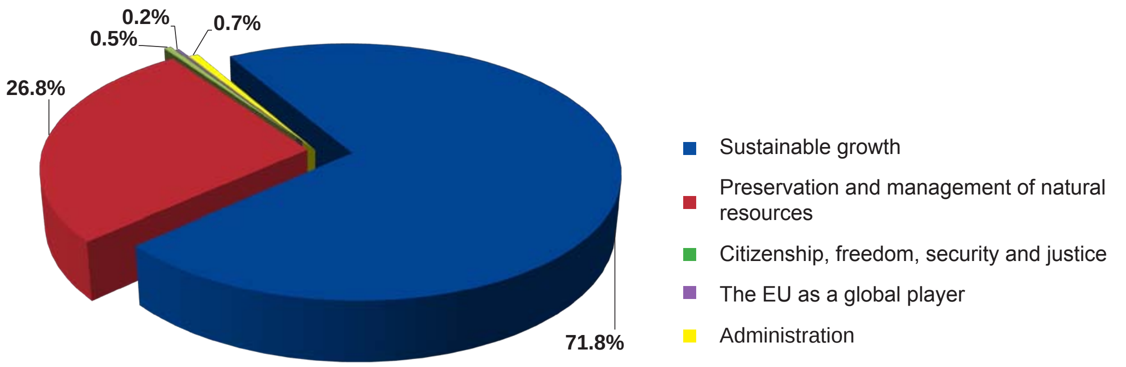
Year	2004	2005	2006	2007	2008	2004-2008
Total	815.8	1,074.9	1,330.1	1,721.0	2,441.1	7,382.9
Annual growth in %	x	31.8	23.7	29.4	41.8	x

Source: European Commission – *EU budget 2008 – Financial Report.*

39 Lower contribution in 2004 is caused by the fact that the Czech Republic acceded the EU as lately as on 1.5.2004.

The following Graph 6 shows that the biggest share of expenditure falls to the *Sustainable growth* chapter, under which Cohesion Policy takes place and which accounts for almost 72% of all expenditure. That is followed by the Common Agricultural Policy ("CAP"), which takes up more than 26% of all expenditure provided to the Czech Republic. Payments made in the context of these policies account for over 98% of all expenditure.

Graph 6: Share of EU budget expenditure in the CR in 2008

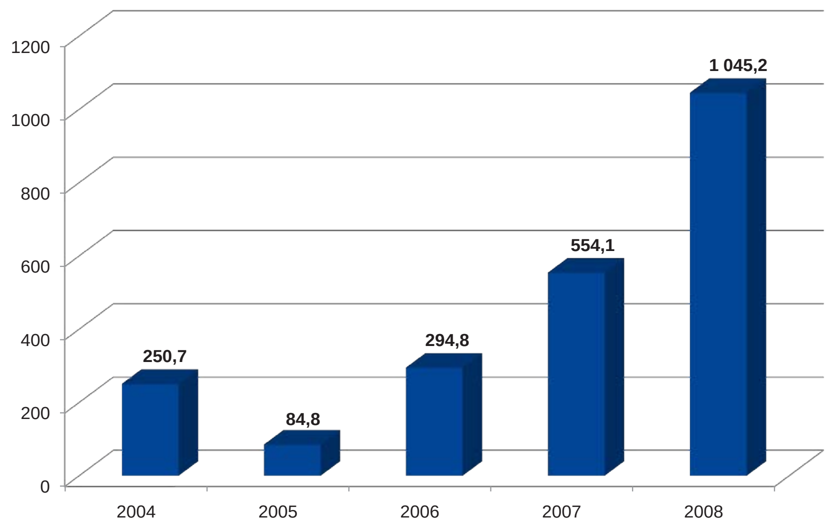


Source: European Commission – *EU budget 2008 – Financial Report.*

A.2.3.3 The Czech Republic's net position

The Czech Republic is one of the Member States whose revenue obtained from the EU budget exceed their payments; it therefore continues to be a net recipient. Graph 7 below shows the development of the Czech Republic's net position in the years 2004–2008.

Graph 7: Net position of the CR in 2004–2008 (EUR million)



Source: European Commission – *EU budget 2008 – Financial Report.*

In total, the Czech Republic has paid €5,153.3 million into the EU budget and obtained €7,382.9 million from its accession to the EU to 2008. The Czech Republic's overall net position is thus €2,229.6 million. In 2008, the value of the Czech Republic's net position was almost double that of 2007 (see Graph 7); according to data from the MoF published in January 2010, the net position for 2009 attained a record value of EUR 1,600.2 million, or CZK 42.3 billion[40]. This development is caused by the fact that the Czech Republic's drawdown from the EU budget is increasing at a faster rate than its payments into the EU budget.

40 Conversion based on the Czech National Bank's average 2009 exchange rate of CZK/EUR 26.445.

B. Sector matters

B.1 EU budget revenues

B.1.1 Measures to improve the fight against VAT fraud in the EU – current development

Proper collection of VAT is one of the essential requirements for the correct working of the EU's internal market. Combating VAT fraud is therefore a priority that has received considerable attention in recent years. The importance of this fight is borne out by, among other things, the conclusions of a study[41] published by the Commission in October 2009, in which an external contractor attempted to determine the gap between the amount of VAT due and the amount actually collected in 25 EU Member States between 2000 and 2006. Based on its analysis of the available data the contractor reached the conclusion that the estimated loss per year in uncollected VAT for this period was €90 to 113 billion, representing 12% of the theoretical VAT liability. The Czech Republic's VAT gap for 2006 was estimated at as much as 18%.

Since the effective working of instruments in the fight against fraud cannot be ensured unless they are applied in concert and simultaneously throughout the EU, the responsible authorities of the EU have adopted various measures to modify the existing framework. This is a long-term process.[42] The measures proposed in 2009 were based mainly on the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on a coordinated strategy to improve the fight against VAT fraud in the European Union* from December 2008[43]. This Communication contained an Action Plan of short-term measures intended to make cooperation between tax administrators more effective.

41 *Study to quantify and analyse the VAT gap in the EU-25 Member States*, DG Taxation and Customs Union, 2009.
42 A basic overview of activities performed in the years 2006 to 2008 is found in Chapter B.1.1.3 of the *EU Report 2009*.
43 Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on a coordinated strategy to improve the fight against VAT fraud in the European Union*, COM(2008) 807 of 1 December 2008.

Since the Communication was published, proposals have been submitted for amendments to the Directive on the common system of VAT[44], for example. The first proposal consisted in harmonising the conditions for exemption from Value Added Tax in the case of import of goods, if the import is followed by the supply or transport of such goods to a taxable person in another Member State[45] and in the introduction of penalties on suppliers amounting to the lost VAT if it contributed to the VAT loss by failing to report its delivery (or by reporting it late or reporting incorrect or incomplete data) to the responsible authority. The other submitted proposal concerned invoicing rules. Its aim was to increase the use of electronic invoicing in everyday practice in order to reduce the administrative burden on business.[46] However, this proposal had not been approved by the end of October 2009 and on the occasion of the publication of an overview of progress to date the Commission urged the EP and the Council to adopt the proposed measures[47].

Other activities undertaken in 2009 include the submission of a reworked proposal to amend the rules on administrative cooperation in the area of VAT[48]. According to this proposal, the aim of improving the quality of administrative cooperation and making the fight against VAT fraud more effective should be achieved through the following measures:

- automated exchange of selected data concerning the identification of taxable persons and their activities in another Member State;
- common minimum standards for the registration and de-registration of taxable persons in the VIES[49] database to prevent potential fraud by abuse of VAT identification numbers;
- creation of a EUROFISC network, which would help improve cooperation between the responsible authorities in order to detect fraudsters at an early stage. At a later stage, this network would also set up a risk analysis mechanism for intra-Community transactions[50]. The Council approved the creation of EUROFISC on 7 October 2008, simultaneously specifying the basic principles the network would abide by.
  The model for EUROFISC is the already operational system of quick and targeted information exchange – EUROCANET – developed by the Belgian tax administration in collaboration with other Member States and with support from the Commission and OLAF. Member States' participation in this system is voluntary, however[51]. At the end of 2008, the EP identified the fact that three large Member States (Germany, Italy, and the United Kingdom) did not participate in EUROCANET as a weakness of this system[52]. This weakness should be remedied by the creation of the compulsory EUROFISC network.

Similarly, the conclusions of another Commission report[53] bear out the need for future modifications to the existing working of administrative cooperation between the responsible authorities in the fight against VAT fraud. Its results are not different from the conclusions of previous studies (e.g., ECA Special Report No. 8/2007 concerning administrative cooperation in the field of value added tax mentioned in the *EU Report 2009*). The report states that although the legislative amendment made in 2004 introduced increased possibilities for the fight against fraud, administrative cooperation between Member States to prevent VAT fraud is still insufficient. It also draws attention to the need for increased cooperation efforts by the Member States' responsible authorities (faster replies to requests for information, more intensive sharing of information without prior request, more frequent presence of officials in enquiries in another Member State, increased use of the other possibilities offered by the existing legislation, etc.). The most alarming fact is therefore that the identified shortcomings keep being repeated, indicating the possibility that at Member State level the fight against VAT fraud is not receiving the level of attention and effort it deserves.

44 Council Directive 2006/112/EC on the common system of value added tax.
45 Introduced by Council Directive 2009/69/EC amending Directive 2006/112/EC on the common system of VAT as regards tax evasion linked to imports. The directive is applicable from 1 January 2011.
46 This proposal, based on giving electronic and paper-based communication the same status, is also one of the Commission's key initiatives for reducing bureaucracy in enterprise by 25% by 2012.
47 Press release IP/09/1562 of 22 October 2009.
48 Council Regulation (EC) No. 1798/2003 on administrative cooperation in the field of value added tax and repealing Regulation (EEC) No. 218/92.
49 Abbreviation of *Value Added Tax Information Exchange System* – this is a system for information exchange between Member States concerning on the VAT attached to transactions between economic operators from EU Member States.
50 Submissions effected in the context of the EU internal market.
51 24 Member States, including the Czech Republic, participate in the system.
52 European Parliament resolution of 4 December 2008 on the European Court of Auditors' Special Report No. 8/2007 concerning administrative cooperation in the field of value added tax.
53 Report from the Commission to the Council and the European Parliament on the application of Council Regulation (EC) No. 1798/2003 concerning administrative cooperation in the field of value added tax, COM(2009) of 18 August 2009.

B.1.2 SAO's audit work in the field of the collection and administration of VAT

Since the Czech Republic's accession to the EU, scrutiny of VAT administration is an area of the SAO's long-term interest. In previous years, for example, a parallel audit of this issue was carried out with the SAI of the Federal Republic of Germany; and in 2008 a report[54] was published containing a list of findings and recommendations. The findings essentially correspond to the opinion of the Commission and the ECA on the situation regarding cooperation in the administration of VAT. Both SAIs also agreed that a follow-up parallel audit would be performed in 2009 in order to check how selected cases of intra-Community transactions were resolved and whether and how the responsible authorities took into account the submitted recommendations. The most important areas scrutinised in this audit[55] were the following:

a) registration for VAT

The first parallel audit detected problems in tax procedures in the field of intra-Community transactions caused by different rules for registering VAT payers in the Czech Republic and in Germany. As these rules differ in all EU Member States, it was recommended to unify the rules at EU level. Certain common minimum criteria were indeed adopted subsequently at EU level.[56] Moreover, as regards the registration of VAT payers, new legislation[57] was adopted in the Czech Republic with a view to eliminating problems with the time limit for de-registration of VAT payers. That is because it had been found that the tax authorities often did not de-register "not established"[58] payers even though these payers were not discharging their duties under law and should therefore be de-registered, because the original legal provision did not specify a sufficiently long timeframe.

b) submission of recapitulative statements on intra-Community deliveries of goods

Based on the findings made during the first parallel audit, a recommendation was made to shorten the time limit in the EU for filing recapitulative statements on deliveries of goods to other EU Member States to one month so that checks of individual tax cases could begin sooner. This change was in fact introduced[59] in the EU, necessitating the corresponding adjustments to national legislation. This took place in the Czech Republic by an amendment effective as of 1 January 2010[60]. This amendment also implemented another EU directive[61]. Now recapitulative statements will have to be filed in electronic form only and will have to be filed even if intra-Community services are provided to a person registered for tax in another Member State, provided the recipient of the goods is obliged to declare and pay tax on the services.

c) checking selected cases of intra-Community transactions

A follow-up audit found that the majority of the tax procedures in the selected cases of intra-Community transactions that were still ongoing during the time of the previous audit had been completed. In certain cases, an additional declaration of acquisition of goods was lodged or an additional assessment of VAT was made, but one case was also found where the difference in the values of acquired goods had not been clarified. The values in the additional VAT declarations filed by the Czech taxpayer were not consistent with the data in the recapitulative statements filed by the German taxpayer; under international information exchange it was only possible to clarify the differences in values exceeding the specified limit of €15,000. It was also found in Germany that when values in VAT declarations filed by German taxpayers were corrected on the basis of the results of tax proceedings, the relevant values of deliveries of goods in recapitulative statements were not corrected, as the German tax authorities had no way themselves of correcting errors in filed recapitulative statements. Even though this finding had already been made in the preceding parallel audit, no changes were made in this area in Germany. The consequence of the existing state of affairs is that out-of-date data concerning deliveries of goods from certain taxpayers from Germany remain in the VIES system.

54 *Report on the Results of the Parallel Audit of the Administration of Value Added Tax in the Czech Republic and in the Federal Republic of Germany*, accessible at http://www.nku.cz.
55 Audit No. 09/11, SAO Bulletin 2/2010.
56 Proposal for a Council Regulation on administrative cooperation and combating fraud in the field of value added tax, COM(2009) 427 of 18 August 2009.
57 Act No. 302/2008 Coll., amending Act No. 235/2004 Coll., on value added tax, as amended.
58 These are payers that do not have a seat or place of business in the Czech Republic.
59 Council Directive 2008/117/EC amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions.
60 Act No. 489/2009 Coll., amending Act No. 235/2004 Coll., on value added tax, as amended.
61 Council Directive 2008/8/EC amending Directive 2006/112/EC as regards the place of supply of services.

d) eliminating the biggest weaknesses in the risk management system by introducing uniform criteria, components, and approaches in each EU Member State

As mentioned above, the EU's responsible authorities are pushing for the establishment of a single network (EUROFISC) to improve cooperation between Member States' tax administrations; this network could later become a source for risk assessment within the EU. That is because it is very difficult to identify the impacts of tax procedures on VAT without coordinated cooperation when investigating transactions involving an entity that does not communicate with the tax administrators. When investigating high-risk transactions, especially in connection with investigations involving "missing traders", tax administrators have limited possibilities and it is difficult to prove fraudulent conduct in a tax entity involved in transactions that cut across several states by physically inspecting documents alone. Even though some Member States do not participate or participate only passively, the functioning EUROCANET system may be an important source of information of high-risk transactions. The Czech Republic became an active member of this system in the first quarter of 2008 and the parallel audit therefore focused on scrutinising how the Czech administrative authorities performed tasks related to participation in this system. It was found that transactions recorded in the system and concerning Czech tax entities are scrutinised by tax administrators in the Czech Republic. However, shortcomings were found in the quality of this work and in the drawing of conclusions from the conducted enquiries. In some cases, for example, VAT payers were only de-registered a long time after they had failed to discharge their duties; information about the assets of high-risk taxpayers was not ascertained in good time and in sufficient scope; the option of administrative cooperation in the field of VAT was not used; or the further movement of goods from incoming high-risk transactions was not tracked.

e) international assistance in recovering claims

The aim of the audit in the field of the recovery of claims was to check how successful international assistance has been in this process. In the Czech Republic, it was found in this regard that in the audited period of 2006-2008 the appropriate authority handling international cooperation, i.e., MoF, sent requests for international assistance in recovery of claims to foreign tax administrations in inordinately long time after receiving the request from the relevant Czech tax administrator. Nor was the situation any better in the case of requests sent to the Czech Republic. In 88.5% of the cases scrutinised, the legally defined six-month time limit for informing the requesting body of a foreign State was not complied with. In extreme cases, based on the requests from other states the appropriate tax administrator was charged with recovering claims a year and a half after receipt of the request was confirmed. In some cases, this fact had a negative influence on the outcome of debt collection in the Czech Republic. The results of claims recovery were also influenced by the fact that some taxpayers possessed almost no assets or could not be contacted. Consequently, only nine of the entire number of claim recovery requests obtained from other countries were fully recovered (i.e., 9.4%) and fourteen partially (i.e., 14.6%) and in five cases the taxpayer was paying off the debt in instalments. Out of eighteen claim recovery requests sent from the Czech Republic to other countries, the claim was partially recovered in just two cases (11.1%).

These findings correspond to the conclusions of Report[62] on the use of legal provisions on mutual assistance in the recovery of claims. According to information obtained from EU Member States, the global recovery ratio for recovery requests is estimated at just 5%. In this regard, the SAO agrees with the opinion expressed in this Report that recovery instruments have to be strengthened at national level and that at EU level mutual recovery assistance must be reinforced.

f) payments in cash

The follow-up audit identified cases in the Czech Republic where a taxpayer paid its commitment to a foreign company based in the EU in cash over the limit laid down by the Czech legislation[63] and did so by paying the commitment when taking receipt of goods in a different EU Member State. This obviates the purpose of this legislation, which is to combat the legalisation of the proceeds of crime and reduce tax evasion. Cash payments made in connection with tax evasion, e.g., on excise duty and VAT, can still take place on the EU's common market. In this context, the SAO recommends initiating the creation of uniform rules on this issue at EU level. Without a uniform solution the national rules on cash payments will not deliver the intended effect.

62 Report from the Commission to the Council and the European Parliament *on the use of the provisions on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures in 2005-2008*, COM(2009) 451 of 4 September 2009.

63 Act No. 254/2004 Coll., on the restriction of cash payments and amending Act No. 337/1992 Coll., on the administration of taxes and fees, as amended.

It is clear from the list of findings that SAO's audits led it to similar findings, even though at national level only, as those detected by the ECA or the Commission in the fight against VAT fraud. The SAO shares the view of the necessity for reinforcing administrative cooperation between the responsible authorities when prescribing and collecting VAT in certain areas and its recommendations for improving the current situation are also consistent with the submitted proposals for amendments to EU legislation. Specifically, these recommendations are that a centre for the coordination of scrutiny of high-risk transactions, covering taxpayers from several EU Member States, should be set up; that international cooperation in the recovery of claims should be improved; and that the rules of registration for VAT should be improved and unified. The findings, recommendations, and assessments of the follow-up parallel audit will be set out in a joint report of the SAO and German SAI due for publication in the middle of 2010.

B.1.3 ECA's audit mission focusing on traditional own resources

At the end of 2008, the ECA conducted an audit in the Czech Republic for DAS 2008 concerning traditional own resources. The audit took place at bodies of the Customs Administration of the Czech Republic and MoF and encompassed:

- a check of accounting systems used for recording and aggregating established claims;
- a check of "B accounts"[64] maintained by Member States;
- an assessment of the effectiveness of control systems used by the Customs Administration.

The audit was performed on a sample selected from a list of import declarations issued in May 2008. The audit revealed various shortcomings in the procedure of selected cases on "B accounts" and in the work of the Czech customs authorities. Most of the shortcomings were classified by the ECA as findings with a financial impact or potential financial impact and the ECA recommended that the Czech authorities adopt appropriate measures to remedy the audit findings detected.

Based on audits conducted in the Czech Republic, Greece, and the Netherlands the ECA subsequently formulated the conclusion in the *Revenue* chapter of its Annual Reports for 2008 that *supervisory and control systems for customs and for traditional own resource accounting were functioning well*[65]. However, as in previous years, there are problems affecting amounts included in the "B accounts" which, while not sufficiently material to affect the overall conclusion, should be remedied. Specifically, these problems are delays in the establishment and recovery of duties and fees in cases where the customs authorities were already aware of the amounts due and the identity of the debtors, and shortcomings in the national instructions to estimate the amount of debts whose recovery is unlikely.[66] The completed questionnaire sent to the national authorities regarding the findings referred to in the ECA's Annual Report and affecting their countries shows that in the Czech Republic the responsible authorities have already adopted measures to remedy these shortcomings. In the first case (delayed establishment of duties) the remedy should take the form of repeated notification of the responsible authorities of the applicable wording of the internal regulation; in the second case the corresponding internal management document was changed in February 2009.

B.1.4 Protection of the EU's financial interests in the EU budget revenues area

All Member States bear the responsibility for ensuring that the EU has access to traditional own resources and must use all the available means to fulfil this obligation. It has long been the case, however, that the obligation to pay in the established own resources has been successfully discharged by Member States, as more than 95% of legitimate claims are recovered without problems and made available to the Commission. In the remaining cases, Member States are obliged to recover the amounts owed and to take action against irregularities and fraud. Member States can escape the obligation to pay in the established claims only if they can prove that these claims are irrecoverable, either because of *force majeure* or for reasons that cannot be attributed to the Member States.

If the amount of a requested debt write-off exceeds €50,000, Member States are obliged to report these cases to the Commission.[67] An increased number of requests for debt write-offs were registered in 2008 than in 2007. This was evidently caused by the legislative change made in 2004, whereby a five-year time-frame was introduced

64 "B accounts" are used for claims that are not secured or are challenged and where the amount of the claim may change after the arisen disputes are resolved.
65 Point 4.13, ECA's Annual Reports concerning the financial year 2008.
66 Point 4.14, ECA's Annual Reports concerning the financial year 2008.
67 If the amount is lower, it is reported only in response to a special request by the Commission.

within which a Member State had to provide the Commission with information on an amount of traditional own resources deemed irrecoverable. In 2008, 589 debt write-off requests[68] worth a total of €188.76 million were lodged. In that year, the Commission processed 465 requests, in most cases asking the Member States to submit additional information (64.3% of cases) and rejecting some requests (6.88% of cases). Based on the rejected requests, Member States additionally paid over €14 million in 2008. Other finances (over €70 million) were then transferred into the EU by Member States up to 2008 on the basis of administrative errors committed by these States when establishing eligible claims. Both these additional payment mechanisms should encourage Member States to perform their duties better when administering and collecting traditional own resources.

The obligation for Member States to report cases of irregularities and fraud in the case of traditional own resources is laid down if the financial magnitude of an irregularity or fraud exceeds €10,000. The data in the database of reported irregularities change in line with the course of investigations into the detected irregularities. At the time when the Report on the protection of the EU's financial interests and the fight against fraud in 2008 was being written, the number of reported irregularities for 2008 was lower than in the previous year and, similarly, their total financial volume should also be lower (12.5% lower in both cases). In total, 5,344 irregularities or cases of fraud worth a total of €351.6 million were reported in 2008. The most frequent detection method continues to be checks (including both on-the-spot audits and audits of documents) performed by the Member States' responsible authorities.

The trend of the growing number of irregularities reported by Member States that joined the EU in 2004 ("EU-10") stopped. The following table shows the development in the number of irregularities reported by the EU-10 in 2007–2008.

Table 4: Overview of cases reported through OWNRES in 2007–2008

Member State	2007		2008		Change cases 2007 – 2008	Change amount 2007 – 2008	Recovered from 2008
	Cases	Amount (in €)	Cases	Amount (in €)			
Cyprus	11	750,964	14	787,523	27.27%	4.87%	17.03%
Czech Republic	**50**	**2,290,130**	**64**	**5,025,048**	**28.00%**	**119.42%**	**25.71%**
Estonia	12	423,140	17	1,358,643	41.67%	221.09%	30.30%
Hungary	69	6,265,722	64	5,852,076	- 7.25%	- 6.60%	51.07%
Lithuania	41	1,283,365	57	1,544,550	39.02%	20.35%	44.59%
Latvia	40	2,253,690	25	944,415	- 37.50%	- 58.09%	7.8%
Malta	10	404,949	3	449,940	- 70.00%	11.11%	4.52%
Poland	159	8,492,588	142	5,609,503	- 10.69%	- 33.95%	32.66%
Slovenia	27	1,579,108	26	915,631	- 3.70%	- 42.02%	67.00%
Slovakia	21	1,263,418	12	469,810	- 42.86%	- 62.00%	50.35%
Total	**440**	**24,980,074**	**424**	**22,957,139**	**- 3.64%**	**- 8.10%**	**36.11%**

Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15.7.2009

B.2 EU Common Agricultural Policy and Common Fisheries Policy

B.2.1 Czech Presidency of the EU Council

The foundations of the EU's Common Agricultural Policy were laid in 1957; since then, the principles of its working have changed considerably. A basic overview of the adjustments made up to the "Health Check"[69] in 2007 and the agreement on modifications to the CAP for the 2009–2013 period adopted in November 2008 was given in previous

68 In 2007 there were just 100 requests.
69 This initiative assessed the current functioning of the CAP.

editions of the *EU Report*. TFEU already differentiates between the Common Agricultural Policy and the Common Fisheries Policy.[70]

The Czech Presidency of the Council of the EU in the first half of 2009 based its work programme on the continuity of the policies. It defined as its priority for agriculture the attainment of progress in attempts to resolve the fundamental problems and imbalances in the existing CAP instruments, with particular regard to its future functioning.

For instance, in the field of direct payments, the Czech Presidency continued with the discussion on their form after 2013 in an attempt to find the kind of instruments of its future working that would lead to more effective spending of funds and to European agriculture being more competitive. Equal conditions for all EU Member States should be an essential prerequisite for achieving this objective; that means equal conditions in the level of direct payments and also in the actual disbursement system, which will respect the diversity of agriculture in individual Member States.[71] The differences in national specifics should also be taken into account in the new definition of "less favoured areas ("LFAs") in the context of Rural Development Policy. The Czech Republic is in favour of a definition based on biophysical criteria unified at EU level, but deems it necessary to enable Member States to define the specific rules to prevent drastic changes in delimitation of LFA.[72] Other key segments of the Czech Presidency's agenda in agriculture were forestry; simplification of the CAP; Common Fisheries Policy; and Foodstuffs Quality Policy.

A number of discussions and expert-level meetings were held regarding the selected topics. The conclusions of the Agriculture and Fisheries Council (approved in May and June 2009) and the approved legislative proposals are testimony to the successful achievement of the Czech Presidency's goals. Specifically, these include the confirmation of the Council's commitment to reduce bureaucracy by 25% by 2012 and the expression of support for the necessity of evening out the level of direct payments between Member States.

B.2.2 Implementation of the Common Agricultural Policy in the Czech Republic

B.2.2.1 Basic framework for the implementation of the Common Agricultural Policy in the Czech Republic

There were no changes to the CAP implementation structure in the Czech Republic in the past period. In 2008, the Czech Republic received CZK 28,894 million under the CAP; of that amount the national share was approx. CZK 9,362 million and EU co-financing approx. CZK 19,532 million. The following table shows expenditure in individual sectors of the CAP.

Table 5: Overview of SAIF funds paid out for the main areas of the CAP in the CR in 2008 **(CZK thousand)**

Type of expenditure	CR	EU	Total
Direct payments	5,592,167	11,125,822	16,717,989
Common Market Organisation	2,011,437	1,727,743	3,739,180
Rural Development Programme	1,124,429	4,187,811	5,312,240
HRDP	623,361	2,483,112	3,106,473
Promotion of honey consumption	294	734	1,028
Promotion of organic farming	10,480	7,594	18,074
Total	**9,362,168**	**19,532,816**	**28,894,984**

Source: Annual Report of the SAIF for 2008.

Unlike in previous years, this table also includes expenditure on promoting honey consumption (the programme, implemented in the years 2006–2008, was co-financed by the Czech Beekeepers Union as well as by the Czech and EU budgets) and spending on promoting organic farming (the programme runs from 2008 to 2010). The aim of these promotional programmes financed from EU joint funds is to improve the marketing and sales of selected agricultural and food products of individual Member States both on the common market and on third-country markets.

70 Under this Treaty, any references to the CAP or agriculture and use of the term "agricultural" also apply to fisheries.
71 *Work Programme of the Czech Presidency*, Europe Without Barriers, 2009, p.15.
72 Document *Czech Republic's Presidency of the Agriculture and Fisheries Council*, Ministry of Agriculture, 2008.

The following table shows a breakdown of the finances paid out in the biggest heading of CAP by volume – direct payments – in 2008.

Table 6: Overview of SAIF funds paid out for direct payments in 2008 in the CR (CZK thousand)

Direct payments	CR	EU	Total
SAPS	0	10,412,436	10,412,436
Separate Sugar Payment	0	672,589	672,589
Top-Up	5,592,167	0	5,592,167
Energy crops	0	37,757	37,757
Instalment of credit for direct payments	0	3,040	3,040
Total	**5,592,167**	**11,125,822**	**16,717,989**

Source: Annual Report of the SAIF for 2008; MoA – document *Agriculture 2008.*

The table reveals that the simplified system of direct payments, the Single Area Payment Scheme ("SAPS") is still applied in the Czech Republic. Moreover, the amount of funds provided to support beneficiaries from EU sources under this system is to a large extent topped up to the level of direct payments in EU States that joined before 2004 ("EU-15") from national resources ("Top-Up").

B.2.2.2 Horizontal Rural Development Plan and *Rural Development Plan*

The last funds from the *Horizontal Rural Development Plan* ("HRDP") programme were paid out to final beneficiaries at the end of March 2008. The Czech Republic thus drew down the full amount of finances allocated to HRDP by the EU for the 2004–2006 programming period. Since 28 March 2008, payments of support for the remaining eligible claims have been made out of the *Rural Development Programme* ("RDP"), which follows on from the HRDP and whose rules allow such payments. A total of CZK 3,106 million was spent on the HRDP in 2008, CZK 623 million of which was from the Czech Republic's budget and CZK 2,483 million from the EU budget.

The following table gives an overview of the total amounts spent on the RDP in 2008.

Table 7: Overview of funds paid out for RDP in 2008 (CZK thousand)

Axis	CR	EU	Total
Axis I – Improving the competitiveness of agriculture and forestry	195,375	586,123	**781,498**
Axis II – Improving the environment and landscape	813,018	3,251,898	**4,064,916**
Axis III – Quality of life in rural areas and diversification of rural economy	112,821	338,463	**451,284**
Axis IV – LEADER	1,683	6,730	**8,413**
V. Technical assistance	1,532	4,597	**6,129**
Total	**1,124,429**	**4,187,811**	**5,312,240**

Source: Annual Report of the SAIF for 2008.

Out of the many diverse RDP measures, the greatest single volume of finances was paid out for Agri-environmental measures ("AEMs") and LFAs (both measures are part of Axis II) and *Modernisation of Agricultural Holdings* (Axis I) and *Village Renewal and Development, Public Amenities and Services* (Axis III).

B.2.3 Implementation of the Common Fisheries Policy in the Czech Republic

In the 2007–2013 period, the Common Fisheries Policy has been implemented using resources from the newly established *European Fisheries Fund* ("EFF"). Its principles and objectives are implemented in the Czech Republic through the Operational Programme ("OP") *Fisheries 2007–2013* approved by the Commission on 11 December 2007. This programme defines specific instruments for ensuring the competitiveness of Czech fisheries through the use of traditional production systems with environmentally friendly methods, while maintaining or increasing employment.

The total level of support from the EFF for the 2007–2013 period is fixed at €27.1 million. The first call for proposals was published in 2008; it concerned only Axis II. In November 2008, the project control and assessment process was completed and a decision was made to provide grants worth CZK 53.8 million, CZK 40.3 million of which out of EFF resources and CZK 13.5 million from Czech public funds. The first disbursement of finances to final beneficiaries under this programme had therefore not taken place by the end of 2008.

B.2.4 Audits in the field of the Common Agricultural Policy and the Common Fisheries Policy

B.2.4.1 Annual Reports of the European Court of Auditors concerning the financial year 2008

Chapter *Agriculture and Natural Resources* of the ECA's Annual Report informs about the results of testing a representative statistical sample of 204 transactions covering all expenditure in agriculture and rural development, the environment, fisheries, maritime affairs, health and consumer protection, and an assessment of the supervisory and control system. Based on the audit, the ECA reached the conclusion that the estimated error rate for the 2008 financial year was slightly below the 2% materiality threshold for payments in this group of policies. Rural development expenditure continued to display more errors than expenditure from the *European Agricultural Guarantee Fund* ("EAGF") – most notably spending on direct payments and Common Market Organisation. However, the estimated error rate in rural development spending was also lower than in previous years.[73] Most of the assessed supervisory and control systems were found to be partially effective.[74]

Supervisory and control systems

The ECA scrutinised the reliability of supervisory and control systems related to claims under the EAGF both for SAPS and the single payments scheme ("SPS") and for rural development expenditure. Two audit missions were undertaken at the Czech Paying Agency for DAS 2008 purposes - the first in respect of SAPS and the second of rural development. The Czech Republic is only mentioned specifically in the ECAS´s Annual Reports in the context of rural development spending, however.

The regularity of transactions in agriculture and rural development has been still ensured through the Integrated Administration and Control System ("IACS"). This system primarily covers payments from the EAGF. In the case of payments from the *European Agricultural Fund for Rural Development* ("EAFRD"), the IACS system only covers certain basic elements of these payments; others are covered by specifically designed controls. As the test results indicate that IACS is an effective control system, its limited use for EAFRD payments may have a negative influence on the overall error rate found with this fund. Because of the increased error rate in EAFRD payments, the ECA therefore urged again the responsible authorities to make greater efforts to ensure beneficiaries fulfil their obligations. Similarly, attempts to simplify the rules and conditions of support should also go ahead.

Despite the effectiveness of the IACS, the ECA repeatedly drew attention to the need to ensure precise records of reported areas and claims, in particular by ensuring the created databases are reliable. It will also be necessary to tighten the rules for payments of direct support so that this support is not paid to applicants who neither used land parcels for farming nor maintained them in good agricultural and environmental condition.[75]

With specific regard to the Czech Republic, the ECA detected weaknesses in the establishment of samples of beneficiaries to be checked on the spot based on insufficient or not-updated risk analysis[76]. The ECA assessed the system encompassing administrative procedures and controls to ensure correct payments, including the quality of the database, as effective in the Czech Republic. The on-the-spot inspection methodology, the selection, execution, quality control, and reporting of individual results were rated partially effective. Cross-compliance was not assessed in the Czech Republic.[77]

73 Point 5.13 (or 5.62), ECA's Annual Reports concerning the financial year 2008.
74 Point 5.63, ECA's Annual Reports concerning the financial year 2008.
75 Point 5.65, ECA's Annual Reports concerning the financial year 2008.
76 Point 5.44, ECA's Annual Reports concerning the financial year 2008.
77 Table 2.2, ECA's Annual Reports concerning the financial year 2008.

Regularity of transactions in agriculture and rural development

In the case of EAGF payments, the ECA's testing of the regularity of the selected sample found the following:

- errors consisting in payments to beneficiaries who were not eligible as they had not carried out any agricultural activity nor maintained the land in good agricultural and environmental condition[78];
- errors consisting in over-declaration of area claimed, leading to overpayment[79]; and
- animal registers that were not updated and databases that were not in operation[80].

In EAFRD expenditure, the errors consisted in:

- non-respect of specific conditions attached to the aid for AEM and forestry measures, and ineligible claims under AEM[81];
- incorrect calculation of eligible costs and of the amount payable, over-declarations of area claimed and non-respect of the minimum amount per hectare[82]; and
- non-execution of the totality of works financed[83].

B.2.4.2 ECA's Special Report No. 10/2009

In 2009, the ECA published a Special Report[84] devoted to an assessment of the working of information provisions and promotion measures for agricultural products. The EU has executed and co-financed these measures since the 1980s, most commonly in the form of one-year to three-year programmes. This ECA's audit focused on the effectiveness of information provision and promotion measures and the regularity of expenditure earmarked for this purpose. It was carried out at the Commission and in the United Kingdom, Italy, and Spain.

The ECA stated that despite the improvements displayed in recent years there is still no definition of the specific objectives to be attained through these measures. Without such a definition there is no yardstick for evaluating the effectiveness of this policy. The ECA therefore recommends that the policy objectives be specified; these objectives should be expressed as "SMART"[85] objectives and should be consistent with the committed budgets. Another output of the audit is the finding that the policy's expected impact is considerably circumscribed by a relatively modest budget in relation to the large number of products and geographical areas covered.

The ECA also recommends improving the selection process for individual programmes, with particular regard to information requirements concerning the programme's expected impact and how it will be measured and improving the executed controls. The Commission is currently working on a review of this instrument, which may result in the adoption of adjustments to its working. It should be noted that the findings made by the ECA and the recommendations for eliminating the identified shortcomings in this area are the same as the conclusions of the SAO's audits done on other programmes, specifically the fisheries support programmes in the Czech Republic described in the following part of the *EU Report 2010*.

B.2.4.3 SAO's audit work

In the years 2008 and 2009, the SAO carried out two audits focusing on the work of selected agriculture and rural development instruments implemented under the OP *Rural Development and Multifunctional Agriculture* ("OP RDMA"). The first audit targeted *Leader+* and *Leader* measures[86] and the second one focused on measures in the fisheries sector[87]. In the second audit, the OP *Fisheries* applicable for the 2007-2013 programming period was also partially scrutinised.

Although the implementation structure was essentially identical for both audits[88], the rate and materiality of the identified shortcomings in the two audits led to differing conclusions regarding the reliability of the financing

78 Point 5.17, ECA's Annual Reports concerning the financial year 2008.
79 Point 5.19, ECA's Annual Reports concerning the financial year 2008.
80 Point 5.22, ECA's Annual Reports concerning the financial year 2008.
81 Point 5.18, ECA's Annual Reports concerning the financial year 2008.
82 Point 5.20, ECA's Annual Reports concerning the financial year 2008.
83 Point 5.21, ECA's Annual Reports concerning the financial year 2008.
84 Special Report No. 10/2009: *Information Provision and Promotion Measures for Agricultural Products*, European Court of Auditors.
85 Policy goals fulfil criteria "SMART" if they are specific, measurable, attainable, realistic and timely.
86 Audit No. 08/25, SAO Bulletin 4/2009.
87 Audit No. 09/12, SAO Bulletin 1/2010.
88 Only minor organizational changes were made because of new programming period.

system. In the first case (*Leader*+ and *Leader*), the financing system was found to be essentially functional, as administration took place properly – except some shortcomings – and State budget and EU funds were provided in line with the prescribed rules and conditions. In the second case (fisheries support), the financing system proved to be not fit for ensuring sound financial principles. In this regard, State budget and EU funds were not provided properly in line with the requirements of the EU and Czech legislation. This failing was the consequence of shortcomings in project selection, monitoring, and control.

In this context, it should be mentioned that the SAO's audits have repeatedly identified errors in the creation and implementation of monitoring indicators for programmes and projects. These errors consist primarily in the absence of suitable indicators at both programme and project level and in the failure to define the initial and target values of indicators created at programme level. That makes it very difficult to monitor and evaluate the progress achieved through the assistance. Moreover, if further instruments of assistance benefits are not created, the goals that are supposed to be attained through the assistance are not defined using the "SMART" method. This shortcoming was found in both the conducted audits, namely as regards resources financed from the Czech and EU budget during the 2004–2006 programming period. The Managing Authorities did not define initial and target values of monitoring indicators and, in some cases, did not even update the values on the basis of the actual implementation of support.

Furthermore, errors in the gathering and reporting of the values of the defined indicators were revealed in the case of finances earmarked for fisheries support. These errors consisted mainly in the absence of any checking of the data submitted by beneficiaries and in the failure to eliminate duplications in data aggregation. The system for reporting monitoring indicators was thus assessed as unreliable and potentially containing incorrect data. What is more, in contravention of the EU legislation the Ministry of Agriculture ("MoA") did not submit information about the progress achieved through the support in its Annual Reports, confining itself merely to financial and technical data on the various calls and submitted projects.

In the case of finances earmarked for fisheries support, the monitoring shortcomings were moreover combined with failures in the project assessment and control system. That is because projects were selected on the basis of criteria that provided no insight into the quality of the projects. There were even cases where the vast majority of projects submitted in response to a particular call attained the maximum possible points score without that providing much testimony as to the projects' quality (as it was enough to satisfy technical criteria such as electronic submission or an extra voluntary annex). Finally, projects were selected for financing on the basis of the time at which applications were lodged. In the case of one call, project assessment was omitted – in contravention of EU legislation – because there were sufficient funds to implement the projects. The assessment criteria in no way covered the aspects of economy, efficiency, and effectiveness that have to be achieved when spending public money. In this way, the MoA failed to ensure that the requirements for the provision of these funds laid down by both the national legislation and by EU regulations were fulfilled. Yet, the problem with insufficient project assessment continues to exist in the new programming period with EFF co-financing.

The aforementioned approach taken by Managing Authorities to monitor and select projects in the case of finances earmarked for fisheries was then reflected in the quality of the executed control work. Besides not checking the reported values of monitoring indicators on individual projects, there was not even any assessment of whether the projects targets defined in the applications were achieved; control work was restricted to checking the attainment of a work's technical parameters and documentation of expenditure.

Some other shortcomings found by the two audits in the way systems were set up and functioned are as follows:

- the decision issuance process showed shortcomings,
- there existed lack of clarity concerning the binding version of the rules that applicants and beneficiaries were meant to follow;
- implementing bodies did not comply with internal rules and time limits for administration of applications; and
- the question of time limits for administration of payment applications to ensure that final beneficiaries receive the claimed funds in the shortest possible time was insufficiently addressed.

It was also repeatedly stated that there had been a long-term violation of the national regulation on the exercise of financial control[89] in Managing Authorities, national regulations governing the recording of data in public records of provided grants, and national regulations on financial settlement thereof. One specific problem only detected in finances earmarked for fisheries support was shortcomings in the system for recording irregularities that had not to be reported to the Commission. Data on these irregularities were not prepared in the form in which they had to be provided if so requested. The risk of this shortcoming also applies to OP *Fisheries*.

The main shortcomings identified at projects level were:

- claiming of ineligible costs (work done without a contract or in contravention of the contractual terms or legislative requirements),
- funding of projects that did not satisfy the programme rules and should have been discarded during the assessment phase,
- errors in accounting for expenditure related to project implementation, and
- shortcomings in the public procurement.

The cases of irregularities detected by the SAO's audit (an in many cases not detected by internal controls) should subsequently be addressed in the process of investigating suspicions of irregularities.

It is clear from the above that the findings made by the SAO during the two audits are consistent with the ECA's conclusions stemming from its scrutiny of projects. The shortcomings found in the project selection, monitoring, and control system correspond to the conclusions of the ECA's Special Report No. 10/2009. Heightened attention should be paid by the bodies in the implementation structure to the issue of ensuring sound financial management of public spending and achieving value for money.

B.2.5 Protection of the EU's financial interests in the CAP area

Since 1 January 2007, EU Member States have been obliged to report irregularities related to the CAP whose value exceeds €10,000 (the original level was €4,000). Moreover, in 2008, a new information system for reporting irregularities[90] was introduced, making it possible to send reports via an internet interface. Launching this new system naturally involved some teething troubles related to the timeliness and level of detail in the data of some reports for 2008.[91]

Member States reported a total of 1,142 new irregularities in 2008; nine were later reclassified, so the total number of irregularities for 2008 is 1,133, with a total value of approx. €102 million. That meant a further fall in the number of irregularities compared to the previous period. It is expected that this fall will continue.[92] The financial value of the reported irregularities was also down on 2007[93].

When reporting irregularities, Member States are obliged to provide additional data that help reduce the level of errors and help combat fraud in the future. The quality of reporting again improved in 2008: the average rate of fulfilment of the data content requirements was put at 92% (78% in 2007). Most Member States, including the Czech Republic, scored over 90% in their discharge of the obligations. The following graph gives a comparison of the Czech Republic and the EU average:

89 Act No. 320/2001 Coll., on financial control in public administration and on amendments to some related Acts (Act on Financial Control).

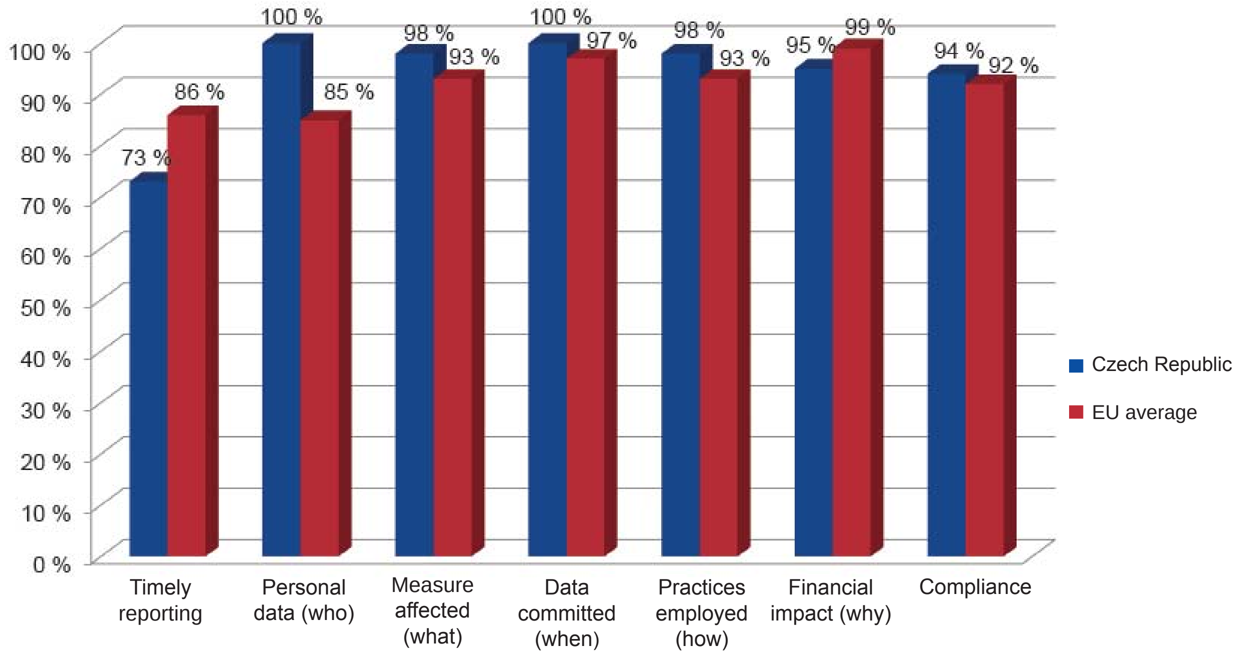
90 For now the system is used under the name *Pre-IMS Module 1848*. After its functioning has been tested, it will be used under the name *IMS Module 1848*.

91 P. 29 and 32 of *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15. 7.2009.

92 P. 30 of *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15. 7.2009.

93 In 2007, a total of 1,577 irregularities were reported, with a value of €155 million.

Graph 8: Reporting discipline relating to irregularities communicated as regards expenditure for agriculture and fisheries in 2008



Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15.7.2009

Shortcomings in irregularity reporting nevertheless persist in the timeliness of reporting (as the graph shows, this is the biggest weakness of reports sent from the Czech Republic) and some States still do not report detailed information on the identity of the self-employed and legal persons involved because of data-protection-reasons. In practices employed, there exist shortcomings in reporting in cases classified under the category marked as "other" without giving more detailed information.

It still applies that the rate of irregularity reporting is very low (0.004%) in the biggest expenditure item in the budget (i.e., separate direct payments). Besides the fact that these payments are covered by IACS, which is deemed a reliable control system, another factor here is that a large number of direct payments to farmers do not exceed €10,000. If irregularities are found, these payments do not satisfy the minimum value limit for the reporting duty (they are only reported if there is a suspicion of fraud in the case at hand). The commodities that displayed the highest error rates in 2008 were olive oil (11.48%), cereals (7.57%), and beef and veal (6.16%). The items with the greatest financial volume of errors were fruit and vegetables, rural development (for the 2000–2006 period), and products of the wine-growing sector. Not one irregularity was reported for the EFF in 2008.

However, the ratio between the reported irregularities (roughly 90% of which were detected after payment had been made) and the total volume of finances spent on agriculture remains consistently low (0.21% for 2008).

The following table presents data on reported irregularities in 2008 for the EU-10.

Table 8: Irregularities reported by EU-10 for 2008

Member State	Number of irregularities	Amount affected by irregularity (in €)	Irregularities in % of MS' expenditure
Cyprus	0	0	0
Czech Republic	**22**	**764,680**	**0.11%**
Estonia	13	278,131	0.31%
Hungary	6	747,522	0.08%
Lithuania	24	803,754	0.26%
Latvia	13	208,144	0.11%
Malta	1	37,814	0.76%
Poland	46	1,126,137	0.05%
Slovenia	1	38,808	0.02%
Slovakia	11	639,613	0.19%
Total	**137**	**4,644,603**	**0.09%**

Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008,* SEC(2009) 1003 of 15.7.2009.

The table shows that in the case of these ten States the error rate in payments ranged from 0% to 0.76% of the total amount of finances paid out in the given State in 2008. The proportion of the total volume of irregularities accounted for by irregularities in EU-10 was just 4.54%, even though these states obtained 10.65% of all payments under the CAP.

B.3 EU Cohesion Policy

Cohesion Policy is an important instrument enshrined in Article 158 of the *Treaty establishing the European Communities* (and in Article 174 of TFEU). Its aim is to reduce disparities between the regions. The practical implementation of Cohesion Policy is very expensive. It currently accounts for a significant proportion of expenditure in the EU budget: for example, in 2008 payments by the Commission on structural operations totalled €35,554 million, i.e., approx. 31% of all expenditure. It is financed by the Structural Funds and the *Cohesion Fund* over multi-annual programming periods. The Objectives[94] that are set in each programming period present a general definition of the supported activities and territories.

The year 2009 on the one hand brought a definitive end to the implementation of projects from the 2000–2006 programming period, and on the other hand, intensification in the drawdown of finances earmarked for the new programming period of 2007–2013. Although, the number and focus of the Objectives is different in the current programming period, the basic principles remain unchanged.

B.3.1 Benefits of the Czech Presidency to Cohesion Policy

The first half of 2009, when the Czech Republic for the first time held the Presidency of the EU Council, was influenced by several significant events. One of the challenges that needed tackling was the outbreak of the global financial and later also economic crisis in 2008. In response, the Commission drew up the *European Economic Recovery Plan*, which contains, *inter alia*, anti-crisis measures that draw on Cohesion Policy resources. Seeing to the implementation of these adjustments therefore logically became a priority of the Czech Presidency. That was linked to the quest for ways to simplify the administration of the Structural Funds. In the context of the crisis, discussions about a concept of territorial cohesion and about the form of Cohesion Policy after 2013 were held.

94 Besides the Objectives there are also Community Initiatives designed to tackle specific problems affecting the entire EU territory.

B.3.1.1 Changes to legislation

Amendments to three fundamental regulations on the Structural Funds and the *Cohesion Fund* were adopted during the Czech Presidency. Later, in September 2009, an amendment of an implementing regulation[95] was also adopted. These steps made it possible to realise the proposals contained in the *European Economic Recovery Plan* concerning the Structural Funds and the *Cohesion Fund* which were designed to help overcome the economic crisis. Other adjustments are designed to simplify the implementation of Cohesion Policy or are a response to certain causes of confusion that emerged in the practical application of the concerned legal regulations. The key changes are listed below:

Council Regulation (EC) No. 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund[96]

Advance payments to Operational Programmes were increased by 2% for States that joined the EU after 1 May 2004 (raising the advance payments in 2009 to 4%) and awarding advance payments of 2.5% to EU-15 states. The involvement of the European Investment Bank ("EIB") and the European Investment Fund in the implementation of financial engineering instruments[97] was facilitated and the possibility of support from these institutions to Member States was strengthened. Eligibility of financial engineering instruments expenditure was widened to include in-kind contributions and the payment of advances under State aid was facilitated (under Article 107 of TFEU). The option of including funds spent on major projects not yet approved by the Commission as expenditure should help speed up implementation.

Regulation (EC) No. 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund

The ERDF can be used to fund measures to improve energy efficiency and the use of renewables in existing housing both in the States that acceded in 2004 and the EU-15; this expenditure may account for up to 4% of the ERDF allocation. The range of eligible expenditure (indirect costs reported as a flat rate, flat-rate payments and lump-sum payments for an operation or a part thereof) was widened to facilitate the administration of projects and reduce the incidence of shortcomings.

Regulation (EC) No. 1081/2006 of the European Parliament and of the Council on the European Social Fund

Two new procedures were added for defining and reporting eligible expenditure in order to help simplify management, administration, and control. Specifically, these are flat-rate and lump-sum payments for an operation or a part thereof.

Commission Regulation (EC) No. 1828/2006 setting out rules for the implementation of Council Regulation (EC) No. 1083/2006

Besides adjustments reflecting the changes made to the legislation mentioned above, the amendment most notably increases flexibility for intervention in housing, where there was a relaxation of the requirements for the number of criteria that are decisive for this support. In addition, the requirements for reporting irregularities were modified and changes were made to the implementation rules for financial engineering instruments.

B.3.1.2 Other activities

A conference entitled *The Future of Cohesion Policy* was held in March 2009. Attended by top-level representatives of Member States, the conference discussed the possible future of Cohesion Policy. The discussions revealed that Cohesion Policy should concentrate more on specific goals and priorities in the next programming period. The eligibility limit for regions' involvement should also be staggered, instead of the existing limit of 75% of GDP per capita, which would help eliminate the "border effect" between certain regions. Another proposal was that the *Cohesion Fund* should be involved in financing the science and research infrastructure.

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95 Commission Regulation (EC) No. 1828/2006 setting out rules for the implementation of Council Regulation (EC) No. 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and of Regulation (EC) No. 1080/2006 of the European Parliament and of the Council on the European Regional Development Fund.

96 Council Regulation (EC) No. 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No. 1260/1999.

97 These are venture capital funds, guarantee funds, loan funds, and urban development funds, i.e. funds investing in Public Private Partnership and other projects included in an integrated plan for sustainable urban development.

B.3.2 Current developments in Cohesion Policy in the Czech Republic

B.3.2.1 Programming period 2004–2006

At the start of 2009, there was a significant change in the timetable for the entire shortened 2004–2006 programming period, with the Commission deciding to extend the time limit for drawing finances from the Structural Funds earmarked for this period. The new final date for eligibility was set at 30 June 2009; this was meant to enable Member States to draw down the full amount of allocated resources, thus alleviating the impact of the economic crisis. The Czech Republic decided to make use of this option for all OPs (with the exception of OP RDMA), for both Single Programming Documents and for the *Equal* Initiative.

State of drawdown of the allocated amount

The Czech Republic's allocation in the 2004–2006 programming period was €2,902 million[98] (i.e., approx. CZK 77 billion[99]). These funds were provided from four EU Structural Funds and the *Cohesion Fund*. The following table shows the most important data on the current state of the implementation of EU Structural Funds programmes and *Cohesion Fund* by 31 December 2009.

Table 9: Spending of allocations in the programming period 2004–2006 by 31.12.2009 (EUR million)

Assistance	Allocation	Spending	Spent in % **	Remains to be spent
OP Industry and Enterprise	260,9	259,1	99.33	1.7
OP Human Resources Development	318,8	332,5	104.28	- 13.7
OP Infrastructure	246,4	199,3	80.90	47.1
OP Rural Development and Multifunctional Agriculture	173,9	170,6	98.12	3.3
Objective 1 total	**1,454,3**	**1,420,6**	**97.68**	**33.7**
SPD for Objective 2 Prague	71,3	71,8	100.64	- 0.5
SPD for Objective 3 Prague	58,8	59,1	100.50	- 0.3
Objectives 2 and 3 total	**130,1**	**130,8**	**100.58**	**- 0.8**
Community Initiative Interreg IIIA	55,0	60,1	109.36	- 5.1
Community Initiative Equal	32,1	32,9	102.54	- 0.8
Community Initiatives total	**87,1**	**93,1**	**106.85**	**- 6.0**
Cohesion Fund/ISPA*	**1,230,5**	**945,6**	**76.84**	**284.9**
Structural operations total	**2,902,0**	**2,590,0**	**89.25**	**311.9**

* A part of the ISPA allocation is included in the *Cohesion Fund* allocation.
** Red numbers highlight allocation overrun.
Note: Spending is understood as a certified amount of expenditure.

Source: Data for Structural Funds and EC Initiatives – Ministry for Regional Development ("MfRD"); document *Drawing down Structural Funds in 2004–2006 by 31.12.2009*, data for *Cohesion Fund*/ISPA – MoF.

As the table clearly shows, almost all Objective 1 OPs have already drawn down more than 90% of their allocation. Only the OP *Infrastructure*, where the latest certification is not included[100], is below this limit. In both Single Programming Documents and in the case of both Initiatives, the certified amount was more than the allocated amount. The situation is the same in the case of the *Joint Regional* OP and the *Human Resources Development* OP ("OP HRD"). Final payments from the Commission will not exceed 100% of the allocation, however.

By 31 December 2009, more than €945.6 million, i.e., almost 77% of the allocation, had been drawn down from the *Cohesion Fund*, which also covers projects approved under the ISPA. With this fund, finances may be drawn down until the end of 2010 and the "n+2" rule does not apply to it.

98 Part of the ISPA (*Instrument for Structural Policies for Pre-accession*) allocation is included here as well.
99 The European Central Bank's CZK/EUR exchange rate for January 2010 is 26.40, accessible at http://ec.europa.eu/budget/inforeuro/index.cfm?fuseaction=currency_historique&currency=47&Language=en
100 According to the MoF, the value of this certification is approx. €57 million.

"n+2" rule

The "n+2", and/or its modification "n+3",[101] rules are significant instruments for ensuring smooth and timely implementation of EU programmes. This rule is used in the financial management of the Structural Funds. Under this rule, the Commission will automatically cancel any part of a budget commitment to a given programme that was not used on advance or interim payments or for which no payment application was sent by the end of the second (or in some cases third) year after the year in which the given budget commitment was adopted. The Commission is obliged to notify Member States when this risk of automatic cancellation has arisen.

At present, the Managing Authorities ("MAs") are preparing the final documents[102] so that individual programmes from the 2004–2006 programming period can be duly completed. These final documents must be sent to the Commission no later than 15 months after the final date of programme expenditure eligibility, i.e., by 31 March 2010.The deadline for programmes for which eligibility was extended to 30 June 2009 is 30 September 2010. Implementation of the "n+2" rule does not need to be scrutinised separately for allocations for the year 2006, as not just the allocation for 2006 but the entire 2004–2006 allocation (including advance payments) must be drawn down by the deadline for submitting the final documents.

Number of projects implemented under programmes co-financed by the Structural Funds

Other important data that testify to the state of implementation of Cohesion Policy in the Czech Republic are the number of supported projects and the degree of their implementation. The following table gives information about the number of projects that were approved for financing under individual programmes, completed and paid for by 31 December 2009.

Table 10: Number and status of projects co-financed from the Structural Funds in the CR by 31.12.2009

Assistance	Number of projects approved	Number of projects with contracts/ decision		Number of projects completed		Number of projects with realized payments	
		total	in %	total	in %	total	in %
Joint Regional OP	2,750	2,750	100%	2,648	96.3%	2,640	96.0%
OP Industry and Enterprise	2,864	2,843	99%	2,802	98.6%	2,815	99.0%
OP Human Resources Development	2,742	2,627	96%	2,619	99.7%	1,918	73.0%
OP Infrastructure	423	420	99%	396	94.3%	342	81.4%
OP Rural Development and Multifunctional Agriculture	3,598	3,349	93%	3,349	100%	3,349	100%
Objective 1 total	**12,377**	**11,989**	**97%**	**11,814**	**99%**	**11,064**	**92%**
SPD for Objective 2 Prague	276	276	100%	269	97%	266	96%
SPD for Objective 3 Prague	787	783	99%	783	100%	783	100%
Objectives 2 and 3 total	**1,063**	**1,059**	**100%**	**1,052**	**99%**	**1,049**	**99%**
Community Initiative Interreg IIIA	546	546	100%	546	100%	546	100%
Community Initiative Equal	165	150	91%	149	99%	123	82%
Community Initiatives total	**711**	**696**	**98%**	**695**	**100%**	**669**	**96%**
Total	**14,151**	**13,744**	**97%**	**13,561**	**99%**	**12,782**	**93%**

* Number of projects with realised payments is higher, because it demonstrates paid phases.

Source: MfRD – document *Drawing down Structural Funds in 2004–2006 by 31.12.2009*.

The table shows that projects under almost all programmes have already been completed and paid for.

101 The "n+2" rule is applied throughout the whole 2004–2006 programming period and 2007–2013 programming period in the years 2011–2013. The "n+3" modification is only applied in the Czech Republic for Structural Funds and the *Cohesion Fund* for the 2007–2010 period.

102 Final documents, i.e., final statement of expenditure, final payment application, final report on the programme implementation, and closure declaration.

Number of projects implemented under the *Cohesion Fund* and ISPA

The closing date for the eligibility of expenditure in the case of *Cohesion Fund* or ISPA projects is 31 December 2010. According to data from the end of 2009, 60 projects were approved and 22 of them completed by 31 December 2009. As the following Table 11 shows, only those ISPA projects whose implementation began before 2004 have already been completed.

Table 11: Projects under the *Cohesion Fund* and ISPA in the CR by 31.12.2009

Sector		Transport		Environment		Floods 2002*	Technical assistance		Total
		ISPA	CF	ISPA	CF		ISPA	CF	
Projects	in realisation total	8	5	13	25	1	7	1	60
	– of which completed	5	0	11	0	1	5	0	22

* Investments in transport and the environment.
Source: MoF – Overview of CF funds – situation by 31.12.2009

B.3.2.2 Programming period 2007–2013

In the first half of 2009, the audit strategies were approved for the various Operational Programmes (with the exception of the strategy for the *Research and Development for Innovations* OP, which was approved on 10 September 2009). In the second half of 2009, the Commission approved the descriptions of OPs' management and control systems on whose basis the payment of interim payments may commence.[103] The only exception is the *Research and Development for Innovations* OP, whose description was approved by the Commission on 18 February 2010[104].

With regard to the low rate of drawing of EU finances to date, the MfRD initiated proposals for changes to the relevant national regulations designed to cut bureaucracy and simplify the drawing conditions. One of the steps being considered is the following adjustments to the budget rules[105] – simplification of expenditure reporting, scrapping of the requirement for the Ministry of Finance to approve projects over CZK 100 million from the State budget, and allowing the transfer of an appropriation title to another entity.[106]

Managing Authorities make use of some of the proposed measures under the *European Economic Recovery Plan*. In doing so, they give precedence to those measures designed to speed up the working of the system. That includes certain administrative simplifications, for example, and the concentration of investments at the start of the programme. Conversely, they do not plan to use the option of increasing the contribution to projects, mainly because today's customary level of co-financing is considered sufficient.[107]

Important changes adopted in response to the economic crisis include the modification of the payment system that is gradually being introduced under certain regional Operational Programmes[108]. This is a change from ex-post payments to a modified ex-ante system, where finances are transferred to final beneficiaries' accounts before the due date of individual invoices, which results in the project's implementation phase being less costly for the beneficiary. Using this approach, final beneficiaries do not have to finance supplies and services through a commercial account; this eliminates the beneficiaries' credit costs that pushed up the overall cost of the project.

Another measure that may help alleviate the impacts of the economic crisis is the new way of financing urban revitalisation. In the new programming period, the Commission and EIB have created the JESSICA[109] Initiative, which enables MAs to invest part of the allocated finances in urban development funds ("UDF"). The first step towards the realisation of this Initiative in the Czech Republic is the activity of the Regional Council of the Moravian-Silesian

103 Overview of approvals of Audit strategy and Description of management and control systems by 3 February 2010, Ministry of Finance.
104 Source: Ministry of Finance.
105 Act No. 218/2000 Coll., on the budget rules and amending certain related acts (Budget Rules) and Act No. 250/2000 Coll., on the budget rules for territorial budgets.
106 *Informative annex to the updated framework position of the Czech Republic on the future of EU Cohesion Policy*, available at www.mmr.cz; *Proposals for legislative and other changes with a view to simplifying the administration of the Structural Funds and the Cohesion Fund*, MfRD, February 2010.
107 *Strategic Report of the Czech Republic 2009*, MfRD, December 2009, p. 109.
108 Source: www.ropstrednicechy.cz, www.rada-severovychod.cz, www.rr-moravskoslezsko.cz.
109 Abbreviation of *Joint European Support for Sustainable Investment in City Areas*.

Cohesion Region[110]. The memorandum of understanding signed by representatives of this Regional Council and the EIB in 2009 will become the starting-point for use of this Initiative. After the UDF is established, approx. half a billion CZK will be transferred to it from *Regional Operational Programme Moravia-Silesia* finances earmarked for brownfield regeneration. The UDF, administered by the EIB, will subsequently provide long-term loans, credits, guarantees, and venture capital to public and public-private entities for urban renewal projects. One indisputable advantage compared to classic grant schemes is the possibility of repeated use of finances provided from the EU.

State of drawdown of the allocated amount

The following Table 12 gives a detailed picture of the state of implementation of the OPs in terms of individual Objectives by 7 January 2010.

Table 12: Spending of the allocation for Objectives *Convergence* and *Regional Competitiveness and Employment* in the programming period 2007–2013 in the CR by 7.1.2010

Operational Programme	Allocation (in CZK million)	Submitted projects*		Approved projects*		Finances paid out to beneficiaries* (in CZK million)	Request submitted for payment (in CZK million)	Spent from allocation
		number	CZK million	number	CZK million			
Integrated OP	47,788,1	6,250	26,063,6	5,697	11,194,8	729,0	158,9	0.3%
OP Technical Assistance	7,693,9	71	5,324,8	43	1,933,0	283,7	71,5	0.9%
OP Enterprise and Innovation**	94,265,7	5,612	60,263,5	2,586	24,925,2	7,756,2	5,029,6	5.3%
OP Human Resources and Employment*	56,939,4	447	46,747,2	152	33,213,0	2,428,3	29,6	0.05%
OP Education for Competitiveness*	56,797,7	2,267	40,866,1	448	16,776,9	1,790,3	5,4	0.01%
OP Research and Development for Innovations	64,312,9	135	88,056,9	4	2,365,7	364,7	0,0	0.0%
OP Environment	152,813,8	6,180	140,423,4	2,617	44,312,7	6,853,4	2,387,1	1.6%
OP Transport	178,900,7	149	163,232,3	88	58,340,9	30,920,9	10,510,8	5.9%
Thematic OPs total	**659,512,2**	**21,111**	**570,977,8**	**11,635**	**193,062,2**	**51,126,5**	**18,192,9**	**2.8%**
ROP NUTS II Central Bohemia	17,354,8	944	18,800,3	243	5,100,3	2,004,1	736,7	4.2%
ROP NUTS II Southwest	19,243,1	2,168	40,068,4	341	6,998,6	2,266,3	660,6	3.4%
ROP NUTS II Northeast	20,396,9	764	23,650,2	336	10,372,7	3,440,0	726,3	3.6%
ROP NUTS II Central Moravia	20,378,4	873	17,650,6	418	8,222,5	3,834,8	1,311,9	6.4%
ROP NUTS II Southeast	21,874,3	1,122	27,950,6	397	11,870,1	3,226,6	724,5	3.3 %
ROP NUTS II Moravia-Silesia	22,239,6	784	17,085,3	211	4,599,5	1,716,8	835,4	3.8%
ROP NUTS II Northwest	23,159,8	605	28,121,7	185	10,377,1	1,287,0	380,8	1.6%
ROPs total	**144,646,9**	**7,260**	**173,327,1**	**2,131**	**57,540,8**	**17,775,6**	**5,376,2**	**3.7%**
OP Prague Competitiveness	7,279,3	442	8,822,8	127	3,488,3	1,010,0	540,8	7.4%
OP Prague Adaptability	3,366,2	1,953	10,440,7	178	1,245,2	481,2	4,4	0.1%
OPs Prague total	**10,645,5**	**2,395**	**19,263,5**	**305**	**4,733,5**	**1,491,2**	**545,2**	**5.1%**
Total	**814,804,6**	**30,766**	**763,568,4**	**14,071**	**255,336,5**	**70,393,3**	**24,114,3**	**3.0%**

* The table only contains data for individual projects and global grants. Data for individual grant projects are not given in the table.
** The data are not complete (do not include Technical Assistance projects).
Note: In some cases, the applicant's own share is not included in "submitted payment applications" but is included in "finances paid to beneficiaries".

Source: MfRD – *Monthly monitoring report on drawing down Structural Funds, the Cohesion Fund, and national resources in the 2007–2013 programming period*, December 2009.

110 Source: www.rr-moravskoslezsko.cz.

In total, projects worth over CZK 255 billion have already been approved under the *Convergence* and *Regional Competitiveness and Employment* Objectives; that represents approx. 31% of the total allocation. As the descriptions of the management and control systems have been approved, the first certification of expenditure has already taken place for most of the OPs. Thus, 3% of the total allocation for the 2007–2013 programming period has been drawn down.

Under the third Objective of the 2007–2013 programming period *European Territorial Cooperation*, almost 1,300 projects have been submitted to date; over 550 of these projects have already been approved. The value of the approved projects amounts to 53% of the total allocation for the programming period. Here, too, the first certification of expenditure has already taken place.

Since finances provided from the Structural Funds and the *Cohesion Fund* are viewed as one of the important instruments for alleviating the impact of the economic crisis, the MfRD drew up an *Analysis of the Use of the Structural Funds and the Cohesion Fund for Tackling the Consequences of the Economic Crisis*. This document identified the main risks for drawing from OPs (sustainability of indicators, drop in revenues of municipalities and regions, risk of insufficient co-financing, secondary insolvency and insolvency, securing direct liquidity for applicants, fewer applications for grants, falling demand for services and products, exchange rate risk). The document also contains an analysis from the point of view of the “n+3” rule.

“n+3” rule

Regarding the implementation of the “n+3” rule for the 2007 allocation, the year 2010 is the first one when a commitment may be automatically cancelled. To prevent this situation arising, individual OPs must have certified finances of on average at least approx. 30% of the OP allocation for 2007. The MfRD analysis reveals that 11 OPs[111] have been assessed as having no major risk. The *Integrated* OP, *Research and Development for Innovations* OP[112], and *Czech Republic-Poland* OP can be regarded as particularly high-risk; that is due to a concurrence of several negative factors, most notably a very small number of approved projects. The remaining programmes may contain an element of risk relative to the 2007 allocation but they have a realistic chance of fulfilling the “n+3” rule if they satisfy certain conditions.

Overall, it may be said that despite the initial delay in the start of the 2007–2013 programming period the intensity of drawdown has currently increased.

B.3.3 SAO’s audit work

Since the *EU Report 2009* was issued, the SAO has completed a total of seven[113] audits that touch upon EU Cohesion Policy. Operational programmes both from the 2004–2006 programming period and from the current period of 2007–2013 were audited. The following section contains the most important findings from these audits.

B.3.3.1 Finances earmarked for waste-water treatment

The audit[114] focused on the current state of implementation of the waste-water treatment directive[115] and the financing and execution of water management constructions financed, *inter alia*, out of the *Infrastructure* OP, *Environment* OP, and the *Cohesion Fund*.

- Act No. 320/2001 Coll., on financial control in public administration and on amendments to some related Acts (the Act on Financial Control) does not contain any specific rules enabling delegation of powers in the area of audit of finances provided out of the EU budget; delegation of the exercise of these controls from the Ministry of the Environment (“MoE”) as the Intermediate Body (“IB”) to the State Environmental Fund (“SEF”) in the position of Implementing Body did therefore not comply with this Act. For more details on this issue see Section C.1.1.
- There is a risk that the Czech Republic will not satisfy the terms of the Directive and that the necessary measures will not be completed in all concerned agglomerations by 31 December 2010. This would put the Czech Republic at risk of being penalised by the Commission.

111 That comprises all seven regional OPs, OP *Transport,* OP *Enterprise and Innovations,* OP *Prague Adaptability,* and OP *Prague Competitiveness.*
112 As this OP was approved late, its allocation for 2007 was combined with the 2008 allocation.
113 Two audits in which finances both drawn from Cohesion Policy and finances that are part of the CAP were scrutinised are described in the chapter B.2.4.3.
114 Audit No. 08/22, SAO Bulletin 2/2009.
115 Council Directive 91/271/EEC concerning urban waste-water treatment.

- Although the MfRD in the role of the MA repeatedly found certain shortcomings among final beneficiaries in 2006 and in 2007 in follow-up audits, it did not check whether the MoE and SEF performed the duties delegated to them sufficiently when administering and auditing supported projects. Similarly, the MoE did not check sufficiently whether the SEF was carrying out the activities it delegated to it.
- In certain projects financed out of the *Cohesion Fund,* contracts between the owner and operator of infrastructure did not satisfy the condition of the "best international practice" laid down by the Commission's decisions. Consequently, there is a risk that the level of payments to these projects from the EU budget will be reduced.
- The most significant shortcomings found at the level of final beneficiaries concerned public procurement and the conclusion and performance of contracts.

B.3.3.2 Finances earmarked for support programmes for energy generation from sustainable energy resources and for energy savings

The audit[116] focused on projects that were financed under the OPs *Infrastructure*, *Industry and Enterprise, Enterprise and Innovations,* and *Environment* and dealt with energy savings and the use of renewables.

- The *Infrastructure* OP lacks any quantitative expression of the goals for renewables. Although the expected benefit and actually achieved benefit of individual projects can be compared on the basis of indicators laid down in the Decision and contract on the provision of support, the lack of identified goals means the programme itself cannot be evaluated.
- Achieving the goals of Axis 3 - OP *Environment* has no significant impact on the fulfilment of the conceptual goals set at the national level, as the savings stemming from the implementation of OP *Environment* compared to the savings from the *Energy Efficiency Action Plan* contribute approx. 0.6% of the set goal. A similar problem with the significance of the provided support related to the goals specified in conceptual materials was detected in the case of projects supported under OP *Infrastructure*. The SAO therefore stated that the audited programmes' contribution to increasing the use of renewables or to energy savings was small or negligible.
- The principal finding in projects co-financed by the EU was non-compliance with the prescribed public procurement procedures. Moreover, beneficiaries did not always notify the providers about project changes within the required time limits; in some cases, beneficiaries failed to meet deadlines for completion of an operation or supplying information. In principle, the beneficiaries did not have problems achieving the required outputs in the use of renewables and energy savings, or are assumed to achieve the targets in the future.
- The SAO detected that final beneficiaries included ineligible expenditure in their requests for payment. These shortcomings were not revealed by the IB's checks in some cases.

B.3.3.3 Financial means allotted for programmes of support for development of industrial zones and regeneration of brownfields

The aim of the audit[117] was to scrutinise the use of finances earmarked for support of the development of industrial zones and regeneration of brownfields. These activities were funded both out of national programmes and out of programmes co-financed by the EU. The identified shortcomings mainly concerned the national programmes. With regard to EU-financed programmes it was found, for example, that the system for assessing OP *Enterprise and Innovations* does not make it possible to put a figure separately on the impact of the support on the audited measure.

B.3.3.4 Funds earmarked for implementation of the Single Programming Document for Objective 2 for the Prague Cohesion Region

This audit[118] focused on projects supported under the *Single Programming Document for Objective 2 for the Prague Cohesion Region* ("SPD 2").

- Discrepancies were repeatedly identified between the actual working of preliminary administrative controls and the requirements laid down on these control mechanisms by the Act on Financial Control. This Act does not provide any empowerment to delegate the exercise of these control functions to persons who are not employees of the control body in question.

116 Audit No. 08/38, SAO Bulletin 3/2009.
117 Audit No. 08/29, SAO Bulletin 2/2009.
118 Audit No. 09/09, SAO Bulletin 1/2010.

- The project assessment system made insufficient allowance for the significance of the projects' economic and financial side. Criteria assessing the applicant's financial health and projects' economic aspects played a very minor role in the overall assessment.
- As part of the audit, a recommendation was made to define more categorically the binding nature of projects' quantifiable goals in decisions to provide support to prevent uncertainties regarding the parameters of the project that must be met.
- At the time when submitting the project applications, final beneficiaries could draw on a list of general monitoring indicators without any more detailed specification. The fact that the MA only drew up a substantive definition of monitoring indicators at project level in April 2008 after the vast majority of approved projects had been implemented did not eliminate the risk that relevant monitoring indicators would not be prescribed for the approved projects. The need for a more detailed definition to ensure the comparability of monitoring indicators and a uniform interpretation was thus not met for the majority of the SPD 2 implementation period.
- Among final beneficiaries, shortcomings were found in the field of public procurement, e.g., candidates were not excluded from tender proceedings even though they did not satisfy the award conditions, or violation of equal treatment of candidates in the case when two candidates' bids received different points scores even though it had been stated that both equally satisfied the requirements.
- Audit of final beneficiaries detected shortcomings that were not detected by the IB's checks: specifically, the claiming of ineligible expenditure by final beneficiaries, e.g., reimbursement was claimed for works that were not performed.
- In one of the audited projects, whose output was supposed to be a joint research assignment, it was found that the SPD 2 documentation did not contain sufficient control mechanisms making it possible to verify the assignment had been carried in the context of the project's sustainability. The SAO believes that the mechanisms referred to in the Act on support for research and development could be used for these purposes, thus eliminating this detected risk.

B.3.3.5 Analysis and generalisation of the results of the SAO's audit work

An analysis of the SAO's published audit conclusions shows that the following areas can be identified at various implementation levels that displayed shortcomings most commonly:

Bodies implementing structural operations

- the set-up of the system for monitoring indicators to check the effectiveness of programmes and assessment of the progress made in achieving the programme's quantifiable goals (e.g., the absence of initial and target values of monitoring indicators, the unsuitability of selected indicators as regards their specificity and measurability for assessing the achievement of programme goals, etc.)[119];
- the project assessment and selection system (e.g., the specification of assessment criteria neglecting the principles of sound financial management, specifying insufficient selection criteria that give no information about project quality, or the absence of formal procedures regulating the exclusion of projects, etc.)[120];
- legislation governing management and control systems (e.g., insufficient rules on delegation of administrative control powers between implementing bodies)[121];
- checks performed by MAs and IBs (e.g., in IBs, the failure to check up on activities delegated, insufficient checks before making payments)[122].

Final beneficiaries

- public procurement (e.g., shortcomings in tender documentation, unclear definition of tender conditions, errors in the points scoring of tenders, conclusion of contracts deviating from the tender documentation, etc.)[123];

119 Audit No. 08/06, SAO Bulletin 1/2009; Audit No. 08/25, SAO Bulletin 4/2009; Audit No. 09/09, SAO Bulletin 1/2010; and Audit No. 09/12, SAO Bulletin 1/2010.

120 Audit No. 08/25, SAO Bulletin 4/2009, Audit No. 08/06, SAO Bulletin 1/2009; Audit No. 09/09, SAO Bulletin 1/2010, and Audit No. 09/12, SAO Bulletin 1/2010.

121 Audit No. 08/22, SAO Bulletin 2/2009; Audit No. 09/09, SAO Bulletin 1/2010; and Audit No. 09/12, SAO Bulletin 1/2010.

122 Audit No. 08/06, SAO Bulletin 1/2009; Audit No. 08/22, SAO Bulletin 2/2009; Audit No. 09/09, SAO Bulletin 1/2010; Audit No. 09/12, SAO Bulletin 1/2010.

123 Audit No. 08/22, SAO Bulletin 2/2009; Audit No. 08/38, SAO Bulletin 3/2009; Audit No. 09/09, SAO Bulletin 1/2010, and Audit No. 09/12, SAO Bulletin 1/2010.

- compliance with the terms laid down for project implementation (e.g., claiming ineligible costs, failure to meet project completion deadlines, failure to inform about project changes, etc.)[124];
- accounting records and proof showing that the content and cost of suppliers' work are consistent (e.g., absence of separate analytical accounting records of a project, absence or insufficient clarity of documents concerning the performance of services, works, and supplies by suppliers executing the project, etc.)[125].

The analysis and a comparison of its results with previous analyses (*EU Report 2008* and *EU Report 2009*) show that some improvements can be identified at the implementing bodies' level. There were neither significant audit findings regarding the creation and modification of programming documents and the eligibility rules nor findings regarding programme publicity. On the other hand, shortcomings persist in all areas at the level of final beneficiaries.

B.3.4 ECA's audit work

Based on results of audit work focusing on Cohesion Policy, the ECA's Annual Report for 2008 expressed the opinion on the legality and regularity of transactions that the payments on which the accounts for the 2008 financial year are based are materially affected by errors. In the group of policies such as "Science, Energy, and Transport", "External Aid, Development, and Enlargement", and "Economic and Financial Affairs", the supervisory and control systems were assessed by the ECA as partially effective from the point of view of the prevention or identification and remedy of the payment of over-declared or ineligible expenditure, but it explicitly omitted Cohesion Policy from this group. In the "Cohesion" policy group, it assessed Member States' supervisory and control system as only partially effective for remedying errors detected by national controls in most cases[126]. From its assessment of supervisory and control systems, the ECA drew the conclusion that "Cohesion" remains the most problematic area, where the error rate is estimated at over 5%, i.e., far higher than the error rate in other areas.[127]

At the same time, the ECA repeatedly stated that the legality and regularity of transactions related, *inter alia*, to Cohesion Policy was significantly influenced by the complicated and unclear legal requirements (eligibility rules, for example)[128].

Having compared the results of the audits underpinning the DAS 2008 and those for DAS 2007, the ECA stated that a large number of the sums paid as costs on Cohesion projects again contained errors, so a large number of projects were over-reimbursed. The proportion of projects containing errors in the representative statistical sample was 43%, compared to 54% in the previous period. The ECA estimated that, as in 2007, at least 11% of total costs reimbursed in Cohesion projects should not have been reimbursed[129].

According to an analysis conducted by the ECA, a significant proportion of the estimated error rate is accounted for by eligibility errors, which are the most common type of quantifiable error in the audit sample. The eligibility errors were caused by the following:

a) projects or beneficiaries did not meet the conditions of the specific fund;
b) serious failings in respecting procurement rules;
c) inclusion of costs that could not be reimbursed.

Almost 80% of the estimated error rate is accounted for by the first two causes of eligibility errors[130].

58% of the errors detected in the audit sample are non-quantifiable errors, so these are not factored into the estimation of the error rate. Most of these errors concerned compliance with the regulations, i.e.:

a) shortcomings in tender and contract award procedures;
b) non-respect of publicity rules[131].

124 Audit No. 08/22, SAO Bulletin 2/2009; Audit No. 08/25, SAO Bulletin 4/2009; Audit No. 08/38, SAO Bulletin 3/2009; Audit No. 09/09, SAO Bulletin 1/2010, and Audit No. 09/12, SAO Bulletin 1/2010.
125 Audit No. 08/06, SAO Bulletin 1/2009 and Audit No. 09/09, SAO Bulletin 1/2010.
126 Point XI DAS, ECA's Annual Reports concerning the financial year 2008.
127 Point 1.35, ECA's Annual Reports concerning the financial year 2008.
128 Point XII DAS, ECA's Annual Reports concerning the financial year 2008.
129 Point 6.17, ECA's Annual Reports concerning the financial year 2008.
130 Point 6.18, ECA's Annual Reports concerning the financial year 2008.
131 Point 6.20, ECA's Annual Reports concerning the financial year 2008.

B.3.4.1 Comparison of ECA's and SAO's findings

Unlike the ECA, the SAO does not select an audited sample of transactions by statistical methods, so the identified error rate in projects cannot be extrapolated to an entire Operational Programme[132]. However, it is possible to generalise the audit findings to some extent and assess their significance in the context of the selected sample of transactions.

Analysing the audit findings made by the SAO in audits targeting Cohesion Policy projects and generalising them and allocating them to thematic areas reveals the similarity with the conclusions of the ECA's analysis using a representative statistical sample of projects in EU Member States. In five out of eight SAO's audit conclusions, a contractor selection procedure that is not compliant with the legislation on public procurement was found in a significant proportion of the audited sample of projects.

Comparing both the analyses of shortcomings also reveals a similarity in the assessment of the significance of errors consisting in non-fulfilment of the conditions laid down in decisions on support from the Structural Funds or the *Cohesion Fund*. In five out of eight SAO's audit conclusions, it is stated on some of the projects in the audited sample that final beneficiaries did not satisfy the conditions laid down for implementation of the projects and claimed for ineligible costs.

A certain similarity is also evident in some specific audit findings concerning the 2008 financial year; for example, as part of an audit of two ERDF-financed OPs, the ECA also scrutinised projects that were originally financed from Member States' national resources. The projects (which did not refer to the Czech Republic) were already completed at the time when they were presented for co-financing out of the EU budget. The ECA ascertained that these projects were more prone to errors than projects selected in the customary way. That is because there was no effective preliminary verification by national authorities as to whether they complied with EU funding rules[133]. Based on the audit, the ECA stated that as the end of the 2000–2006 programming period drew closer, national authorities were under pressure to absorb the EU financial allocation. That simultaneously increased the risk that costs of ineligible projects could be paid out of the EU budget[134].

The SAO made a similar finding in its audit of an OP financed out of the *European Social Fund* ("ESF"). A pilot project approved in December 2007, whose aim was to scrutinise the possibilities of financing certain State employment policy instruments out of the ESF in the form of refunds of State spending, was selected for the audit sample. Expenditure paid for out of the State budget during 2007 was refunded. The pilot project was prepared mainly so that the ESF allocation for 2005 could be drawn down[135], as application of the "n+2" rule made it necessary to draw down this allocation by 31 December 2007 at the latest. The implementation of the pilot project failed to respect, however, the requirements of EU legislation on eligibility of costs and securing publicity[136].

B.3.5 Audit work by the Commission in the Czech Republic

The National Coordination Authority[137] arranged for an analysis of four completed audits conducted by the Commission in the Czech Republic in the shortened programming period 2004–2006, focusing on programmes financed out of the ERDF and ESF[138]. The analysis was complemented by the results of ex-post checks demanded by the Commission in the case of transactions financed in this programming period from the ERDF and the *Cohesion Fund*. One output of the analysis was the categorisation of the most common findings and recommendations for making management and control systems more effective for the 2007–2013 programming period in particular.

The summary of the Commission's ERDF-related audits reveals the following:

- The administrative capacities of the IBs were not considered sufficient in consequence of staff fluctuations.

132 The SAO mainly uses the multi-criteria method to select the audit sample.
133 The fund's specific eligibility rules and other Community rules, e.g., the EU rules on public procurement and on State aid.
134 Point 6.19, ECA's Annual Reports concerning the financial year 2008.
135 Total drawdown was CZK 284.7 million, i.e., 8.2% of the total allocation for Priority 1 in OP *Human Resources Development*.
136 Audit No. 08/06, SAO Bulletin 1/2009, which was also mentioned in *EU Report 2009*.
137 The National Coordination Authority is part of the Ministry for Regional Development.
138 Material entitled "*Audits*" drawn up by MfRD for a meeting of the Management and Coordination Committee on 8 December 2009.

- The updating of work procedures was unsatisfactory, as the IB's internal handbooks were not systematically approved by the MA.
- In the application administration process, acceptability criteria were defined too generally; moreover, even in this form the criteria were not rigorously upheld and additional criteria were used with no advance notice to applicants.
- There were no formal procedures for cases when unsuccessful applicants lodged an appeal.
- The procedures for verifying the compliance with the rules of state aid *de minimis* were unclear.
- Audit of projects detected shortcomings in the planning and methodology of on-the-spot checks.
- There was insufficient evidence of monitoring of corrective measures adopted in response to audit findings, and checks in the area of public procurement were rated insufficient.
- Audit of systems revealed insufficient monitoring of the 5% sample of transactions selection procedure.
- Regarding certification, the work of the Paying and Certifying Authority before certification was rated unsatisfactory, most notably in connection with public procurement.

The summary of ESF-related audits showed similar findings, e.g., insufficient administrative capacities in the MA and IB for performing on-the-spot checks. It was stated that projects checks and system audits did not begin because of the early phase of project implementation. The Commission also drew attention to delays in the payments process, posing a risk as regards fulfilment of the "n+2" rule.

The outputs from ex-post checks ERDF-financed projects, which the Commission requested on a selected sample, are currently only available in the form of preliminary findings and are still being discussed by the Czech Republic and the Commission. Nevertheless, the nature of the findings and the subsequent proposed recommendations for MAs for the 2007–2013 programming period confirm the similarity with the findings of the audits performed by the Commission.

B.3.5.1 Comparison of Commission's and SAO's findings

Comparison of the aforementioned analysis of the results of audits conducted by the Commission in the Czech Republic regarding programmes financed from the ERDF and ESF in the 2004–2006 programming period and the SAO's audit findings reveal matches in certain thematic areas:

- Regarding administrative capacity for ERDF-financed programmes, for example, the Commission states that staff fluctuations in the IB jeopardise its functioning. The SAO rarely included scrutiny of this issue in its audit work, yet it made a similar finding in the case of an ESF-financed OP. Its audit conclusion declared that insufficient personnel capacity mainly affected administration of the grant scheme. The outcomes were that, for example, there were marked delays in the conclusion of contracts with successful applicants or the administration of ongoing projects was insufficient, resulting in impacts on payment of the claimed amounts to some final beneficiaries.[139]
- Similarly, the Commission criticised the administration of applications because the acceptability criteria in the assessment of ERDF-financed projects were defined too generally and were not rigorously upheld and additional criteria were also used. Regarding selection decisions, the Commission stated that there were no even formal procedures for cases when unsuccessful applicants lodged an appeal. The same findings made the SAO, too.[140] Furthermore, similarly to the Commission's findings, the SAO drew attention to shortcomings in the project assessment process in audits of programmes financed out of the ERDF, the *European Agricultural Guidance and Guarantee Fund* ("EAGGF") and the EFF, where points-scoring criteria that did not rate efficiency and economy were used.[141] An absence of procedures for appeals by applicants was detected.
- There are also similarities in the Commission's and SAO's findings from project audits. The Commission's primary findings highlight shortcomings in the methodology of on-the-spot checks as regards their goal, number of projects, scope, and other details[142]. The SAO repeatedly drew attention to the fact that checks performed by MAs were not carried out in accordance with the Community regulations and the Act on Financial Control. The MAs delegated powers to perform administrative controls to the IB, even though the Act on Financial

139 Audit No. 08/06, SAO Bulletin 1/2009.
140 Audit No. 08/25, SAO Bulletin 4/2009.
141 Audit No. 08/06, SAO Bulletin 1/2009; Audit No. 08/25, SAO Bulletin 4/2009; Audit No. 09/09, SAO Bulletin 1/2010; and Audit No. 09/12, SAO Bulletin 1/2010.
142 Pursuant to Article 4 of Commission Regulation (EC) No. 438/2001 laying down detailed rules for the implementation of Council Regulation (EC) No. 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds.

Control does not permit such delegation.[143] Administrative controls before project approval did not focus on 3E[144] assessment. Administrative interim and follow-up checks displayed shortcomings, too.[145]

On the other hand, some audit findings were made by either the Commission or the SAO alone:

- The Commission declared that the procedures for verifying the compliance with the rules of state aid *de minimis* were unclear and found shortcomings in the procedure for selecting a 5% sample of transactions in systems audits. However, the SAO did not detect these errors.
- Conversely, the SAO repeatedly drew attention to shortcomings in the system of monitoring indicators for monitoring the effectiveness of programmes and assessing the extent to which programmes' quantified goals were achieved[146]. The Commission made no such findings, however.[147]

B.3.6 Protection of EU's financial interests in the Cohesion policy area

Cohesion Policy is implemented through shared management of the budget; for that reason individual Member States are responsible for preventing, detecting, reporting, and remedying irregularities. As in previous years, the most common irregularities according to the Commission's data concerned ineligible expenditure, breach of public procurement rules, and lacking or incomplete documentation. A large number of irregularities are also still placed in the "other irregularities" category[148]. Most irregularities were detected in documentary checks, followed by financial audits. The next biggest category was irregularities detected without any specification of the method used. A significant quantity of irregularities was also reported on the basis of the results of additional checks requested by the Commission, but this method concerned only Italy (341 cases) and the Czech Republic (11 cases).

In 2008, 82 irregularities were reported to the Commission in the context of programmes in the Czech Republic co-financed out of the Structural Funds and the *Cohesion Fund*; which was more than double the number in 2007 (40 irregularities). The following table provides more details.

Table 13: Number of irregularities reported by the CR in 2008

Number of irregularities reported	82
of which Structural Funds	80
of which Cohesion Fund	2
Volume of reported irregularities (in €)	14,016,754
of which Structural Funds	13,928,544
of which Cohesion Fund	88,210
Volume of recovered amounts (in €)	603,143
of which Structural Funds	603,143
of which Cohesion Fund	N/A

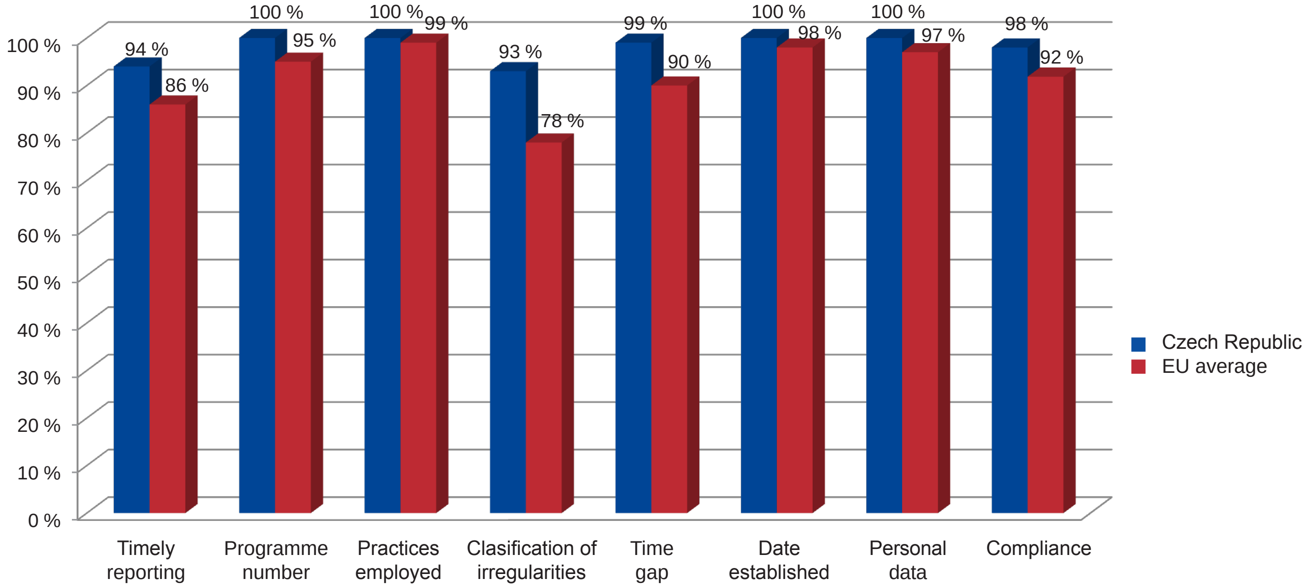
Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15.7.2009.

Of the 80 irregularities reported in the case of the Structural Funds, the largest number (48 in total) concerned the ERDF, representing a value of €12.7 million; 30 irregularities worth approx. €1.1 million concerned the ESF. The two remaining irregularities concerned the EAGGF (approx. €0.136 million).

The Commission's Report on the protection of financial interests also contains data on the discharge of duties associated with Member States' reporting of irregularities. The following Graph 9 compares the Czech Republic and the EU average in this area:

143 Audit No. 09/09, SAO Bulletin 1/2010 and Audit No. 09/12, SAO Bulletin 1/2010.
144 3E stands for *Effectiveness, Efficiency,* and *Economy*.
145 Audit No. 09/12, SAO Bulletin 1/2010.
146 This is discussed in greater detail in Chapter B.3.3.4.
147 Material entitled "*Audits*" drawn up by MfRD for a meeting of the Management and Coordination Committee on 8 December 2009.
148 The third most frequently given irregularity code.

Graph 9: Compliance with the reporting obligations in 2008



Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15.7.2009.

As the graph shows, the Czech Republic ranks among the more disciplined Member States in terms of discharging its reporting duty, as it exceeds the EU average in all parameters (the Czech Republic's overall average is 98%, the EU overall average 92%). It is also important to mention that there was improvement in all the parameters compared to 2007.

Irregularities detected by the SAO

The SAO, as an external audit body, identifies the primary suspicion of irregularity and subsequently initiates action.[149] In the previous period, a considerable volume of shortcomings were found by, for example, the audit No. 08/06, which detected irregularities in six ESF-financed projects.

Given by the seriousness of the findings that concerned this audit, there was communication between the Audit Authority ("AA") and the Commission in 2009 regarding the response to the detected problems. The AA sent the Commission an action plan for withdrawal of shortcomings; the Ministry of Labour and Social Affairs ("MoLSA") is responsible for this action plan's execution. In addition, on 9 April 2009, the Paying and Certifying Authority suspended its certification of expenditure for the period from 1 October 2008 to 28 February 2009. The AA then informed the Commission about the state of corrective measures, including the discussion on this matter by the Government in January 2010. As the body for issuing winding-up declarations, when OP HRD is being wound up the AA will demand that MoLSA as MA implement the Action Plan and will subsequently consider the need for further audit work. Another consequence of the audit was that, based on the SAO's findings, the Office for the Protection of Competition officially decided to impose a fine on MoLSA in December 2009. The reason for the fine was the unclear and non-transparent defining of criteria in the award of a public contract worth CZK 148 million excl. VAT.

B.4 Other EU expenditure

Other EU expenditure represents a set of activities that contribute to cooperation between Member States in tackling common problems in areas related to Community policies. This other expenditure is financed directly from the EU budget and accounts for just a small part of it. As in the case of Operational Programmes financed out of the Structural Funds, these are mostly multiyear financial instruments. The composition and the content of these

149 Article 34 (18) of Czech National Council Act No. 337/1992 Coll., on the administration of taxes and fees; Article 8 (1) of Act No. 141/1961 Coll., on judicial criminal proceedings (Criminal Code).

instruments are adjusted according to current priorities when required. In the financial perspective for 2007–2013, most of the financial instruments are placed in Heading 1 *Sustainable Growth* and Heading 3 *Citizenship, Freedom, Security and Justice*. Appendix No. 3 of the *EU Report 2010* contains an overview of financial instruments by headings of the financial perspective.

B.4.1 Other EU financial instruments in the Czech Republic

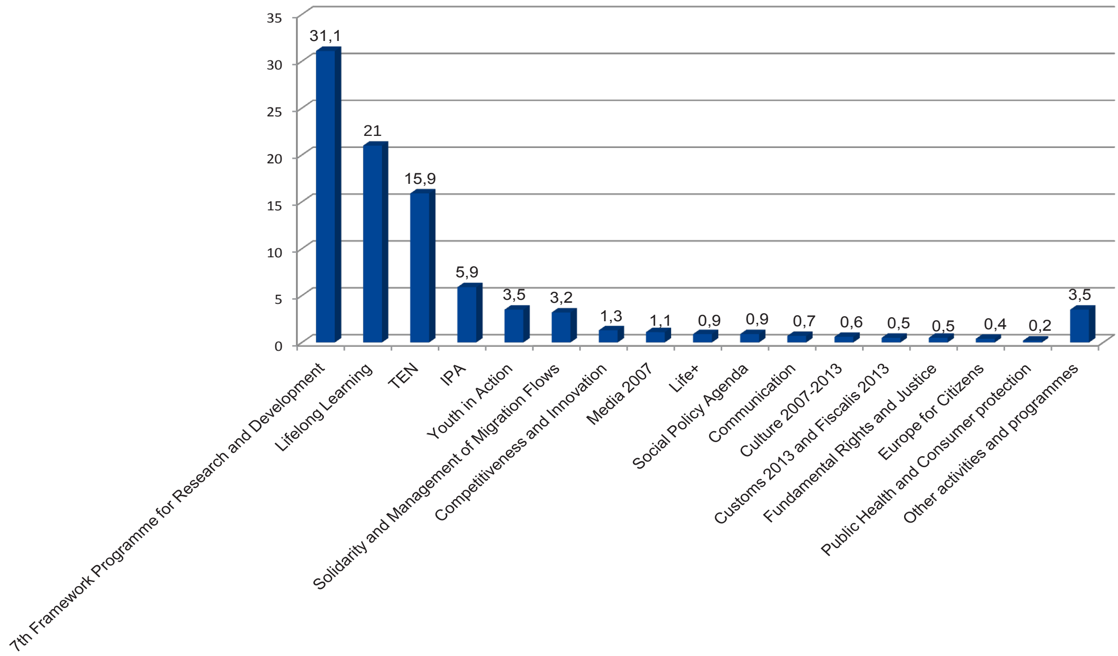
Unlike Operational Programmes, the administration of the other financial instruments and preparation of calls is, as a rule, in the competence of the Commission or specialised agencies created by the Commission for this purpose. In the Czech Republic, these instruments only have a contact point at the authority managing of the programme. There are also exceptions, and some of the financial instruments are implemented directly in the Czech Republic through national agencies (e.g., the National Agency for European Educational Programmes).

Another difference between these instruments and Operational Programmes is that most of the resources under these programmes are not allocated to individual Member States but for the specific financial instrument. For applicants from the Czech Republic this means that to succeed with their projects they have to stand up to international competition.

A close look at the use of other financial instruments in Member States in 2008[150] shows that beneficiaries in the Czech Republic obtained approx. €91.2 million under these programmes. Compared to the previous year, this amount was almost €20 million higher, but the percentage of the total amount paid out remains unchanged at 0.9% of the expenditure channelled into all Member States[151]. Even though the Czech Republic takes a small share of the finances, it should be mentioned that whereas in 2007 the biggest proportion (€15 million) of all expenditure was accounted for by a pre-accession instrument, in 2008 this expenditure fell sharply and spending on other financial instruments grew. The situation therefore improved slightly and shows a positive trend for the future. In addition, the differences between the Czech Republic and countries with a comparable population size are not so big as in 2007 (e.g., Portugal obtained €101 million and Hungary €103.5 million); only Belgium, with drawdown of €1,001 million, stands apart.

The following graph shows the state of drawdown of “other financial instruments” in the Czech Republic in 2008.

Graph 10: Use of other financial instruments in the Czech Republic in 2008 (EUR million)



Source: European Commission – *EU budget 2008 – Financial Report* .

150 European Commission – *EU budget 2008 – Financial Report*.

151 This share is calculated on the basis of EU expenditure effected in Member States, not total EU expenditure which also includes external expenditure. Expenditure on Community agencies was also not included in the calculation.

B.4.1.1 Pre-accession instruments

Since 1 January 2007, the EU pre-accession assistance has been provided to countries[152] through the IPA[153] pre-accession instrument, which is included in Heading 4 of the 2007–2013 financial perspective *The EU as a global player*. At present, pre-accession assistance programmes financed under this instrument in the Czech Republic are coming to an end.

All pre-accession projects of the programme entitled *Poland and Hungary: Assistance for Restructuring their Economies* ("Phare") implemented in the years 1998 to 2006 have already been completed, but the completion of projects implementation does not automatically mean the winding up of the programme. Based on the results of the final audits performed as a rule two to three years after the end of the project implementation, the Commission declares the programme closed. However, final beneficiaries must continue to fulfil their obligations stemming from financial memoranda or memoranda of understanding for a further five years since the official closure of the programme. By 31 March 2009, only seven out of a total of 38 Phare programmes from 1998, 1999, and 2000 were closed[154].

Following the Czech Republic's accession to the EU, Phare was followed by the 2004–2006 *Transition Facility*[155], with a total allocation of almost €36.06 million. By 15 December 2009, activities financed out of the *Transition Facility* budget were ceased; payments will continue until 15 June 2010.

Appendix No. 4 contains an overview of allocations and drawing from the Phare and *Transition Facility* programmes in the Czech Republic and their state on 31 March 2009.

The implementation of projects under *The special pre-accession programme for agriculture and rural development* ("SAPARD") was completed in 2006; the Czech Republic obtained the last payment from the Commission in 2007. When the Czech Republic joined the EU, projects funded by ISPA were transferred to the *Cohesion Fund*; their financing is ongoing.

B.4.2 Financial management and control in relation to other EU financial instruments

Other EU financial instruments are subject to various forms of financial management of the EU budget. The most common form is called direct centralised management, where the Commission itself selects projects that will receive support from these instruments and then provides the financing directly to the selected applicants. Other types are indirect centralised management and shared management[156]. In most cases, Member States are not responsible for managing these finances.

B.4.2.1 Audit work by the ECA

The ECA's Annual Report deals with other financial instruments not only in the DAS but also in the separate headings that analyse audit findings in detail. As far as the legality and regularity of transactions underlying the accounts is concerned, the ECA issued an unqualified opinion only in respect of expenditure on "Education and Citizenship". In the areas of "Economic and Financial Affairs", a qualified statement was issued owing to errors detected in the transactions relating to the *6th Framework programme on research and technological development*. In the remaining areas (i.e., "Research, Energy and Transport" and "External Aid, Development and Enlargement"), the ECA issued an adverse statement, indicating that these policy groups are materially, at various levels, affected by errors[157].

In 2008, the ECA did not undertake a mission in the Czech Republic concerning other financial instruments; the aforementioned conclusions are therefore not based on findings applying to the Czech Republic.

152 Countries that acceded in 2004 and 2007, candidate countries, and potential candidate countries.
153 Acronym for Instrument for Pre-Accession Assistance. Its goal is to help candidate countries and potential candidate countries. It was created by integrating preceding programmes and financial instruments such as Phare, Phare CBC, ISPA, SAPARD and CARDS, and the financial instrument for Turkey.
154 *Annual Report on the progress in using funds from the budget of the EU Transition Facility programme, the EEA and Norway Grants, and other financial support provided to the Czech Republic from abroad (Swiss-Czech Cooperation Programme)* - Government ref. No. 747-09.
155 Instrument for temporary assistance to new EU Member States.
156 Chapter D Internal Policies and Annexes 4 and 5 to the *EU Report 2008* explain in detail the different forms of management and the categorisation of financial instruments by management method.
157 Speech by Mr Vítor Caldeira, President of the ECA – www.eca.eu.

B.4.2.2 Audit work by the SAO

In 2009, the SAO completed two audits that focused on other financial instruments.

The first audit[158] dealt with the preparation of the Brno-Vienna road link (R52), including the risk assessment for financing this investment through OP *Transport*. This audit was included in this part of the *EU Report* because the Brno-Vienna project is defined by the EU legislation as a priority project on the Gdansk-Brno/Bratislava-Vienna motorway axis, which is part of the TEN-T network. The audit found that the plan to build the R52 road did not satisfy some EU requirements placed on the creation of the TEN-T network, e.g., insufficient allowance was made for environmental impacts and the alternative that the Brno-Vienna link could follow other routes using existing infrastructure was not analysed.

The aim of the second audit[159] was to scrutinise the provision, drawing, and use of finances earmarked for construction of a university campus for Masaryk University in Brno. Some of the finances used on the construction project came from the EIB in the form of a State-guaranteed loan[160]. The audit found that the construction project was extended by four years, pushing up the total construction cost significantly. For that reason the conditions for construction of the university campus were out of line with the investment plan and the size of the construction project was reduced. The audit found no shortcomings in public procurement.

B.4.3 Protection of the EU's financial interests in the other EU expenditure area

B.4.3.1 Instruments subject to direct centralised management by the Commission

In the case of financial instruments subject to the direct centralised management by the Commission[161], 932 irregularities were registered in the ABAC system for the EU as a whole in 2008. These irregularities' total financial impact on the EU budget was €34.7 million[162]. Most irregularities were detected by the Commission's administrative controls. The most common types of irregularity with the greatest impact on the budget included cases where the funded actions did not conform to the rules, followed by missing documents and expenditure lacking legal founding.

Seven irregularities were detected among beneficiaries from the Czech Republic in 2008; their total value was approx. €204,000. None of these irregularities was qualified as suspected fraud.

B.4.3.2 Pre-accession instruments

The obligation to report irregularities in the area of pre-accession assistance is enshrined in financing agreements, i.e., memoranda signed by the existing Member States and candidate countries on the one hand and the Commission on the other. These reports must possess certain requisite features, e.g., information about the period the irregularity occurred in and when it was detected, information about the subjects involved in the irregularity, how the irregularity arose, and information about the classification of irregularities.

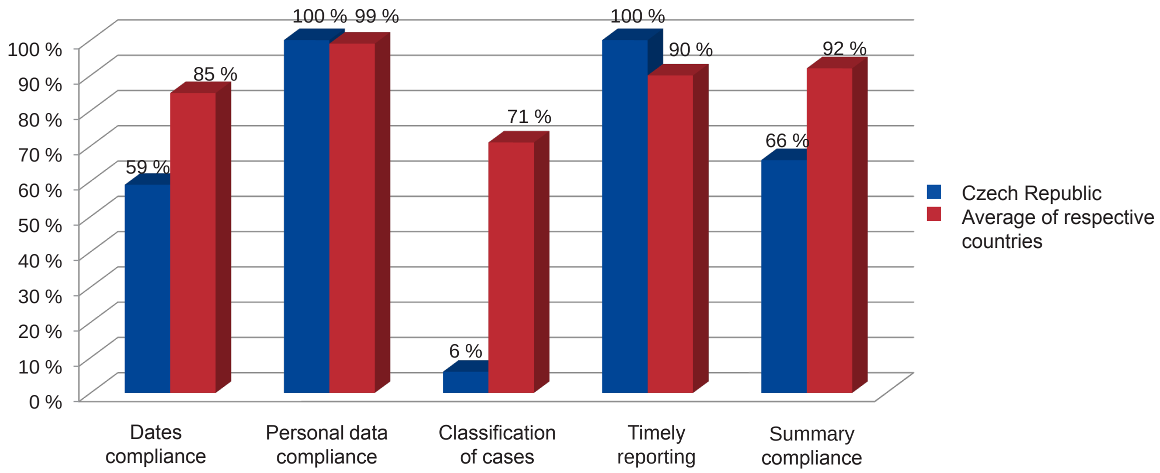
Every year, the Commission analyses the irregularities reported by Member States. The analysis for 2008[163] reveals that, as in 2007, the majority of irregularities were detected through controls of documents, administrative controls, and on-the-spot checks. The most common irregularities were failure to respect the conditions set out in contracts and regulations, claiming for ineligible expenditure, and failure to fulfil commitments entered into. As in the previous year, the irregularities with the biggest impact on the budget included falsified supporting documents.

158 Audit No. 08/26, SAO Bulletin 2/2009.
159 Audit No. 08/33, SAO Bulletin 3/2009.
160 In line with the SAO's audit powers, as regards the EIB it is authorised to audit only direct loans to the Czech Republic and loans to other entities which the Czech Republic guarantees.
161 The Commission only monitors irregularities in this type of financial management, using the ABAC system for this purpose. This system, which has been fully functional since 2008, only records irregularities where recovery orders have been issued. It does not cover irregularities that are detected at the start of project implementation and lead to a reduction in the interim or final payment. In these cases it is not necessary to issue a recovery order and these irregularities are not recorded in the ABAC system.
162 *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15. 7.2009.
163 *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008*, SEC(2009) 1003 of 15. 7.2009.

In 2008, the Czech Republic reported a total of seventeen irregularities worth a total of €464,000. All the irregularities affected the Phare programme only.

The following graph shows the degree to which the Czech Republic has discharged its obligation to notify the Commission about identified shortcomings. The data for the Czech Republic are compared with data for selected Member States and candidate countries[164] that draw the pre-accession EU assistance.

Graph 11: Compliance rate of the reporting discipline against Commission



Source: *Annex to the 2008 report from the Commission on the protection of the European Communities' financial interests and the fight against fraud - Statistical evaluation of irregularities, own resources, agriculture, structural measures, pre-accession funds and direct expenditure - year 2008,* SEC(2009) 1003 of 15.7.2009.

The graph shows that the average score in the discharge of reporting discipline among States drawing pre-accession assistance is 92%. The figure for the Czech Republic is just 66%. As in 2007, the reporting of the classification of irregularities had a fundamental impact on reducing the Czech Republic's resultant average, as the irregularity was classified in just one out of the seventeen cases of irregularity. Although the individual irregularity reports were lodged in time in the Czech Republic, the consequence was that information about the detection of individual irregularities was submitted late to the Commission.

In 2008, the Commission issued a recovery order to the Czech Republic for €9.35 million paid under Phare. The Government decided not to accommodate this request because it did not agree with the way it was issued. The reason for the refusal was the lack of arbitrage with a view to reaching mutual agreement and settling the dispute. The Czech Republic also disagreed with the amount the Commission was demanding. The Commission rejected these arguments and offset its claims against two interim payments earmarked for programmes under *Joint Regional* OP and the *Single Programming Document for Objective 3 of the Prague Cohesion Region* totalling €10.81 million. In response, the Czech Republic lodged an action[165] against the Commission with the European Court of Justice, specifically the Court of First Instance, on 15 October 2008. A decision on this action is currently pending. [166]

Based on its investigation, the Commission also decided in 2009 that a total of €1.56 million in wrongfully paid-out funds under Phare should be paid back. The Government decided to pay this sum to the Commission, but it is of the opinion that the Commission's announcement of the debt was unauthorised, i.e., without due scrutiny of the actual state of affairs and without considering the arguments of the Czech State authorities. In this context, the Government charged the relevant authorities with examining the option of an action with the European Court of Justice to have the Commission's decision annulled.[167]

164 The following countries: Bulgaria, Estonia, Croatia, Hungary, Lithuania, Latvia, Malta, Poland, Romania, Slovakia, Slovenia, and Turkey.
165 EU Official Journal 2008/C 327/69.
166 Submission Report "*Lodging a complaint against nullity of Commission Decision of 7 August 2008 on paying off obligations and outstanding debts*", ref. No. 1456/08 to Czech Republic's Government Resolution No. 1222 of 1 October 2008.
167 Submission Report „*Draft procedure regarding the debit note for EUR 1,564,448.14 from Phare 2003, CZ 2003/005-601.08.05*", ref. No. 1345/09 to Czech Republic's Government Resolution No. 1210 of 16 September 2009.

C. Other activities related to the EU’s financial management

C.1 Legal matters

With regard to the performance of audits, the SAO focuses its attention, *inter alia*, on scrutiny of the adequacy of the legal framework for management with public budget finances and State property. Any suggestions for improvements to the legal environment are presented to the responsible authorities either in SAO’s audit conclusions or under the interdepartmental comments process on draft legislation. The following part of the *EU Report 2010* deals with suggestions related to the EU financial management that were mainly based on audit work done in 2009.

C.1.1 Adaptation of the Act on Financial Control to the requirements of Community regulations

Community regulations dealing with the management of finances of the Structural Funds and the *Cohesion Fund* in the 2004–2006 programming period presupposed the existence of a multilevel implementation structure in Member States[168]. However, these regulations did not contain any express empowerment for MAs to delegate activities[169].

168 For instance, Article 2 (2) of Commission Regulation (EC) No. 438/2001 laying down detailed rules for the implementation of Council Regulation (EC) No. 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds.

169 The only exception was the provision of Article 9 (i) and Article 27 of Council Regulation (EC) No. 1260/1999 laying down general provisions on the Structural Funds.

The MAs in the Czech Republic often delegated a number of their tasks to IBs. These delegated activities included the performance of preliminary, interim, and follow-up project controls. The national legislation[170] governing the exercise of financial controls does not reckon with the delegation of controls to any other body than the under whose authority the exercise of control falls pursuant to this Act. An explicit legal empowerment[171] is required to enter into contracts outsourcing the exercise of State administration (i.e., including the exercise of public-administration control). Neither the Czech nor Community legislation for the 2004-2006 programming period contains any such explicit empowerment to conclude delegating contracts, however. For that reason, certain MAs that delegated such control did so in contravention of the national law. At the same time, the relevant Community regulations instructed the MAs to proceed fully in accord with the institutional, legal, and financial framework of their country when carrying out their tasks[172].

The SAO repeatedly drew attention to the fact that the Act on Financial Control is not suitably adapted to the requirements of the Community legislation and the practical requirements, as it does not enable the relevant authorities to delegate their control powers and obligations to other entities[173]. The draft amendment that had been prepared to eliminate this shortcoming was not adopted[174]. The unsatisfactory national legislation on the delegation of MAs' tasks thus persists in the new programming period, too.

C.1.2 Setting time limits for approving projects and for reimbursing aid beneficiaries' expenditure

The legislation governing the process of the administration of aid from the Structural Funds requires that the relevant authorities proceed without undue delay, or as fast as possible, when administering projects[175]. Specific time limits are not set for the completion of the various stages of the administrative process, however. The provision of the Code of Administrative Procedure setting specific time limits for issuing project approval decisions is not applied by MAs in practice[176].

The SAO has repeatedly drawn attention to the fact that the absence of specific time limits means that the project approval and claim reimbursement processes are inordinately protracted in practice[177]. In some programmes, time limits are not set even in the internal regulations issued by the grant provider. In other cases, the provider does define time limits but then fails to ensure they are complied with. Uncertainty surrounding the date when project administration ends causes final beneficiaries a number of difficulties, most notably preventing them from managing their own cash flow effectively[178]. For these reasons, specific time limits for completion of administration should be defined directly in the national legislation.

C.1.3 Adaptation of national legislation to the change in the set of EU funds

The national legislation provides that bodies in the implementation structure are obliged to submit reports on the results of financial controls to the Ministry of Finance[179]. Above all, these reports should contain a summary assessment of the results of controls executed by the relevant body and more detailed information about the audits performed in individual expenditure programmes. To this end, an implementing Decree[180] provides

170 Act No. 320/2001 Coll., on financial control in public administration and on amendments to some related Acts (Act on Financial Control).
171 Provision of Article 160 (5) of Act No. 500/2004 Coll., Code of Administrative Procedure.
172 Article 34 (1) of Council Regulation (EC) No. 1260/1999 laying down general provisions on the Structural Funds.
173 Audit No. 08/22, SAO Bulletin 2/2009; Audit No. 09/09, SAO Bulletin 1/2010; Audit No. 09/12, SAO Bulletin 1/2010.
174 Parliamentary document No. 63 of 2006, V electoral terms, was not approved, as the petitioner (the Government) revoked it.
175 For instance, Article 32 (1) of Council Regulation (EC) No. 1260/1999 laying down general provisions on the Structural Funds, Article 80 of Council Regulation (EC) No. 1083/2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No. 1260/1999, and Article 6 (1) of Act No. 500/2004 Coll., Code of Administrative Procedure.
176 In the past, the SAO drew attention to uncertainties concerning the extent of the application of the Code of Administrative Procedure to grant proceedings.
177 See, e.g., Audit No. 08/25, SAO Bulletin 4/2009; Audit No. 05/32, SAO Bulletin 2/2006.
178 Aid beneficiaries often have to pre-finance supported activities out of their own resources. If they do not have sufficient own resources, they are compelled to take out a loan. The absence of binding time limits means they have no legal certainty as to the length of time they will need the loan for, and delays in disbursing finances mean that additional costs incur in the form of higher interest on these loans.
179 Act No. 320/2001 Coll., on financial control in public administration and on amendments to some related Acts (Act on Financial Control).
180 Decree No. 416/2004 Coll., implementing Act No. 320/20001 Coll., on financial control in public administration and on amendments to some related Acts (Act on Financial Control), as amended by Act No. 309/2002 Coll., Act No. 320/2002 Coll., and Act No. 123/2003 Coll..

specimens of the obligatory appendices that are to contain the results of audits relating to individual expenditure programmes (or to individual EU funds).

The SAO drew attention to the fact that the Decree has not yet been adapted to the new structure of EU funds. The results of public-administration audits conducted regarding EFF expenditure cannot be entered in any of the appendices, as these appendices do not reckon with the existence of the new EFF. It will consequently be difficult for the relevant control body to report the results of audits concerning OP *Fisheries*, which is financed out of the EFF.[181]

C.1.4 Changes to the legislation on VAT administration

During 2008 and 2009, there were a number of amendments of both Community and national legislation on VAT administration. Some of the changes made (e.g., shortening of the period for which recapitulative statements are made or specification of the conditions for de-registration) correspond to the recommendations made by the SAO and the German SAI in the *Report on the Results of the Parallel Audit of the Administration of Value Added Tax in the Czech Republic and in the Federal Republic of Germany*. To a certain extent, the shortcomings in the legislation highlighted by the SAO and the German SAI were thus remedied. Other recommendations regarding the national legislation have not been accepted yet, however (e.g., introduce an obligation to submit VAT returns in electronic form in the Czech Republic).

For more details on this issue see Chapter B.1 of the *EU Report 2010*.

C.2 International activities of the SAO

The SAO's endeavour to improve the effectiveness of its external audit work, which by law encompasses audit of EU budget finances, leads it to try to gain practical experiences in order to share the most effective audit instruments and techniques. For that reason, the most significant cooperation within the EU is conducted with the ECA and the Contact Committee of the Heads of the SAIs of the EU Member States is one of its most important partners at multilateral level. Bilateral activities with SAIs of EU countries are another form of cooperation.

C.2.1 Audit work

C.2.1.1 Audits conducted in cooperation with national SAIs and the ECA

The EU Report 2009 mentioned the completion of a parallel audit[182] with the German SAI dealing with the administration of VAT. The audit, rated positively by both SAIs, was followed up by an audit intended to check the state and development of measures adopted to remedy the identified shortcomings. The focus of the follow-up audit included monitoring selected cases of business transactions between the Czech Republic and Germany and checking payments of VAT by large businesses. The audit also scrutinised the procedures followed by the two countries' tax administrations in international cooperation when recovering tax arrears. The audit entitled *Administration of Value Added Tax* was included in the SAO's Audit Plan under number 09/11. Details of this audit can be found in Section B.1.2.

Based on an analysis of reports on the EU financial management published by some SAIs, the ECA initiated a proposal for a pilot project for co-ordinated audits at the start of 2009, whose results could also be used for the statement of assurance. This constitutes an entirely new concept of cooperation with the interested SAIs[183], which in the short run should lead to sharing of experience regarding audit practices. If such co-operation is continued, a reduction in the administrative burden on authorities in the Member States responsible for administration of EU funds could be the result in the long run. The area of finances earmarked for the *Rural Development Programme*, specifically measures under Axis II focusing on projects to improve the environment and the countryside, was chosen for the pilot project with the SAO.

181 Audit No. 09/12, SAO Bulletin 1/2010.
182 Audit No. 06/27, SAO Bulletin 2/2007.
183 Besides the SAO, the SAIs of Denmark and the Netherlands are also discussing to undertake a co-ordinated audit with the ECA.

C.2.1.2 Audits performed in the context of cooperation with the Contact Committee

At a meeting in Luxembourg in December 2008, the Contact Committee tasked the Working Group on Structural Funds with performing a coordinated audit of the costs of the internal control system when implementing structural measures. The SAO participated in this endeavour and made this issue an integral part of its Audit No. 09/26 *Funds Earmarked for Transport Infrastructure Projects under the Regional Operational Programmes*. The audit outputs are supposed to be presented to the steering group by January 2011 so that a joint report can be written.

C.2.1.3 Audit missions of EU institutions in the Czech Republic

The SAO has been a long-term and regular participant in ECA's audit missions in the Czech Republic, in which the SAO coordinates the handover of information from auditees and takes part in the mission as an observer. Cooperation in the context of ECA's missions can be described as highly functional.

In 2009, the ECA undertook four audit missions in the Czech Republic:

- EAGF-related audit focusing on SAPS and IACS. The outputs from this audit, which included on-the-spot inspections of a sample of six selected projects, formed part of the basis for the DAS 2008.
- INTERREG 2004–2006[184] related audit focusing mainly on the national administration system, the reporting of irregularities, and the project selection method. The audit's outputs will serve as part of the basis for the DAS 2009.
- EAFRD-related audit intended to scrutinise the set-up and working of the supervisory and control system and the legality and regularity of transactions selected for a sample from all four Axes of the *Rural Development Programme*. The audit's outputs will serve as part of the basis for the DAS 2009.
- audit related to the reform of the EU sugar industry and the associated EU support, intended to check whether the reform's goals were achieved and whether this was done in an efficient and economical manner. The audit looked at the following types of support: SSP, restructuring aid paid to sugar beet growers, restructuring aid paid to machinery contractors, and diversification support. The audit results will form the basis for a Special Report.

In two other cases, the SAO was asked by the ECA to cooperate in picking up information through a questionnaire survey. In this process, the SAO was the coordinating body that summarised the replies. This involved follow-up audits focusing on measures under selected priority Axes of the *Rural Development Programme*:

- audit concerning AEMs;
- audit concerning the *Leader* Initiative.

As in previous years, SAO auditors took part in the Commission's audit missions in the Czech Republic on an exceptional basis. Thus, improving its awareness of audits conducted by the Commission continues to be one of the SAO's priorities for improving mutual cooperation.

In 2009, SAO auditors took part in the following Commission missions:

- audit concerning the administration and implementation of LPIS/GIS (Land Parcel Information System) and audit of rural development measures (agri-environmental measures) performed by auditors of the Directorate-General (DG) for Agriculture and Rural Development.
- audit concerning measures to improve the environment and landscape under Axis II of the *Rural Development Programme* conducted by auditors of the DG Agriculture and Rural Development.
- audit concerning export compensations and Common Market Organisation for sugar conducted by DG Agriculture and Rural Development auditors.
- two audits concerning selected projects co-financed out of the *Transition Facility* which were conducted by auditors from Moore and Stephens under an authorisation of DG Enlargement.

C.2.2 Experience sharing within the Contact Committee

At its November 2009 meeting in Budapest, the Contact Committee discussed mainly the role of SAIs in relation to measures adopted in response to the financial and economic crisis. Another key topic was the independence of SAIs. One new development in 2009 was the creation of two networks of experts to cooperate in the area

184 These are programmes designed to promote cross-border, trans-national, and inter-regional cooperation.

of fiscal policy and of the Lisbon strategy. In addition, a platform was established for information exchange regarding EU-related audits. Its aim is to facilitate the exchange of important data in a structured and clear form. As regards other activities, a coordinated audit of funds earmarked for the trans-European transport network, specifically for the Lyon-Terst-Koper-Ljubljana-Budapest rail link, went ahead.

Of the Contact Committee Working Groups the SAO is represented in, the first that should be mentioned is the new **Public Procurement Updating Group**. This Working Group's task is to follow on from the work of the previous Working Group on Public Procurement, which only had a temporary mandate. It will review the documentation already drawn up, prepare a proposal for a database of documents related to public contracts, and organise a seminar to acquaint auditors with the possible outputs from this database.

The SAO also plays an active role in the Working Group on VAT, the Working Group on Common Auditing Standards, the Working Group on the Structural Funds IV, and the Working Group on National SAI Reports on EU Financial Management.

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E. Appendices

Appendix No. 1: List of Acronyms

AA	Audit Authority
AEM	Agri-environmental measure
CAP	Common Agriculture Policy
CR	Czech Republic
DAS	Declaration d´assurance (Statement of Assurance)
EAFRD	European Agricultural Fund for Rural Development
EAGF	European Agricultural Guarantee Fund
EAGGF	European Agricultural Guidance and Guarantee Fund
EC	European Communities
ECA	European Court of Auditors
EEA	European Economic Area
EFF	European Fisheries Fund
EIB	European Investment Bank
EP	European Parliament
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EU-10	Member States that acceded to the EU in 2004

EU-15	Member States that acceded to the EU before 2004
FIFG	Financial Instrument for Fisheries Guidance
DG	Directorate-General
GNI	Gross National Income
HRDP	Horizontal Rural Development Plan
IACS	Integrated Administration and Control System
IB	Intermediate Body
IPA	Instrument for the Pre-accession Assistance
ISPA	Instrument for Structural Policies for Pre-accession
LFA	Less Favoured Areas
MA	Managing Authority
MfRD	Ministry for Regional Development
MoA	Ministry of Agriculture
MoE	Ministry of the Environment
MoF	Ministry of Finance
MoLSA	Ministry of Labour and Social Affairs
OLAF	European Anti-Fraud Office (L'Office Européen de Lutte Anti-Fraude)
OP	Operational Programme
OP HRD	Operational Programme *Human Resources Development*
OP RDMA	Operational Programme *Rural Development and Multifunctional Agriculture*
OWNRES	Own Resources
PHARE	Poland and Hungary: Assistance for Restructuring their Economies
PHARE CBC	Poland and Hungary: Assistance for Restructuring their Economies Cross Border Cooperation
RDP	Rural Development Programme
ROP	Regional Operational Programme
SAI	Supreme Audit Institution
SAIF	State Agricultural Intervention Fund
SAO	Supreme Audit Office
SAPARD	Special Accession Programme for Agriculture and Rural Development
SAPS	Single Area Payment Scheme
SEF	State Environmental Fund
SPS	Single Payment Scheme
SPD 2	Single Programming Document for Objective 2 for the Prague Cohesion Region
SSP	Separate Sugar Payment
TEN-T	Trans-European Network – Transport
TFEU	Treaty on the Functioning of the European Union
UDF	Urban Development Fund
VAT	Value Added Tax
VIES	Value Added Tax Information Exchange System

Appendix No. 2

Actions in the Action Plan to strengthen the Commission's supervisory role under shared management of structural actions and their implementation stage by 3.2.2009			
	Action	**Deadline**	**Implementation stage by 3.2.2009**
1. Actions under the Structural Actions joint audit strategy for 2000-2006			
1.1	Carry out targeted audits on high-risk management bodies (2000-06)	31. 12. 2009	Ongoing
1.2	Complete the follow-up of the Member States' implementation of 27 current remedial action plans to remedy serious deficiencies in those Member States' management and control systems.	31. 12. 2009	Ongoing
1.3a	Bring to conclusion the 20 suspension and financial correction procedures currently underway for 2000–2006.	31. 12. 2009	Ongoing
1.3b	Bring to conclusion the 34 financial correction procedures from closure audits for 1994–1999.	30. 6. 2009	Ongoing
1.4	Follow up the individual substantive error cases for DAS 2006 together with any systemic implications.	30. 9. 2009	Ongoing
2. Main actions under Action Plan towards an Integrated Internal Control Framework			
2.1	Action 9 - Construct effective tools for sharing audit and control results and support a uniformed audit approach.	31. 12. 2008	Completed
2.2	Action 10 – Conduct initial estimation and analysis of costs of controls for ERDF.	31. 5. 2008	Completed
2.3	Action 11N – Examine the reliability of national reporting systems for recoveries and financial corrections.	31. 12. 2008	Completed
2.4	Action 14b – Provide guidelines for beneficiaries and/or intermediate levels on controls and responsibilities in the control chain	30. 6. 2008	Completed
2.5	Action 15 - Promote "Contracts of Confidence" in connection with Structural Funds (due to which the Commission will be able to rely on national audit work in the period 200-2006 and which will form a base for similar co-operation in 2007-2013).	30. 9. 2008	Completed
2.6	Action 16 - Co-ordinate audit standards, error rate reporting etc. as regards Structural Funds.	31. 12. 2008	Completed
3. Preventive actions for closure of 2000-2006 programmes and projects			
3.1	Complete the audit enquiry on the review of the work of the winding-up bodies (2000-06).	31. 12. 2009	Ongoing
3.2	Finalise internal procedures to ensure rigorous examination of closure documents.	30. 6. 2008	Partially completed
3.3	Raise awareness of Member States of closure guidelines issued by the Commission in 2006.	31. 12. 2008	Completed
4. Preventive actions for the 2007-2013 programming period			
4.1	Review of compliance assessment reports and opinions.	30. 9. 2009	Ongoing
4.2	Review of national audit strategies.	30. 9. 2009	Ongoing
4.3	Actions on simplification:		Completed
	a) Note on partial closure under Article 88 of Council Regulation (EC) No. 1083/2006 and inclusion of the topic in annual meetings with Managing Authorities.	31. 12. 2008	
	b) Note on using flat rate for indirect costs (ESF only) and inclusion of the topic in annual meetings with Managing Authorities.	31. 12. 2008	
4.4	Review and clarification on eligibility issues for the period 2007-2013:		Completed
	a) Compilation of all the Community eligibility rules for 2007-2013 in a brochure.	30. 9. 2008	
	b) Finalization of a guidance note on Article 55 of Council Regulation (EC) No. 1083/2006 - revenue-generating projects.	30. 6. 2008	
	c) Finalization of a guidance note on State Aid rules.	30. 6. 2008	
4.5	Raise awareness of public procurement rules.	31. 12. 2008	Completed
5. Actions to improve primary controls at a national level			
5.1	Organise a seminar for managing and certifying authorities and inclusion of the topic in annual meetings with Managing Authorities.	30. 6. 2008	Completed

Actions in the Action Plan to strengthen the Commission's supervisory role under shared management of structural actions and their implementation stage by 3.2.2009			
Action		Deadline	Implementation stage by 3.2.2009
5.2	Update guidance documents on good practice for primary controls and the certification function for the period 2007–2013.	30. 6. 2008	Completed
5.3	Provide a self-assessment tool for Managing Authorities on compliance.	30. 6. 2008	Completed
6. Actions to improve reporting on financial corrections by Member States			
6.1	Follow up on data reported by Member States to complete gaps and correct inaccuracies.	30. 6. 2008	Completed
6.2	On-the-spot verification of a sample of data reported by Member States.	31. 12. 2008	Completed
7. Actions to improve reporting by Commission on impact of audit activity			
7.1	Improve systems for recording and reporting on steps that follow up on audit recommendations.	30. 9. 2008	Completed
7.2	Improve systems for recording and reporting on corrections resulting from the Commission's control and audit activity.	30. 9. 2008	Completed
8. Actions to increase impact of Commission audit activity			
8.1	Establish and implement policy of suspending payments by Commission as soon as possible following detection of serious weaknesses in national systems.	30. 4. 2008	Completed
8.2	Modify internal procedures for suspension and financial corrections to speed up applications.	30. 4. 2008	Partially completed
9. Actions to improve assurance provided by Annual Activity Reports			
9.1	Undertake the following actions in connection with the Annual Activity Reports preparation:	31. 3. 2008	Completed
	a) Provide information on steps that were taken in respect of all systems in which serious system shortcomings were identified in 2006.		
	b) Report on Action Plan implementation by Member States to remedy shortcoming.		
	c) Report on decisions to suspend interim payments, other preventive measures taken by authorising officers by delegation as regards interim payments, financial corrections made by Member States at a request of Commission, and resolutions on financial corrections taken by Commission.		
	d) Provide a detailed statement of reasons for not expressing a reservation when serious system shortcomings were identified.		
	e) Report on steps following up previous ECA's recommendations.		
10. Actions to maximise value of annual summaries under Article 53b of the Financial Regulation			
	Analyze summaries received, include results in the Annual Activity Report, and take measures as to non compliance with obligations by Member States.	31. 12. 2008	Completed

Source: Communication from the Commission to the European Parliament, the Council and the Court of Auditors: *Report on the implementation of the action plan to strengthen the Commission's supervisory role under shared management of structural actions*, COM(2009) 42 final, 3 February 2009.

Appendix No. 3

Financial perspective 2007 - 2013	
Heading	**Framework Programme's name**
Heading 1a - Competitiveness for Growth and Employment	7th Framework programme on research and technological development
	7th Framework programme of the European Atomic Energy Community (Euratom) for nuclear research and training activities
	Integrated action programme in lifelong learning
	CIP (Competitiveness and innovation framework programme)
	TEN (Trans-European transport network) - granting of Community financial aid in the field of the trans-European transport energy networks
	Marco Polo II
	Galileo
	Progress (Community programme for employment and social solidarity)
	European Institute of Innovation and Technology
	Customs
	Fiscalis
	Hercule II
	European statistical programme
	Modernisation of European enterprise and trade (MEETS)
	Erasmus Mundus
	Pericles
	European globalisation adjustment fund
	Decommissioning of nuclear power stations
	Safer Internet Programme
	ISA (Interoperability solutions for European public administrations)
	Programme to support specific activities in the field of financial services, financial reporting and auditing
Heading 2 - Preservation and Management of Natural Resources	LIFE+
Heading 3a - Freedom, Security and Justice	Solidarity and management of migration flows
	Security and safeguarding liberties
	Fundamental rights and justice
Heading 3b - Citizenship	Youth in action
	Culture 2007-2013
	MEDIA 2007
	Europe for citizens
	Civil protection financial instrument
	Second programme of Community action in the field of health
	Community action in the field of consumer policy
	EU Solidarity fund
Heading 4 - The EU as a Global Player	Instrument for pre-accession assistance (IPA)

Source: *www.mfcr.cz* and legal Acts of the EU setting up the respective programmes.

Appendix No. 4

Overview of allocations, drawdown from Phare and Transition Facility programmes, and situation by 31.3.2009 (€ million)					
Programme's code	**Programme's name**	**Allocation**	**Funds transferred to beneficiaries**	**Drawdown ratio (%)**	**Programme 's state of affairs**
CZ 98.06-12	Phare National Programme 1998	22,450,000.00	18,666,826.56	83.15	incomplete
CZ 98.04	CBC Phare 1998 - Germany	7,000,000.00	6,695,498.80	95.65	incomplete
CZ 98.05	CBC Phare 1998 - Austria	2,900,000.00	2,812,863.45	97	**completed**
Total for programmes in 1998		**32,350,000.00**	**28,175,188.81**	**87.09**	
CZ 99.01-05	Phare National Programme 1999	16,000,000.00	13,811,146.81	86.32	incomplete
CZ 99.08	Large Scale Infrastr. Facility - part IV	2,400,000.00	1,098,300.63	45.76	incomplete
CZ 99.09	CBC Phare 1999 - Poland	3,000,000.00	2,931,171.21	97.71	incomplete
CZ 99.10	Large Scale Infrastr. Facility - part V	14,200,000.00	13,849,964.00	97.53	**completed**
CZ 99.12	CBC Phare 1999 - Austria	10,600,000.00	10,317,463.44	97.33	incomplete
CZ 99.13	CBC Phare 1999 - Slovakia	2,000,000.00	1,727,601.49	86.38	**completed**
CZ 99.14	CBC Phare 1999 - Germany	29,400,000.00	28,607,487.08	97.3	incomplete
CZ 99.15	Consensus III	2,000,000.00	1,778,344.94	88.92	incomplete
CZ 99.16	Projects preparation	2,000,000.00	1,815,487.29	90.77	incomplete
Total for programmes in 1999		**81,600,000.00**	**75,936,966.89**	**93.06**	
CZ 00.02-10	Phare National Programme 2000	59,000,000.00	49,822,035.82	84.44	incomplete
CZ 00.11	Access	1,670,000.00	1,558,462.03	93.32	incomplete
CZ 00.12	CBC Phare 2000 - Germany	10,000,000.00	9,629,240.91	96.29	**completed**
CZ 00.13	CBC Phare 2000 - Poland	5,000,000.00	4,865,887.86	97.32	**completed**
CZ 00.14	CBC Phare 2000 - Austria	4,000,000.00	3,906,482.69	97.66	**completed**
CZ 00.16	Supplementary investment programme	8,100,000.00	8,089,043.85	99.86	**completed**
Total for programmes in 2000		**87,770,000.00**	**77,871,153.16**	**88.72**	
CZ 01.02-10	Phare National Programme 2001	65,400,000.00	52,589,028.97	80.41	incomplete
CZ 01.11	CBC Phare 2001 - Austria	4,000,000.00	3,972,844.06	99.32	incomplete
CZ 01.12	CBC Phare 2001 - Germany	10,000,000.00	9,854,542.09	98.55	incomplete
CZ 01.13	CBC Phare 2001 - Poland	5,000,000.00	4,936,944.97	98.74	incomplete
CZ 01.14	Horizontal programme for Community support in the field of nuclear safety	2,190,000.00	1,911,266.73	87.27	incomplete
Total for programmes in 2001		**86,590,000.00**	**73,264,626.82**	**84.61**	
CZ 02.02-09	Phare National Programme 2002 - part I	78,493,285.00	62,978,669.88	80.23	incomplete
CZ 02.10	Phare National Programme 2002 - part II	6,300,000.00	5,183,976.65	82.29	incomplete
CZ 02.11	CBC Phare 2002 - Austria	4,000,000.00	3,944,208.16	98.61	incomplete
CZ 02.12	CBC Phare 2002 - Germany	10,000,000.00	6,775,834.99	67.76	incomplete
CZ 02.13	CBC Phare 2002 - Poland	5,000,000.00	4,939,018.10	98.78	incomplete
Total for programmes in 2002		**103,793,285.00**	**83,821,707.78**	**80.76**	
CZ2003/004-338	Phare National Programme 2003 - part I	38,500,000.00	35,514,113.85	92.24	incomplete
CZ2003/005-601	Phare National Programme 2003 - part II	56,680,000.00	49,054,662.81	86.55	incomplete
CZ2003/005-077	CBC Phare 2003 - Poland	5,000,000.00	4,980,294.96	99.61	incomplete
CZ2003/005-079	CBC Phare 2003 - Austria	4,000,000.00	3,603,834.91	90.1	incomplete
CZ2003/005-095	CBC Phare 2003 - Germany	10,000,000.00	9,130,276.44	91.3	incomplete
2003/5812.02	Programme for European Community support in the field of nuclear safety for 2003	1,830,000.00	1,768,577.02	96.64	incomplete
Total for programmes in 2003		**116,010,000.00**	**104,051,759.99**	**89.69**	
	Horizontal programme preparing candidate countries for extended decentralisation (EDIS)	300,000.00	295,817.00	98.61	incomplete

Overview of allocations, drawdown from Phare and Transition Facility programmes, and situation by 31.3.2009 (€ million)					
Programme's code	**Programme's name**	**Allocation**	**Funds transferred to beneficiaries**	**Drawdown ratio (%)**	**Programme 's state of affairs**
	Horizontal programme for European Community support in the field of nuclear safety for 2002 (NUS 2002)	4,060,000.00	3,717,219.70	91.56	incomplete
	Nuclear safety	1,100,000.00	936,334.18	85.12	incomplete
	Repair of Nuclear Research Institute facilities destroyed by flooding in 2002	455,000.00	454,636.00	99.92	incomplete
Total for horizontal programmes		**5,915,000.00**	**5,404,006.88**	**91.36**	
Total for Phare and CBC 98-03 programmes		**514,028,285.00**	**448,525,410.33**	**87.26**	
	Transition Facility 2004	17,100,000.00	12,093,007.99	70.72	incomplete
	Transition Facility 2005	11,800,000.00	9,683,402.86	82.06	incomplete
	Transition Facility 2006	7,160,000.00	3,509,279.50*	49.01*	incomplete
Total for Transition Facility programme		**36,060,000.00**	**25,285,690.35***	**76.58***	

*Numbers are not final; drawdown of funds will be completed on 15 June 2010.

Source: *Annual Report on the progress in using funds from the budget of the EU Transition Facility programme, the EEA and Norway Grants, and other financial support provided to the Czech Republic from abroad (Swiss-Czech Cooperation Programme)* – Government ref. No. 747-09.

Appendix No. 5

Overview of audits carried out in 2008 and 2009 partially or fully focused on EU budget funds		
Number	**Name of the audit**	**SAO Bulletin**
08/22	Financial means allotted for waste-water treatment	2/2009
08/25	Financial means allotted for LEADER and LEADER+ implementation in the framework of the Common Agriculture Policy	4/2009
08/26	Financial means allotted for construction of the Brno-Vienna (R52) road connection	2/2009
08/27	Financial means allotted for mending and maintaining of roads	2/2009
08/29	Financial means allotted for programmes of support for development of industrial zones and regeneration of brownfields	2/2009
08/33	Financial means allotted for the construction of the Masaryk University Campus in Brno	3/2009
08/38	Financial means allotted for support programmes for energy production from sustainable energy resources and for energy savings support	3/2009
09/09	*Funds earmarked for implementation of the Single Programming Document for Objective 2 for the Prague Cohesion Region*	1/2010
09/11	Administration of the Value Added Tax	2/2010
09/12	Support for fisheries in the Czech Republic in accordance with Operational Programmes in 2004–2008	1/2010

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