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**REPLIES OF THE COMMISSION TO THE SPECIAL REPORT OF THE
EUROPEAN COURT OF AUDITORS**

EUROPEAN UNION ASSISTANCE TO THE TURKISH CYPRIOT COMMUNITY

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COURT OF AUDITORS**

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EXECUTIVE SUMMARY

III. The Commission admits that not operating under more devolved procedures is a constraint, but has made considerable efforts to work with the options available to provide the most appropriate alternative institutional set-up.

IV. The loss of the sea water desalination plant project was an unfortunate setback. After extensive efforts to rescue and proceed with the project, the Commission had to act to protect its financial interests and terminated the construction contract. No payments have been made under this contract. The Commission agrees with the Court's conclusion on the risks to sustainability and the reasons for it and will continue to help the Turkish Cypriot community to develop administrative and technical capacity.

V. First indent - The Commission largely agrees with the Court's recommendations. The Commission attempted to find the best practical solution considering that the establishment of a Delegation within EU territory is not possible. Since the audit, further efficiency improvements have been achieved. When considering further devolution of management, however, the Commission must balance the possible efficiency gains against the risks of reducing the supervision from headquarters, given the particular circumstances of the assistance to the TCc.

V. Second indent - The Commission is committed to providing continued assistance to the Turkish Cypriot community and to working towards reunification of the island of Cyprus. A phasing-out of the operations is not currently planned and these will continue on an appropriate scale.

V. Third indent - Reunification is the central aim of the assistance programme. The Commission recognises that reunification would require a -review of the assistance to Cyprus. The Commission would make timely preparations for this scenario.

OBSERVATIONS

14. The scope of the aid programme is laid down in the Council Regulation as adopted by the Council. The Commission agrees that it was a programming and implementation challenge to cover the broad range of topics.

16. The 2004 proposal contained preliminary allocations only. This was a new programme for the Commission and, during the period of delay in the adoption of the Aid Regulation, further consultation took place with stakeholders. The allocations in the December 2006 Financing Decision were adjusted as a result and therefore somewhat different from those of the 2004 planning. The Commission prioritises the 'reconciliation and confidence-building' objective, and the final contracted amounts in 2009 included use of the programme reserve for demining activities and for support to the Committee on Missing Persons. By the end of 2009, including the commitments on Green Line crossing points, the 'reconciliation and confidence-building' objective was supported by commitments only about 18% below the level envisaged in 2004, rather than 35% less.

Besides this, another substantial amount was committed for the (bi-communal) Nicosia waste water treatment plant, which was included with reconciliation as a prime motivation.

In addition to the above, the entire allocation for 2010, which was €3 million, was devoted, through the Committee on Missing Persons, to the 'reconciliation and confidence-building' objective.

17. The Court's comments on the difficulties of providing effective technical assistance highlight one aspect of the challenging environment for the assistance programme.

21. The Commission agrees that a multi-annual perspective would facilitate the planning and implementation of assistance to the TCc, but this must be seen in the broader political context. The Commission strongly supports efforts towards a settlement of the Cyprus issue and reunification. Meanwhile, the Commission proposes to continue supporting the Turkish Cypriot community on the basis of the current Aid Regulation.

22. The Commission had to consider very carefully how to establish the most efficient management structure from the options available at the same time as it was developing the technical elements of the programme to be delivered.

23-25. Joint reply:

The Commission admits that not operating under more devolved procedures is a constraint, as the establishment of a Delegation in an EU Member State is not possible. The Commission has worked with the options available to provide the most appropriate alternative institutional set-up.

The Commission has taken measures to facilitate operations and financial circuits including derogations of normal procedures and regular missions from the Authorising Officer by sub-Delegation (AOSD) to Nicosia. A new IT structure was put in place at the end of 2011 to allow common file access between Nicosia and Brussels and the 2012 reorganisation of DG ELARG has streamlined the internal processes; the number of units involved in contracts and payments has been reduced from four to two.

The Commission has also to take into account the risks arising from operations in such a sensitive political environment.

26. The Commission Representation (ECR) in the Republic of Cyprus is formally consulted as part of DG COMM in the context of the Commission "inter-service" process. This ensures information flow, cooperation and coordination. The delays in the ECR's responses were also caused by the substantial workload.

The current staff reinforcement of the ECR – also due to the incoming Council Presidency of Cyprus – will further strengthen the cooperation with the other services of the Commission.

27. The situation of the contractual agents in EUPSO is indeed different from that of contractual agents in Delegations. As the Court notes, moreover, current legislation (Article 3b, Article 88, first paragraph, point b of the Conditions of Employment of Other Servants of the European Union) does not allow the engagement of contract staff for a total period of more than three years and does not provide for any derogation from that rule. In December 2011, the Commission proposed to change the Staff Regulations and the Conditions of Employment (COM 2011/890/final) to prolong the duration of the contracts to a maximum of six years. This proposal has still to be adopted. In reviewing the length of contracts, however, the Commission will have to take into account the availability of funds as well as the overall political situation in the context of the settlement talks.

28. The Commission will start an overall programme evaluation in 2012. The advantages of implementing some parts of the programme through the UNDP will be considered in this review.

29. Weaknesses in the first Committee on Missing Persons Contribution Agreement (joint management with UNDP) found by the Court have been addressed in later Agreements e.g. better definition of indicators related to EU funding, better definitions of numbers exhumed and identified, better general output-input relation and improved reporting.

30. Decisions on the management arrangements, including setting up the EUPSO office and the degree of "devolution", formed part of the risk analysis undertaken by the Commission.

33. No funds have been disbursed yet under the construction contract and the contract was terminated in December 2011, after considerable efforts to rescue the project, when there was no prospect of progress. The Commission's financial interests have been protected.

The risk management included designing a two-phase project starting with a pilot plant, but the developments that led to termination could not reasonably have been anticipated at the start of the project.

Box 2 – Management of Implementation Risks:

(a) The Commission evaluated the risk in the context of the selection of the company for the construction of the seawater desalination project. The outcome of this international open tender was fully based on established rules.

(b) The guarantee was not provided by the contractor. In the early stages this was primarily due to issues arising from the complex local context, which the Commission tried to solve. Even if the contract had been terminated in January 2010, it would not have been possible to recommit the money, since the contracting deadline had passed.

(c) The assistance to the Turkish Cypriot community was a new programme for the Commission. During the 3-year contracting window between 2006 and 2009 allowed by the regulations, the programme management and logistics, as well as the projects themselves, had to be developed. Given the need for thorough project preparation, the Commission considers that it would not have been possible to contract the works for the desalination plant at an earlier date.

(d) Commission staff were involved at all stages and started negotiations as soon as problems became apparent. A delay to the start of the contract, pending resolution of site access issues was formally agreed on 17 December 2009. Contacts with the TC authorities were numerous and, given the large size of the contract and the nature of the problems arising, it was clear that the TC leadership was fully aware of the situation. The high-level intervention from the Commission side (letter from the Commissioner to the leader of the Turkish Cypriot community of June 2010) followed after the elections in the Turkish Cypriot community.

35. The telecom liberalisation "law" was adopted on 11 January 2012. The assistance programme can now proceed with the completion of the hardware component and preparation for hand-over to the beneficiary.

36. The absence of a formal Financing Agreement with the (non-recognised) beneficiary was a risk of which the Commission was aware. The Commission has implemented a considerable aid programme within short contracting deadlines and a wide mandate to fulfil. Equipment and infrastructure were provided in the areas specifically mentioned in the Aid Regulation and where it was necessary to make a real impact. In some areas it was necessary to try to deliver real benefits and encourage sector reforms in parallel.

37. This is the first experience by the TCc of major EU assistance. The complexity of the alignment to the *acquis* and the size of the reforms necessary in this context were underestimated by the beneficiary. The aid programme for the TCc is still relatively new and the major contracting took place only in 2009. The Commission services had no previous experience of working with the TC beneficiary.

38. The seawater desalination plant design change arose from stakeholder and expert consultations, and was related to concerns that the requirements of the Water Framework Directive would not otherwise be met.

39. The problems affecting the implementation of the construction contract for the desalination plant illustrate the difficult operational environment.

40. The failure of the desalination plant project is a disappointment. The environmental effects of the salination of the Morphou aquifer will be taken into account, however. The water sector situation is changing with significant new elements arising. Water and waste water investments remain in the draft assistance programme which is being drawn up for the coming years.

41.(a) Reliable baselines and indicators were not available for water distribution, which is one of the reasons why investments in the water laboratory were made, but the evidence is that there are considerable improvements in service and leak rates for Nicosia water, the latter being previously up to 50% in some areas.

41.(b) UNDP is implementing the Mia Milia/Haspolat project under joint management. The UNDP Deputy Director for Europe is aware of the need for the "joint entity" for the WWTP and, along with the Commission, is engaged in resolving this.

42. In addition to the training that was provided by the suppliers of the laboratory equipment, the Capacity Building project provided training in sampling and analysis to meet the requirement of the Water Framework Directive, Drinking Water Directive and Bathing Water Directive.

Training on the Laboratory Information System (LIMS) is planned for 2012. The laboratory was inspected and passed the accreditation audit for four procedures for heavy metals, pesticides, microbiology and food.

45. The Commission agrees that sustainability is a critical issue. Unless reunification occurs before, this issue will be taken up in the programming for 2012-13.

One of the challenges of the programme environment is the difficulty of working with a beneficiary that is not formally recognised.

46. The issue of property is a sensitive one and tracing the ownership history has proved a significant complicating factor in project implementation.

47. The TCc is not formally represented in the Project Steering Committee, but no project goes ahead without the agreement/approval of the relevant TC interlocutors. Implementation through the UNDP does somewhat restrict the experience gained by local bodies, but does give more confidence in the physical completion of projects. The problem of capacity development in local bodies is partly addressed by the access to the Community Development grants, outside the UNDP Contribution Agreement.

48. The missing persons issue is sensitive and the work of the Committee on Missing Persons (CMP) work is much appreciated by both communities and strongly supported by the European Parliament. A significant proportion of the total number of "missing" has not been found or identified yet. The Commission has not yet planned an exit strategy, but is aware that, eventually, programme activities will decrease. It is important that the two communities take the initiative in this process.

49. Continuation of the European Forum Cyprus by building upon the alumni network is foreseen.

Members of the European Forum Cyprus (EFC) alumni network participated in the European Forum for Democracy in Limassol in October 2011.

50. The Commission will consider the need for further capacity building in future programmes to the extent that funds are available.

53. The Commission agrees that a multi-annual perspective would facilitate the planning and implementation of assistance to the TCc, but this must be seen in the broader political context.

54. The ex-post survey on the scholarships referred to by the Court will be launched in 2012.

55. The Commission agrees that collaboration between DGs ELARG and COMM could be strengthened and is making supplementary efforts in this respect.

Box 4 – Implementation problems in the Air Quality Monitoring project

(b) Environment is very important from the point of view of the *acquis communautaire*. The programme therefore calls for significant support in this area.

CONCLUSIONS AND RECOMMENDATIONS

59. The Commission admits that there are constraints associated with running the EUPSO programme office without fully devolved management, but, since a Delegation could not be established, the most appropriate alternative institutional set-up was provided for. Measures have been taken to facilitate operations (see the response to point 23), including some streamlining since the audit was carried out.

Improvements have also been made to Contribution Agreements since the time of the audit.

60. The Commission's financial interests have been protected with the cancellation of the desalination plant project. No payments have been made under the construction contract. The failure of this project, despite the Commission's efforts to complete it, is, nevertheless, a setback to efforts to improve the water supply problem and the related issue of salination of the aquifer. The water and waste water sector remains high on the list of priorities for future support.

The Commission agrees with the Court's conclusion on the general risks to sustainability and will continue to support the Turkish Cypriot community with a view to enhancing administrative and technical capacity.

61. The Commission has committed itself to providing continued assistance to the Turkish Cypriot community. Reinforcing the sustainability of new and existing projects is a priority.

64.(a) The Commission agrees that a multi-annual perspective would facilitate the planning and implementation of assistance to the TCc, but this must be seen in the broader political context. The Commission strongly supports efforts towards a settlement of the Cyprus issue. Until this is achieved, the Commission intends to continue supporting the Turkish Cypriot community on the basis of the current Aid Regulation.

64.(b) The Commission agrees with this recommendation. The overall length of future contracts will depend on the outcome of the Commission's proposed change to the Staff Regulations.

64.(c) Since the audit, efficiency improvements have been made in Commission headquarters, (see for example point 23 above), which help to streamline finance and contract procedures. The Commission will consider the issue of devolution, taking into account both its potential advantages and risks in the particular circumstances of assistance to the TCc.

64.(d) The Commission accepts the recommendation on coordination with the Commission Representation (ECR) in Nicosia. There are already formal procedures for inter-DG cooperation at headquarters and the Commission is making further efforts to improve cooperation between the ECR in Nicosia and the Task Force on the ground.

The current staff reinforcement of the ECR – also due to the incoming Cyprus Council Presidency – will help to strengthen cooperation with the other services and this will also bring the benefit of achieving better coherence and consistency.

64.(e) The recommendation on improvements to Contribution Agreements is accepted by the Commission and these improvements have already been made including better definition of indicators related to EU funding, better definitions of numbers exhumed and identified, better general output-input relation and improved reporting.

64.(f) The recommendation on ensuring sustainability will be taken into account in completing existing projects and the programming of new interventions will reflect the steps taken by the TC beneficiary in creating an appropriate environment in terms of organisation, operation, maintenance etc.

64.(g) The Commission accepts the recommendation on water supply. A water sector evaluation has already been carried out since the audit.

64.(h) The Commission agrees with the Court's analysis in terms of the needs for the legal and administrative framework and continues to cooperate with the beneficiary in these areas. The Commission must, however, take into account the current political and legal context, which does not allow the imposition of any legal commitment on the TCc.

65. The Commission is committed to providing continued assistance to the Turkish Cypriot community and to working towards reunification of the island of Cyprus. A phasing-out of the operations is not currently planned and these will continue on an appropriate scale.

66. Reunification is the central aim of the assistance programme. The Commission recognises that a breakthrough in the reunification process would require a review of the assistance to Cyprus. The proposal for the next financial perspective contains a clause to this effect.