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**COVER NOTE**

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from:	Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt:	3 February 2012
to:	Mr Nicolai WAMMEN, President of the Council of the European Union
Subject:	Special report No 14/2011: Has EU assistance improved Croatia's capacity to manage post-accession funding?

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Sir,

I enclose a copy of special report No 14/2011 "Has EU assistance improved Croatia's capacity to manage post-accession funding?" together with the Commission's replies.

The special report, which is shortly to be published, was adopted by the Court at its meeting on 25 October 2011 and is accompanied by the replies from the Commission, which was notified of the preliminary findings on 18 July 2011.

(Complimentary close).

(s.) Vítor CALDEIRA

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Encl.: Special report No 14/2011: Has EU assistance improved Croatia's capacity to manage post-accession funding?<sup>1</sup>

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<sup>1</sup> In English only. The other languages of this report are available on the European Court of Auditor's website: <http://eca.europa.eu/>.

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EUROPEAN COURT OF AUDITORS  
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## Special Report No 14/2011

(pursuant to Article 287(4), second subparagraph, TFEU)

Has [EU assistance](#) improved [Croatia](#)'s capacity to manage post-accession funding?

together with the Commission's replies

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## **ACRONYMS AND ABBREVIATIONS**

BRI	Business Related Infrastructure
CAP	Common Agricultural Policy
CARDS	Community Assistance for Reconstruction, Development and Stabilisation
Agriculture and Rural Development DG	Directorate-General for Agriculture and Rural Development
Enlargement DG	Directorate-General for Enlargement
Employment, Social Affairs and Inclusion DG	Directorate-General for Employment, Social Affairs and Inclusion
Regional Policy DG	Directorate-General for Regional Policy
EAFRD	European Agricultural Fund for Rural Development
ESF	European Social Fund
IPA	Instrument for Pre-Accession Assistance
IPARD	Instrument for Pre-Accession Assistance in Rural Development
ISPA	Instrument for Structural Policies for Pre-Accession
LPE	Local Partnership for Employment
OBNOVA	Croatian word for "rebuilding"
OP	Operational Programme
Phare	The main EU pre-accession instrument 1989-2006
SAP	Stabilisation and Association Process
Sapard	Special Accession Programme for Agriculture and Rural Development
USKOK	Office for Prevention of Corruption and Organised Crime

## **EXECUTIVE SUMMARY**

- I. A key aim of the EU pre-accession assistance to Croatia (150 million euro per annum from 2007) is to help build up the country's administrative capacity in order for it to be able to manage the very significant funding Croatia will receive from the EU after accession, notably from the European Agricultural Funds and the Structural and Cohesion Funds.
- II. The objective of the audit was to assess how effective the EU assistance had been, both in terms of its relevance and the results achieved.
- III. The Commission has developed new approaches since the 2004 and 2007 enlargements to improve the framework for assistance. Programming procedures are well-designed to ensure capacity building priorities are addressed, and projects examined by the Court in Croatia were found to be very relevant. However, more attention needs to be paid to building up procurement capacity and the capacity of regional and local authorities.
- IV. In terms of results, EU assistance has made an important contribution to building up Croatia's capacity for managing post-accession funding, including through learning by doing. However, implementation of assistance has been delayed and some of the intended results of projects have yet to be secured. In the area of the Structural and Cohesion Funds, learning by doing has been particularly useful though a focus on developing major infrastructure projects has been at the expense of developing other projects, particularly at the regional and local level. Rural development measures have suffered from low absorption and progress in capacity building has been modest. Some important steps have been taken to strengthen the anti-corruption body but significant challenges remain.
- V. The report concludes that EU pre-accession assistance is making a significant contribution to supporting Croatia prepare for managing EU funds after accession but has so far been only partially successful. It sets out recommendations which identify where additional assistance is particularly

required for further progress in building capacity for managing pre- and post-accession funds, and which are likely to be relevant to EU pre-accession assistance in other countries.

## **INTRODUCTION**

### ***Background***

1. In June 2000, the Feira European Council decided, in the framework of the European Union's Stabilisation and Association Process (SAP), that all the Western Balkan countries should have the prospect of joining the EU. Croatia presented its application for EU membership in 2003 and received the status of Candidate Country from the Council in June 2004. Accession Partnerships were established in 2006 and 2008 setting out what the European Commission considered to be priority areas for Croatia to make progress in before accession.
2. As for other Candidate Countries, in order to join the EU Croatia has to meet the Copenhagen criteria<sup>2</sup>, accept the entire EU legal framework, known as the *acquis communautaire*<sup>3</sup>, and make EU law part of its own national legislation. To facilitate the accession negotiations, the *acquis* is divided into EU policy chapters (see **Annex I**). Negotiations on the various chapters are not limited to regulatory and legislative aspects, but also cover the setting up of the necessary administrative structures and the progress achieved in building up their management capacity.
3. Accession negotiations were formally opened on 3 October 2005. The chapter by chapter negotiations with the EU Council started in June 2006 and were closed by a Ministerial Accession conference on 30 June 2011. As

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<sup>2</sup> The Copenhagen criteria set by the European Council in June 1993 consist of:  
(a) Political criteria: stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;  
(b) Economic criteria: the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces in the Union;  
(c) The ability to assume the obligations of membership, including adherence to the aims of political, economic and monetary union.

<sup>3</sup> The *acquis communautaire* denotes the whole range of principles, policies, laws, practices, obligations and objectives that have been agreed or developed within the European Union.



provided for by the June 2011 European Council, the Accession Treaty should be signed by the end of 2011<sup>4</sup>. The target date for Croatia's accession to the EU, as agreed by the Member States, is 1 July 2013.

### ***EU pre-accession assistance to prepare for membership***

4. The purpose of EU pre-accession assistance is to support the adoption and implementation of the *acquis communautaire*, and to help the Candidate Countries strengthen their administrative capacity in preparation for managing the larger amounts of EU funding available to them once they become Member States. The Commission follows two complementary approaches to strengthening administrative capacity. Firstly, it directly funds activities such as institution building, the setting up of management systems and training. Secondly, it also supports capacity building through funding programmes similar to those under the European Agricultural Fund for Rural Development (EAFRD) and the Structural and Cohesion Funds in order to enable Candidate Countries to “learn by doing” as they implement such programmes before their accession.

5. Since 2001 the Commission has provided pre-accession assistance to Croatia through several instruments (see ***Figure 1***)<sup>5</sup>. Initially, this was provided through the Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme. The Phare programme, the Commission's main pre-accession instrument, was introduced in Croatia in 2005. It was complemented by the Instrument for Structural Policies for Pre-Accession (ISPA), financing infrastructure projects in the transport and environment

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<sup>4</sup> European Council Brussels, 24.6.2011, EUCO 23/11.

<sup>5</sup> EU assistance to Croatia started in 1991, immediately after the outbreak of armed conflict in former Yugoslavia. Over the period 1991-2000, 382 million euro was provided through the European Commission Humanitarian Office (1991 – 1998), and through the OBNOVA (Croatian word for “rebuilding”) programme 1998-2000, which focused on the return and reintegration of refugees and displaced persons, reconstruction of infrastructure, economic revitalisation of war-affected areas and demining.

sectors and the precursor of the EU Cohesion Fund, and the Special Accession Programme for Rural Development (Sapard) which was similarly intended as a precursor for the European Agricultural Fund for Rural Development (EAFRD). From 2007 these three instruments were replaced by the Instrument for Pre-Accession (IPA), which provides funding of approximately 150 million euro per annum through five components (see **Table 1**). Following accession EU funding to Croatia will greatly increase.

**Figure 1 – EU expenditure in Croatia before and after accession**

Period	Financial Instrument	EU Budget (annual average, in million euro)
2001 – 2004	<b>CARDS</b> Council Regulation (EC) No 2666/2000	65
2005 - 2006	<b>PHARE</b> (Council Regulation (EEC) No 3906/1989)	75
2005 - 2006	<b>ISPA</b> (Council Regulation (EC) No 1267/1999)	30
2006	<b>SAPARD</b> (Council Regulation (EC) No 1268/1999)	25
2007 – 2013	<b>IPA</b> (Council Regulation (EC) No 1085/2006)	150
<b>EU Funding Allocations Post-accession</b>		
2013 – 2015	2013 (6 months)	602
	2014	1 176
	2015	1 374
<i>Provisional allocations based on the draft text of the Accession Treaty with Croatia, excluding agricultural direct payments and rural development payments. (Council of the European Union, 14509/1/11 REV 1, 22 September 2011). The actual amount Croatia will receive will depend on the outcome of the negotiations on the EU financial Framework 2014-2020.</i>		

Source: European Court of Auditors.

**Table 1 - IPA assistance to Croatia 2007-2013 (million euro)**

Component	I. Transition Assistance & Institution Building	II. Cross-border Cooperation	III. Regional Development	IV. Human Resources Development	V. Rural Development	Total
<b>Totals (2007-2013)</b>	299	105	379	104	184	1 071

Source: COM(2009) 543 final of 14 October 2009 – Instrument for pre-accession assistance (IPA) - Multi-annual Indicative Financial Framework for 2011-2013.

6. EU assistance to Croatia is planned by the Commission in conjunction with the Croatian authorities. The Accession Partnerships and the National Programme for Integration of Croatia into the EU are the main elements of the political framework for assistance. EU funding is allocated to the assistance priorities set out in the Multi-annual Indicative Planning Documents (MIPDs) established by the Commission in close consultation with the national authorities. The Croatian authorities draw up relevant project proposals and, together with the Commission, short-list and refine the proposals into mature projects ready for implementation. Projects are generally required to be completed within a three or four year time frame. They are implemented through grant schemes, contracts (for services, supplies or public works) or twinning contracts<sup>6</sup>. As regards the assistance under the Instrument for Pre-Accession Assistance in Rural Development (IPARD), the projects are selected solely by the Croatian competent Agency.

7. EU assistance to Croatia has been managed in three ways. Under the CARDS programme, it was predominantly managed centrally by the Commission. However, for the more recent instruments the Commission has conferred management powers on accredited Croatian authorities for managing

<sup>6</sup> Twinning is an instrument designed by the Commission to facilitate the transfer of know-how from EU Member States administrations to the administrations of recipient countries. They complement the transfer of know-how through service contracts with consultancy companies for technical assistance.

EU funding<sup>7</sup>, subject to ex ante checks by the EU Delegation in Croatia over tendering and contracting (decentralised management with ex ante controls). The third, most advanced, management mode is when the national authorities are assessed by the Commission to have sufficient management capacity to manage EU assistance without any ex ante checks by the EU Delegation (decentralised management without ex ante controls). This is the management mode which most closely corresponds to the way in which EU funding is managed after accession but in most areas the Commission has not yet approved its introduction<sup>8</sup>. **Annex II** sets out the different management modes for each instrument and component.

### **AUDIT SCOPE AND METHODOLOGY**

8. The audit was carried out between June 2010 and June 2011. It aimed at answering the overall question:

“Has EU pre-accession assistance been effective in supporting Croatia prepare for managing EU funds after accession?”

The audit focused on the following two key areas:

- (a) Has the Commission planned EU assistance in a way which satisfactorily helps Croatia to prepare for managing EU funds after accession?
- (b) Have the EU financed projects achieved the intended results in terms of strengthening Croatia’s capacity for managing EU funds?

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<sup>7</sup> Before the Commission grants conferral of management powers, the authorities have to undergo an accreditation process by the Government of Croatia.

<sup>8</sup> The area of rural development is an exception in this regard. Decentralised management with ex ante checks is not applicable to the Special Accession Programme for Agriculture and Rural Development (Sapard) and the Instrument for Pre-Accession Assistance in Rural Development (IPARD). The Candidate Country is required to obtain conferral of management powers for decentralised management without ex ante checks before starting implementation of measures under these two programmes.

9. The audit did not seek to address the effectiveness of the EU assistance in supporting Croatia's adoption and implementation of the *acquis communautaire*. It was also not the aim of the audit to make an overall assessment of Croatia's readiness for EU Membership.

10. The audit findings are based on:

- (a) an analysis of the documents relating to the programming and implementation of the pre-accession assistance;
- (b) the audit of a sample of 16 projects financed by IPA Components I, III and IV and by the previous financial instruments CARDS, Phare, ISPA and Sapard (see ***Annex III***). The total value of EU assistance to these projects amounted to 96,6 million euro which represents approximately 11 % of overall funding over the audit period<sup>9</sup>. The projects were assessed on the basis of documentary and interview evidence and on-the-spot visits which took place in October 2010 to eight of them;
- (c) interviews with Commission staff in Brussels and Zagreb;
- (d) interviews with the Croatian ministries, agencies and regional and local authorities involved in the management of EU funds in Slavonski Brod, Split, Tovarnik, Vinkovci, Zadar and Zagreb.

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<sup>9</sup> Overall EU assistance to Croatia from 2001 to 2009 amounted to 860 million euro (see ***Table 3***).

### **Map – Location of the projects audited**



Source: Eurostat.

## **OBSERVATIONS**

### ***Coherent and well-targeted planning***

**Drawing on the lessons of previous enlargements, a new framework for pre-accession assistance has been introduced**

11. In designing its framework for managing pre-accession funds the Commission took account of lessons drawn from previous enlargements. Thus the introduction of IPA in 2007 brought together all pre-accession financial assistance under one instrument rather than it being dispersed across three

different instruments (Phare, ISPA and Sapard) as was previously the case. This has considerably facilitated the planning of EU assistance.

12. Prior to IPA separate mechanisms covered the coordination of the different instruments, but under IPA a more coherent system is in place for coordinating the planning of EU funded capacity building activities. Within the Commission, the Directorate-General for Enlargement (Enlargement DG) has been assigned the lead role in coordinating IPA assistance with three other Directorates-General: the Directorate-General for Regional Policy (Regional Policy DG) for Component III (Regional Development), the Directorate-General for Employment, Social Affairs and Inclusion (Employment, Social Affairs and Inclusion DG) for Component IV (Human Resources Development), and the Directorate-General for Agriculture and Rural Development (Agriculture and Rural Development DG) for Component V (Rural Development). The four Directorates-General coordinate their activities related to the programming and implementation of the assistance, as well as to the negotiation of chapters, both informally and then through formal inter-service consultations.

13. The Commission has also strengthened the link between the planning and implementation of EU pre-accession assistance and the pre-accession negotiation process. This has been done by introducing into this process benchmarks to be met before the closure of chapters. This new approach has been applied to the chapters where there is EU pre-accession funding, notably Chapter 11 (Agriculture and Rural Development) and Chapter 22 (Regional policy and coordination of structural instruments), and has led to a greater focus on Croatia's progress in building up its capacity in these areas with the help of EU pre-accession assistance. Thus, for example, Chapter 11 benchmarks include the capacity of the Paying Agency and this has also been a key focus of EU assistance (see also paragraph 37). Nevertheless, this benchmark approach could have been more widely applied in Croatia than has actually been the case. For example, the establishment of sufficient capacity in Croatian authorities for them to be authorised to manage pre-accession

assistance without ex ante control by the EU Delegation has not been used as a benchmark for Chapter 22.

**The IPA programming procedures are well designed and have prioritised the strengthening of Croatia's administrative capacity although procurement still needs attention**

14. A significant shortcoming of the EU assistance to prepare Candidate Countries for the 2004 and 2007 enlargements was that the Economic and Social Cohesion programmes financed by Phare were only annual programmes<sup>10</sup>. Croatia has benefited from the approach introduced under IPA which provides for multi-annual operational programmes akin to those used under the Structural Funds. This has both improved the possibilities for "learning by doing" by establishing planning procedures closer to those applicable post-accession and also enabled better planning of specific capacity building interventions. Under IPA, Regional Policy DG and Employment, Social Affairs and Inclusion DG have also been able to provide their expertise to assist the Croatian authorities in this multi-annual planning process more easily than was the case for the previous two accessions.

15. A key step towards better post-accession management of funding by Croatia has been the Commission's introduction of a more rigorous approach to ensuring Croatia has the capacity for managing its pre-accession funding than was the case for previous Candidate Countries<sup>11</sup>. A central part of this approach is the planning system it has developed for assessing Croatia's capacity building needs and identifying the necessary assistance to meet these needs, in order to be able to introduce decentralised management, first with ex

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<sup>10</sup> See European Court of Auditors Special Report No 5/2004 concerning PHARE support to prepare Candidate Countries for managing the Structural Funds (OJ C 15, 20.1.2005, p. 1).

<sup>11</sup> Prior to the previous enlargements, the management mode of decentralised management with ex ante checks was used in candidate countries without the Commission first making an assessment of the country's capacity to effectively manage funding through this system.



ante checks by the Delegation and subsequently without these ex ante checks (see paragraph 7).

16. However, there remains a particular need to focus assistance on helping to build up Croatia's procurement capacity. The Court's financial audits in the framework of its annual Statement of Assurance on the EU Budget consistently find that procurement is a major source of irregularities in EU Member States in the area of Cohesion<sup>12</sup>. As **Table 2** shows, the EU Delegation in Croatia in the framework of its decentralised management ex ante checks has regularly had to reject the documents submitted because they are not fully compliant with EU procedures. While there has been a clear reduction in rejection rates from 2007 to 2010, Enlargement DG in its 2010 Annual Activity Report stated that they have 'remained relatively high' for more complex contracts, mainly relating to public works, due to the 'inadequate quality of the technical control expertise'<sup>13</sup> (see also paragraph 23).

**Table 2 - Rate of tender evaluation reports and contracts submitted by Croatian authorities which were rejected by EU delegation in Croatia (%)**

		2007	2008	2009	2010
<b>Evaluation reports</b>	1st submission	60	22	20	14
	Further submissions	34	35	67	20
<b>Contracts</b>	1st submission	60	20	21	20
	Further submissions	34	37,5	33	10

Source: Enlargement DG, 2010 Annual Activity Report.

<sup>12</sup> See, for example, paragraphs 4.18 to 4.20 of the Court's Annual Report concerning the financial year 2009 (OJ C 303, 9.11.2010, p. 1). One of the two main sources of error was 'serious failures to respect public procurement rules'.

<sup>13</sup> Enlargement DG, 2010 Annual Activity Report, p. 20.

**The audited projects have addressed capacity building priorities although assistance so far has been largely directed to the central authorities rather than the regional level**

17. The Commission has generally ensured, in consultation with the Croatian authorities, that the key capacity needs have been identified. There is a systematic approach to assessing and updating Croatia's needs for Commission funding: top-down from the Accession Partnership and bottom-up with project proposals from the potential beneficiaries, mainly Croatian ministries.

18. The EU assistance in the form of specific projects complemented the Croatian authorities' own efforts to strengthen ministries' capacity and set up bodies specifically to manage future EU funding. In general, the specific objectives of the 16 audited projects were very much in line with the capacity building priorities set out in the Accession Partnership. Even where projects did not include direct capacity building through technical assistance and twinning contracts, projects had an important "learning by doing" dimension which provided the opportunity to gain valuable practical experience of managing EU funding before the accession.

19. In nearly all cases the Commission funding was targeted at Croatian bodies which would be responsible for implementing EU assistance post-accession. However, the assistance was largely directed to central bodies who would be responsible for managing post-accession funding and much less to the regional level, although regional bodies have an important role to play in the implementation of post-accession funding. As a result there is a risk that bodies at regional level will not have had adequate experience in implementing EU assistance by the time of the accession<sup>14</sup>.

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<sup>14</sup> A 2009 review of Phare assistance to prepare for the Structural Funds in Croatia carried out by consultants financed by the Commission found that capacity building for local and regional bodies was not receiving sufficient priority. The

***An important contribution to building up Croatia's capacity for managing post-accession funding, but significant delays and areas where further progress is needed***

**Pre-accession assistance has often not been implemented according to the original timetable**

20. **Table 3** shows the extent to which planned spending has been committed and spent. The Phare, ISPA and Sapard programmes all experienced difficulties in implementing funds according to the original timetables. Under IPA slow implementation remains an issue, particularly for the Transport and Environment Operational Programmes (IPA III) and the IPARD programme (IPA V), with the risk that funds will have to be decommitted due to these delays<sup>15</sup>.

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review recommended that the experience of new Member States be heeded and that 'the process of developing the required capacity not be left until it was too late for such bodies to participate effectively'.

<sup>15</sup> Article 166(3) of the Financial Regulation states that under the "N+3" rule, the Commission shall automatically decommit any portion of the budgetary commitment for the programme that has not been paid out by 31 December of the third year following the year in which the budgetary commitment was made (Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1)).

**Table 3 - Implementation of EU assistance to Croatia (million euro, March 2011)**

Programmes in Croatia	Budget	% of budget contracted	% of budget paid <sup>1</sup>
CARDS	260	97 %	92 %
Phare	147	86 %	78 %
ISPA	59	96 %	63 %
Sapard	25	62 %	48 %
IPA I 2007	45	90 %	57 %
IPA I 2008	42	27 %	20 %
IPA I 2009	42	11 %	11 %
IPA II 2007-2009	8	64 %	36 %
IPA III 2007-2009 (of which)	143	29 %	7 %
- OP Transport	54	20 %	4 %
- Operational Programme (OP) Environment	54	25 %	2 %
- OP Regional Competitiveness	35	48 %	20 %
IPA IV 2007-2009 – OP Human Resources Development	38	71 %	9 %
IPA V 2007-2009 (IPARD) – Measures 101 and 103	51	12 %	0 %
<b>Total</b>	<b>860</b>	<b>68 %</b>	<b>55 %</b>

<sup>1</sup> Excluding advance payments of 30 % for Components III, IV, V.

Source: EU delegation to Croatia.

21. The implementation of EU assistance in Croatia has suffered several start up delays following the introduction of new instruments. Croatia became eligible for pre-accession assistance under the Phare, ISPA and Sapard instruments from 1 January 2005. However, due to the need to determine

sectoral objectives which corresponded to the strategic priorities, it then took approximately 12 months for the ISPA and Sapard programmes and 18 months for the Phare programme before the Financing Agreements could be finalised. In the case of the 2007 programmes under the different IPA components Financing Agreements were not concluded until approximately 16 months after the entry into force of the IPA Implementing Regulation. This was mainly due to the time required for the conferral of management powers before implementation could begin, a new condition required by the IPA Regulation (see paragraph 7).

22. Several pre-IPA projects audited by the Court were not yet ready to be implemented after the Financing Agreement had been signed. This was because the necessary terms of reference or technical specifications needed to enable the launch of tenders had not been finalised by the Croatian authorities. Thus the average time from the Financing Agreement to the tender launch was 12 months for the contracts audited. There was some improvement under IPA, the corresponding time being reduced to eight months, but there remains scope for better performance in this area.

23. Once tenders were launched delays frequently also occurred due to the Croatian authorities' still limited capacity for managing EU procurement procedures (see paragraph 16). This has meant that the EU Delegation has frequently had to reject tender and contract documentation and send it back to the Croatian authorities for the necessary improvements to be made (see **Table 2**). This led to delays which would not occur if the documentation were prepared to the set standards. The Court examined a sample of 18 contracts and found that contracts were concluded on average ten months later than the original timetable which is quite considerable when the normal project time frame is limited to three to four years.

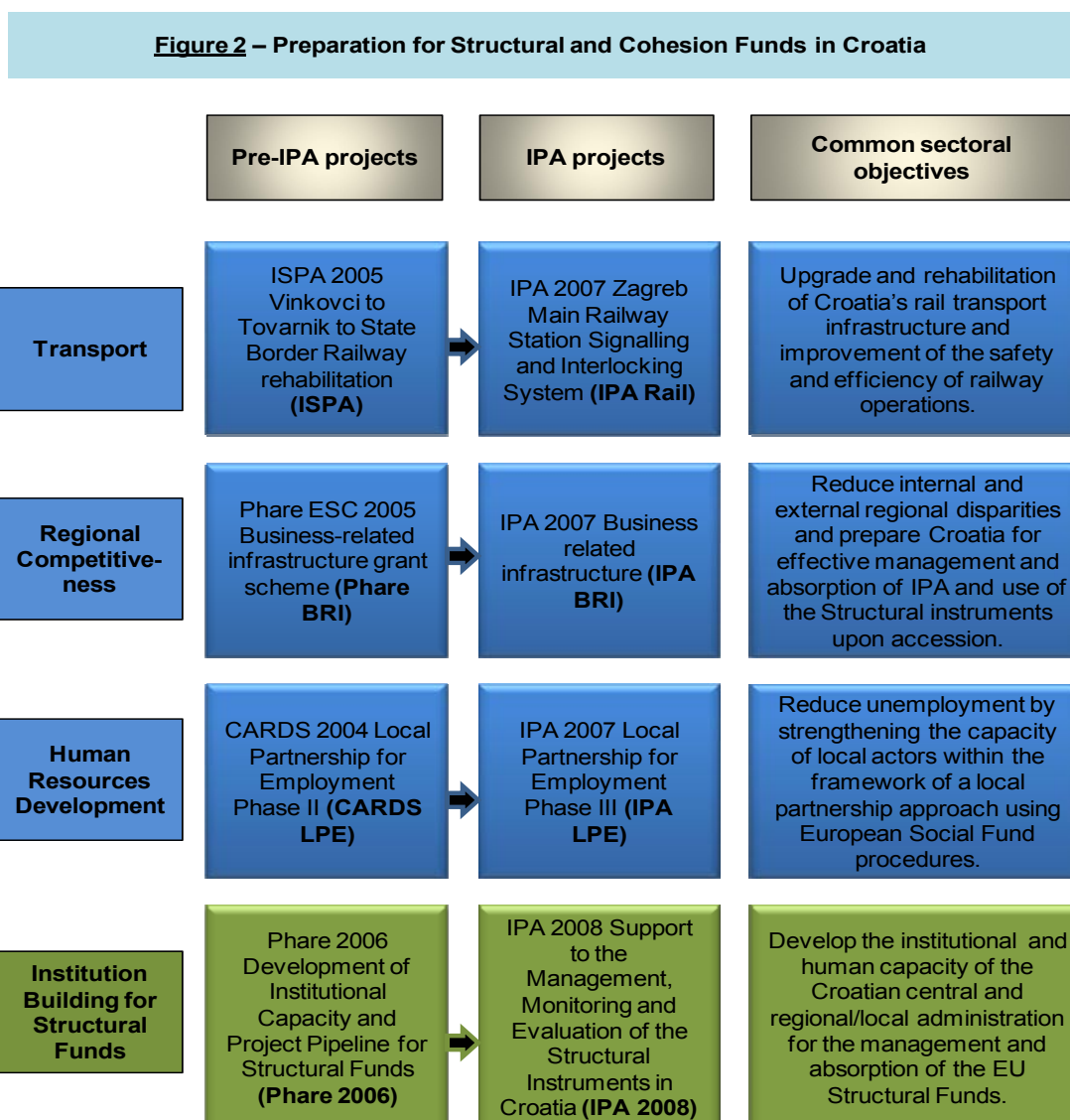
24. In view of the difficulties encountered by Croatia in implementing the EU assistance according to the original timetable, the Commission extended the implementation deadlines by one year for projects assisted under Phare 2005,

Phare 2006, and Sapard, and by either one or two years for the ISPA projects. Based on that experience, longer deadlines were introduced by the Commission for IPA Component I. However, for IPA Components III, IV and V the disbursement deadlines based on the “N+3” rule represent a significant challenge (see footnote 14).

25. As the following sections demonstrate in relation to specific projects (see paragraphs 26 to 47), delays, mainly resulting from capacity issues within the Croatian administration, have reduced the progress made through pre-accession assistance in building up Croatia’s administrative capacity before accession. This points to a risk that Croatia will not have the capacity to fully absorb the increased post-accession allocations within the regulatory timeframes.

**Structural Funds type projects: varied results but ‘learning by doing’ benefits**

26. The audit examined eight Structural Funds type projects relating to four key areas (see **Figure 2**). The achievement of the projects’ intended results varied, partly due to delays, as did their potential sustainability. It was clear that the Croatian authorities are benefiting from “learning by doing” but there are still capacity issues which need attention.



Source: European Court of Auditors.

Several aspects of the monitoring and evaluation of assistance were still in need of improvement

27. Insufficient use of “SMART”<sup>16</sup> objectives and related indicators often made it difficult to assess project results, particularly in relation to grant schemes. While the follow-up IPA projects which the Court examined were better in this respect than the pre-IPA projects there was still scope for improving the way in which

<sup>16</sup> Specific, Measurable, Achievable, Relevant and Timely.

project effectiveness was assessed. The Commission has a well-designed monitoring system which is being implemented by the Croatian authorities although the audit found that on occasions the monitoring reports tended to underestimate the problems faced by projects. The projects have sometimes not been subject to external assessment, particularly in relation to the grant schemes financed. This is, partly because the Commission intends to combine an interim evaluation of IPA programmes with an ex ante evaluation of operational programmes for the Structural Funds but this approach is delaying feedback on possible improvements to IPA project assistance.

The sustainability of results for the Human Resources Development projects audited is uncertain

28. The CARDS 2004 project included the first decentralised ESF-type scheme in Croatia and provided a valuable capacity building experience in the four counties covered by the project<sup>17</sup>. In each county a Local Partnership for Employment (LPE) was created which undertook a range of Human Resources Development activities. However, when EU funding ended in 2008 the LPEs became largely inactive, calling into question their sustainability.

29. The lack of financial and other support to existing LPEs did not augur well for the development of LPEs in Croatia's 13 other counties, which was one of the aims of the follow-up IPA LPE project. Moreover, the late start of the service contract funded as part of the IPA project meant that there was insufficient time for the consultants employed under the contract to help in the setting up of LPEs in these counties before grant schemes were launched. However, the Commission has recognised that sustainability is a key issue and is assessing what would be the best model to be adopted for the LPEs to improve the prospects for their sustainability.

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<sup>17</sup> Another four counties were covered by an earlier 2002 CARDS project.



Significant capacity issues remain in relation to the regional competitiveness projects funded

30. The results of the Phare 2005 Business Related Infrastructure (BRI) project varied. The implementing bodies were able to use the full budget, albeit with delays, and ensure that for each selected grant project infrastructure was put in place. However, the audit of the Benkovac grant project (one of seven grants under the Phare BRI scheme) indicated that the local authorities were not sufficiently addressing the sustainability of the EU-funded infrastructure. There were shortcomings in the maintenance of the infrastructure and no strategy to attract companies; the infrastructure was little used.

31. The design of the follow-up IPA 2007 BRI project took into account and built upon the experience of the 2005 project. However, as for the 2005 project, there were delays in the grant scheme evaluation procedure and grant beneficiaries frequently did not have the capacity to prepare complete technical documentation. The potential benefits in terms of learning by doing were reduced because the project did not directly target the designated bodies responsible for the future Regional Competitiveness Operational Programme. Furthermore, focusing on the ten least developed counties in Croatia meant that local authorities in other counties did not benefit from the opportunity to learn from implementing BRI grant schemes before accession although they would also be eligible for funding<sup>18</sup>.

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18 The 2009 ad hoc interim evaluation of PHARE assistance to preparation for Structural Funds in Croatia also concluded that too much emphasis is put on less developed regions and that all other regions in Croatia also face significant challenges in terms of the European Union competitiveness.

The expected project outputs in the transport sector were being achieved but with lengthy delays in project preparation and procurement

32. The ISPA 2005 railway rehabilitation project to upgrade 33 km of track on the main Trans European Corridor X<sup>19</sup> railway line was the first transport infrastructure project prepared and implemented according to EU rules in Croatia. It therefore brought important “learning by doing” benefits. It started two years behind the original schedule because the project was not mature enough when implementation was scheduled to begin. Lack of procurement capacity then caused delays in the tendering process. The IPA 2007 rail project for works at Zagreb main railway station also suffered delays in the procurement process, mainly due to incomplete tender documentation, although these delays were less than under the previous ISPA project.

33. At the time of the Court’s on-the-spot audit in October 2010, the ISPA project was still under implementation due to the delays incurred. The projects’ planned outputs were likely to be achieved by the end of 2011, although their ultimate impact depends on the implementation of other rail projects on Corridor X in Croatia and neighbouring countries.

Assistance to prepare a ‘project pipeline’ for Structural and Cohesion Funds and increase capacity has been only partially successful

34. Although one of the main original objectives of the Phare 2006 project was to establish a system for developing a ‘pipeline’ of mature projects for the Structural and Cohesion Funds, the Commission subsequently decided to focus on developing a limited number of major infrastructure projects<sup>20</sup>. As a

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<sup>19</sup> This Corridor follows the route Salzburg - Ljubljana - Zagreb - Beograd - Niš - Skopje - Veles – Thessaloniki.

<sup>20</sup> According to the Structural Funds Regulation, a “major” project is defined by the Commission as being greater than 50 million euro. Projects below this threshold are classified as being “non-major”. Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and

result fewer Croatian authorities received capacity building assistance than had previously been planned and the number of personnel to be trained fell from 1 000 to 90. While concentrating in this way on the preparation of major projects is likely to lead to a higher rate of absorption at the beginning of the Structural and Cohesion Funds, there is also a need for mature “non-major” projects to be prepared due to their importance for regional development. More generally the Commission did not sufficiently address the need to stimulate and assist regional and local promoters to prepare projects for future Operational programmes by providing support at this level. Only nine major infrastructure projects were prepared and for some of these the technical documentation was incomplete. Guidelines for applications for nearly 50 grant schemes were produced although there was insufficient time to pass on knowledge relating to these schemes from central to regional level. EU funded expertise has made a significant contribution to programming the National Strategic Reference Framework and Operational Programmes for assistance under the Structural and Cohesion Funds. On the other hand, little progress was made in developing a Management Information System for these Funds.

35. Significant delays in the preparation and procurement procedures for work in this context carried out under the IPA 2008 programme are likely to lead to a loss of momentum. The Croatian authorities also face significant challenges in terms of the number and turnover of staff in the area of the Structural and Cohesion Funds.

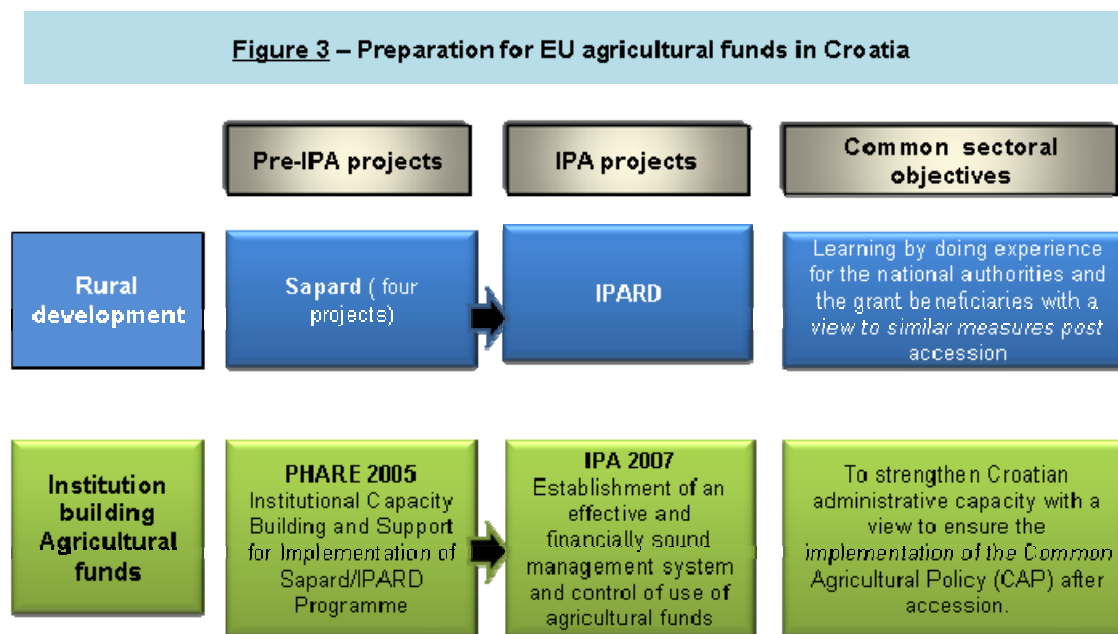
### **Preparing for EU Agricultural Policy: mixed results**

36. The effectiveness of the EU pre-accession assistance to the agricultural sector was assessed by examining two institutional capacity building projects funded under Phare 2005 and IPA 2007 Component I and the Sapard and

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repealing Regulation (EC) No 1260/1999 (OJ L 210, 31.7.2006, p. 25 ).  
Regulation as amended by Regulation (EU) No 539/2010 of the European  
Parliament and of the Council of 16 June 2010 (OJ L 158, 24.6.2010, p. 1).

IPARD programmes, including four investment projects co-financed in the framework of Sapard (see **Figure 3**).



Source: European Court of Auditors.

Some progress has been made in respect of the conferral of management powers for rural development measures

37. Results in terms of building up the capacity of the Croatian Paying Agency to make proper use of pre-accession and post-accession funding have been mixed. Croatia had to build up sufficient management capacity for the Commission to grant it the necessary conferral of management powers for decentralised management without ex ante checks before it could start to implement pre-accession rural development measures. In the event for Sapard conferral of management powers was granted for only two rural development measures in September 2006<sup>21</sup> instead of the four initially planned.

<sup>21</sup> Commission Decision 2006/658/EC of 29 September 2006 conferring management of aid on implementing agencies for pre-accession measures in agriculture and rural development in Croatia in the pre-accession period (OJ L 271, 30.9.2006, p. 83).

38. Progress was modest in relation to building capacity for obtaining IPARD funding, in particular because the Phare 2005 project's objectives in terms of accreditation by the Croatian authorities<sup>22</sup> and conferral of management powers were not very ambitious. On the one hand, the programme sought only the accreditation for IPARD of the two measures which had already been accredited under Sapard. On the other hand, for the new IPARD measures, the objective was not to obtain accreditation but only to prepare documentation for possible future accreditation. Although the assistance under IPARD was available from the 2007 EU budget, the Phare 2005 project contained no precise targets for the conferral of management powers by the Commission with a view to giving Croatia access to IPARD funding as soon as possible.

Pre-accession assistance to rural development did not fully replicate the post-accession working conditions

39. Sapard was the first "learning by doing" programme for the EAFRD, all the implemented projects being part of a process to help the Croatian authorities set up the administrative framework for the implementation of co-financed projects post-accession. These included management of the applications (completeness checks, analysis of the business plan), on-the-spot checks prior to the project approval, decision on granting Sapard funds, contracting, verification of the eligibility of expenditure, payment, and reporting to the Monitoring Committee and to the Commission.

40. For the measures where the Croatian authorities have received the conferral of management powers, allowing them to use decentralised management without ex ante controls, pre-accession programmes can in principle be implemented under similar conditions to those which will apply post-accession. However, in practice, the implementation of the Sapard and

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<sup>22</sup> See paragraph 7, footnote 7 on accreditation.

IPARD programmes has not fully replicated the post-accession environment for managing EU funding:

- (a) the Sapard programme has been entirely managed at the central level of the Paying Agency and, at the time of the audit, IPARD was also being managed centrally. As a result the Paying Agency regional offices have not yet had the opportunity to gain practical experience in the management of EU pre-accession rural development programmes although they will have to play a key role in this post-accession<sup>23</sup>;
- (b) for Sapard and IPARD projects, the Paying Agency has been operating entirely manual procedures;
- (c) under Sapard, no ranking system for project applications was developed and applied by the Agency. Instead project applications were dealt with on a first come-first served basis.

Low absorption of Sapard and IPARD funding raises concerns for the future absorption of EAFRD funds.

41. Absorption of Sapard funding by Croatia has been low, declared expenditure at the end of the programme amounting to only 48 % of the funds allocated. According to the output indicators of the Sapard Programme, 161 eligible projects were expected to be funded within the framework of the two measures whereas in reality contracts were signed for only 49 projects and just 37 were completed (see **Table 4**). In five of the 21 counties there was not a single successful Sapard application. Some sectors were particularly underrepresented in the implementation of Measure 1 (Investment in Agricultural Holdings), notably the milk sector, greenhouses sector and fruits

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<sup>23</sup> The Croatian authorities have decided that the Paying Agency regional offices will check the admissibility of the applications and perform the administrative and on-the-spot controls.

and vegetable sector. This points to serious weaknesses in the capacity and preparedness of these sectors to absorb EU funds<sup>24</sup>.

**Table 4 – Sapard projects in Croatia**

Measure	Number of				Completed/ Expected/
	Expected projects	Applications	Contracted projects	Completed projects	
1. Investments in Agricultural Holdings	110	84	26	19	17 %
2. Improving the Processing and Marketing of Agricultural and Fishery products	51	53	23	18	35 %
<b>Total</b>	<b>161</b>	<b>137</b>	<b>49</b>	<b>37</b>	<b>23 %</b>

Source: Annual and final Report on the implementation of the Sapard Programme in the Republic of Croatia (2006-2009), May 2010.

42. The amounts contracted under IPARD confirm the continuing difficulties in absorbing EU funding for rural development programmes. Financial commitments were made in the 2008 budget for both IPARD 2007 (25,5 million euro) and IPARD 2008 (25,6 million euro) which, in accordance with the EU budget procedures (see paragraph 20), Croatia had to spend by the end of 2011. However, in May 2011 investments had only been approved for approximately 16,9 million euro (EU part of the funding) after four calls for applications (33 % of the 2007 and 2008 IPARD budget)<sup>25</sup>. Given the time needed to launch and process additional calls and to implement approved

<sup>24</sup> In the milk sector two projects were completed compared with the 16 projects (12,5 %) expected, in the greenhouses sector two projects were completed compared with the 14 projects (14,3 %) expected and in the fruit and vegetable sector seven projects were completed compared with 42 projects expected (16,7 %).

<sup>25</sup> Report on implementation of IPARD programme by Croatian Paying Agency for Agriculture, Fisheries and Rural Development Sector for Structural Support, 24.5.2011.

projects, there is a clear risk that a large part of the 2007-2008 budget will have to be decommitted.

43. As a result of the low level of absorption, Croatian farmers and agro-processors have not yet become as familiar with EU funding procedures through “learning by doing” in the framework of the Sapard and IPARD programmes as had been intended. This will make it in turn more difficult to absorb the expected large increases in the EU funding when the rural development measures in Croatia will be fully phased in after accession.

44. The Commission only finally established in 2009 that a key reason for the low absorption of Sapard programme was a national scheme which offered more favourable conditions, together with fewer procedures and controls, for the same measures as funded by Sapard. Following the Commission’s intervention, Croatia decided to abolish this competing national scheme in November 2009, after the end of the Sapard contracting period. However, the slow start of the IPARD programme indicates that the reasons for low demand from farmers for the rural development scheme in Croatia have still to be fully addressed.

**Pre-accession assistance has contributed to strengthening Croatia’s administrative capacity in the fight against corruption and organised crime but significant challenges remain**

45. The fight against corruption and organised crime is a very sensitive issue and is a key part of building up Croatian capacity to ensure EU post-accession funding, as well as national funding, is well used. EU pre-accession assistance has been used to fund two institutional capacity building projects funded by the CARDS 2002 and IPA 2007 programmes (see ***Figure 4***).



**Figure 4 – Strengthening capacities to fight against corruption and organised crime**



Source: European Court of Auditors.

46. The CARDS project was launched to improve the functioning of the Office for Prevention of Corruption and Organised Crime (USKOK), which had been set up in 2001. Despite significant delays in its preparatory phase which meant the project only started in 2005, the project activities were completed by the end of 2006. For one indicator of the project's effectiveness, an increasing number of cases of serious organised crime and corruption discovered and prosecuted, the first results of the investigation activities supported by the project started to become visible in 2009 in terms of reported high level corruption cases. For the other indicator, a better ranking in the Transparency International Corruption Perception Index, Croatia rose from 70 in 2005 to 62 by 2010 and its score in the Index improved from 3,4 in 2005 to 4,1 for most years since the end of the project.

47. The activities of the IPA 2007 project, which is scheduled to be completed in 2012, have been well designed to build on the previous project. In the meantime the overall number of cases being handled by USKOK has continued to increase and the indictments and convictions of high-ranking politicians indicate that USKOK is on the right track to tackle corruption at the highest level. Nevertheless, as the Commission's 2010 Progress Report on Croatia emphasises, the recently upgraded legal and administrative structures remain

to be fully tested in practice while USKOK's capacity for dealing with sophisticated financial crimes is a particular challenge.

## **CONCLUSIONS AND RECOMMENDATIONS**

### ***Conclusions***

48. Overall EU pre-accession assistance to Croatia is making a significant contribution to Croatia's progress in building up its administrative capacity for managing increased EU funding post-accession. Nevertheless, the assistance has only been partially successful so far in achieving its objectives and further progress in capacity building has to be supported in a number of key areas both before and after accession. In most areas of pre-accession assistance the Commission has not yet assessed Croatia's capacity to be sufficient for it to authorise Croatia to implement the assistance without the Commission's ex ante checks. Despite recent progress made, procurement capacity and anti-corruption are two areas where there is a particular need to reinforce support to the Croatian authorities.

49. In general, assistance to address Croatia's capacity building needs has been soundly planned by the Commission and the Croatian authorities. Lessons were learned from previous enlargements and new approaches adopted to planning assistance and linking it to the negotiation process. Programming systems have been well-designed and prioritised capacity building although procurement capacity still requires particular attention. Audited projects were found to be very relevant to capacity building priorities but had focused on the central authorities with only limited support to regional bodies so far, despite the latter also having an important role to play in implementing post-accession support.

50. In terms of results, EU assistance has made an important contribution to building up Croatia's capacity for managing post-accession funding, including through learning by doing. Nevertheless the intended results of some projects have still to be secured and the audit identified a number of key issues in this

respect. Implementation of project assistance in Croatia has frequently fallen behind the original timetable, particularly due to delays caused by projects not being sufficiently mature and a lack of procurement capacity. Scope remains for improving the monitoring and evaluation of Structural Fund projects. Although there has been a strong emphasis on preparing large infrastructure projects at central level, non-major projects have received only limited attention and a system for developing project proposals from regional and local level has still to be fully established. Implementation in the rural development sector has suffered from low absorption rates and learning by doing at the regional and grant beneficiary levels has been limited. Although some progress has been made through EU projects to fight corruption and organised crime, significant challenges remain in this area.

51. Despite there still being scope for further improvement, the Commission has clearly learned important lessons from previous enlargements which has made its assistance to Croatia more effective.

### ***Recommendations***

52. The Commission and the Croatian authorities should work closely together to address the following recommendations:

#### ***Recommendations regarding EU assistance to Croatia***

1. Increase the priority given to building up procurement capacity by implementing plans for on- and off-the-job training focused in particular on:
  - (a) the development of tender documentation fully complying with EU standards;
  - (b) the management of the tendering and contracting of complex public works projects.

2. Take greater steps to meet capacity building needs at regional and local level notably by:
  - (a) ensuring that all relevant bodies at this level have the opportunity to learn by doing before the accession;
  - (b) improving the mechanisms for stimulating and assisting in the development of project ideas.
3. Develop further the assessment of project effectiveness by:
  - (a) reinforcing the use of SMART objectives;
  - (b) helping to raise the quality of monitoring reports by the Croatian authorities;
  - (c) ensuring interim and ex-post evaluations are carried out.
4. Build up a portfolio of mature projects to be able to fully absorb the increased post-accession funding available, in particular by ensuring that:
  - (a) for major projects, which have been the focus of efforts so far, the necessary technical documentation is completed;
  - (b) more attention is given to establishing a complementary portfolio of non-major projects for the post-accession period.
5. Take action in relation to rural development programmes to:
  - (a) ensure that the national authorities build up their capacity in order to obtain conferral of management for all the measures planned;
  - (b) identify ways to generate more projects in the milk, greenhouses, and fruits and vegetables sectors.

6. Strengthen anti-corruption measures through:

- (a) providing ongoing support to the upgraded legal and administrative structures through twinning and other advisory inputs, including a particular focus on assistance in tackling sophisticated financial crimes;
- (b) continuing rigorous monitoring of corruption levels and issues, during the pre-accession period and in relation to EU post-accession funding.

53. With reference to its pre-accession assistance to other Candidate Countries and potential candidates the Commission should:

***Recommendations regarding EU pre-accession assistance to other countries***

7. Take into account the lessons learnt from its pre-accession assistance to Croatia in its pre-accession assistance to other countries wherever applicable, and, in particular:

- (a) ensure a sufficient track record in decentralised management of pre-accession funds without ex-ante controls before the date of accession.
- (b) pay greater attention to ensuring that project proposals for pre-accession assistance are sufficiently mature for implementation within the set timeframe.

This Report was adopted by Chamber III, headed by Mr Karel PINXTEN, Member of the Court of Auditors, in Luxembourg at its meeting of 25 October 2011.

*For the Court of Auditors*

Vitor Manuel da SILVA CALDEIRA  
*President*

**THE 35 CHAPTERS OF THE ACQUIS (30 JUNE 2011)**

<b>N°</b>	<b>Chapters</b>	<b>Negotiations opened</b>	<b>Negotiations provisionally closed</b>
1	Free movement of goods	25.7.2008	19.4.2010
2	Freedom of movement for workers	17.6.2008	2.10.2009
3	Right of establishment and freedom to provide services	26.6.2007	21.12.2009
4	Free movement of capital	2.10.2009	5.11.2010
5	Public procurement	19.12.2008	30.6.2010
6	Company law	26.6.2007	2.10.2009
7	Intellectual property law	29.3.2007	19.12.2008
8	Competition policy	30.6.2010	30.6.2011
9	Financial services	26.6.2007	27.11.2009
10	Information society and media	26.6.2007	19.12.2008
11	Agriculture and rural development	2.10.2009	19.4.2011
12	Food safety, veterinary and phytosanitary policy	2.10.2009	27.7.2010
13	Fisheries	19.2.2010	6.6.2011
14	Transport policy	21.4.2008	5.11.2010
15	Energy	21.4.2008	27.11.2009
16	Taxation	2.10.2009	30.6.2010
17	Economic and monetary policy	21.12.2006	19.12.2008
18	Statistics	26.6.2007	2.10.2009
19	Social policy and employment	17.6.2008	21.12.2009
20	Enterprise and industrial policy	21.12.2006	25.7.2008
21	Trans-European networks	19.12.2007	2.10.2009
22	Regional policy and coordination of structural instruments	2.10.2009	19.4.2011
23	Judiciary and fundamental rights	30.06.2010	30.6.2011
24	Justice, freedom and security	2.10.2009	22.12.2010
25	Science and research	12.6.2006	12.6.2006
26	Education and culture	11.12.2006	11.12.2006
27	Environment	19.2.2010	22.12.2010
28	Consumer and health protection	12.10.2007	27.11.2009
29	Customs union	21.12.2006	2.10.2009
30	External relations	12.10.2007	30.10.2008
31	Foreign, security and defence policy	30.6.2010	22.12.2010
32	Financial control	26.6.2007	27.7.2010
33	Financial and budgetary provisions	19.12.2007	30.6.2011
34	Institutions	5.11.2010	5.11.2010
35	Other issues	N/A	30.6.2011

**COMMISSION'S GRANTING OF CONFERRAL OF MANAGEMENT TO  
CROATIAN AUTHORITIES RESPONSIBLE FOR EU FUNDS (15 JUNE 2011)**

Programme	Conferral of decentralised management	
	with ex ante controls	without ex ante controls
<b>Phare</b>	7.2.2006	Not introduced
<b>ISPA</b>	13.2.2006	Not introduced
<b>IPA I</b>	28.10.2008	Not yet introduced
<b>IPA II</b>	14.11.2008	Not yet introduced
<b>IPA III</b>		
- Transport	3.11.2008	Not yet introduced
- Environment	29.10.2008	Not yet introduced
- Regional Competitiveness	29.10.2008	Not yet introduced
<b>IPA IV</b>	1.12.2008	Not yet introduced
<b>Sapard</b>		
- Measure 1 Investments in agricultural holdings	N/A <sup>26</sup>	29.9.2006
- Measure 2 Improving the processing and marketing of agricultural and fishery products	N/A	29.9.2006
<b>IPA V (IPARD)</b>		
- Measure 101 Investments in agricultural holdings	N/A	30.11.2009
- Measure 103 Investments in the processing and marketing of agricultural and fishery products	N/A	30.11.2009
- Measure 201 Preparatory actions for implementation of the agri-environmental measures	N/A	Not yet introduced
- Measure 202 Preparation and implementation of local rural development strategies	N/A	Not yet introduced
- Measure 301 Improvement and development of rural infrastructure	N/A	17.3.2011
- Measure 302 Diversification and development of rural economic activities	N/A	17.3.2011
- Measure 501 Technical assistance	N/A	Not yet introduced

<sup>26</sup> N/A – Not applicable. Sapard and IPARD can only be implemented under decentralised management without ex ante controls.

**LIST OF PROJECTS AUDITED**

Pre-IPA projects		Contracted amounts in millions of euro		
		EU contribution	National contribution	EU + national contribution
1	Sapard Measure 2 - GLAZIR	1,019	0,339	1,358
2	Sapard Measure 2 - CONEX Trade	1,033	0,344	1,377
3	Sapard Measure 1 - AGROMEDIJURJE	0,251	0,083	0,334
4	Sapard Measure 1 MURKOVIĆ	0,256	0,086	0,342
5	Phare 2005 Business-related Infrastructure Grant Scheme	5,280	4,264	9,544
6	ISPA 2005 Vinkovci to Tovarnik to State Border Railway Rehabilitation	28,789	31,394	60,183
7	CARDS 2004 Local Partnership for Employment Phase II	1,488	-	1,488
8	CARDS 2002 Capacity building for USKOK	0,650	-	0,650
9	Phare 2005 Institutional capacity building and support for implementation of Sapard/IPARD	3,822	-	3,822
10	Phare 2006 Development of Institutional Capacity and Project pipeline for structural funds	6,200	-	6,200
<b>Total Pre-IPA projects</b>		<b>48,788</b>	<b>36,510</b>	<b>85,298</b>
IPA projects		Budgeted amounts in millions of euro		
		EU contribution	National contribution	EU + national contribution
11	IPA Component IIIc Regional Competitiveness Operational Programme 2007-2009	19,823	6,608	26,431
12	IPA 2007 Component III Zagreb Main Station Signalling & Interlocking System	14,025	4,675	18,700
13.a	IPA 2007-2009 Component IV Local Partnership for Employment Phase III	2,210	0,390	2,600
13.b	IPA 2007-2009 Component IV Local Partnership for Employment Phase III	1,615	0,285	1,900
14	IPA 2007 Component I Strengthening capacities of USKOK	1,000	-	1,000
15	IPA 2007 Component I Establishment of effective and financially sound management system and control of use of agricultural funds	5,114	0,375	5,489
16	IPA 2008 Component I Support to Management, Monitoring and Evaluation of Structural instruments	4,000	0,288	4,288
<b>Total IPA projects</b>		<b>47,787</b>	<b>12,621</b>	<b>60,408</b>



## **REPLY BY THE COMMISSION TO THE SPECIAL REPORT BY THE EUROPEAN COURT OF AUDITORS**

### **"HAS EU ASSISTANCE IMPROVED CROATIA'S CAPACITY TO MANAGE POST-ACCESSION FUNDING?"**

#### **EXECUTIVE SUMMARY**

III. The Commission welcomes the assessment of the Court. In the accession negotiations, Croatia has given clear commitments to build up procurement capacity and the capacity of regional and local authorities. The Commission is closely monitoring Croatia's compliance with the commitments given and its further preparations all the way to accession.

IV. The Commission considers that pre-accession assistance has successfully contributed to building up Croatia's administrative capacity.

Delays in implementation were largely linked to the complex accreditation procedure and are gradually being overcome.

The initial focus on major projects reflects the experience from new Member States where weaknesses in preparation and implementation of major projects caused most of the delays in implementing cohesion policy.

Compared to Sapard, the first rural development Programme implemented in Croatia, the current IPARD has attracted more interest from potential beneficiaries which increases the prospect of a more successful implementation. Under this component, the Commission has already conferred management powers without *ex ante* controls for several measures. As mentioned under point 7 of this report, this is the management mode which most closely corresponds to the way in which EU funding is managed after accession.

V. The Commission welcomes the assessment by the Court. The recommendations are consistent with the lessons learned from the Commission's own evaluations and are already being followed up or are being integrated in the design of financial assistance, in particular the revised multi-annual planning documents for 2011-2013.

#### **OBSERVATIONS**

5. As regards Figure 1 (EU funding allocations post accession), for 2013, the allocations referred to in the table are those set out in the draft text of the Accession Treaty with Croatia, excluding CAP expenditure. For 2014 onwards, the actual amount Croatia will receive will depend on the outcome of the negotiations for the EU Financial Framework 2014-2020. The Commission therefore considers that the data for 2014-2015 in Figure 1 should be treated as estimates.

13. The Commission considers that the benchmark approach was applied to Croatia in a wide and comprehensive way by including institutional management and implementation aspects. The negotiating framework for Croatia provided for the use of benchmarks for the opening and closing of negotiating chapters. Benchmarks and achievement of them are decided by the Council, upon recommendations by the Commission. Benchmarks enhance the quality of the negotiating process by ensuring that the candidate country is sufficiently prepared for meaningful negotiations and for taking on the obligations of membership. Benchmarks are individual for each negotiating chapter (e.g. Chapter 11 or Chapter 22) and depend on the areas addressed and the system to be established. Benchmarks take into account the need to build up capacity gradually and to have the relevant

capacity and structures fully in place by the date of accession, and measure progress towards setting up these structures. The Commission closely monitors progress towards the benchmarks, using all available tools such as annual progress reports and meetings under the Stabilisation and Association Agreement (SAA).

16. Systematic feedback from the Commission on errors made and improvements needed has helped Croatia to build up and improve its procurement capacity. Before it can withdraw *ex ante* controls, the Commission must verify that the beneficiary country satisfies the minimum requirements set in Article 18(2) of the IPA Implementing Regulation, i.e. has effectively functioning management and control systems. Regular meetings are held with Croatia to discuss remedial action on the basis of roadmaps. Moreover, the EU will continue to support the process of building up procurement capacity with financial assistance and workshops and seminars too.

In the case of complex infrastructure projects which require specific skills and knowledge, the Commission organised support from JASPERS (Joint Assistance for Supporting Projects in European Regions) with a view to building up the capacity of all stakeholders in Croatia and to developing a pipeline of mature projects in order to improve absorption of Structural and Cohesion Funds in the future.

19. Croatia's institutional framework for cohesion/rural development policy builds on existing structures for implementing IPA Components II, III, IV and V (largely at central level). This choice was made together with Croatian authorities, partly to secure institutional continuity at the time of accession and to avoid losing investments in capacity-building. Building up the capacity of relevant local and regional bodies is a commitment given by Croatia and which will be monitored by the Commission until accession.

20. Delays in implementation remain an issue, particularly for the Transport and Environment Operational Programmes, due to late accreditations of management systems at national level and, consequently, conferrals of management by the Commission. Implementation could not start until conferrals of management were granted. Furthermore, the infrastructure projects which are funded under the two IPA III Operational Programmes are complex by nature, with the added requirement that planning, procurement and implementation activities must be carried out in accordance with EU rules. Mitigating measures were introduced and will be reinforced, such as continuous technical assistance, close cooperation with the EU Delegation, increased guidance, dedicated seminars and workshops. Proposals to streamline and increase the efficiency of the IPA, based on lessons learned, will also be discussed within the next financial framework (see point 51).

As for Component V, in April 2011 the Commission informed the Croatian authorities about the risk of decommitment of 2007 and 2008 rural development funds and urged them to take appropriate remedial action, including a detailed analysis of the obstacles to take-up of the funds by potential beneficiaries and an action plan to remove such obstacles as far as possible. Croatia was also asked to report bi-monthly to the Commission on the progress made in contracting under Component V.

21. An important distinction has to be drawn between ISPA projects and IPA programmes. Under ISPA, the Financing Agreement (i.e. the Financing Memorandum) could not be signed until the Commission had adopted the decision approving the project. Under IPA, though, the Financing Agreement could not be signed immediately after the Commission had adopted the decision on the Operational Programme. The additional condition for signature of the Financing Agreement was conferral of management powers. This difference makes it difficult to compare ISPA directly with IPA.

See also the reply under point 20.

22. Speeding up procurement is one area which is being intensively monitored, with the Croatian authorities and the Commission constantly exploring ways to launch tenders and conclude contracts earlier. Benchmarks to that effect have been incorporated in the roadmaps for waiving *ex ante* controls.

23. The Commission is helping to build up procurement capacity by means of systematic guidance, meetings on procurement issues with the national authorities and feedback on errors made and improvements needed. Although this means occasional delays, it is an important aspect with a view to sound financial management of post-accession funds.

Delays are mainly due to the learning curve the authorities were and still are on, in particular as regards infrastructure projects which are complex and take a long time to prepare (see point 16). The issues of building up procurement capacity and reducing delays in implementation are regularly raised in relevant fora (e.g. monitoring committees).

24. The 'N+3' rule is a challenge, particularly for those programmes where conferral of management powers is required and, more particularly, conferral without *ex ante* controls by the Commission. As regards the disbursement deadlines, a country has, in principle, three years to spend funds (N+3 rule). In practice, however, this period is much shorter — implementation cannot start until conferral of management has been granted.

The Commission also refers to its reply to point 20.

25. Experience gained under IPA Components III-V should facilitate the national accreditation process and therefore allow an easier and faster start-up.

The institutional continuity between IPA and post-accession instruments should help to reduce the risk of slow absorption of post-accession assistance. That should ease compliance assessment.

Technical assistance, including JASPERS (see reply to point 16), is made available under IPA to support national authorities with preparing procurement documents so that they will be ready to be published as soon as the post-accession allocations become available.

As far as the post accession Rural Development Programme (RDP) is concerned, this programme will include a wider range of potential beneficiaries/measures than IPARD, thus facilitating greater absorption of rural development funding.

27. The Commission plans to make a more systematic use of SMART objectives and related indicators in its programming and planning activities.

The interim evaluations for the candidate countries under IPA III are scheduled for the end of 2011/beginning of 2012. In the case of Croatia, the timing of the interim evaluations coincides with the timing of the *ex ante* evaluation for the Structural Funds Operational Programmes (Croatia committed itself to submit the final OPs for Structural Funds by the end of 2012). Future Structural Funds OPs will be ex-IPA OPs which will be extended to take into account the additional budget.

28. A project that replicated the LPE model in all 21 counties was supported under IPA Component IV. This project re-activated the LPE structures since 2009 which became extensively involved in formulating the human resource development strategies and action plans in the counties, paving the way for their future involvement in ESF projects. Ongoing technical assistance schemes are currently investigating options for the sustainability of LPEs.

29. Under the second phase of IPA IV (2010-2011), a project was proposed to build up the administrative capacity of the LPEs. The call for proposals is expected to be published by the end of 2011 and will focus on supporting the LPEs with developing county policy, improving the action plans and preparing and evaluating projects.

30. Before any construction can start and the area is put to use, the companies which purchased the plots must obtain the relevant permits. In Croatia this administrative part of this procedure normally lasts two years. As the procedures for obtaining permits are still in progress, it is too early to assess whether the project is successful or not. The delay is only an indication of the length of the administrative procedures preceding any construction activity.

31. The delays in the evaluation procedure for the grant scheme were mainly due to the large number of applications in response to the call.

The capacity of the potential project beneficiaries is being built up with the support of external experts (technical assistance contract under the grant scheme) and the experienced staff of the relevant ministry.

As regards the designated bodies responsible for the future Regional Competitiveness Operational Programme (RCOP), Croatia has finally decided that the RCOP will continue to be implemented by the Central Finance and Contracting Agency (CFCA) after accession too. The bodies designated at the time of the audit by the Court (BICRO, HAMAG and the ARD) will no longer be involved.

When deciding to focus on the ten least developed counties, the Commission made a trade-off between the need to concentrate the assistance and reduce regional disparities on the one hand and the risk of losing opportunities for the other counties on the other.

In the Commission's view, this gradual approach is the most appropriate way to secure the best results and the highest impact from the IPA's limited resources (for the RCOP, about 12 million euros per year over the period 2007-2011).

32. The ISPA 2005 railway rehabilitation project was the first railway investment that Croatia implemented with EU assistance. At that time, there was a general, understandable, lack of experience and capacity for preparing tender documents in Croatia which resulted in delays. Nevertheless, these delays have been partly made up and the project is expected to be completed successfully by the end of 2011.

Indeed, the IPA 2007 rail project for works at Zagreb main railway station confirms that lessons have been learned from the ISPA project. The shortening of the delays for the second round of railway projects seems to confirm a 'learning by doing' effect.

33. The ISPA contract in question is by far the biggest contract funded from the EU budget in Croatia, yet it could reconstruct only a small stretch of railway compared with the whole length of the corridor. However, other sections on the same corridor have already been planned and the funds have been secured. The corridor will be upgraded in phases, as funds become available.

See also the reply under point 32.

34. The focus on major projects reflects the priorities of Croatia in relation to the *acquis* (requirements and short transition periods for the environmental *acquis* and focus on TEN-T infrastructure).

The Commission has taken additional action to help regional and local promoters to prepare projects for future Operational Programmes, from awareness workshops in all targeted regions to targeted technical assistance to support promoters to prepare successful applications under the second and third calls. Preparation of all necessary technical documentation is closely followed up by the Commission and the Croatian authorities.

As regards the Management Information System for these funds, progress has been reported after the audit by the Court. DG REGIO has recently concluded after an audit that:

‘Satisfactory progress has been made concerning practical application of the Management Information System (MIS). Some modules should be finalised in order to facilitate implementation and monitoring of the projects’.

Due to the nature and type of beneficiaries, IPA Component IV consists only of non major projects in the field of human resources development.

35. The Commission recognises that recruiting and retaining qualified staff in public administrations is and will remain a challenge, not only in Croatia or in candidate countries but also in Member States.

The Commission is constantly addressing this issue and will continue monitoring progress in this field, including during audit missions, monitoring activities and bilateral meetings.

As regards the challenge faced by the Croatian authorities, it is important to recognise the efforts made by them, as reflected in the European Union Common Position Paper on Chapter 22, dated 15 April 2011.

37. The Commission considers that the completion of the bodies for implementing Sapard and IPA Component V and the conferral of management powers without *ex ante* controls by the Commission are significant achievements, all the more so if due consideration is given to the sizeable challenge that setting up an entirely new system for implementation of Sapard posed to the Croatian authorities, with little experience in this domain.

Furthermore, the benchmark approach to building up the capacity of the Croatian Paying Agency in preparation for post-accession funding has yielded substantial results. Croatia has stepped up its efforts and demonstrated sufficient progress towards setting up the Paying Agency, thus fulfilling the condition for closure of the agriculture and rural development chapter.

Commission staff are closely monitoring the progress made by the Croatian Paying Agency and are providing intensive guidance for setting up EU-compliant management and control systems for the common agricultural policy. IPA 2007 is offering additional support to the Paying Agency.

38. Conferral of management has been granted for four IPARD measures in November 2009 and March 2011 respectively, with two more in the pipeline. It was appropriate for the technical assistance project not to contain precise targets for the conferral of management powers, in order to leave the ownership of the system and calendar in hands of the national authorities, which is imperative for the functioning of the system and its smooth transition to post-accession environment.

See the reply under point 37.

40.

(a) Both Sapard and IPARD programmes were designed to be managed at central level, given that at the time when they were approved the Paying Agency's regional offices did not yet exist.

The Paying Agency (including regional 'branch' offices) was officially established by the Law on the Paying Agency for Agriculture, Fisheries and Rural Development (February 2009, OG 30/2009). Regional offices and their employees are currently included in ongoing project/contracts under IPA Component I with a view to preparing the Paying Agency for implementation of the CAP after accession.

Moreover, the Commission monitoring audit missions regarding the setting-up of the future EAGF/EAFRD Paying Agency have covered both the central and the regional offices. Both the headquarters and a few regional offices were visited. The subsequent recommendations targeted the improvements/action needed to meet the accreditation criteria and the related capacity-building aspects at both levels (i.e. training, staff increases, consolidation from 86 branch and regional offices to 21 with the associated relocation of office equipment and security).

(b) It was considered disproportionate, for cost-effectiveness reasons, to opt for a computerised system under Sapard and IPA Component V. Furthermore, there are still nearly two years before accession for the Paying Agency to familiarise itself with the business procedures which are now being framed in the IACS (Integrated Administration and Control System) with the help of the IPA Component I 2007 project sampled for this audit. The project plans to bring the system to the testing phase in early 2012. The rural development modules will be tested on the existing Sapard and IPARD measures and the direct payment modules will be tested on the national schemes.

(c) Due to the very short time for which Sapard was implemented, it was agreed that Croatia should not apply ranking criteria. A ranking system is, however, in place for IPARD.

41. The situation has improved considerably under the IPARD programme. The last modification of the programme, approved in November 2010, aimed to generate more projects under the IPARD in sectors such as milk, beef, pigs, poultry, cereals, fruit and vegetables and greenhouses. The results of this revision are visible in the number of applications received from potential beneficiaries. By 30 June 2011, Croatia had received 193 projects under IPARD, out of which 46 have been contracted for the first two measures. Under Measure 1, the individual sectors are represented proportionally, for instance the milk sector with 17 projects, the meat sector with 18 projects and the fruit and vegetable sector with 28. The contracting is still on-going.

42. There is a risk of decommitment of part of the 2007 and 2008 IPARD allocations, mainly due to the demanding requirements for the conferral of management without *ex ante* controls. The Commission urged the Croatian authorities to take appropriate remedial action, including a detailed analysis of the obstacles to take-up of the funds by potential beneficiaries and an action plan to remove such obstacles as far as possible. It also requested a bi-monthly report on contracting in order to monitor the progress made in contracting and disbursement on IPARD projects.

Discussions with the Croatian authorities on how to remedy the low level of absorption started immediately after the results of the first calls for proposals for rural development funds were known. Corrective measures were adopted by Croatia, such as access to favourable credits and warranty lines or improved assistance for the beneficiaries to draw up project documentation. Amendments made to the programme and approved by the Commission in November 2010 introduced a new type of eligible investment/sectors allowing new groups of potential beneficiaries to apply for funds and thus improve absorption.

43. The Commission expects the situation to improve for subsequent years. The increasing number of applications under IPARD shows growing interest, mainly from farmers and small rural entrepreneurs. The continuation of calls for applications will give the Croatian beneficiaries an opportunity to become familiar with EU funding procedures before accession.

The post-accession programming for Member States will give access to a much wider range of potential beneficiaries due to the larger catalogue of measures proposed under the RDP than in IPARD. Croatia will have more opportunities to choose the most appropriate measures and, in this way, to best allocate and distribute EU funds.

44. Both Sapard and IPARD programmes were designed to complement, and not overlap with, national measures. However, the Commission initially had no knowledge about the potential risks of competing measures. It was only in the second version of the 2008 Sapard Implementation Report that Croatia first informed the Commission about the potential overlap with a national scheme.<sup>27</sup> The Commission immediately raised this issue with the Croatian authorities. During the preparatory Monitoring Committee meeting in November 2009, they informed the Commission that the measures concerned had been abolished.

With regard to IPARD, the information available to the Commission shows greater interest from potential beneficiaries, raising expectations of more successful implementation than in the case of Sapard. See also the reply to point 41.

45. The Commission will continue to provide assistance to Croatia to fight corruption and organised crime. This is reflected in the Multiannual Indicative Planning Document (MIPD) for 2011-2013 for Croatia. For instance, support is envisaged under the 2011 IPA National Programme to strengthen the National Police Office for Prevention of Corruption and Organised Crime. For the first year after accession, the EU will provide temporary financial assistance ('Transition Facility') to Croatia to build up its administrative and judicial capacity to implement and enforce EU legislation and to foster exchanges of best practice between peers.

46. In spite of the difficulties encountered in the preparatory phase of this project, Croatia has now established a track record of substantial results in investigation and prosecution of organised crime and corruption cases at all levels. The law enforcement agencies, in particular the Office for Prevention of Corruption and Organised Crime (USKOK), have been reinforced and are proving effective in tackling corruption in Croatia. This project has been one factor in achieving progress in this key area.

The track record of effective handling of corruption cases needs to be built up further.

47. USKOK has continued to be active and issued indictments in some major cases. In a number of mid- and high-level corruption cases, investigations are underway or indictments have been issued, often involving State-owned companies and senior political figures. There have also been court rulings and final judgments in such cases, including cases involving a former Deputy Prime Minister and a former Minister of Defence.

## **CONCLUSIONS AND RECOMMENDATIONS**

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<sup>27</sup> 'It is evident that there are potential overlaps with the Sapard programme but the amounts that were permitted within the model are significantly lower than those foreseen by Sapard.', 2008 Sapard Implementation Report, p. 10.

48. The Commission welcomes the Court's assessment of the contribution made by pre-accession assistance to building up the capacity of Croatia for implementing post-accession funds. Following the conferral of management powers, Croatia has introduced a sound financial management and control system. However, for one specific area - public procurement – the Commission is still monitoring progress through ex-ante controls. The experience gained under all IPA components is expected to facilitate absorption of post-accession funds (including compliance assessment).

The Commission will continue to support the Croatian authorities with building their procurement and anti-corruption capacity. This includes systematic feedback by the Commission on errors made and improvements needed in the procurement process. In line with Article 18 of the IPA implementing regulation and on the basis of roadmaps submitted by Croatia, the Commission is constantly assessing the beneficiary country's progress towards achieving a possible waiver of *ex ante* control. While further efforts by Croatia are needed to pave the way for such a waiver, good progress has been made on this point under all IPA components.

49. The Commission welcomes the assessment of the Court. The institutional framework in Croatia for the cohesion/rural development policy is embedded in existing mechanisms for IPA components II-V which are implemented mostly at central level. This direction was decided together with Croatian authorities. Building the capacity of relevant local and regional bodies is a commitment which Croatia has given and which will be monitored by the Commission up to accession.

50. The Commission welcomes the assessment by the Court. The main causes of delays in programme implementation were late accreditations of management systems at national level and of the subsequent conferrals of management by the Commission, as these were pre-conditions for implementation. As all the operating structures are now in place and fully functional, Croatia is now catching up with implementation.

In the specific case of infrastructure, one of the main reasons for projects falling behind the original timetable is that infrastructure projects funded under IPA Component III must comply with EU rules on procurement, planning and implementation which required a longer learning curve.

Targeting major projects reflects Croatia's priorities in relation to the *aquis* (requirements and short transition periods for the environmental *acquis* and focus on TEN-T infrastructure).

The approach has been focusing on national institutions and bodies that will be responsible for managing Structural and Cohesion Funds after accession (see also the reply to observation 19).

Even though a low absorption rate was noted under Sapard, performance has improved under its successor IPA Component V. The results of five calls for applications launched have shown greater interest from potential beneficiaries from different agricultural sectors. The action plan currently being implemented to improve absorption of funds under IPARD is regularly discussed between the Commission and Croatian authorities. The emphasis is put on assisting potential beneficiaries with preparing for calls for applications. Several measures have also been taken to involve regional agricultural services in assisting farmers and agricultural entrepreneurs.

### ***Recommendations regarding EU assistance to Croatia***

1. The Commission recognises the importance of building up procurement capacity in Croatia. Practical measures have been taken to increase the capacity of stakeholders in the field of procurement, including those listed below.



(a) This recommendation is being implemented. A new Act on Public Procurement aiming at full alignment with the *acquis* was adopted by the Croatian Parliament on 15 July 2011 and will enter into force in January 2012. A working group established to define more detailed provisions to implement the new Public Procurement Act will define standard documentation that should be used in tendering for EU co-financing and will draft standard documentation in the last quarter of 2011. The Commission is closely monitoring these developments.

(b) The implementation of this recommendation is underway. On the basis of the lessons learned, JASPERS (Joint Assistance for Supporting Projects in European Regions) will aim to build up the capacity of all stakeholders in Croatia and develop a pipeline of mature projects in order to improve the future absorption of Structural and Cohesion Funds.

2.

(a) As regards Structural Funds, the Commission has been focusing primarily on the national level which bears responsibility for the overall processes. Even though support for local bodies is then the responsibility of the central authorities of Croatia, the Commission will gradually further assist through increased guidance, workshops and seminars in building up procurement capacity at regional and local level as well.

As regards agriculture, the involvement of regional agricultural services to assist the IPARD beneficiaries has been one of the Managing Authority's priorities since 2010.

Furthermore, regional offices and their employees are currently included in ongoing project/contracts under IPA Component I with a view to preparing the Paying Agency at all levels for the implementation of the CAP after accession.

(b) The Commission will continue to provide assistance for developing project ideas. Such assistance has been provided under Phare 2006 and various Operational Programmes. By providing constant technical assistance along with increased guidance, workshops and seminars, the Commission will offer further assistance for gradually improving the mechanisms for stimulating the development of project ideas.

3.

(a) Since 2011, the Commission's strategic planning includes a move from a project approach to a sectoral approach: efforts are being made to focus on setting clear SMART objectives when drafting strategic planning documents and in the programming process. The Commission will step up systematic use of SMART objectives and related indicators in the next generation of IPA programmes.

(b) The Commission will look into ways on how to improve the quality of the monitoring reports.

(c) Interim and ex-post evaluations are planned and will start soon and will serve, *inter alia*, for revision of the Operational Programmes.

4.

(a) The Commission has started to address this issue. Discussions started in 2010 between the Commission/EIB and the Croatian authorities in order to make JASPERS available to Croatia. JASPERS will be used to prepare a pipeline of mature projects and increase the quality of procurement documents as from 2011.

(b) The Commission intends to continue paying attention to a complementary portfolio of major and non major projects for the post accession period. However, the operational programmes for transport and environment are, by nature, designed to include mainly projects of EU and national interest and therefore major projects.

5.

(a) The Commission will continue to provide capacity-building assistance to Croatia. In a fully decentralised system, however, such a decision to opt for one or more conferral of management 'waves' lies with the national authorities. The Commission has consistently provided guidance to Croatia, whenever appropriate, to reduce bottlenecks and risks in the procedures, and has also worked with Croatia, in parallel with the preparation of the financial and operational implementing arrangements, to help it prepare for setting up the necessary institutions and procedures. This has taken the form of both extensive assistance (twinning projects, technical assistance, etc.) and continuous exchanges of information in seminars and fact-finding and advisory missions.

(b) The Commission is addressing this concern. The last modification of the programme, approved in November 2010, aimed to generate more projects under IPARD by: (1) raising the upper quantitative ceiling for the size of eligible farms in sectors such as milk, beef, pigs, poultry, cereals, fruit and vegetables and greenhouses; and (2) introducing a new type of eligible investment in the milk sector (milk sheep and goat farms) and new eligible investments in the fruit and vegetables sector (including greenhouses). The results are visible in the increased number of applications received from potential beneficiaries.

Moreover, the Commission is currently evaluating the new proposal for revision of the programme. One of the changes aims to broaden the scope of potential beneficiaries under Measure 101 'Investment in agricultural holdings' to also include the above-mentioned sectors.

6.

(a) This recommendation is already being implemented as demonstrated by the Multiannual Indicative Planning Document (MIPD) for 2011-2013 for Croatia. In the first year after accession, the EU will provide temporary financial assistance ('Transition Facility') to Croatia to build up its administrative and judicial capacity to implement and enforce EU legislation and to foster exchanges of best practice between peers.

(b) The Commission will continue to follow this issue closely, in close cooperation with OLAF.

***Recommendations regarding EU pre-accession assistance to other countries***

7.

(a) The Commission agrees with this recommendation.

(b) The Commission takes note of the recommendation and will draw lessons from the Croatian experience.