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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Seventh Annual Report 2012 on the implementation of Community assistance under Council regulation (EC) No 389/2006 of 27 February 2006 establishing an instrument of financial support for encouraging the economic development of the Turkish Cypriot community

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1. INTRODUCTION

Council Regulation (EC) No 389/2006[1] (the "Aid Regulation") is the basis for the assistance to the Turkish Cypriot community (TCc) and requires annual reporting to the Council and the European Parliament. This report covers the year 2012.

2. PROGRAMMING OF THE ASSISTANCE

Between 2006 and the end of 2012, €311 million was programmed for operations under the Aid Regulation. Development of the 2012 programme (€28 million) used input from stakeholder consultations, particularly workshops at sector level, from external evaluations and took account of the European Court of Auditors (ECA) Special Report No. 6 on assistance to the Turkish Cypriot community[2]. The 2012 allocation was made available under two Commission Decisions[3].

3. IMPLEMENTATION MECHANISMS

The programme is implemented in those areas of the Republic of Cyprus in which the Government does not exercise effective control and where the application of the acquis communautaire is temporarily suspended pursuant to Protocol 10 of the Treaty of Accession. Assistance is implemented primarily through centralised management by the European Commission. Some projects are jointly managed with the United Nations Development Programme (UNDP).

The Commission operates in a unique political, legal and diplomatic context. *Ad hoc* arrangements are needed to implement the programme while respecting the principles of sound financial management. In EU-funded aid programmes, in normal circumstances, agreements with a beneficiary government would establish the legal framework for development assistance. No such agreements can be made for the assistance to the TCc and the Commission has to rely on what it understands to be the rules and conditions applicable locally. This introduces a certain level of risk. Management and mitigation of this risk is part of the Commission's responsibility and measures adopted include intensive monitoring and support to beneficiaries, revised payment conditions and a more widespread use of bank guarantees.

The TCc needs to provide sufficient priority and resources to make this programme a success and in particular to ensure its long-term sustainability. They have to make sure that the EU-funded assets remain in public hands. Turkish Cypriot (TC) stakeholders are consulted about their needs for future funding and TC experts take part in tender evaluations and play a key role in project steering committees.

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1 OJ L65, 7.3.2006, p.5.

2 http://eca.europa.eu/portal/page/portal/pressroom/Presspacks/Previouspresspacks/2012/PresspackSR62012

3 Commission Decisions C(2012)4628 and C(2012)8361.

Cooperation between the Turkish Cypriot and Greek Cypriot communities remains necessary for full effectiveness of the programme and for achieving the ultimate goal of reunification.

The Programme Team uses the EU Programme Support Office (EUPSO) in the northern part of Nicosia. The Representation of the Commission in Cyprus also hosts meetings and seminars and communicates to the Cypriot public on the programme as part of its standard role.

Due to the specific circumstances described above, sector development programmes cannot easily be conceived. The assistance instead includes a significant amount of grant support, particularly to non-public actors. Management of these schemes is demanding in terms of the Programme Team's resources, where the staffing situation is particularly disrupted by a high turnover rate due to the short duration of staff contracts.

The challenges of medium and long-term planning remain, due to the current arrangement of financing from the margins of the EU Budget. This means that the budget is unpredictable, with no guarantee of annual allocations. In its Report mentioned above, the ECA assessed that this uncertainty makes programme management more difficult and, has a negative impact on its effectiveness and sustainability.

4. IMPLEMENTATION DURING THE REPORTING PERIOD

4.1. General overview

The ECA concluded that, despite the difficult political context and a compressed timetable, the Commission managed to establish a programme which reflected the Regulation's objectives, appropriately prioritised all sectors referred to in the Regulation's objectives, and introduced largely suitable implementation methods and risk mitigation measures. The ECA also noted a number of weaknesses in programme management, and considered that sustainability of projects is often in doubt due to limited administrative capacity, the delayed adoption of relevant legal texts and the uncertainties over future funding on the part of the TCc. The Commission has accepted the ECA's recommendations with some caveats. The Council adopted conclusions on the ECA's Report[4] in July. The European Parliament's Committee on Budgetary Control adopted a report[5] in December.

The part of the programme originating from the large 2006 financial allocation included major supply and construction contracts in water/wastewater, solid waste, nature protection, energy and telecommunications as well as substantial technical assistance programmes, and around 1000 grant contracts under various schemes for NGOs, SMEs, farmers, rural communities, schools, and students. By the end of 2012, many of these were completed. Consequently, 2012 was a year when programme deliverables became particularly visible and benefits to the TCc materialised. Focus has been maintained on the bi-communal activities and confidence building, particularly with continued and increased support to the Committee on Missing Persons and to the bi-communal Technical Committee on Cultural Heritage through joint management with UNDP. Work also included preparation for the full application and implementation of the *acquis* following a possible solution to the

[4] 12526/12
[5] PE497.895v03-00

Cyprus problem, and the dissemination of information on the European Union's political and legal order to the TCc. Four new grant schemes were launched in the course of 2012 to provide support to rural enterprises, SMEs, schools, students and teachers.

Many contracts (190) were closed during 2012, primarily grants, leaving 402 contracts still open at the end of the year. This number will rise as the 2011 and 2012 programmes reach full speed. The past year, with the winding down of the activities originating from 2006, was also the occasion to launch a substantial evaluation effort.

The problem that arose in 2011 concerning the status of bank guarantees remained unsolved. As reported last year, a local contractor filed a suit with a local "court", rather than following the dispute settlement procedures foreseen in the contract, which resulted in injunctions preventing call-up of bank guarantees issued by local banks. In order to safeguard the EU's financial interests, the Commission will refrain from signing contracts of a similar nature with TC beneficiaries and contractors until this issue is satisfactorily solved. Local contractors imposed a boycott of UNDP contracts affecting EU funded cultural heritage projects for a period of eight months over issues related to the place of jurisdiction for disputes.

Sustainability of investments is another, on-going concern. The beneficiaries have not always prepared sufficiently well for the handover of projects, despite considerable support from the EU. The TCc has struggled to find resources for operation and maintenance of new infrastructure, although contracts are finally in place for management of recently delivered wastewater treatment plants.

4.2. Progress by objectives

The overall objective of the Aid Programme is to facilitate the reunification of Cyprus by encouraging the economic development of the TCc, with particular emphasis on the economic integration of the island, on improving contacts between the two communities and with the EU, and on preparation for the *acquis*. A considerable contribution has been made towards improvements in some areas, notably water, wastewater and environment.

4.2.1. Objective 1: Developing and restructuring of infrastructure

The new Morphou/Güzelyurt *wastewater treatment* plant was taken over by the beneficiary in January. Plant management has been handed over to an operating company engaged by the local beneficiary. Once the local beneficiary has completed all the house connections to the sewerage network handed over in 2011, the system will provide, for the first time, wastewater collection and treatment in this region for about 10,700 people.

Commissioning of the new *wastewater treatment* plant in Famagusta was underway at the end of the year, with the treatment process functioning and the plant producing clean effluent. Work was still in progress on the sewerage and drinking water networks (95 km total) with some delays, however, due to defective pipe connections causing ingress of saline water leading to corrosion problems in the treatment plant. The plant will serve about 30,000 people.

The construction of the new Nicosia bi-communal *wastewater treatment* plant at Mia Milia/Haspolat, co-funded by the EU and the Sewerage Board of Nicosia and implemented through the UNDP, continued in 2012. In November, the sewage treatment was started up and the input volume is gradually being increased.

Completion and take-over of the works is foreseen for the first half of 2013. The plant will serve about 270,000 people.

The water/wastewater capacity building programme ended in December with a concluding workshop. Outputs of the project included *inter alia* the preparation of legal texts aligned with the EU *acquis*, awareness raising, asset management planning, and training in analytical techniques.

On *nature protection*, no progress has been possible on the unfinished information and management centres in four Special Environmental Protection Areas (SEPAs). Following a contract termination in 2011, the Turkish Cypriot contractor filed a suit with the local "court" to prevent the Commission from calling the guarantees from the local bank. Projects initiated by the TCc, for example road widening project in the Karpasia/Karpaz peninsula or extensive quarrying in the Kyrenia mountains raise concerns about the implementation by the TCc of its own management plans for the SEPAs, which were prepared with EU assistance.

In the area of *solid waste*, the new Koutsoventis/Güngör landfill, Famagusta transfer station and related waste handling equipment were handed over in March. Management of the landfill passed to an operating company engaged by the beneficiary. The Kato Dhikomo/Aşağı Dikmen dump, after rehabilitation and closure, was handed over in October. The solid waste management capacity building project finished in December.

In the *energy sector*, the main action was the integration of the 1.27 MW Solar Power Plant, fully operational since November 2011, with the control system for remote monitoring. However, the allocation of dedicated staff by the beneficiary is still missing for the effective and sustainable use of some of the equipment supplied, for instance in the case of the customer care call centre.

All "next generation network" *telecommunications* equipment has been installed. The testing phase has, however, required further capacity building of the operator and several outstanding issues still have to be addressed by the supplier and the beneficiary. Legal texts detailing the modalities of liberalisation of the electronic communications sector were adopted in December 2011, but the conditions necessary to separate the provision of services from the network operation are still missing.

Under the *traffic safety* project, almost all contracts are now closed. The remaining component to eliminate traffic accident "black spots" was completed in the third quarter of 2012. Potential further actions in this sector will depend on a clear policy decision from the beneficiary

4.2.2. Objective 2: Promoting social and economic development

Aid was given to farmers, veterinarians and *rural development* stakeholders on animal husbandry and disease eradication, plant health, crop diversification, organic farming and support for grant implementation. The Animal Husbandry Project and the Technical Assistance team supporting the Rural Development Policy completed their activities. A pilot project for the agricultural reuse of treated sewage water was carried out and pilot epidemiological surveillance was initiated for diseases in cattle, sheep and goats in order to prepare for a larger intervention in animal disease eradication.

A new *rural development* €3.3 million grant call for "Increasing Competitiveness, Diversification and Sustainability" was launched. Ten grant projects from the 2009

scheme "Community Development through Village Initiatives" were completed, but a number of others suffered delays, arising, in particular, from infrastructure works through the grant contracts.

Under the project *Upgrading of Urban and Local Infrastructure* implemented through joint management with UNDP, the renovation of the old market in the northern part of the walled city of Nicosia was completed early in 2012 and the market was opened by Commissioner Füle in June. In order to revitalise this historical location, small grants, awarded through UNDP, were implemented for cultural and community activities. A second grant call was launched in December, targeting the market in Famagusta and Nicosia as well as villages, where EU-financed renovations have been carried out.

In the *education* sector, a €700,000 call: School Initiatives for Innovation and Change was launched in September. Seven of the 72 grants awarded under previous calls continued into 2012 and at year's end, five of these were close to completion.

The TA programme developing vocational education training and labour market (VETLAM) finished during 2012 and a study was conducted to assess future needs in these areas.

Supporting *SME Competitiveness,* a €5 million grant scheme was launched in June to aid SME modernisation, with a component for start-ups. Training sessions on EU grant procedures were given to over 300 TC enterprises. Help was also given on entrepreneurship, ICT, company law and business management. A Project Management Unit (PMU) has been set up to support beneficiaries both of SME grants and of rural development grants (see above). The Nicosia and Famagusta downtown market initiatives have started to promote local products and services with modern approaches to marketing. Development work was carried out on e-commerce and e-service strategies and a workshop took place in December on possible future EU support for the Private Sector Development Strategy.

Economic progress is monitored through a Trust Fund with the World Bank. An Economic Update Report was provided in June.

4.2.3. Objective 3: Fostering reconciliation, confidence building measures, and support to civil society

Support *to the Committee on Missing Persons,* managed jointly with UNDP, continued and a new Contribution Agreement was signed. During 2012, UNDP signed a contract with the International Committee on Missing Persons (ICMP) for DNA analyses at the ICMP facilities in Bosnia and Herzegovina. CMP achievements 2012 include: excavations at 92 sites, 284 set of remains prepared by the anthropological laboratory and sent for DNA analyses, 22 sets of remains identified and 22 sets returned for burial to their families. It would be important to increase the contribution by other donors.

Programme visibility has been enhanced through distribution of a brochure to schools and a UN-organised visit to Cyprus of family members of missing persons from conflicts in Kosovo[6] and Serbia. A CMP live music event took place in December, attended by families of missing persons.

[6] This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

Out of 27 remaining projects funded under three grant schemes of the *Cypriot Civil Society in Action* programme, 23 were completed in 2012. An impact assessment of the civil society support was launched in December.

Cultural Heritage protection has continued with a €2 million Contribution Agreement signed with the UNDP in April for emergency stabilisation on sites selected by the bi-communal Technical Committee, including the Othello Tower in Famagusta. The project was delayed eight months by a boycott of TCc Contractors Union over the conditions for dispute settlement. This problem was finally resolved early in 2013.

The project for *demining* the buffer zone was completed and a closure event was organised jointly with UNDP in March, to mark the International Day of Demining (4 April).

4.2.4. Objective 4: Bringing the TCc closer to the EU

After five annual scholarship schemes, an evaluation was carried out in 2012. The 2012-13 programme was a pilot scheme, adopting a number of proposals from the evaluation, and 28 scholarships were awarded. Other recommendations, including widening of the scheme to professionals outside the academic fields and outsourcing the grant management, will be pursued.

The *InfoPoint* project continued its role as an information channel to the TCc preparing events, videos and providing information on grant calls. The frequently visited bi-lingual web site was maintained and six news bulletins in Turkish were published.

4.2.5. Objective 5: Preparing the Turkish Cypriot community to introduce and implement the acquis

The Commission's Technical Assistance and Information Exchange (TAIEX) instrument helps prepare the TCc for implementation of the EU *acquis* following the settlement of the Cyprus problem. TAIEX supports the preparation of *acquis*-compliant legal drafts. EU experts carried out 415 actions in 2012, including training courses, workshops, and study visits. Progress of draft legal texts aimed at *acquis*-alignment was critically slow in 2012, although legal texts on environment, animal health and seatbelts were adopted. Preliminary work was also done on Free Movement of Goods, Intellectual Property Rights and Mutual Recognition of Professional Qualifications.

Support to trade across the Green Line (Regulation 866/2004) continued. EU Member State experts carried out regular phytosanitary inspections of potatoes and citrus products. Analyses of local honey showed that the conditions of Commission Decision 2007/330 (movement of animal products) have been met, opening the possibility of trade in honey under the Green Line Regulation.

4.3. Financial execution (contracts and payments)

4.3.1. Contracting

Commitments in 2012 (€14.6 million) were 85% of the forecast figure. Delays in the launching of grant calls prevented reaching the target.

4.3.2. Payments

In 2012, payments were €25.2 million, 69% of the forecast amount. The deficit was almost entirely due to a shortfall in payments for works and supply contracts from

the 2006 programme. The 40% payment due on final acceptance of the €10 million telecom system was delayed beyond 2012 due to testing problems.

4.4. Monitoring

Since the Commission acts as Contracting Authority, the level of supervision by Commission staff is high, with "spot-check" visits, site meetings, steering committees and Project Management Unit reporting. In addition, the Implementation Review Mechanism (IRM) provides a detailed review together with the beneficiaries of all projects. TAIEX activities are monitored through more than 20 Project Steering Groups, plus bi-annual Monitoring Mechanism meetings. TAIEX logistics are monitored through the on-line TAIEX Management System.

Low capacity of grant beneficiaries causes implementation difficulties, for example with EU procedures for procurements using grant funds. To address this, the PMU set up in 2008 to support the Rural Development projects was extended to the SME grant sector in 2012.

4.5. Audit and controls

Between 2010 and 2012, a total of 96 grant beneficiaries were subject to financial monitoring and 16 audits were carried out. Problems were cleared on a case-by case basis. Findings on grant contracts included observations on accounting, procurement, rule of origin, budget management and VAT. This will be addressed in future grant calls by extended training and grantee supervision. The Internal Audit Capability of DG ELARG conducted an audit on Joint Management to assess internal control systems of the DG. The report is expected in 2013.

The Commission introduced improvements in the implementation of the programme following ECA's recommendations. It also made proposals in the context of the Multiannual Financial Framework (MFF) to improve sustainability by increasing the predictability of funding.

4.6. Evaluation

Four sector-level evaluations/needs assessments were carried out in 2102 on: 1) scholarships, confirming appreciation by beneficiaries and recommending widening of the scheme; 2) water/wastewater, giving a clear list of priorities; 3) vocational training/lifelong learning, recommending a follow-up to support career guidance and employment services; 4) solid waste, identifying the lack of waste recycling or composting, the need for closure of old dumpsites and for better medical waste treatment. An overall programme evaluation, to be completed in 2013 was also launched. Evaluations in the fields of education and civil society were contracted in December.

4.7. Information, Publicity and Visibility

There were 86 visibility actions in 2012, considerably more than in 2011, including many project-related events and information or networking activities organised by the *InfoPoint*. A Europe Day event was carried out at the historic, EU-renovated Bedestan and a CMP live music event took place. There were art and photography exhibitions, project events and handovers, plus information sessions on grants. A brochure on the main achievements under the aid programme was produced[7]. Press

[7] http://ec.europa.eu/cyprus/documents/2012/eu_assistance_to_tcc_brochure.pdf

releases on the aid programme for the TCc were disseminated by the Commission Representation in Cyprus.

4.8. Consultations with the Government of the Republic of Cyprus

Regular meetings were held with representatives of the Government of the Republic of Cyprus, in particular when senior Commission officials visited the island. The Commission continues to rely on its cooperation for verification of property rights, and also meets regularly with the Permanent Representation in Brussels.

5. CONCLUSIONS

The programme, which effectively started its implementation on the ground in 2009, has brought some visible benefits to the TCc during 2012, notably with big contributions to wastewater and solid waste management. More efforts will have to be made, however, to make progress in other environmental sectors, in particular on nature protection, and especially in respect of potential Natura 2000 sites. It is important to show that the EU can deliver effective assistance and a positive message. It is now up to the TCc to ensure the sustainability of projects which have been delivered and accelerate the implementation of the assistance.

Progress towards meeting the main objective of the Regulation to *facilitate the reunification of Cyprus by encouraging the economic development* is difficult to achieve, given the operating context in the northern part of the island.

In order to protect the EU's financial interests, the Commission will not sign contracts requiring bank guarantees until legal certainty is ensured.

Preparation for the future adoption and implementation of the *acquis* slowed down in 2012. The TCc needs considerable support in order to meet *acquis* requirements in many areas following a settlement and reunification. Lack of resources, inefficient structures and unclear responsibilities remain serious issues to be urgently addressed in order to ensure the sustainability of EU-funded projects. The TCc has reassured the Commission that EU-funded assets shall not be subject to privatisation.

Some parts of the programme have become established as core components with particular value in confidence building or in bringing the TCc closer to the EU. These include the support to the CMP and to the Committee on Cultural Heritage and the scholarship programme.

The completion of many of the projects from the 2006 programme brings a natural milestone and a considerable evaluation effort has been made in 2012.

Medium and long-term planning is challenging in the absence of predictability of annual allocations. Sectors important for future *acquis* compliance require multi-annual support for intervention to succeed fully. In its 2012 report, the ECA linked the lack of multi-annual programming to problems of programme sustainability.