

**ANNUAL REPORT ON THE ACTIVITIES
FUNDED BY THE EIGHTH, NINTH AND 10TH
EUROPEAN DEVELOPMENT FUNDS (EDFs)**

Annual Report on the activities funded by the eighth, ninth and 10th European Development Funds (EDFs)

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THE COURT'S OBSERVATIONS

INTRODUCTION

1. This annual report presents the Court's assessment of the European Development Funds (EDFs). Key information on the activities covered and the spending in 2012 is provided in **Table 1**.

Table 1 — European Development Funds — Key information 2012

(million euro)

Budget title	Policy area	Description	Payments 2012	Management mode	
European Development Funds	Eighth EDF	Operational expenditure	<i>Projects</i>	22	Decentralised
			<i>Projects</i>	5	Centralised direct
			<i>Projects</i>	2	Centralised indirect
			<i>Projects</i>	0	Joint management
			<i>Budget support</i>	0	Centralised direct
		Administrative expenditure	0		
			29		
	Ninth EDF	Operational expenditure	<i>Projects</i>	383	Decentralised
			<i>Projects</i>	95	Joint management
			<i>Projects</i>	90	Centralised direct
			<i>Budget support</i>	16	Centralised direct
			<i>Projects</i>	15	Centralised indirect
		Administrative expenditure	0		
			599		
	10th EDF	Operational expenditure	<i>Budget support</i>	824	Centralised direct
			<i>Projects</i>	775	Joint management
			<i>Projects</i>	624	Decentralised
			<i>Projects</i>	299	Centralised direct
<i>Projects</i>			45	Centralised indirect	
Administrative expenditure		97			
		2 664			

Total operational expenditure (Projects)	2 355
Total operational expenditure (Budget support)	840
Total operational expenditure	97
Total payments	3 292
– <i>advances</i>	1 738
+ <i>clearings of advances</i>	1 369
Audited population	2 923

Total individual commitments ⁽¹⁾ **3 226**

Total global commitments ⁽¹⁾ **3 163**

⁽¹⁾ Global commitments relate to financing decisions. Individual commitments relate to individual contracts.

THE COURT'S OBSERVATIONS

Specific characteristics of the European Development Funds

2. The EDFs are the main instrument for providing European Union aid for development cooperation to the African, Caribbean and Pacific (ACP) States and overseas countries and territories (OCTs). The partnership agreement signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') is the current framework for the European Union's relations with ACP States and OCTs. Its main focus is on reducing and eventually eradicating poverty.

3. The EDFs are funded by the Member States, governed by their own financial regulations and managed, by the European Commission, outside the framework of the EU general budget. The European Investment Bank (EIB) manages the investment facility, which is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure ⁽¹⁾ ⁽²⁾.

4. The EDFs are managed almost entirely by the Commission's Directorate-General for Development and Cooperation (EuropeAid), which also manages a wide range of expenditure from the EU budget ⁽³⁾ ⁽⁴⁾.

⁽¹⁾ See Articles 118, 125 and 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund (OJ L 78, 19.3.2008, p. 1) and the Court's Opinion No 9/2007 on the proposal for this Regulation (OJ C 23, 28.1.2008, p. 3).

⁽²⁾ In 2012 a tripartite agreement between the EIB, the Commission and the Court (Article 134 of Regulation (EC) No 215/2008) set out rules for the audit of these operations by the Court.

⁽³⁾ The Directorate-General for Humanitarian Aid and Civil Protection (DG ECHO) manages 1,2 % of expenditure from the EDFs.

⁽⁴⁾ See chapter 7 'External relations, aid and enlargement' of the Court's 2012 annual report on the implementation of the EU budget.

THE COURT'S OBSERVATIONS

5. EDF interventions are implemented through projects and budget support ⁽⁵⁾ under three main arrangements. In 2012, 43 % of payments were made under centralised management, 30 % under decentralised management and 27 % under joint management ⁽⁶⁾ (see **Table 1**).

6. The expenditure covered in this report is made under a wide range of delivery methods, put into action in 79 countries. Rules and procedures are often complex, including those for tendering and the award of contracts. The Court has assessed the risk as inherently high.

7. In two areas — budget support ⁽⁷⁾ and EU contributions to multi-donor projects carried out by international organisations ⁽⁸⁾ such as the UN — the nature of the instruments and of the payment conditions limit the extent to which transactions are prone to errors as defined in the Court's audit of regularity.

8. Budget support is paid in support of a state's general budget or its budget for a specific policy or objective. The Court examines whether the Commission has respected the specific conditions for making budget support payments to the partner country concerned and has demonstrated that general eligibility conditions (such as progress in public sector financial management) have been complied with.

9. However the Commission has considerable flexibility in deciding whether these general conditions have been met. The Court's audit of regularity cannot go beyond the stage at which aid is paid to a partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in the Court's audit of regularity.

⁽⁵⁾ Budget support involves the transfer of funds by the Commission to the national treasury of the partner country. It provides additional budgetary resources to support a national development strategy.

⁽⁶⁾ Under centralised management, aid is implemented directly by the Commission's services (headquarters or delegations) or indirectly through national bodies (e.g. a development agency of an EU Member State). Under decentralised management, implementation is delegated to a third country. Under joint management, implementation is delegated to an international organisation.

⁽⁷⁾ Gross payments estimated at 840 million euro in 2012.

⁽⁸⁾ Gross payments estimated at 632 million euro in 2012.

THE COURT'S OBSERVATIONS

10. The Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure.

CHAPTER I — EIGHTH, NINTH AND 10TH EDFs**Implementation**

11. EDF agreements are usually concluded for a commitment period of around five years, but payments can be made over a longer period. In 2012, payments were made from the eighth, ninth and 10th EDFs. The eighth EDF (1995-2000) amounts to 14 625 million euro and the ninth EDF (2000-2007) to 15 200 million euro.

12. The 10th EDF (2008-2013) totals 22 682 million euro. Of this amount, 21 967 million euro are allocated to ACP countries and 285 million euro to OCTs. These sums include, respectively, 1 500 million euro and 30 million euro for the investment facility managed by the EIB for the ACP and OCT countries. Finally, 430 million euro are earmarked for the Commission's expenditure on programming and implementing the EDF.

13. In 2012, total contributions from the Member States amounted to 2 600 million euro.

14. **Table 2** shows the use, during 2012 and cumulatively, of EDF resources. Individual commitments were 27 % above the initial forecast, particularly due to the approval of the EU support to the Sustainable Energy for All initiative of 400 million euro, which had not been initially planned. Payments were 8 % more than initially forecast, mainly due to the higher than expected amount of commitments. Outstanding commitments remained stable compared with 2011.

The Commission's annual report on the financial management of the eighth to 10th European Development Funds

15. The Financial Regulation applicable to the 10th EDF requires the Commission to report each year on the financial management of the EDFs ⁽⁹⁾. In the Court's opinion, this report accurately presents relevant financial information.

⁽⁹⁾ Articles 118, 124 and 156 of Regulation (EC) No 215/2008.

Table 2 — Use of EDF resources at 31 December 2012

(million euro)

	Situation at end of 2011		Budgetary implementation during the financial year 2012 (net) ⁽⁶⁾				Situation at end of 2012				
	Global amount	Implementation rate ⁽²⁾	Eighth EDF ⁽³⁾	Ninth EDF ⁽³⁾	10th EDF	Global amount	Eighth EDF	Ninth EDF	10th EDF	Global amount	Implementation rate ⁽²⁾
A — RESOURCES ⁽¹⁾	48 854		– 79	– 102	246	66	10 584	16 450	21 885	48 920	
B — USE											
1. Global commitments ⁽⁴⁾	40 827	83,6 %	– 64	– 297	3 524	3 163	10 576	16 157	17 258	43 991	89,9 %
2. Individual commitments ⁽⁵⁾	34 833	71,3 %	– 46	– 187	3 460	3 226	10 448	15 504	12 107	38 059	77,8 %
3. Payments	29 208	59,8 %	15	539	2 655	3 209	10 345	14 566	7 507	32 417	66,3 %
C — Outstanding payments (B1 – B3)	11 619	23,8 %					231	1 591	9 751	11 574	23,7 %
D — Available balance (A – B1)	8 027	16,4 %					8	293	4 627	4 929	10,1 %

⁽¹⁾ Include initial allocations to the eighth, ninth and 10th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

⁽²⁾ As a percentage of resources.

⁽³⁾ Negative amounts correspond to decommitments.

⁽⁴⁾ Global commitments relate to financing decisions.

⁽⁵⁾ Individual commitments relate to individual contracts.

⁽⁶⁾ Net commitments after decommitments. Net payments after recoveries.

Source: Court of Auditors, based on the EDF reports on financial implementation and financial statements at 31 December 2012.

CHAPTER II — THE COURT'S STATEMENT OF ASSURANCE ON THE EDFs**The Court's Statement of Assurance on the eighth, ninth and 10th European Development Funds (EDFs) to the European Parliament and the Council — Independent Auditor's Report**

I — Pursuant to the provisions of article 287 of the Treaty on the Functioning of the European Union (TFEU) and Article 141 of the Financial Regulation applicable to the 10th EDF, which also applies to previous EDFs, the Court has audited:

- (a) the annual accounts of the eighth, ninth and 10th European Development Funds which comprise the balance sheet, the economic outturn account, the statement of cash flow, the statement of changes in net assets and the table of items payable to the European Development Funds and the report on financial implementation for the financial year ended 31 December 2012 approved by the Commission on 16 July 2013; and
- (b) the legality and regularity of the transactions underlying those accounts within the legal framework of the EDFs in respect of the part of the EDF resources for whose financial management the Commission is responsible ⁽¹⁰⁾.

Management's responsibility

II — In accordance with Articles 310 to 325 of the TFEU and the Financial Regulations applicable to the eighth, ninth and 10th EDFs, management is responsible for the preparation and presentation of the annual accounts of the EDFs on the basis of internationally accepted accounting standards for the public sector ⁽¹¹⁾ and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the EDFs (Article 317 of the TFEU).

Auditor's responsibility

III — The Court's responsibility is to provide, on the basis of its audit, the European Parliament and the Council with a Statement of Assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance as to whether the annual accounts of the EDFs are free from material misstatement and the transactions underlying them are legal and regular.

⁽¹⁰⁾ Pursuant to Articles 2, 3, 4, 125(4) and 134 of the Financial Regulation applicable to the 10th EDF this Statement of Assurance does not extend to the part of the EDFs resources that are managed by the EIB and for which it is responsible.

⁽¹¹⁾ The accounting rules and methods adopted by the EDF accounting officer are drawn up on the basis of International Public Sector Accounting Standards (IPSAS) or by default, International Financial Reporting Standards (IFRS) as respectively issued by the International Federation of Accountants and the International Accounting Standards Board.

IV — An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the EDFs, whether due to fraud or error. In making those risk assessments, internal control relevant to the preparation and fair presentation of the accounts, and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, are considered in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the accounts.

V — The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its opinions.

Reliability of the accounts

Opinion on the reliability of accounts

VI — In the Court's opinion, the annual accounts of the eighth, ninth and 10th EDFs for the year ended 31 December 2012 present fairly, in all material respects, the financial position as at 31 December 2012, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the EDF Financial Regulation and with internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue underlying the accounts

VII — In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2012 is legal and regular in all material respects.

Commitments

Opinion on the legality and regularity of commitments underlying the accounts

VIII — In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2012 are legal and regular in all material respects.

Payments*Basis for adverse opinion on the legality and regularity of payments underlying the accounts*

IX — The Court concludes that the supervisory and control systems are partially effective in ensuring the legality and regularity of payments underlying the accounts. The Court's estimate for the most likely error rate for expenditure transactions from the eighth, ninth and 10th EDFs is 3,0 %.

Adverse opinion on the legality and regularity of payments underlying the accounts

X — In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2012 are materially affected by error.

5 September 2013

Vítor Manuel da SILVA CALDEIRA

President

European Court of Auditors
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THE COURT'S OBSERVATIONS

Information in support of the Statement of Assurance*Audit scope and approach*

16. Observations regarding the reliability of the EDF accounts are set out in paragraph VI of the Statement of Assurance and are based on an audit of the financial statements⁽¹²⁾ and the report on the financial implementation of the eighth, ninth and 10th EDFs⁽¹³⁾. It involved the testing of amounts and disclosures and the assessment of the accounting principles used, significant estimates made by management and the overall presentation of the accounts.

17. **Annex 1.1, part 2**, of chapter 1 of the 2012 annual report of the Court of Auditors on the implementation of the budget describes the Court's overall approach and methodology. Observations regarding the regularity of EDF transactions are set out in paragraphs VII to X of the Statement of Assurance and are based on the following components:

- (a) the examination of all contributions from Member States and a sample of other types of revenue transactions;
- (b) the examination of a sample of 30 commitments⁽¹⁴⁾;
- (c) the examination of a sample of 167 interim and final expenditure transactions approved by seven EU delegations or the Commission headquarters⁽¹⁵⁾. Where necessary, implementing organisations and final beneficiaries were visited on the spot to verify the underlying transactions declared in financial reports or cost statements;
- (d) an assessment of the effectiveness of supervisory and control systems at EuropeAid's headquarters and EU delegations, covering the following elements:

⁽¹²⁾ See Article 122 of Regulation (EC) No 215/2008: the financial statements comprise the balance sheet, the statement of economic outturn, the statement of cash flow, the statement of changes in net assets and the table of items payable to the EDF.

⁽¹³⁾ See Article 123 of Regulation (EC) No 215/2008: the reports on financial implementation include tables of appropriations, commitments and payments.

⁽¹⁴⁾ Global financial commitments and the corresponding legal commitments (financing agreements) following the adoption of a financing decision by the Commission.

⁽¹⁵⁾ EuropeAid: 126 projects and 40 budget support payments; DG ECHO: one project payment on humanitarian aid.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

- (i) *ex ante* checks by authorising officers, external supervisors (for works contracts) or external auditors (for programme estimates⁽¹⁶⁾, grants and fee-based service contracts). The Court analysed why the errors it detected had occurred;
 - (ii) monitoring and supervision. This included an examination of EuropeAid's study on the 2012 residual error rate (RER), which partly relied on the work carried out by the Commission's Internal Audit Service (IAS)⁽¹⁷⁾;
 - (iii) internal audit;
- (e) a review of the annual activity report (AAR) by the Director-General of EuropeAid.

18. As indicated in paragraph 4, EuropeAid implements most of the external assistance instruments financed from the general budget and the EDFs. The Court's observations concerning both the effectiveness of supervisory and control systems and the reliability of the AAR and the Director-General's declaration for 2012 refer to EuropeAid's entire area of responsibility.

Reliability of the accounts

19. The economic outturn account includes as revenue interest on pre-financing in respect of pre-financing payments to beneficiaries of more than 250 000 euro. In order to recover interest on larger pre-financing payments from beneficiaries (i.e., those over 750 000 euro), the Commission is required to issue recovery orders on an annual basis⁽¹⁸⁾. However, such recoveries are rarely done. In addition, interest generated by pre-financing payments is sometimes netted off against claims for reimbursement of costs incurred: this interest is not recognised as revenue in the financial statements.

19. *The Commission acknowledges that despite a reminder to the sub-delegated AOS in the annual preclosure note, the recoveries for interest on PFs over 750 000 euro are not always made annually. However, DEVCO wants to emphasise that interest gained by pre-financing is always taken into account when establishing the financial situation before contracts are closed. In 2013 DEVCO will carry out a specific action on this issue:*

- *note reminding AOS of FR rules on this issue,*
- *detailed review of all contracts with open PFs of over 750 000 euro at year end 2012.*

⁽¹⁶⁾ A programme estimate is prepared, usually annually, to establish a work programme and the resources necessary to carry this out. It is implemented by the institution or beneficiary concerned but is subject to prior approval by the partner country's representative and the Commission.

⁽¹⁷⁾ The IAS is a directorate-general of the Commission. It is headed by the Commission's Internal Auditor and reports to its Audit Progress Committee. Its task is to provide independent assurance as to the effectiveness of internal control systems and to help the Commission by means of opinions, advice and recommendations.

⁽¹⁸⁾ Article 8(3) of the Financial Regulation applicable to the 10th EDF.

THE COURT'S OBSERVATIONS

20. As in previous years, the Court frequently identified transactions that had been incorrectly recorded⁽¹⁹⁾. A study carried out by EuropeAid in 2012 also found that the transactions were frequently recorded incorrectly in the Common RELEX Information System (CRIS). While the Court did not find any material errors in this connection for the reliability of the accounts, these mistakes remain a source of concern as they affect the accuracy of the data used for the preparation of the annual accounts, in particular with respect to the cut-off exercise at the end of the year⁽²⁰⁾.

Regularity of transactions

21. **Annex I** contains a summary of the results of transaction testing.

Revenue

22. The Court's audit of revenue transactions found them to be free from material error.

THE COMMISSION'S REPLIES

For PFs which are more than 250 000 euro but smaller than 750 000 euro the local CRIS FED system at this moment only allows recovery orders to be re-imputed to the original line of the expense, thus not allowing recognition of the interest. DG DEVCO has foreseen a development of the CRIS system to allow recognition which is scheduled to be available no earlier than October 2013.

20. As the Court mentioned, the Commission has made important efforts in 2012 which resulted in a considerable improvement of data quality. The Commission stresses its intentions to continue its efforts to improve data quality.

Following the extensive study made in 2012, an Action Plan has been elaborated and is being finalised (adoption targeted by mid July 2013), with several elements already being investigated and/or implemented. Together with this Action Plan, the Commission is now working to further improve data quality through several axes amongst which are:

- (a) improvement of CRIS in order to ensure that less errors are made by users (for example action 4.0 in the 'Master plan', targeting an improved CRIS user interface, revision of the CRIS documentation as well as the creation of a data dictionary);
- (b) continued CRIS data monitoring by Headquarters, via automated checks, targeted accounting quality tests and launch of studies on specific items following a risk assessment;
- (c) improvements to the information provided to users through the CRIS knowledge database and specific courses;
- (d) establishment of more targeted KPIs to increase the awareness of importance of good and complete data quality.

⁽¹⁹⁾ E.g. contract type, contract start and end dates, management mode.

⁽²⁰⁾ The cut-off exercise seeks to ensure that both revenue and expenditure are completely and accurately recorded in the correct accounting period.

THE COURT'S OBSERVATIONS

Commitments

23. The Court's audit of commitments found them to be free from material error.

Expenditure transactions

24. Out of the 167 transactions audited by the Court, 44 (26 %) were affected by error. The Court estimates the most likely error to be 3,0 % ⁽²¹⁾.

Projects

25. Of the 127 expenditure transactions sampled, 41 (32 %) were affected by errors, of which 28 (68 %) were quantifiable errors. Of the 28 transactions affected by quantifiable errors, 20 were final transactions that had already been checked by the Commission.

26. Errors were more frequently found in transactions related to programme estimates, grants and contribution agreements between the Commission and international organisations than in other forms of support: of the 71 transactions of this type that were tested, 31 (44 %) were affected by error.

27. The main types of quantifiable errors found in transactions related to projects concerned (see box 1):

- (a) eligibility: expenditure related to activities not covered by the contract (12 transactions), non-compliance by the beneficiary with procurement procedures (four transactions), and expenditure incurred outside the implementation period (two transactions) or exceeding budget set (affecting two transactions);
- (b) occurrence: absence of invoices or other supporting documents to justify expenditure (two transactions), services not delivered or works not carried out (two transactions) and expenditure not incurred by beneficiaries (one transaction);
- (c) accuracy: incorrect calculation of expenditure claimed (three transactions).

⁽²¹⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,5 % and 4,5 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

Box 1 — Examples of errors in project transactions*Works not carried out*

The Court examined an interim payment of 464 640 euro under a contract for road maintenance in Senegal. Works concerning the consolidation of the lower part of an embankment invoiced by the contractor, certified by the supervisor and paid for by the Commission had not been carried out. The Commission subsequently launched a comprehensive technical audit of the contract.

Contract value increased above the allowable limit

The Court examined the clearance of an advance of 305 738 euro under a health sector support programme in the Democratic Republic of the Congo. The value of two contracts had been increased by 58 % and 68 % respectively for additional works that were necessary to complete the original contract. The project management unit in the national government department was not aware that there was a limit of 50 % of the value of the initial contract for such additional works.

28. The most frequent types of non-quantifiable errors concerned insufficient supporting documents (five transactions) and shortcomings in procurement procedures (five transactions).

Budget support

29. For the 40 budget support transactions tested, three (8 %) were affected by errors, of which two (67 %) were quantifiable errors.

THE COMMISSION'S REPLIES

Box 1 — Examples of errors in project transactions*Works not carried out*

The technical audit report of April 2013 indicates that in total 39 095 euro (0,94 % of the total contract price) charged for the road banks' reinforcements, had not been realised.

The works contractor meanwhile executed the road banks' reinforcements, which had been invoiced.

The decentralised contracting authority will, at the moment of the final statement of account, decide on the possible imposition of recovery orders and contractual penalties upon the works contractor and service contractor who supervised the works.

Contract value increased above the allowable limit

A complementary audit to identify any other ineligible amounts is ongoing.

The EU Delegation reminded the NAO of the applicable rules. The NAO sent out a circular note, the content of which had been previously agreed upon with the EU Delegation.

29. The Commission does not share the Court's analysis of one quantifiable error.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

30. The quantifiable errors detected by the Court in budget support transactions concerned incorrect application of the scoring method for determining whether recipients had met the conditions for performance-related payments, or failure to assess compliance with specific conditions for payments (two transactions) (see box 2). The Court also identified non-quantifiable errors: the Commission failed to demonstrate satisfactorily that recipients had complied with the general eligibility conditions for budget support payments ⁽²²⁾. The Commission did not compare recipient countries' progress in implementing specific policies or public finance management reform with the objectives set for the period under review (two transactions).

30. Budget support is a policy instrument based on a long-term relationship of trust between the Commission and the partner countries. When deciding upon the release of a payment the Commission takes into account the progress made with regard to the individual indicators and conditions.

The Commission is pleased to note the significant decrease in the number of non-quantifiable errors over recent years.

The Commission considers that the achievement of values of indicators, which had been jointly agreed with the partner government, should not be evaluated in too strict a manner. While conditions for performance related payments play an important role in the process of stimulating countries to make progress on essential political objectives, the Commission considers that the indicators have to be evaluated taking into account the objectives they measure and the context in which the country's development takes place.

Box 2 — Example of error in a budget support transaction*Failure to set a specific payment condition*

The Court examined a payment of 600 000 euro related to the support for the 2007-2010 Economic Reform Programme in Vanuatu, including a performance-based variable tranche of 200 000 euro. According to the financing agreement, the Commission was required to select specific performance indicators set in the annual development report in respect of public finance management, but it did not do so. The Commission considered that it was sufficient for it to rely on an assessment of Vanuatu's overall progress in public finance management reform (a general eligibility condition) to disburse the variable tranche. This was in contradiction with the financing agreement, which provides that the Commission will only make the payment if both specific and general conditions are achieved.

Box 2 — Example of error in a budget support transaction*Failure to set a specific payment condition*

In line with the Commission Decision, both the general and specific PFM conditions in the FA are essentially the same and relate to progress in overall public finance management reform. The Commission positively assessed Vanuatu's overall progress in public finance management reform up until 2010. The relevant indicators on public finance management in the government's annual development report confirm this positive trend. Furthermore, the Delegation confirmed that this positive trend and effort was sustained, in line with the 2008 PFM Reform Strategy, during the politically difficult year of 2011.

⁽²²⁾ The Court also notes systems weaknesses. Financing agreements sometimes include strict and unrealistic quantified payment conditions. For example, one set as a payment condition 100 % coverage for a vaccination campaign. Such level of coverage is met in no country in the world.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Effectiveness of systems

31. **Annex 2** contains a summary of the results of the Court's examination of supervisory and control systems.

Ex ante checks

32. Given the high risk environment (see paragraph 6), EuropeAid relies mainly on *ex ante* checks (checks by Commission staff, external supervisors or external auditors before project payments are made) in order to prevent or detect and correct irregular payments. As in previous years, the frequency of errors found by the Court, including some affecting final claims which had been subject to external audits and expenditure verifications, point to weaknesses in these *ex ante* checks. A study carried out by EuropeAid in 2012 also found that a significant number (one-third) of audit reports received in 2011 were of insufficient quality.

33. Two EU delegations visited by the Court did not properly follow-up audit reports. The AAR acknowledges that a main cause of error is that ineligible amounts are not recovered, or that there is no explanation for non-recovery, following audit or expenditure verification reports ⁽²³⁾.

34. The Court's audit showed that late clearance and contract closure affect the quality of *ex ante* checks and significantly increase the risk of a broken audit trail or lack of supporting documents ⁽²⁴⁾. In both EDF and EU budget transactions, the Court found old contracts, for which expenditure was cleared late. Consequently, the corresponding individual financial commitments are either still open or were closed a long time after the end of the contract implementation period.

32. The Commission attaches the greatest importance to the quality of audits and is developing tools to help audit managers in the Commission better assess the quality of audit reports.

33. In the working plan referred to in the Commission's reply to paragraph 38, it is foreseen to develop through the CRIS Audit module a specific tool that will enable the Commission to make a proper follow up of the audit reports.

34. As part of an external study in 2012 the Commission has put in place a procedure that reviews all contracts for which the activity period has expired for more than 18 months. The services are requested to comment on the reason for the contracts still being open and their plan to ensure the contracts can be closed as soon as possible. This has led to a decrease in open contracts at year end for the EDF of 1 038 contracts (from 7 470 at year end 2011 to 6 432 at year end 2012). A similar exercise has been launched in April 2013 so as to continue this effort.

⁽²³⁾ Page 71.

⁽²⁴⁾ In five out of eight such cases the Court found quantifiable errors.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Monitoring and supervision*Management information system*

35. As indicated in past annual reports ⁽²⁵⁾, there are shortcomings in EuropeAid's management information system on the results and the follow-up of external audits, expenditure verifications and monitoring visits. These make it difficult for the Director-General to hold heads of unit or heads of EU delegation accountable for the timely follow-up and correction of system weaknesses and errors identified.

Monitoring visits

36. All of the seven EU delegations visited by the Court had a good overview of the operational implementation of projects, chiefly through monitoring visits. However, only one of the seven EU delegations selected and planned these visits on the basis of a risk assessment. EuropeAid is developing a tool to help EU delegations better screen their portfolio of projects and prioritise visits to those in particular need of monitoring based on risk assessments. The Court also found weaknesses in the way two out of the seven EU delegations monitored project implementation or followed up the results of these visits.

2012 RER study

37. As previously recommended by the Court ⁽²⁶⁾, EuropeAid carried out its first residual error rate (RER) study to assess the level of error which has evaded all management checks to prevent, detect and correct errors. The study involved examination of a representative sample of transactions from closed contracts in order to determine whether expenditure had taken place for the purposes intended, was in accordance with the relevant rules and was correctly calculated. The errors found were used to estimate the most likely error in the population of closed contracts.

35. The audit module of the external aid management information system (CRIS) was designed to plan, and record the results of external audits rather than track audit follow-up made by the Commission. However the Commission has planned to develop this functionality in the medium term, resources permitting.

The Commission developed a work plan tool for planning of missions. Additionally, the Commission is setting up a reform of monitoring and reporting to be implemented in early 2014.

36. In one case, the EU Delegation has followed-up on the main finding of the monitoring report. The difficult security-situation was the main cause of the problems in the road works execution, identified in the mission report.

In the second case, the Delegation has taken measures to monitor more closely the implementation of the second phase of the project.

⁽²⁵⁾ Paragraph 42 of the Court's 2010 annual report and paragraph 43 of the Court's 2011 annual report.

⁽²⁶⁾ Paragraph 54(a) of the 2009 annual report, paragraph 62(a) of the 2010 annual report and paragraph 58(a) of the 2011 annual report.

THE COURT'S OBSERVATIONS

38. The results of the 2012 RER study are presented in the AAR ⁽²⁷⁾. The study estimates the RER at 3,63 %, i.e. above the 2 % materiality level set by the Director-General of EuropeAid. The main types of errors identified in the study are:

- (a) errors in transactions with international organisations (38,0 % of the RER);
- (b) amounts not recovered (or amounts lacking an explanation for non-recovery, other than international organisations) following audit or verification mission reports (26,7 % of the RER);
- (c) errors related to funds managed indirectly by beneficiaries other than international organisations (20,1 % of the RER);
- (d) lack of documentation concerning procurement procedures (15,2 % of the RER).

39. The design of the RER methodology was in general appropriate, and the study has provided interesting and potentially useful results. However, there is scope for further refinement in the methodology in a number of respects, relating to:

- (a) the degree of reliance placed upon previous audit or verification reports;
- (b) the method of calculation of error rates on individual transactions;
- (c) the treatment of transactions where there was no readily obtainable documentation.

THE COMMISSION'S REPLIES

38. *As foreseen in the Commission's procedures, an Action Plan has been set up to further improve the internal control system. It includes, inter alia, awareness raising actions, training and guidance, reinforcement of the accountability of Delegations, an increased cooperation with international organisations and streamlining the control system.*

39. *The results of the 2012 RER study fed directly into the 2012 AAR assurance process and therefore were actually very useful to the Commission. The 2012 RER study was the first one implemented and the lessons learned from this first exercise will allow for refinements in the methodology.*

- (a)** *The Commission will discuss this issue with the contractor.*
- (b)** *The Commission will discuss this issue with the contractor.*
- (c)** *The steps to be undertaken to perform estimations are set out in detail in the revised RER instruction manual which will be applied for the 2013 RER exercise.*

⁽²⁷⁾ Pages 54-56.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Internal audit

40. In its 2011 annual report ⁽²⁸⁾, the Court indicated that the Commission reorganisation that took place in 2011 had a major impact on the activity of the Internal Audit Capability (IAC) ⁽²⁹⁾. In its reply to the Court's 2011 annual report, the Commission committed itself to assess the capacity of the IAC and to consider strengthening it if necessary ⁽³⁰⁾. This has not been done. There was no improvement in 2012: implementation of the IAC's annual work plan was again significantly and adversely affected ⁽³¹⁾.

Review of annual activity report

41. In his declaration of assurance, the Director-General makes a reservation concerning the legality and regularity of transactions, since the amount considered at risk (259,5 million euro) represents more than 2 % of payments authorised in the reporting period.

42. However, the Director-General also states that 'the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions' ⁽³²⁾. The AAR also indicates that the RER figure of 3,63 % is an estimate of the 'maximum amount at risk' ⁽³³⁾, 'does not put into question the overall control system' and shows that 'most errors are linked to a limited number of weaknesses concerning mainly the implementation of controls, which can and will be subsequently addressed by DG DEVCO during 2013' ⁽³⁴⁾.

40. *Since 2013, due to several measures taken in this respect, the functioning of the IAC has been improving.*

⁽²⁸⁾ Paragraph 50 of the Court's 2011 annual report.

⁽²⁹⁾ The IAC is a unit of a Commission Directorate-General. It is managed by a Head of Unit who reports directly to the Director-General. Its task is to provide independent assurance on the effectiveness of the internal control system with a view to improving the Directorate-General's operations.

⁽³⁰⁾ Commission's reply to paragraph 59(e) of the Court's 2011 annual report.

⁽³¹⁾ The annual work plan forecast completion of one ongoing audit, three new audits and three follow-up audits. Only one audit was completed by the end of 2012.

⁽³²⁾ Page 73.

⁽³³⁾ Page 71.

⁽³⁴⁾ Page 72.

THE COURT'S OBSERVATIONS

43. The Court considers that this is a misleading presentation of the results of the RER study:

- (a) the RER is not a 'maximum amount' but a best estimate (or most likely estimate). The true level of error could be higher;
- (b) the RER is not an estimate of the amount 'at risk' but an estimate of the error which remains undetected and uncorrected at the end of the management cycle and is thus definitive ⁽³⁵⁾;
- (c) supervisory and control systems are not effective when they fail to detect and correct material error;
- (d) the AAR describes the main types of errors occurring in EuropeAid expenditure ⁽³⁶⁾ but, with the exception of weaknesses in the recovery process, it does not analyse why they occurred and which aspects of EuropeAid's supervisory and control system failed.

44. In 2012, the IAS performed a limited audit of EuropeAid's AAR process. It found that the AAR does not provide sufficient information on how the directorate-general built up reasonable assurance about the legality and regularity of expenditure on a multi-annual basis. These findings concur with those of the Court.

THE COMMISSION'S REPLIES

43.

- (a) *The Commission agrees that the amount at risk mentioned in DG DEVCO's 2012 AAR is the most likely estimate, in accordance with the Standing Instructions for the Annual Activity Reports for 2012. The true level of error could be higher, but also lower.*
- (b) *The concept of 'amount at risk' is applied in the AAR in full compliance with the Commission's standing instructions for the preparation of the AAR. These instructions define the 'amount at risk' as the financial impact of the errors in terms of actual budgetary financial exposure during the calendar year.*

The Commission agrees that the results of the RER study are not an estimate of the amount at risk.
- (c) *Most errors are linked to a limited number of weaknesses concerning mainly the implementation of controls. The design of the control system therefore appears to be sound and does not need to be modified.*
- (d) *The Commission will undertake for the next Annual Activity Report the analysis requested in the standing instructions. The Action Plan referred to in paragraph 38 addresses all types of errors identified by the control system and the Court of Auditors. The Action Plan was preceded by a thorough analysis of the origins of these errors. In addition, it also included definitions of the ways in which errors — outlined in the Action Plan — are tackled. The analysis concluded that the control design as such was sound and that the errors which occurred were primarily due to implementation issues.*

⁽³⁵⁾ 'Residual errors are those that have evaded all prevention, detection and correction controls in the existing control framework'. (A Manual for Measuring the Residual Error Rate for EuropeAid, May 2013).

⁽³⁶⁾ Pages 56 and 71.

Conclusions and recommendations

Conclusions

45. Based on its audit work, the Court concludes that the EDFs' accounts for the financial year ending 31 December 2012 present fairly, in all material respects, the financial position of the EDFs as of 31 December 2012, and the results of their operations and cash flows for the year then ended, in accordance with the provisions of the EDF Financial regulation and the accounting rules adopted by the accounting officer.

46. Based on its audit work, the Court concludes that, for the financial year ending 31 December 2012:

- (a) the revenue of the EDFs was free from material error;
- (b) the commitments entered into by the EDFs were free from material error;
- (c) EDF expenditure transactions were affected by material error (see paragraphs 24 to 30).

47. Based on its audit work, the Court found that the examined supervisory and control systems of EuropeAid were partially effective (see paragraphs 18 and 31 to 44).

47. *The Commission agrees that, while the design of the control system is broadly consistent and sound, progress still has to be made on the implementation of the control mechanisms.*

Recommendations

48. **Annex 3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2009 and 2010 annual reports, the Court presented 16 recommendations. EuropeAid fully implemented five recommendations, while three were implemented in most respects and eight were implemented in some respects.

49. As regards the recommendations implemented in some respects only, EuropeAid is taking action but more time is needed for the recommendations to be satisfactorily implemented:

- (a) EuropeAid has joined a working group headed by DG Budget to review the cost-effectiveness of its overall control architecture;

THE COURT'S OBSERVATIONS

- (b) it is developing tools and guidance for EU delegations to better prioritise their monitoring visits to projects and assess the quality of audit reports;
- (c) it is developing new functions within of the audit module of its CRIS information system to improve the follow-up of audit reports.

50. Insufficient progress has been made in respect of the quality of data in the CRIS information system. Despite efforts made by EuropeAid to raise awareness among EU delegations, this remains a source of concern (see paragraph 20).

51. Following this review and the findings and conclusions for 2012, the Court recommends that EuropeAid should:

- **Recommendation 1:** review its RER methodology;
- **Recommendation 2:** provide an accurate description, in the AAR of the results of RER studies;
- **Recommendation 3:** ensure the timely clearance of expenditure;
- **Recommendation 4:** promote better document management by implementing partners and beneficiaries;

THE COMMISSION'S REPLIES

50. The Commission has defined a 'Master plan' for Data Quality that includes various Action Plans, including those for the training of staff and the communication towards the Delegations. This will ensure that the Commission's staff is better trained and more aware of best practices and guidelines when encoding data in CRIS. An extensive project on the CRIS User Interface improvement has also been launched to reduce encoding errors.

The Commission agrees to a refinement of the RER methodology on the basis of the lessons learnt from this first exercise. The Commission has already taken measures in this regard. At the start of the 2013 exercise the contractor has been requested to elaborate a revised methodology and a manual which will take into account the lessons learnt during the first RER exercise in 2012. This refined methodology will be applied during the 2013 RER exercise.

The 2012 AAR contained a description of the RER exercise that was as detailed as possible and followed the drafting instructions. The Commission agrees that in the 2013 AAR a clear distinction should be drawn between the RER study results and their use for the purpose of assurance.

The Commission accepts this recommendation and action has recently been taken with a view to ensuring clearance of expenditure is done without delay.

The Commission agrees with the recommendation.

THE COURT'S OBSERVATIONS

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- **Recommendation 5:** take effective measures in order to enhance the quality of expenditure verifications carried out by external auditors;

 - **Recommendation 6:** ensure the correct application of specific conditions for budget support payments;

 - **Recommendation 7:** make sure that recovery orders in respect of interest on pre-financing over 750 000 euro are issued annually.

THE COMMISSION'S REPLIES

The Commission accepts this recommendation and, in the framework of the Action Plan referred to in paragraph 38, it has planned to examine in 2013 the possibilities of enhancing the quality and effectiveness of audits and verifications. This will be carried out notably with regard to audits and verifications conducted by local audit firms hired by the beneficiaries.

The Commission will continue to ensure the correct application of specific conditions for budget support payments. A working group on budget support has been set up to address the specific audit findings of the Court.

The Commission accepts this recommendation and will remind sub-delegated Authorising officers of the rules concerning annual recovery of interest for pre-financing above 750 000 euro. Additionally, in order to raise awareness, a full review of eventual interest received on these pre-financings will be made so as to ensure compliance with the financial regulation.

ANNEX 1

RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

	2012			2011	2010	2009
	Projects	Budget support	Total			
SIZE AND STRUCTURE OF THE SAMPLE						
Total of commitments	23	7	30	30	30	50
Total transactions ⁽¹⁾	127	40	167	163	165	170
RESULTS OF TESTING ⁽²⁾ ⁽³⁾						
Proportion of transactions tested found to be:						
Free of error	68 % (86)	93 % (37)	74 % (123)	67 %	73 %	78 %
Affected by one or more errors	32 % (41)	8 % (3)	26 % (44)	33 %	27 %	22 %
Analysis of transactions affected by error						
Analysis by type of error						
Non-quantifiable errors:	32 % (13)	33 % (1)	32 % (14)	46 %	49 %	65 %
Quantifiable errors:	68 % (28)	67 % (2)	68 % (30)	54 %	51 %	35 %
Eligibility	71 % (20)	100 % (2)	73 % (22)	52 %	70 %	23 %
Occurrence	18 % (5)	0 % (0)	17 % (5)	38 %	17 %	23 %
Accuracy	11 % (3)	0 % (0)	10 % (3)	10 %	13 %	54 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate				3,0 %		
Upper error limit (UEL)				4,5 %		
Lower error limit (LEL)				1,5 %		

⁽¹⁾ The 167 transactions represent 167 sampling units under the Monetary Unit Sampling method used by the Court. Large payments, in particular large budget support payments, may be selected more than once, and appear in the table as more than one transaction (this will happen if they are larger than the sampling interval).

⁽²⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

⁽³⁾ Numbers quoted in brackets represent the actual number of transactions.

ANNEX 2

RESULTS OF EXAMINATION OF SYSTEMS FOR THE EUROPEAN DEVELOPMENT FUNDS AND DEVELOPMENT AID
UNDER THE EU BUDGET

Assessment of the systems examined

System concerned	Ex ante controls	Monitoring and supervision	Internal audit	Overall assessment
EuropeAid	Partially effective	Partially effective	Partially effective	Partially effective

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR ADMINISTRATIVE AND OTHER EXPENDITURE

Year	Court Recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2010	EuropeAid should develop a key indicator for the estimated financial impact of residual errors after all <i>ex ante</i> and <i>ex post</i> controls have been implemented (2010 annual report, paragraph 62(a)).	X						
	EuropeAid should assess the cost-effectiveness of the various controls, notably of the transactions <i>ex post</i> control systems (2010 annual report, paragraph 62(b)).			X			EuropeAid has joined a working group headed by DG Budget to review the cost-effectiveness of its overall control architecture.	
	EuropeAid should strengthen the effectiveness of project monitoring, including on-the-spot visits, on the basis of multiannual monitoring and evaluation plans (2010 annual report, paragraph 62(c)).			X			EuropeAid is developing tools and guidance for EU delegations to better prioritise their monitoring visits to projects and assess the quality of audit reports.	
	EuropeAid should review the reliability of certificates from external supervisors, audits and expenditure verifications (2010 annual report, paragraph 63(a)).			X			In the framework of the Action Plan referred to in paragraph 38, it is foreseen to improve further the quality of the external audits.	
	EuropeAid should introduce management information systems which allow the Director-General and the Heads of Delegation to better monitor the follow-up of results from on-the-spot visits, external audits and expenditure verifications (2010 annual report, paragraph 63(b)).			X			EuropeAid is developing new functions within of the audit module of its CRIS information system to improve the follow-up of audits and expenditure verification reports.	
	EuropeAid should link the CRIS Audit and CRIS Recovery Orders information systems (2010 annual report, paragraph 63(c)).	X						

Year	Court Recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2010	EuropeAid should continue its efforts to ensure that data are recorded in an accurate, comprehensive and timely manner in the CRIS information system (2010 annual report, paragraph 63(d)).			X			Efforts are under way to address those shortcomings, but no financial and/or other critical information is missing in CRIS. A newly defined data quality master plan including actions covering data cleansing, information system improvement, monitoring and control, user documentation and training has been set up and is being implemented.	
	EuropeAid should ensure that Delegations consistently apply the new format and scheme for Delegations' annual reporting on reforms of public finance management systems in recipient countries so as to provide a structured and formalised demonstration of public finance management progress (2010 annual report, paragraph 64(a)).		X				The Commission considers that this recommendation has been fully implemented. An online application for the EAMR (External Assistance Management Report) was introduced in 2011 and includes a specific section on Budget Support and especially on issues related to PFM. This tool is available to all EU Delegations and is compulsory whenever Budget Support programmes are in place in a country.	
	EuropeAid should promote through policy dialogue the setting of clear assessment frameworks in recipient countries' reform programmes on public finance management (2010 annual report, paragraph 64(b)).	X						
2009	EuropeAid should, in the context of its planned review of its overall control strategy, develop a key indicator for the estimated financial impact of residual errors after all <i>ex ante</i> and <i>ex post</i> controls have been implemented, based for example in an examination of a representative statistical sample of closed projects (2009 annual report, paragraph 54(a)).	X						
	EuropeAid should, in the context of this review, assess the cost-effectiveness of the various controls, notably of the transactional <i>ex post</i> control system (2009 annual report, paragraph 54(b)).			X			EuropeAid has joined a working group headed by DG Budget to review the cost-effectiveness of its overall control architecture.	

Year	Court Recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2009	EuropeAid should finalise and disseminate the financial management toolkit targeting the high inherent risk of errors at the level of implementing organisations, contractors and beneficiaries to ensure adequate knowledge of financial management and eligibility rules (2009 annual report, paragraph 54(c)).	X						
	EuropeAid should continue its efforts to ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner (2009 annual report, paragraph 54(d)).			X			Efforts are under way to address those shortcomings, but no financial and/or other critical information is missing in CRIS. A newly defined data quality master plan including actions covering data cleansing, information system improvement, monitoring and control, user documentation and training has been set up and is being implemented.	
	The design of CRIS Audit should be modified to provide information on the amounts of final ineligible expenditure and financial corrections done after the audit clearance process with the auditee has been completed (2009 annual report, paragraph 54(e)).			X			In the working plan that is referred to in the Commission reply to paragraph 38, it is foreseen to develop through the CRIS Audit module a specific tool that will enable the Commission to make a proper follow up of the audit reports.	
	EuropeAid should ensure that the specific conditions for performance-based variable tranches clearly specify the indicators, targets, calculation methods and verification sources (2009 annual report, paragraph 55(a)).	X						
	EuropeAid should ensure that Delegations' reports provide a structured and formalised demonstration of public finance management progress by clearly setting the criteria against which progress was to be assessed (i.e. the results that the recipient Government had to achieve during the period concerned), the progress made and the reasons why the reform programme may have not been implemented according to plan (2009 annual report, paragraph 55(b)).		X				The Commission believes that this recommendation has been fully implemented. The budget support performance framework has been improved, notably through the revision of Budget Support Guidelines issued in 2012.	