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EUROPEAN COURT OF AUDITORS
COUR DES COMPTES EUROPÉENNE
CÚIRT INIÚCHÓIRÍ NA HEORPA

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Special Report No 12/2008

(pursuant to Article 248(4), second subparagraph, EC)

Instrument for Structural Policies for Pre-accession (ISPA), 2000-2006

together with the Commission's replies

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GLOSSARY

Cohesion Fund	Instrument designed to promote economic and social cohesion by financing large projects in the fields of the environment and transport in Member States with a per capita GDP of less than 90 % of the Community average. The Cohesion Fund was originally implemented in Spain, Greece, Ireland and Portugal. Since 1 January 2004, Ireland has no longer been eligible. After their accession to the EU, the on-going ISPA projects of the new Member States were converted into Cohesion Fund projects.
Cost-benefit analysis (CBA)	A technique for comparing all the costs and all the benefits of an intervention to determine whether the benefits outweigh the costs, and if so, by what proportion.
Financing Memorandum	Agreement defining the budgetary commitments of a project, as well as the physical and financial indicators to be used to monitor the performance of the project.
ISPA Manual	Manual intended to ensure that ISPA projects programming and implementation are undertaken according to best practices. It covers the whole project cycle and provides practical guidance of the ISPA and Co-ordination Regulations.
National sectoral strategies	Framework for project identification, including criteria to select and appraise project proposals in the environment and transport sectors.
PHARE	The Programme of Community aid to the countries of Central and Eastern Europe (PHARE) was the main financial instrument of the pre-accession strategy for the Central and Eastern European countries (CEECs) which have applied for membership of the European Union. Although the PHARE programme was originally reserved for the countries of Central and Eastern Europe, it is set to be extended to the applicant countries of the western Balkans.
PRAG	PRAG: Practical Guide providing guidelines for tendering and contracting for PHARE and ISPA projects.

Project application	Set of documents consisting of a Standard Form and supporting documents (e.g. feasibility study, design, cost/benefit and financial analysis, Environmental Impact Assessment) describing and justifying the proposal. It also includes supervision and quality control mechanisms.
Regulations	There are two main Regulations governing ISPA: Council Regulation (EC) No 1266/1999 of 21 June 1999 on coordinating aid to the applicant countries in the framework of the pre-accession strategy and amending Regulation (EEC) No 3906/89 (OJ L 161, 26.6.1999, p. 68) ("Coordination Regulation"). Council Regulation (EC) No 1267/1999 of 21 June 1999 establishing an Instrument for Structural Policies for Pre-accession (OJ L 161, 26.6.1999, p. 73); amended by Regulation (EC) No 2382/2001 (OJ L 323, 7.12.2001, p. 1) ("ISPA Regulation").
Sapard	Special Accession Programme for Agriculture and Rural Development.

EXECUTIVE SUMMARY

I. ISPA was one of the instruments to assist the candidate countries of Central and Eastern Europe in the preparation for accession in the period 2000-2006. Its objectives were to help candidate countries to apply EU environmental standards and to upgrade and expand transport networks, including links with the Trans-European network. It also provided experience in the management of EU funds for large infrastructure projects. The total financial allocation was 7 280 million euro.

II. The Court reviewed this instrument by asking whether there was a coherent strategy and adequate preparation to support ISPA actions, whether projects were implemented according to planning and whether projects were contributing to beneficiary countries' compliance with the EU environmental directives and contributing to the improvement of TEN-T.

III. The Court concludes that there was a coherent strategy, but projects were not always adequately prepared. Three important methodological guidance documents were provided late in relation to the first wave of applications.

IV Projects were not implemented according to planning; there were significant delays and considerable changes in the financing plans.

V. The projects audited by the Court increase the compliance with the EU standards or improve the links to the Trans-European network.

VI. The Court recommends that the Commission make a follow-up of ISPA's implementation and examine how delays could be avoided or reduced in the future, when implementing a similar instrument. In this context, the Commission should make the guidance documents available before the Candidate Countries start preparing their projects and greater attention should be devoted to reduce time needed to complete procedures.

INTRODUCTION

Assistance to EU applicant countries

1. The Instrument for Structural Policies for Pre-accession (ISPA) is one of the three financial instruments (with PHARE and Sapard) to assist candidate countries in the preparation for accession. ISPA was set up in 1999 to contribute to the process of preparation for accession to the European Union concerning Environment and Transport[1] in the former candidate countries of Central and Eastern Europe[2], along the same lines as the Cohesion Fund model designed for the least prosperous EU members (see ***Figure 1***). It also helped candidate countries prepare for the management of EU funds after accession, by providing experience in their use for large infrastructure projects.

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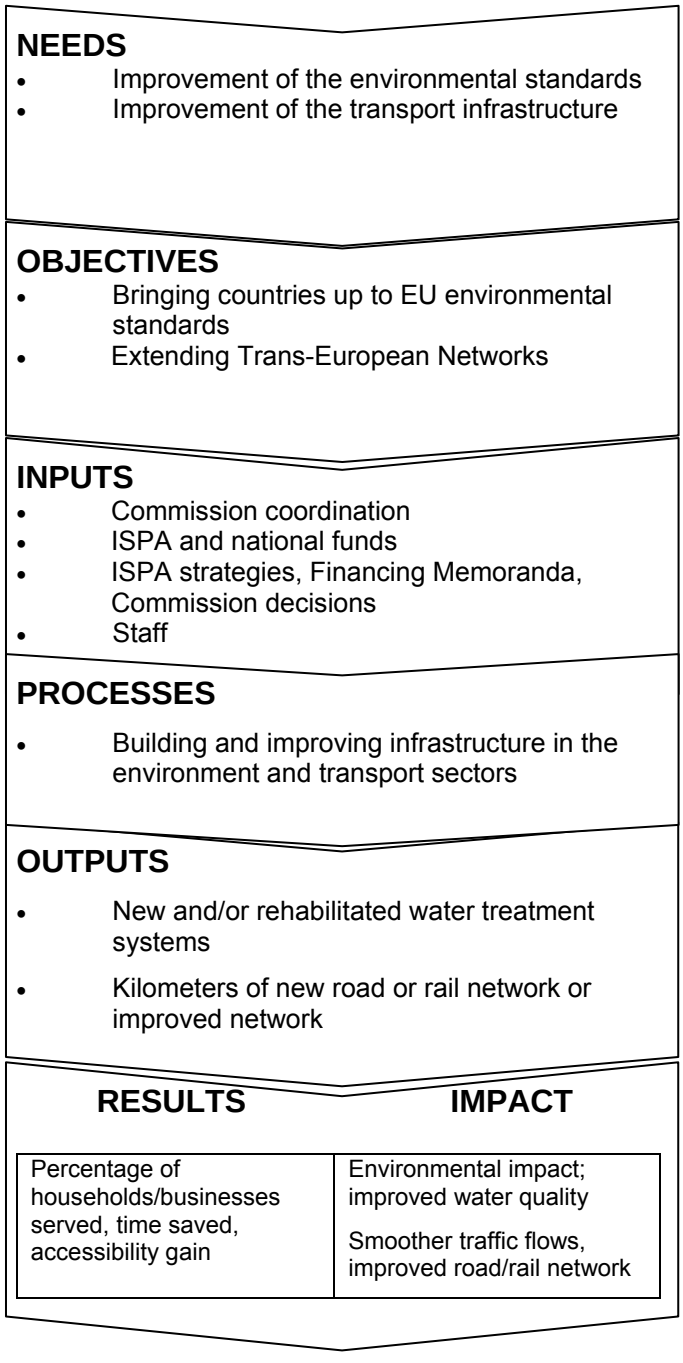
[1] Article 1 of Regulation (EC) No 1267/1999.

[2] Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Figure 1 - ISPA intervention logic



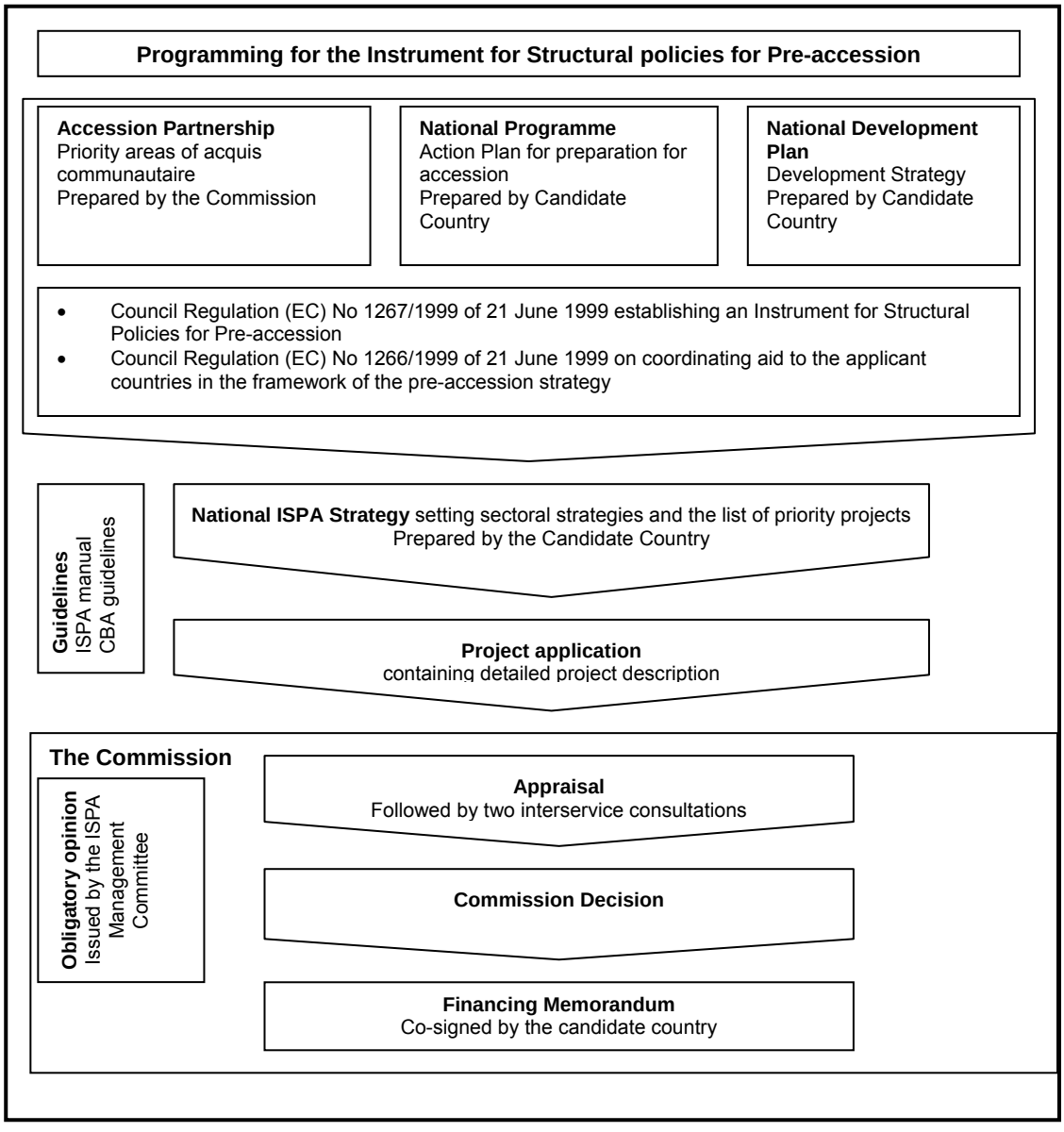
2. ISPA operated during the programming period 2000-2006. From January 2007 onwards, similar actions have been financed under the Instrument for Pre-accession Assistance (IPA)[3].

ISPA management and financial resources

3. ***Figure 2*** shows the framework within which projects are developed and approved.

[3] IPA covers Croatia, the Former Yugoslav Republic of Macedonia, Turkey, Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo under UN Security Council Resolution 1244/99.

Figure 2 – **ISPA procedural framework**



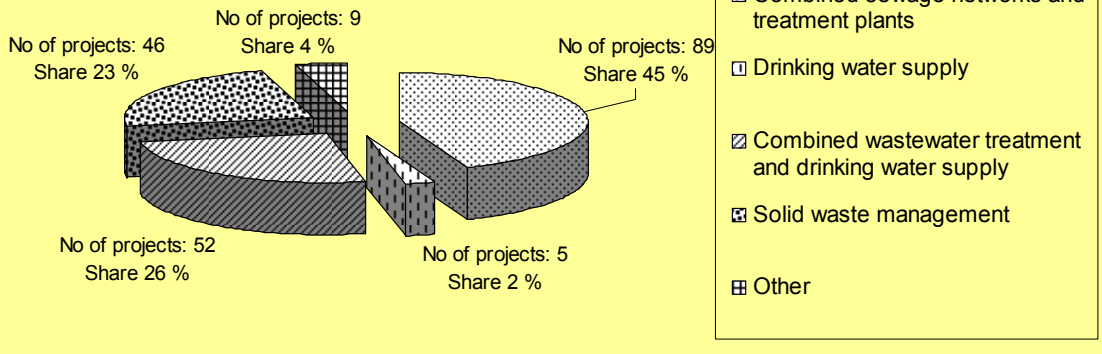
4. The total allocation for ISPA was 7 280 million euro for the period 2000-2006 (1 040 million euro in 1999 prices per year[4]), to be distributed among the

[4] Article 4 of Regulation (EC) No 1267/1999 and Interinstitutional agreement of 6 May 1999 between the European Parliament, the Council and the Commission on budgetary discipline and improvement of the budgetary procedure (OJ C 172, 18.6.1999), p. 2 and Annex II.

beneficiary countries on the basis of selected criteria. ISPA aimed at using these funds according to an appropriate balance between measures in the field of the environment and measures relating to transport infrastructure.

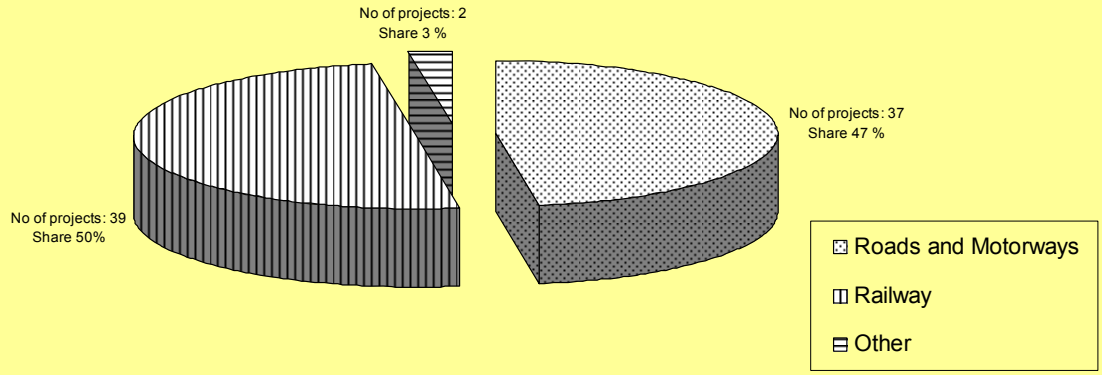
5. In total, 366 projects were approved for ISPA, of which 201 were in the environment sector, 78 in the transport sector and 87 concerned technical assistance. The ISPA budget (in 2006 prices), before amendments and excluding technical assistance was 7 708 million euro[5]. The contribution to ISPA projects in the environment sector was 3 804 million euro and in the transport sector 3 904 million euro. In the environment sector (see ***Figure 3***), the majority of the 201 projects (73 %) were in the field of waste water treatment and water supply. In the transport sector, the 78 ISPA projects were mainly (97 %) in the railways and in the roads and motorways sectors (see ***Figure 4***).

Figure 3 - Distribution of ISPA environment projects



[5] Commission, DG REGIO, situation at 31.12.2007.

Figure 4 - Distribution of ISPA transport projects



6. The co-financing rate of ISPA may be up to 75 % of public or equivalent expenditure[6]. The national contribution sometimes took the form of loans granted by Financial Institutions such as the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD).

AUDIT SCOPE AND APPROACH

7. The implementation of ISPA in the candidate countries represented an initial exposure to large-scale investments co-financed by the European Union. For this reason, in view of the importance of ISPA for the accession of the candidate countries and findings of previous audits[7], the Court decided to carry out an audit of ISPA to answer the following questions:

(a) Was there a coherent strategy and an adequate preparation supporting ISPA actions?

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[6] For projects considered essential for achieving the general objectives of ISPA, this rate can be increased up to 85 % according to article 6(2) of Regulation (EC) No 1267/1999.

[7] The Court's Special Report No 5/2003 concerning PHARE and ISPA funding of environmental projects in the candidate countries (OJ C 167, 17.7.2003, p. 1), Special Report No 15/2000 on the Cohesion Fund (OJ C 279, 2.1.2000, p. 1) and Special Report No 6/2005 on the trans-European network for transport (TEN-T) (OJ C 94, 21.4.2006, p. 1).

(b) Were projects implemented according to planning?

(c) Were projects contributing to beneficiary countries' compliance with the EU environmental directives and to the improvement of TEN-T?

8. ISPA was programmed for the period 2000 to 2006 and the majority of the beneficiary countries acceded to the EU in May 2004. As at 31 December 2007, final reports on only a limited number of the 279 infrastructure projects were available. As such, the Court could only make a preliminary assessment of the performance and achievements of the projects.

9. A sample of 32 projects adopted between 2000 and 2003 (16 environment and 16 transport) covering six beneficiary countries was examined. 16 projects were visited on the spot (eight environment and eight transport) in the Czech Republic, Poland, Latvia and Romania. The other 16 projects were subject to a desk-review. They concern the above-mentioned countries plus Hungary and Bulgaria.

10. File reviews and interviews were carried out both at the Commission headquarters and Commission Delegations. In the candidate countries, meetings were held with the Ministries of Environment and Transport, regional and local authorities, as well as with final beneficiaries.

11. In addition, the Court carried out a survey by sending questionnaires to 155 project managers and bodies responsible for day-to-day management of projects[8] in the four countries visited, in order to collect opinions on the most common problems encountered during ISPA implementation. The Court received 145 answers[9] (93 % response rate).

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[8] The project managers represented 42 % of ISPA projects in the environment and transport sectors.

[9] For technical reasons such as incorrect completion of the questionnaire or incomplete reply, 127 replies were usable (82 %).

12. Moreover, the Court obtained advice from experts in environment and transport projects from international financial institutions.

AUDIT OBSERVATIONS

Was there a coherent strategy and adequate preparation supporting ISPA actions?

General framework and audit criteria

13. National ISPA strategies for the environment and transport sectors were prepared by each beneficiary country at the request of the Commission. Their purpose was to define the priority objectives by identifying sector and sub-sector priorities and geographical priorities such as transport bottlenecks or environmental black spots, and to identify the resources needed. The national ISPA strategies should also provide the framework for project identification and set out the criteria to be used to select and appraise proposed projects (see ***Annex I***).

14. Candidate countries submitted an application to the Commission which had to contain, inter alia, the following elements[10];

(a) the timetable for implementation of the works;

(b) a cost-benefit analysis;

(c) the financial plan, including financing sources other than ISPA.

15. The Court analysed the strategy documentation, and the preparation of ISPA projects, checking whether:

(a) the national sectoral strategies contained an assessment of sectoral needs in the fields of environment and transport designed to catch up with EU

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[10] Article 7(3)(a) and Annex I of Regulation (EC) No 1267/1999.

environmental standards and upgrade and expand links with Trans-European transport networks;

(b) the Commission developed on time manuals and guidelines to enable candidate countries to submit proposals containing all the relevant information.

Well targeted ISPA strategies

16. The Commission's framework documents for the environment and transport sectors proved to be effective in setting out the key criteria for the preparation of national ISPA strategies which included general priorities and identified projects to be implemented with ISPA support (see Textbox 1).

Textbox 1

In the case of Latvia, in the environment sector, the main focus for ISPA was to concentrate on projects which enabled the country to comply with the requirements of Community environmental law and with the objectives of the Accession Partnership. The strategy identifies and selects projects to be proposed for financing under the ISPA instrument that are consistent with the above mentioned criteria. The selection of ISPA projects was based on the government guidelines, which took into consideration assumptions of environmental policy.

17. In the cases where shortcomings were identified, the Commission provided support in order to address these weaknesses (see Textbox 2).

Textbox 2

In Romania, the updated 2003 version of the National Transport Strategy did not receive unreserved consent from the Commission due to several shortcomings . In order to address these shortcomings, the Commission decided to grant a Technical Assistance project aimed at drafting a General Transport Master Plan.

18. Even though in some cases it was not possible to explain the ranking of investment projects[11], an examination of the strategies of the four countries visited has enabled the Court to conclude that, in general, national sectoral ISPA strategies clearly identified the needs in each country, also taking into consideration the existing national planning documents (see Textbox 3). National ISPA strategies acted as a tool in the selection of ISPA projects, linking objectives and priorities to specific project proposals.

Textbox 3

Action to protect the environment in the Baltic region was initiated by the Polish Government at the beginning of the 1990s in cooperation with other countries. The region of Krakow was already identified in the Helsinki Convention[12] as one of the hot spots for the protection of the Baltic sea, as this area, even though far from the coast, contains a high-density of industries discharging waste into the Vistula River, which flows into the Baltic Sea. A common solution for the whole urban area of Krakow was prepared and included in the National Programme for purification of communal wastewater. The project of a sewage treatment plant in Krakow was then included in the national ISPA strategy for the environment in 1999, to be implemented as one of the priority projects.

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[11] This has been pointed out also in the Court's Special Report No 5/2003 (shortcomings in strategies, paragraphs 18 to 20).

[12] Helsinki Convention: convention on the protection of the marine environment of the Baltic sea area, signed in 1974 and revised in 1992 which concerns all the states bordering on the Baltic Sea. The convention covers the whole of the Baltic Sea area, including inland waters as well as the water of the sea itself and the sea-bed. Measures are also taken in the whole catchment area of the Baltic Sea to reduce land-based pollution.

19. In some cases the National ISPA strategies were a development of existing national strategies that had already taken into consideration the need to adopt the *Acquis Communautaire* in the field of the Environment (see Textbox 4).

Textbox 4

In Latvia the main objectives of the National Environment Policy Plan, which was approved in 1995, were to enable the country to comply with the requirements of the Community environmental legal framework and with the objectives of the Accession Partnership. The objectives of this Policy Plan were taken over in the National ISPA strategy for environment. The selection process for the projects was based on these objectives.

Three important guidance documents not available from the beginning of ISPA

20. Three main guidelines were developed by the Commission and made available for project preparation:

(a) an ISPA Manual was provided to the beneficiary countries in 2000, during the preparation phase of the first project applications;

(b) a second version of the ISPA Manual was developed in 2002, clarifying in particular the tendering and contracting procedures;

(c) updated guidance on cost-benefit analysis was made available in 2002, which addressed weaknesses identified in the previous version. In particular it gave average rates of return and recommended time horizons for different sectors. However, it did not provide any details or forecasting techniques concerning impacts on the environment.

21. These methodological guides were developed after the projects audited by the Court were submitted to the Commission for approval. This late availability limited their contribution to familiarising the candidate countries with the policies, procedures and the funding principles of the EU.

Weaknesses in financial and cost-benefit analysis (CBA)

22. Each application for ISPA assistance had to contain a financial and a cost-benefit analysis. For some projects these were not available or presented weaknesses. Nevertheless, the Commission considered that, since most of the projects were required to fulfill basic needs in the Candidate Countries, it was not appropriate to hold them up because of shortcomings in the cost-benefit analysis.

23. The Court's review of the financial and cost-benefit analyses provided for the projects audited identified the following weaknesses[13]:

(a) some missing information about discount rates used and scenario assumptions where a risk analysis was presented;

(b) inconsistencies of CBA and financial analyses figures between different documents for the same project;

(c) unsubstantiated socio-economic benefits and incomplete estimates of effects in the transport sector.

24. In these circumstances, the Commission was unable to confirm from the cost benefit analysis that the projects submitted by the Candidate Countries represented in relative terms the highest added value.

Were projects implemented according to plan?

General framework and audit criteria

25. After the assessment of project application and approval by the Commission, a financing memorandum was signed defining, in particular, the financial resources and planning for implementing the project, including the

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[13] See also Special Report No 5/2003 (weaknesses in project appraisal, paragraphs 30 to 34) and Special Report No 6/2005 (weaknesses in evaluation and selection of projects, paragraphs 30 to 43).

completion date. After project completion, candidate countries had to present a final report.

26. The Court assessed to what extent the main conditions set in the financing memorandum had been respected, that is:

(a) whether projects had been implemented according to initial plan and the reasons for any delay;

(b) whether the financial plans for the projects had been respected and if not, the reasons why.

Almost all projects were delayed

27. If projects are delivered later than expected, the benefits are deferred and the problems they are intended to address continue for longer than necessary. Delays also create uncertainties, as the socio-economic environment may change and may make it difficult to implement projects as foreseen.

28. The 32 projects in the Court's sample were approved between 2000 and 2003. The majority of the projects audited should have been completed between 2004 and 2006 according to the initial Financial Memoranda. However, only five had been completed by the initial expected date[14] at the time of the audit (two in the Czech Republic and three in Latvia)[15]. For the other 27 projects, the completion date was amended. The delays vary from 2 to 5 years (Poland), 4 to 4,5 years (Bulgaria), 2 to 4,8 years (Romania), 1,5 years (Hungary) and 1 to 3 years (Latvia). In the Czech Republic, there were no major delays.

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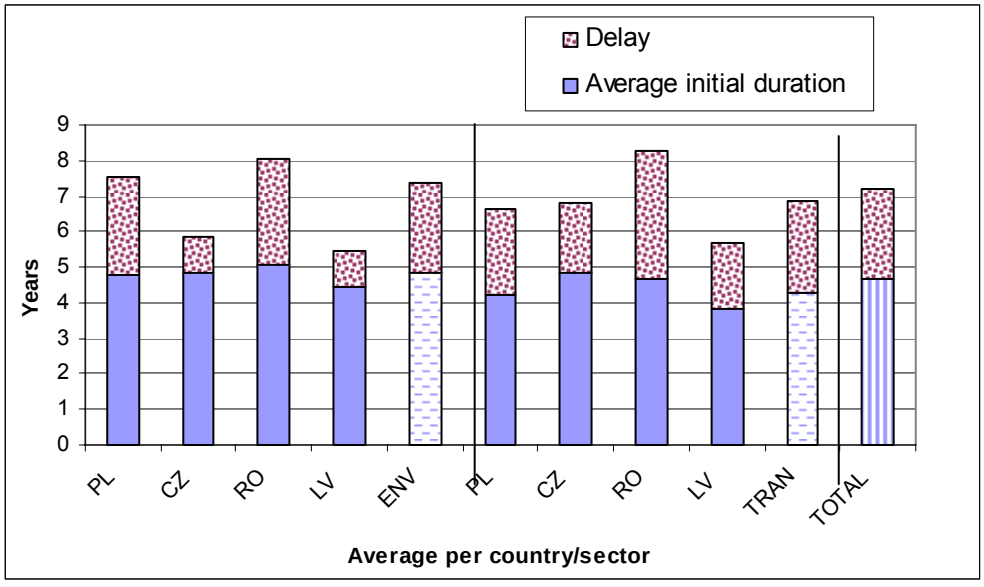
[14] A project is considered completed when the infrastructure is in use. Candidate Countries had to submit a final report to the Commission at the latest six months after the completion of the project.

[15] Out of 32 projects audited, 24 faced delays (75 %).

29. In the survey addressed to the project managers in the four audited countries, the Court obtained information on the delays in implementation and the reasons for the delays.

30. In the environment sector, the average scheduled duration of the projects was 5 years and in the transport sector, 4,2 years. According to the survey, the average delay was 2,5 years in both sectors (see ***Figure 5***).

Figure 5 - Average delays in project implementation



31. In the projects audited, the Court found that the main reasons for delays were[16]:

(a) the lack of familiarity of the candidate countries with EU procedures and with project preparation and implementation as well as difficulties with procurement procedures (see e.g. Textbox 5) (84 % of the projects in the sample);

[16] Some projects were affected by more than one of the problems described.

Textbox 5

In Latvia, in a project for the development of water services, it took three years to launch the tender procedure after the signature of the Financing Memorandum.

In Poland, in a project for sewage treatment, the construction suffered an interruption of almost one year during the tendering phase. The project was divided into subcontracts, one of which was co-financed by the EBRD. According to the EBRD loan agreement, the bank's tendering rules should have been applied to the procurement of the whole project. The tendering had to be stopped until the appropriate procedures had been agreed between the donors.

(b) failure of companies that won tenders to carry out the work (see e.g. Textbox 6) (13 % of the projects in the sample);

Textbox 6

A project for the rehabilitation of sewage network and wastewater treatment facilities faced delays in implementation. The tender had to be cancelled and repeated, due to problems with the composition of the evaluation committee. In addition, the company which was awarded the contract in the second tender failed to proceed with the works in accordance with the timetable and failed to comply with several notices by the supervising engineer. The contract therefore had to be terminated. A third tender had to be organised, but at the time of the audit the project was at a standstill.

(c) unrealistic planning (see e.g. Textbox 7) (22 % of the projects in the sample);

Textbox 7

In Latvia, a project to develop water services was delayed because, amongst other reasons, the cost and the time needed for the study and design work for the pipelines were underestimated.

(d) the change after accession of the ISPA projects into Cohesion Fund projects, which have a different set of rules[17].

32. The survey indicates that the main reasons for not respecting the deadlines in the implementation of the projects are, on the one hand, the length of the procedures and, on the other hand, planning reasons (see ***Figure 6***)[18].

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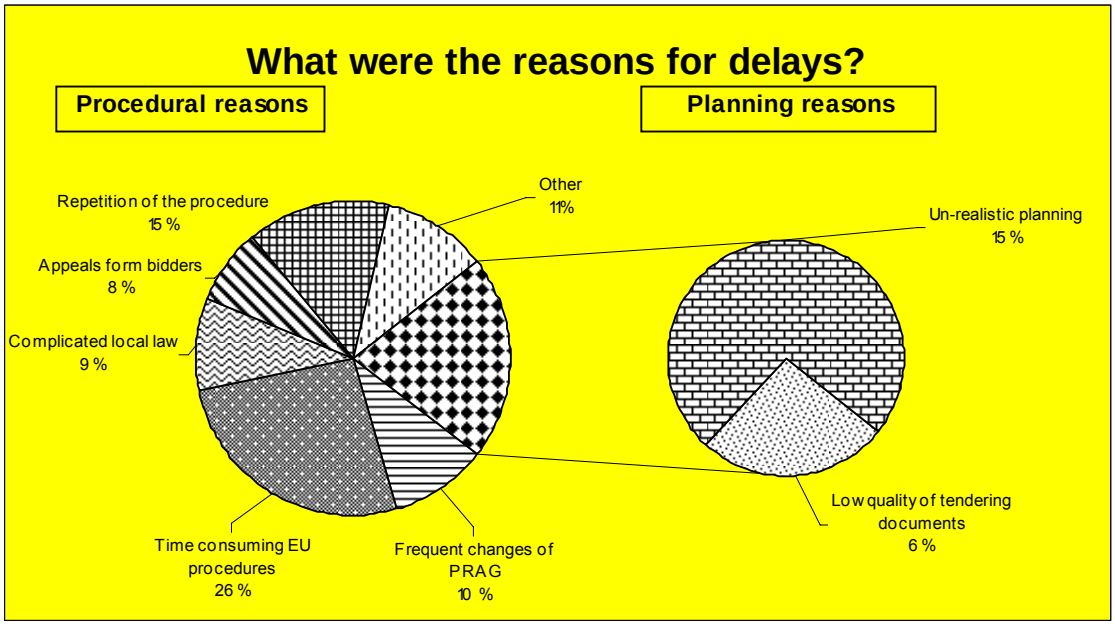
[17] E.g. eligibility of durable equipment expenditure (to be solved on a case-by-case basis), modifications of project decisions, procedures for the award of public contracts.

[18] Problems in project implementation were also pointed out by the Court in its Special Report No 5/2003 (insufficient management resources, delays, difficulties in tendering, paragraphs 35 to 39) but also in its Special Report No 6/2005 (delays in implementation of projects, paragraphs 11 to 25).

Figure 6 - Reasons for delays (Project managers)



Financial plans not implemented as scheduled

33. In 18 out of 32 projects audited the initial financial plan was not respected. In six cases the total cost increased, and in 12 cases the cost decreased. When the cost increased and no additional ISPA resources were made available, candidate countries had to finance the additional costs from their own resources (see Textbox 8).

Textbox 8

In Latvia, in a Railway project, due to price increases, the ISPA grant was not sufficient to cover all the elements initially foreseen. The remaining work had to be funded from national resources.

34. As shown in ***Table 1*** the survey of project managers indicates that for the majority of ISPA projects changes had been made to the original financing plan.

Table 1 – Changes to the original financing plans

SURVEY OF PROJECT MANAGERS		
Replies	***Changes to the original financing plan***	***Maintenance of the original financing plan***
123	66 %	34 %

35. In five cases out of the 32 projects of the sample this can be explained by underestimation of inflation (in 16 % of the cases) (see Textbox 9).

Textbox 9

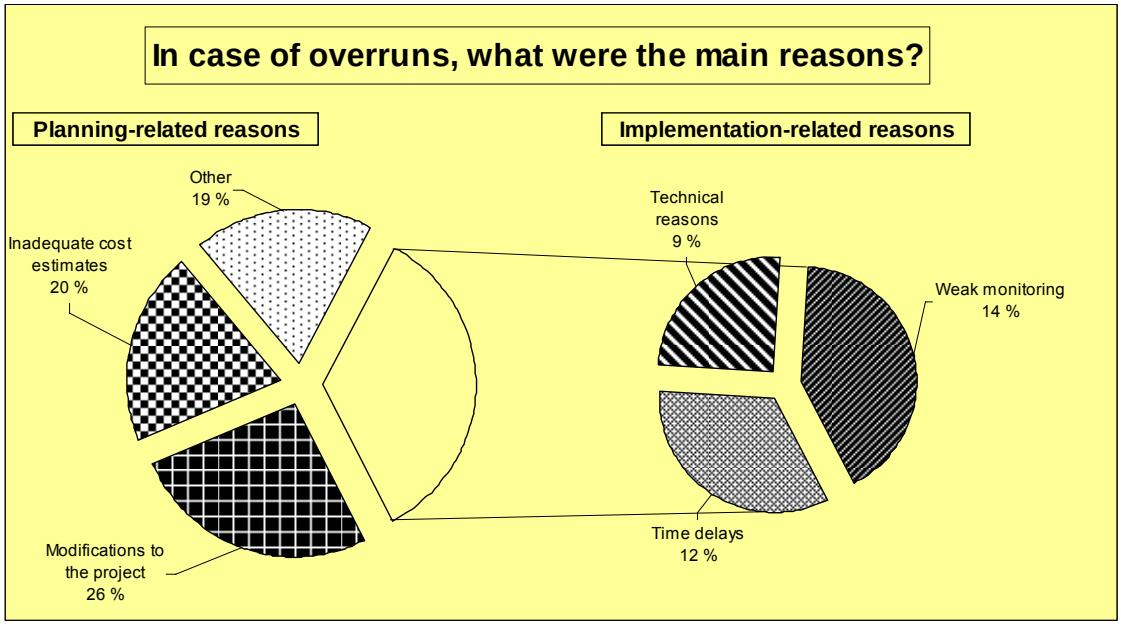
In Latvia, in a project to develop water services, the contractor repudiated the contract because he was no longer in a position to work at the agreed prices as rapid inflation occurred shortly after the start of the works. This led to a revision of the contract, with an increased cost.

36. The replies to the survey of project managers indicated that the reasons for cost overruns can be explained mainly by two categories of factors (see ***Figure 7***):

(a) problems in project preparation, such as inadequate cost estimates;

(b) implementation problems, such as weak monitoring or time delays.

Figure 7 - Cost overruns



Were projects contributing to beneficiary countries' compliance with the EU environmental directives and to the improvement of TEN-T?

General framework and audit criteria

37. The main objective of ISPA was to help the candidate countries reduce their structural gap in the environment and transport sectors. In order to assess the effectiveness of the projects in terms of concrete contributions to improvement of the environment and transport sectors, the Court examined:

(a) whether the environmental projects were consistent with EU directives in the fields of water supply and waste water;

(b) whether transport projects contributed to the completion of the Trans-European Transport Network.

38. As at the time of the audit final reports were available on only a limited number of the 279 infrastructure projects co-financed by ISPA, only partial conclusions could be drawn.

Compliance with EU environmental standards has increased

39. In the environmental sector, out of 16 projects in the sample, only three were completed at the time of the audit. The assessment of these projects shows that, in spite of some shortcomings, they are contributing to compliance with EU environmental standards (see Textbox 10).

Textbox 10

In Latvia, the objective of one project was to improve water supply and sewage services, ensuring that drinking water and purified sewage conform to the national legislation and the requirements of the EU directives. According to the final report, the project has ensured adequate quality of the treated water according to the EU Urban Waste Water Treatment Directive (91/271/EEC) and of the drinking water.

In Latvia, the objective of one project was to develop drinking water quality and waste water services. The EU standards for drinking water quality have been met. However, for waste water, full compliance with legal requirements had not yet been achieved. The rehabilitation and upgrading of a biological wastewater treatment plant had been completed but the nitrogen and phosphorus content in the effluent still exceeded the EU and local norms at the time of the audit.

40. In spite of some shortcomings, the projects that were not completed at the time of the audit, if implemented as planned, are likely to contribute to compliance with EU environmental standards (see Textbox 11).

Textbox 11

In Poland, a waste water treatment project should increase the percentage of the population of the city of Wrocław who are connected to the sewage network to 97 %. This city, with a population of more than 600 000 inhabitants, was considered the main polluter of the river Odra.

In Romania, a project consisted of the rehabilitation and upgrading of a waste water treatment plant, a sewage network and a drinking water network. Due to delays concerning the Waste water treatment plant, the risk of pollution of the river remains.

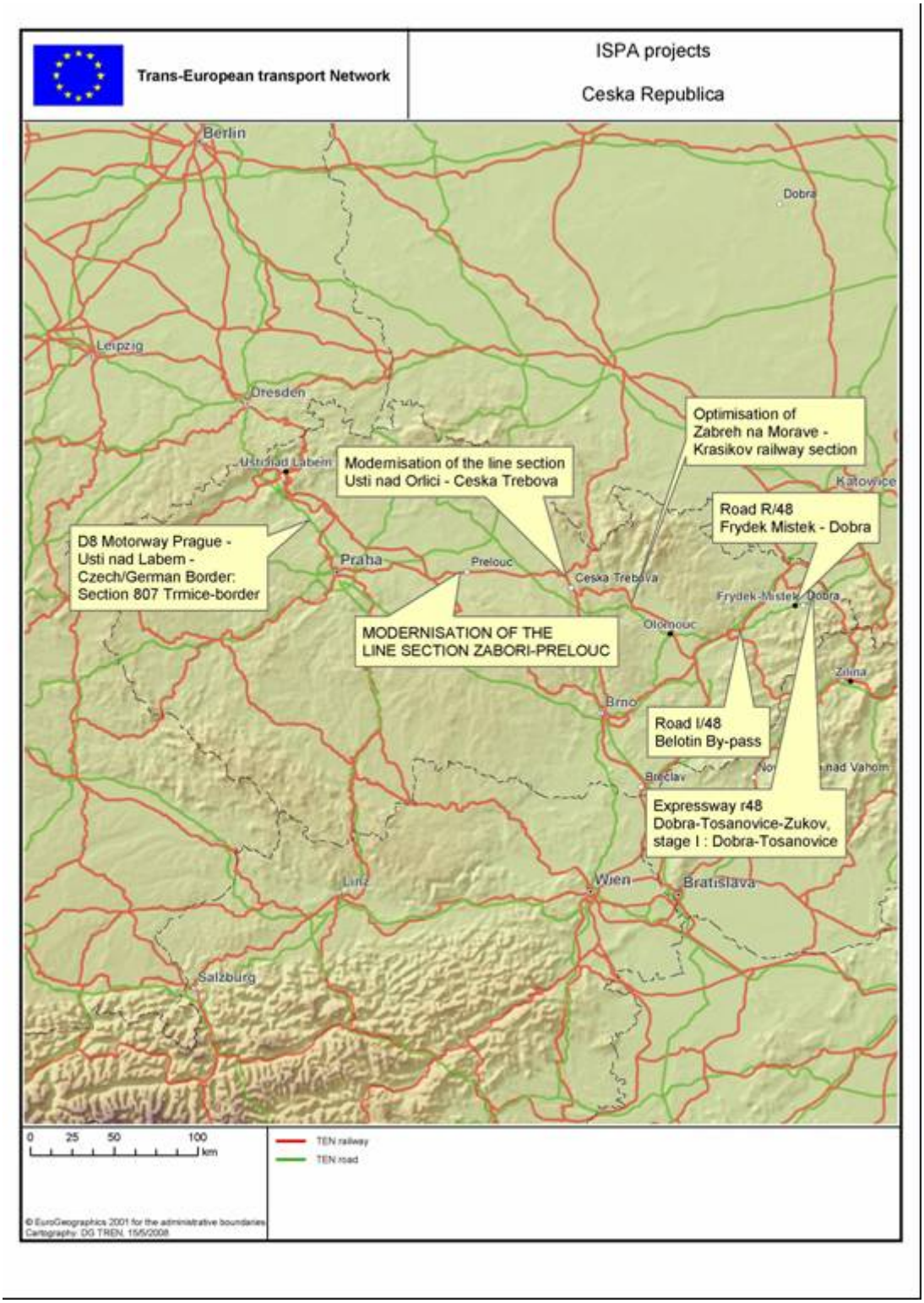
Improvements in links to the Trans-European transport network

41. In the Transport sector out of 16 projects contained in the sample only 2 had been completed at the time of the audit. The assessment of these projects shows that they are contributing to the completion / development of Trans-European networks (see ***Figures 8*** and ***9*** and Textboxes 12 and 13).

Textbox 12

In the Czech Republic the project Modernisation of the line section Zabori-Prelouc is in the Pan European multimodal corridor IV from Dresden to Bratislava. In ***Figure 8***, the projects cofinanced by ISPA in the Czech Republic are highlighted.

Figure 8 **– ISPA projects in the Czech Republic**



Textbox 13

In Latvia, the upgrading of the motorway from Riga to Adazi, which is a section of Via Baltica linking Warsaw to Tallinn, improved the traffic and pedestrian safety as well as the traffic fluidity by bringing this road section in compliance with European road standards and norms (see ***Figure 9***).

Figure 9 – Road network in Latvia

42. The other projects that at the time of the audit were not completed are consistent with the TEN-T network (see for example Textbox 11 and ***Figure 11***). For exemple in Romania, the “Bucharest Cernavoda” project should speed up the traffic between Bucarest and Constanta and is expected to contribute to the development of European Transport Corridor no 7, Igumenitsa-Patras-Athens-Sofia-Budapest (see ***Figure 10***).

Figure 10 - TEN-T networks

<u>Figure 11</u> - TEN-T network

CONCLUSIONS AND RECOMMENDATIONS

43. The Court's main conclusions are as follows:

(a) A coherent strategic framework was in place and national ISPA strategies proved to be a good programming tool clearly identifying needs, objectives and resources. Nonetheless, projects were not always adequately prepared by applicants. This was partly due to the fact that three important guidance documents were provided late in relation to the first wave of applications by the Commission (see paragraphs 16 to 24).

(b) Projects were often not implemented as planned. Financing plans had to be adjusted to changed circumstances and almost all the projects were experiencing significant delays, mainly related to the length of the procedures (at the level of the Commission and of the beneficiary countries) and to weaknesses in the planning process (at the level of beneficiary countries) (see paragraphs 25 to 36).

(c) The Court's audit included five completed projects and 27 projects which are still in progress. Three of the completed projects were environmental. The audit shows that they increase the compliance with EU environmental directives in the respective beneficiary states. The other two completed projects were transport-related. The audit shows that they contribute to the improvement of the Trans-European network in the respective beneficiary states. Furthermore, the audit suggests that the 27 projects still in progress are likely to achieve the objectives if implemented as planned (see paragraphs 37 to 42).

The Court recommends that the Commission closely follows-up the implementation of ISPA. The Commission should, in particular, examine how delays in the implementation of projects could be avoided or reduced in the future, when implementing similar instruments. In the Court's view, this may require more rigorous and realistic planning by projects' applicants/managers and ways to speed up the procedures, both at the Commission level and within national administrations of beneficiary countries.

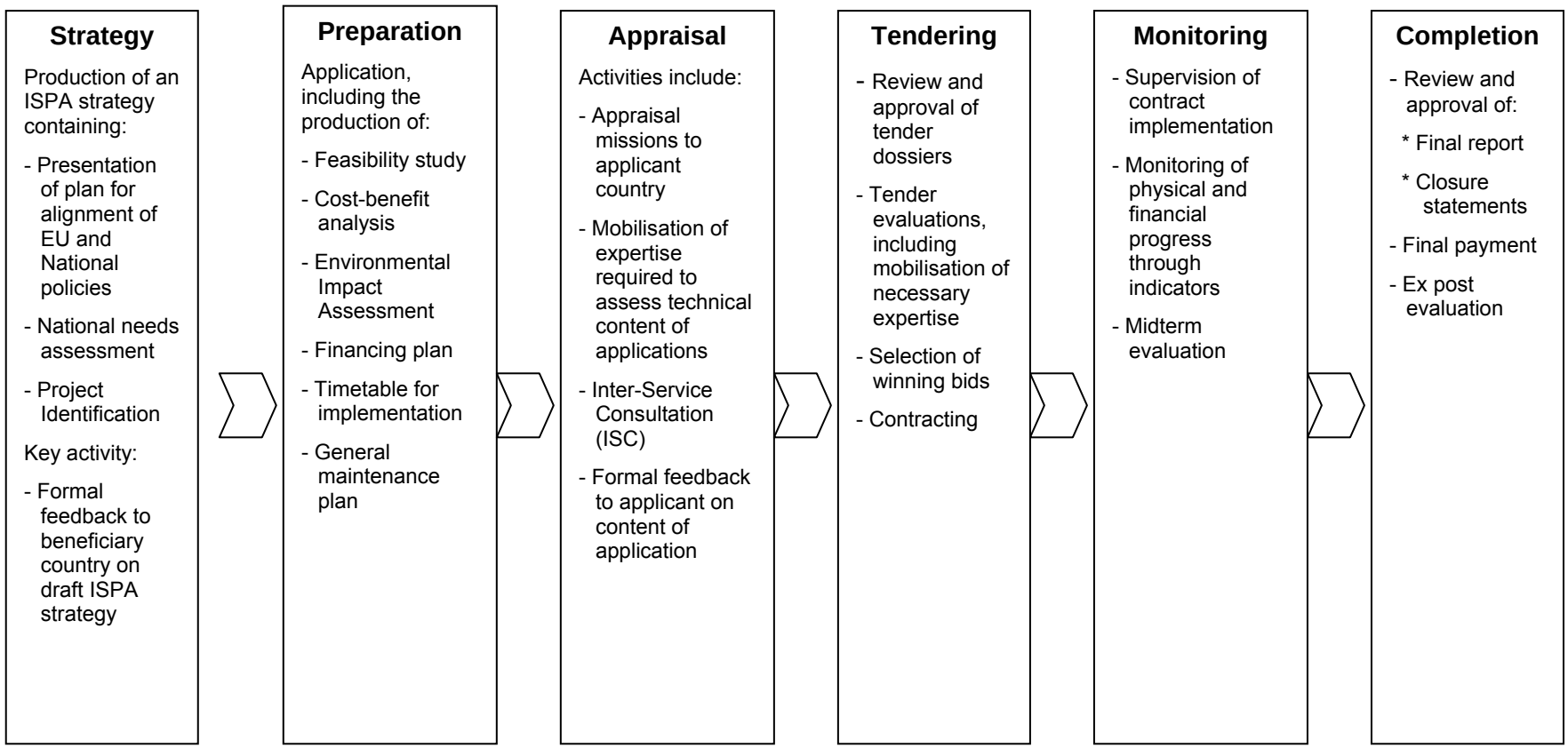
This report was adopted by the Court of Auditors in Luxembourg at its meeting of 11 December 2008.

For the Court of Auditors

Vítor Manuel da Silva Caldeira
President

ANNEX I

ISPA project management stages and key Commission activities[1]



[1] As stated in the Council Regulations (EC) No 1267/1999, (EC) No 1266/1999 and (EC) No 2382/2001 and according to the ECA audit criteria.

REPLY OF THE COMMISSION TO THE SPECIAL REPORT "THE INSTRUMENT FOR STRUCTURAL POLICIES FOR PRE-ACCESSION (ISPA), 2000 – 2006"

EXECUTIVE SUMMARY

III. The poor preparation of some projects was due to a large extent to a lack of capacity and the short timeframe in which projects had to be developed. Guidance was also given through the detailed application forms and existing explanations of procurement procedures.

IV. The delays and changes in planning which occurred in many of the early projects were hard to avoid given the lack of experience in managing major infrastructure projects and the need for ex-ante control of tendering procedures.

VI. The Commission agrees with the Court's recommendation. It will continue to monitor ex-ISPA projects and some will be evaluated in the 2000-2006 ex post evaluation exercise, paying particular attention to cost overruns and delays. The experience with ISPA has already led the Commission to take steps to offer greater assistance with project preparation, such as the special EIB/Commission Technical Assistance facility, JASPERS. It will continue and intensify such technical assistance under the new pre-accession instrument IPA. The Commission has also discussed the problems of delays with Member States.

INTRODUCTION

6. In practice, the grant rate is often lower than 75 %. For example, in Romania the average rate was 73 %, in Bulgaria 56 % and in Slovakia 54 %.

AUDIT SCOPE AND APPROACH

9. Most of the Court's sample was selected from among the older ISPA projects approved in the first or early years of use of the instrument. Some had been prepared even earlier. The very short timeframe in which ISPA had to be implemented had implications for project maturity and the readiness of national authorities.

AUDIT OBSERVATIONS

13. The Commission secured the national strategies for the transport and environment sectors in the candidate countries based on national investment plans and programmes, despite this not being a regulatory requirement. The strategies were also presented by the Commission to the ISPA management committee (Member State representatives) before the presentation of individual projects.

19. The Commission actively encouraged national authorities to build on existing national plans (for example, to implement the urban wastewater treatment directives) because of the limited time available.

20. In addition, guidance was given through the detailed application forms which were made available in 1999 and procurement procedures were explained in the guidance developed under previous pre-accession instruments.

(c) The previous version of the "Guide to cost-benefit analysis of investment projects", which explained the main principles of CBA, had been available since 1997. The 2002 version of the guide responded to the changed regulatory environment and addressed various issues in more depth.

21. The ISPA regulations were adopted in 1999 and the first ISPA Manual was provided in 2000. The advice given in the ISPA Manual and through various other channels (see reply to 20) had to be developed together with the candidate country concerned and to take account of their implementation realities which were evolving. In addition to formal guidance, a major effort was made to prepare the ground for ISPA in a very limited time frame, for example through meetings held in all candidate countries from 1998 onwards with support from PHARE to prepare project pipelines.

22. The shortcomings in CBAs and financial analyses were often due to lack of a consistent approach among the many international consultants that prepared the majority of projects, poor data, or a lack of expertise within the national administrations. Nevertheless, the Commission ensured that revenue-generating projects all had at least a complete financial analysis. It accepted non-quantified socio-econmic analyses or statements in place of a complete CBA for environment projects, in view of the absence of a generally accepted methodology for quantifying environmental benefits and the fact that these projects were in the main implemented in order to comply with EU directives.

23.

(a) The 2000-2001 ISPA projects were the first ones in which CBA was used.

(b) Where there were inconsistencies, the Commission routinely asked for clarifications or corrections. These exchanges improved the reliability of the analyses.

(c) The Commission refers to its reply at point 22.

24. The Commission attempted to ensure that beneficiaries justified their projects according to an economic and financial rationale, and by reference to considerations such as viability and affordability to the population served. However, for environmental projects cost-benefit analysis was of limited relevance where there were no alternatives and the projects had to be carried out anyway to implement the acquis. In some cases a better cost-benefit analysis would have delayed the project without adding much value.

27. The Commission made every effort to monitor the projects and help national authorities to mitigate the consequences of delays. Specific action plans were prepared in some countries for the most problematic projects.

28. By the end of September 2008, a further three of the projects in the sample had been completed by the original date.

30. While delays are certainly not uncommon for large infrastructure projects, in the particular case of ISPA beneficiary countries the first ISPA projects were victims of the start up phase of a new instrument in the candidate countries. There was no experience with external investment assistance programmes on this scale prior to ISPA. However the learning curve (both in the accession countries and in the Commission) improved significantly from the middle of the programming period onwards.

In general, delayed tendering procedures were the main factor. Once works started, most projects made good progress. The ex-ante control by the EC delegations of procurement was mandatory. Delays were one of the costs of ensuring value for money through fair and transparent procurement procedures.

31.

(a) ISPA was intended to provide candidate countries with experience in this area during the pre-accession period, so that they would have less problems with using the Structural and Cohesion Funds after accession. Delays due to ex ante control procedures and retendering were one of the costs of ensuring fair and transparent procurement. Other contributory factors were inadequate land acquisition procedures and bureaucratic building permit processes.

Textbox 5

Procurement procedures in Latvia have much improved since the start of ISPA. For instance, tenders for Cohesion Fund projects approved in 2005 were launched promptly and implementation of most projects started in 2006.

The importance of a fair and effective tendering procedure must take precedence over the risk of delays.

Textbox 6

Retendering protected the Community interest in this case. Work has since resumed on this project.

(c) The Commission refers to its reply at point 30.

Textbox 7

For large and complex infrastructure projects which are expected to be implemented over the period of several years it is not uncommon for certain adjustments to be required to initial plans.

(d) The Commission provided guidance in January 2005 to avoid problems in the transition from ISPA to Cohesion Fund rules in the EU-10 Member States after accession.

32. Delays have mainly been due to ensuring compliance with procurement rules in order to protect the Communities' financial interest. Such delays and the associated potential cost increases due to late tendering are the price to pay for financial soundness, a fact which the Court has recognised in its previous audits of ISPA, where it has acknowledged the beneficial effect of the ex ante control by EC delegations (e.g., point 8.42 of the Court's 2003 Annual Report). In any case, faster approval of flawed tender documents might well have resulted in higher bids or to disputes leading in the end to much higher costs.

Delays due to clarification of applications and cost-benefit analyses must also be accepted.

33. The failure to keep to initial cost estimates was due to inadequate project preparation, despite the use of international consultants, and also to poor cost control during implementation. Some countries suffered high cost inflation in the construction sector due to fast economic growth. As a general rule ISPA financing memoranda were not amended to allow for cost increases thus putting pressure on national authorites to take action to control these.

35. The sharp acceleration of inflation in some of the new Member States after accession was unexpected and not predicted by the financial institutions. It was due to rapid price increases of specific raw materials on world markets and fast economic growth in the majority of the new Member States which led to a boom in the construction sector resulting in above-average price increase in the industry.

36. Other factors contributing to cost overruns included:

- projects being submitted to the Commission at a very early stage where no detailed technical documentation for the best solution existed;

- €/national currency exchange rate fluctuations, especially in favour of the national currencies.

(a) The underestimation of costs sometimes led to no bids being received at the planned prices.

(b) Delays often occurred between the award of the grant and the start of the construction phase.

37. ISPA also had other objectives, of which the main one was to prepare for using the Structural and Cohesion Funds. The relatively low allocation of ISPA in relation to needs means that it could only begin to close the infrastructure gap.

39. By the end of September 2008 a further three of the projects had been completed.

Textbox 10

2nd paragraph. While at the time of the audit full compliance with EU standards had not been achieved, the Commission expects this to be the case after completion of the project.

Textbox 11

2nd paragraph. The Commission is monitoring the implementation of this project in order to accelerate its completion.

41. By the end of September 2008 a further four of the projects had been completed.

CONCLUSIONS AND RECOMMENDATIONS

43.

(a) The inadequate preparation was principally due to lack of capacity and in some cases to the variable performance of the international consultants used, rather than to the availability of guidance documents.

Guidance was also given through the detailed application forms which were made available in 1999 and procurement procedures were explained in the guidance developed under previous pre-accession instruments.

(b) Procedures (for example, procurement) are necessary to protect the taxpayer. They may be lengthy.

Despite the delays, by the end of September 2008 80 of the 279 infrastructure projects had been physically completed.

c) By the end of September 2008 a further seven of the 32 projects audited had been completed.

44. The Commission agrees with the Court's recommendation and will continue to monitor closely the implementation of ex-ISPA projects. Some projects will be evaluated as part of the 2000-2006 ex post evaluation exercise, paying particular attention to cost overruns and delays in implementation and including recommendations on how risk analysis (an important but often weak part of cost benefit analysis) can be improved.

The new regulations for pre-accession assistance were adopted in 2006 and 2007. The new approach is much wider than under ISPA with its narrow focus on infrastructure projects, and is in fact a mini-Structural Fund. The regional development component of IPA takes up earlier recommendations of the Court regarding the adequate preparation of candidate countries for the Structural Funds. The Commission has also discussed the problems of delays with Member States in the Funds Co-ordination Committee, proposing solutions.

Besides the technical assistance facility JASPERS which is available in the new Member States, other means of improving project preparation and implementation which the Commission is encouraging include starting approval procedures early with pre-appraisals and advancing tender preparation.