



COMMISSION OF THE EUROPEAN COMMUNITIES

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**COMMUNICATION FROM THE COMMISSION  
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL**

**The respective responsibilities of the Member States and the Commission in the shared  
management of the Structural Funds and the Cohesion Fund**

**Current situation and outlook for the new programming period after 2006**

## I. EXECUTIVE SUMMARY

This communication fulfils the commitment given by the Commission in the “Synthesis Of Annual Activity Reports 2002 of DGs and Services”<sup>1</sup> to carry out a legal analysis of its responsibilities and those of the Member States for the shared management of the budget of the European Communities and to clarify the procedures through which, in cooperation with the Member States, it can discharge its general responsibility for the implementation of the budget<sup>2</sup>.

In the first part (Section II), the Commission sets out its interpretation of the current rules governing the Structural Funds and the Cohesion Fund in order to clarify the shared management responsibilities of each party. The Commission considers that these rules allow its obligations concerning the implementation of the budget to be reconciled with the specific features of the Union’s cohesion policy and its management system which, under the Council Regulations, make the Member States responsible in the first instance for the management, monitoring and day-to-day financial control of the resources of the Funds. The existing structure includes arrangements which allow the Commission to discharge its general responsibility by ensuring the existence and proper operation of the management and control systems. If its subsequent audit work detects deficiencies in the audit and control systems, the risk of irregular expenditure is determined and appropriate financial corrections are applied. This communication sets out the measures taken by the Commission to comply with these provisions.

The relevance of this problem is highlighted by the obligation on the Member States which joined the Union in May 2004 to establish management and control systems which can guarantee that their initial implementation of the Structural Funds and the Cohesion Fund will ensure effective use of Community funding.<sup>3</sup>

The second purpose of the communication (Section III) is to set out the general guidelines which the Commission followed in preparing the legislative proposals which it adopted on 14 July 2004.<sup>4</sup> These cover the period 2007-2013, the aim being to increase the coherence, complementarity and efficiency of the overall structure of the implementation system, including clarification of the obligations on the Member States to cooperate and the consequences for them if they do not comply with the rules.

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<sup>1</sup> COM(2003)391 final of 09.07.2003, action 5.3.3.C

<sup>2</sup> Ibid., action 5.3.3 A.

<sup>3</sup> COM(2003)433 final, Communication from the Commission to the European Parliament and the Council on the implementation of commitments undertaken by the acceding countries in the context of accession negotiations on Chapter 21 - Regional policy and coordination of structural instruments.

<sup>4</sup> Proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund, COM(2004)492 final of 14 July 2004.

## II. LEGAL ANALYSIS OF THE RESPONSIBILITIES OF THE COMMISSION AND THE MEMBER STATES

Shared management, as defined in Article 53 of the Financial Regulation<sup>5</sup>, is one of the ways in which the Commission implements the Community budget, a task laid on it by Article 274 of the Treaty: *“The Commission shall implement the budget [...] on its own responsibility and within the limits of the appropriations, having regard to the principles of sound financial management. The Member States shall cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management.”*

Since Article 274 of the Treaty makes no distinction based on the mode of management, the Commission's responsibility for implementing the budget is general.

The arrangements for the Commission to discharge this responsibility in the context of the shared management of the Funds, and the obligations on the Member States, are set out in the sectoral legislation.

In the case of the Structural Funds and the Cohesion Fund, shared management is the way in which the legislator chose to have the Community budget implemented, and the Commission has no discretionary power to choose another means of implementation; it *“is not able to act in any other way than as laid down in sectoral legislation.”*<sup>6</sup>

The Member States have an obligation to cooperate with the Commission to ensure that appropriations are used in accordance with the principles of sound financial management, which reflects the general obligation to cooperate correctly (Articles 274 and 10 of the Treaty). Furthermore, Article 280 of the Treaty requires the Member States to *“take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests.”*

Article 53(3) and (5) of the Financial Regulation, on methods of implementing the budget, sets out the general operating principles which apply to all areas of the budget which employ shared management. It first states that *“Where the Commission implements the budget by shared management, implementation tasks shall be delegated to Member States in accordance with the provisions of Titles I and II of part two.”* and then that *“In cases of shared or decentralised management, in order to ensure that the funds are used in accordance with the applicable rules, the Commission shall apply clearance-of-accounts procedures or financial correction mechanisms which enable it to assume final responsibility for the implementation of the budget in accordance with Article 274 of the EC Treaty and Article 179 of the Euratom Treaty.”*

Articles 155 to 159 of the Financial Regulation then state that the general provisions of the Regulation apply to expenditure effected under the Structural Funds and the Cohesion Fund

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<sup>5</sup> 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 of 16.9.2002, p. 1.

<sup>6</sup> Point 16(c) of the Resolution of the EP containing the comments which are an integral part of the decision on the discharge for 2002 - general budget of the European Union (Commission) (SEC(2003)1104-C5-0564/2003-2003/2210 (DEC)) . A5-0200/2004, 21.4.2004.

save as otherwise provided for. These exceptions concern payments by the Commission, automatic decommitments, aspects concerning the management and selection of projects and inspection procedures, provided the sectoral Council Regulation contains provisions to that effect.

#### **A. The rules for 20002006. Decentralisation – Partnership – Cooperation**

In Regulation (EC) No 1260/1999<sup>7</sup>, the basic Regulation governing the Structural Funds, and Regulation (EC) No 1164/94<sup>8</sup> establishing a Cohesion Fund, the Council created a structure for the method of managing the Funds. As regards the Structural Funds in particular, the legislator decided that the action of the Structural Funds and the EAGGF Guarantee Section concerning rural development measures should be “*complementary to, or intended to contribute to, the action of the Member States*” (preamble 27 to Regulation (EC) No 1260/1999) and so should “*complement or contribute to corresponding national actions*” (Article 8(1) of Regulation (EC) No 1260/1999). Accordingly, in the case of rural development measures the Structural Funds and the EAGGF Guarantee Section provide assistance by part-financing measures decided on at national or regional level. The clearest reflection of this principle is additionality (Article 11 of Regulation (EC) No 1260/1999).

Without calling into question the Commission’s responsibility for implementing the budget as laid down by the EC Treaty, Regulation (EC) No 1260/1999 defines for the Structural Funds various arrangements for implementing the budget based on a decentralised structure resting on partnership and cooperation between the Commission and the Member State. Regulation (EC) No 1164/94 does likewise for the Cohesion Fund.

**As regards inspections, the sectoral legislation has two pillars, the first being a series of provisions allowing the Commission to ensure the compliance of the Member States’ management and control systems and the second being a further series of rules which define the arrangements for the financial corrections to be applied when irregularities are detected during audits.**

The regulatory provisions on ensuring the existence and sound operation of national management and control systems are set out in Article 38 of Regulation (EC) No 1260/1999 and Articles 5 and 6 of Regulation (EC) No 438/2001<sup>9</sup>, and in Article 12 of and Article G of Annex II to Regulation (EC) No 1164/94 and Article 5 of Regulation (EC) No 1386/2002<sup>10 11</sup>.

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<sup>7</sup> Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds, OJ L 161, 26.6.1999, p. 1. Regulation as last amended by the 2003 Act of Accession, OJ L 236, 23.9.2003.

<sup>8</sup> Council Regulation (EC) No 1164/94 of 16 May 1994 establishing a Cohesion Fund, OJ L 130, 25.5.1994, p. 1. Regulation as last amended by the 2003 Act of Accession, OJ L 236, 23.9.2003.

<sup>9</sup> Commission Regulation (EC) No 438/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the management and control systems for assistance granted under the Structural Funds, OJ L 63, 3.3.2001 p. 21.

<sup>10</sup> Commission Regulation (EC) No 1386/2002 of 29 July 2002 laying down detailed rules for the implementation of Council Regulation (EC) No 1164/94 as regards the management and control systems for assistance granted from the Cohesion Fund and the procedure for making financial corrections, OJ L 201, 31.7.2002, p. 5.

<sup>11</sup> In the case of the Structural Funds and the Cohesion Fund, the aim of ensuring the existence and sound operation of management and control systems mentioned in Article 35 of Commission Regulation No 2342/2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No

The mechanisms for financial corrections under the Structural Funds as described in Article 39 of Regulation (EC) No 1260/1999 and in Regulation (EC) No 448/2001,<sup>12</sup> are detailed in Commission decision C(2001) 476 of 2 March 2001 “Guidelines on the principles, criteria and indicative scales to be applied by the Commission departments in determining financial corrections under Article 39(3) of Regulation (EC) No 1260/1999”.

More specifically, Article 38(2) of Regulation (EC) No 1260/1999 allows the Commission to carry out on-the-spot checks, including sample checks, or require the Member States to do so. The purpose of these checks is to ensure the existence and smooth functioning of the management and control systems or to check individual operations financed. In addition, Articles 5 and 6 of Regulation (EC) No 438/2001 state that the Commission is to receive from the Member States, within three months of the approval of the assistance, a description of the management and control systems in place and that it is to satisfy itself in cooperation with each Member State that these systems meet the standards required by the Council Regulation concerned. The operation of the system is to be reviewed regularly. The Commission and the Member States adopt bilateral administrative arrangements to coordinate the methodology and implementation of inspections and exchange results. Cooperation continues throughout the programming period through reviews which take place at least once a year at meetings between national and Community auditors. Article 38 also provides for financial corrections if an hitherto undetected serious irregularity affecting expenditure included in an intermediate payment is discovered, while Article 39(2) sets out the procedure the Commission is to follow when it finds failings in the systems, in the form of the suspension of payments, to be followed if necessary by net financial corrections.

Regulation (EC) No 1164/94 and its implementing rules provide for a similar mechanism for managing the Cohesion Fund<sup>13</sup>.

## **B. The allocation of responsibilities**

1. In this decentralised structure, **a Member State has three levels of responsibility.**

a) Through cooperation with the Commission, it is the guarantor of the sound management of Community resources and takes primary responsibility for correct financial implementation through:

- the managing authority, which is responsible for *“the correctness of operations..., particularly by implementing internal controls in keeping with the principles of sound financial management”* and acting in response to any observations or requests for corrective measures to the management, monitoring and control system required by the Commission, the compatibility of operations with the Community policies and the preparation of the data or reports which the Commission requires to monitor a programme (Article 34(1));

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1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002) is achieved by the provisions mentioned in the sectoral legislation.

<sup>12</sup> Commission Regulation (EC) No 448/2001 of 2 March 2001 laying down detailed rules for the implementation of Council Regulation (EC) No 1260/1999 as regards the procedure for making financial corrections to assistance granted under the Structural Funds (OJ No L 64, 6.3.2001 p. 13).

<sup>13</sup> Article 12 of Regulation (EC) No 1164/94 and Article 5 of Regulation (EC) No 1386/2002.

- the paying authority, which certifies expenditure (Article 32(3) of Regulation (EC) No 1260/1999 and Article D(2) to Annex II to Regulation (EC) No 1164/94) and ensures that the managing authority and intermediate bodies have complied with Regulation (EC) No 1260/1999 (Article 9 of Regulation (EC) No 438/2001) or Regulation (EC) No 1164/94 (Article 8 of Regulation (EC) No 1386/2002);
- its contribution to improving estimates of the utilisation of financial resources and the implementation of expenditure by supplying forward estimates;
- the application of the relevant national rules on eligibility where there are no Community rules (41st recital to and Article 30 of Regulation (EC) No 1260/1999);
- its responsibility for the *ex-ante* evaluation for the preparation of the plans, the assistance and the programme complement (Article 41(1) of Regulation (EC) No 1260/1999) and the mid-term evaluation and its updating (Article 42(4) of Regulation (EC) No 1260/1999).

b) Under Article 38 of Regulation (EC) No 1260/1999 and Article 12 of Regulation (EC) No 1164/94, “Member States shall take responsibility in the first instance for the financial control of assistance”, in particular by:

- verifying that management and control arrangements have been set up and are being implemented in such a way as to ensure that Community funds are being used efficiently and correctly and providing the Commission with a description of these arrangements;
- certifying expenditure, ensuring that it is compatible with Community law and the use of the Funds in accordance with the principles of sound financial management (Article 38(1)(g) of Regulation (EC) No 1260/1999 and Article 12(1)(c) of Regulation (EC) No 1164/94);
- taking the corrective measures required by the Commission (Article 38(4) of Regulation (EC) No 1260/1999 and Article G(1) of Annex II to Regulation (EC) No 1164/94);
- providing a final declaration by an independent body on the closure of the assistance in the case of the Structural Funds or the project in the case of the Cohesion Fund.

c) As stated in Article 39 of Regulation (EC) No 1260/1999 and Article 12(1)(h) of Regulation (EC) No 1164/94, the Member State bears responsibility in the first instance for investigating irregularities and making the corrections required.

2. Mirroring the responsibilities of the Member State, **the Commission’s responsibilities** are defined so as to allow it to discharge its responsibility for the implementation of the Community budget by verifying that the Member States are carrying out the tasks entrusted to them correctly. With that end in mind and to ensure the respect of the treaty and of the acts adopted by the Community institutions, the Commission notably intervenes at four levels in order to:

- take the decisions required for the implementation of the Structural Funds where the statutory requirements are respected (Articles 28 and 30 of Regulation (EC) No 1260/1999 and Article 10 of Regulation (EC) No 1164/94);

- ensure, in cooperation with the Member States, that management and control systems exist and are functioning smoothly, which may include making on-the-spot checks, including sample checks, on operations and management systems or asking the Member State to make those on-the-spot checks itself (Article 38(2) of Regulation (EC) No 1260/1999 and Articles 5 and 6 of Regulation (EC) No 438/2001 for the Structural Funds, Article G of Annex II to Regulation (EC) No 1164/94 and Article 5 of Regulation (EC) No 1386/2002);
- ensure the efficiency of assistance:
  - by analysing through the annual reports and the final implementing report the progress of the implementation of assistance in terms of the objectives laid down (Article 37 of Regulation (EC) No 1260/1999 and Article F of Annex II to Regulation (EC) No 1164/94) and the annual review (Article 34(2) of Regulation (EC) No 1260/1999),
  - in financial terms, in particular by the application of automatic decommitments, the suspension of payments when the statutory requirements are not respected and the formulation and, where necessary, adoption of the corrective measures required to support the sound financial implementation of assistance (Articles 31, 32 and 38 of Regulation (EC) No 1260/1999 in the case of the Structural Funds and Articles C(5) and G of Annex II to Regulation (EC) No 1164/94), and
  - the evaluation of the results (Articles 42, 43 and 44 of Regulation (EC) No 1260/1999);
- carry out inspections and on-the-spot audits of operations and systems, particularly through sample checks on them, without prejudice to those carried out by the Member States, and applying financial corrections when irregularities and failings are detected and the Member State has made no such correction (Articles 38 and 39 of Regulation (EC) No 1260/1999 and Articles G and H of Annex II to Regulation (EC) No 1164/94).

### C. A necessary clarification of the scope of the Commission's responsibility

We have to concede, as the European Parliament did most recently in its resolution on the discharge for 2002<sup>14</sup>, that for several years the Court of Auditors has been pointing out in its statements of assurance on the reliability of the accounts that the underlying operations are frequently subject to errors, particularly in areas where shared management applies. Although neither of these two Institutions thought it realistic or compatible with the arrangements for shared management described in the sectoral legislation for the Commission to be required to detect all errors and irregularities affecting payments, they identified the failings of the systems and encouraged the Commission to take steps to improve its supervision of the inspection systems.

**In its Opinion 2/2004<sup>15</sup> the Court of Auditors suggested interesting approaches for consideration and outlined the role it thought the Commission ought to play in discharging its responsibility for implementing the budget, an approach which was very similar to the Commission's own. It identified the key principles which, in its view, should guide the work of inspecting the Community budget at all levels under the law as it stands, and the guidelines which could guide the legislator in the preparation of an amended framework for legislation.**

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<sup>14</sup> See above, footnote 6.

<sup>15</sup> Opinion No 2/2004 of the Court of Auditors on the 'single audit' model (and a proposal for a Community Internal Control Framework).

To begin with, the Court states that: *“no system can reasonably be expected to assure absolute correctness of all transactions”* and *“(it is unrealistic to think that) the purpose of internal control systems is to guarantee or assure the complete legality and regularity of all transactions.”* It therefore considers that controls should present an appropriate cost/efficiency ratio, *“The overall cost of controls should be in proportion to the overall benefits they bring in both monetary and political terms.”* It also considers that the Commission should have the role of supervising the operation of control systems both by defining the minimum requirements for them and by coordinating both the objectives to be achieved and their implementation at all levels, national and Community.

The Commission, which is attentive to the recommendations of the two Institutions responsible for monitoring the implementation of the budget, **has already developed the instruments required to coordinate its work with that of the Member States.** In view of the difficulties encountered by the Member States in developing and applying these instruments during the 1994-1999 programming period, the Commission included in the implementing Regulations for the Structural Funds and the Cohesion Fund the conditions it considered necessary for control procedures which would provide it eventually with reasonable assurance as to the regularity of the transactions carried out by the Member States.

Furthermore, under Article 38 of Regulation (EC) No 1260/1999 and Article G of Annex II to Regulation (EC) No 1164/94, the Commission has encouraged the conclusion of administrative arrangements on audits with the Member States in order to step up the coordination of checks and the exchange of results between the Commission and the Member States concerned and apply joint audit methods. Similarly, as part of the simplification process<sup>16</sup>, the Commission has asked the Member States to make a concerted effort to exchange the detailed annual inspection programmes in good time so as to avoid overlapping and duplication. In the case of the Member States which joined the Union in May 2004, following the approach of cooperation for implementation of the pre-accession instruments<sup>17</sup>, the provisions mentioned in the legislation on the Structural Funds and the Cohesion Fund will be applied.

**The Commission has also developed the concept of the contract of confidence with the Member States.** This is a voluntary commitment by the Member States which assures the Commission that the resources required to allow checks on the regularity of the underlying transactions are in place and providing a global approach to checks on a particular programme, Fund or region, in line with an audit strategy approved by the Commission, and improved annual reporting on the results of that strategy. A contract of this type also depends on the existence of the Commission’s prior assurance that the systems in place comply with the statutory requirements. The contract provides the Commission with a guarantee that it can have confidence in the Member State without imposing further statutory requirements but within a coordinated approach between it and the Member State. However, the effect of such assurance lapses if it is found that the Member State is not complying with its obligations.

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<sup>16</sup> Point 2.5.5 of Commission Communication C(2003) 1255 on the simplification, clarification, coordination and flexible management of the structural policies 2000-2006 (not published).

<sup>17</sup> Articles 11 and 12 of and the Annex to Council Regulation (EC) No 1266/1999 of 21 June 1999 on coordinating aid to the applicant countries in the framework of the pre-accession strategy and amending Regulation (EEC) No 3906/89 (OJ L 161, 26.6.1999 p. 68); Article 9 of and Annex III to Council Regulation (EC) No 1267/1999 of 21 June 1999 establishing an Instrument for Structural policies for Pre-accession (OJ L 161, 26.6.1999 p. 73).



But, as the Court of Auditors noted in its Opinion 2/2004, although the principles or standards required to ensure the effective and efficient internal control of the Funds are already *“either fully or partially in place”*, others will need to be developed and introduced, to ensure that *“the extent and intensity of checking ... make an appropriate balance between the overall cost of operating those checks and the overall benefits they bring.”*

Accordingly, on the basis of its experience with the current rules, the Commission wishes to improve the effectiveness and efficiency of the management and control systems in the next programming period. It has therefore adopted the proposals set out in the next section.

### **III. OUTLOOK FOR THE RULES IN 2007-2013**

One of the main aims of the future rules for the 2007-2013 programming period as regards shared management is to clearly define, on the basis of the obligations imposed by Community law and experience with the present rules, the framework, nature and division of the responsibilities among the various parties involved in the implementation of the Community budget, i.e. on the one hand the Member States and their implementing bodies and on the other the Commission.

The Commission has sought to increase the coherence, the transparency and the security of the overall structure of the systems for implementing and checking the Funds – coherence because the minimum requirements on the control and audit system must be clearly defined at all levels of the process, along with the tasks and obligations of the various parties, and transparency because all those involved in the checks need to know the results achieved by the other parties if the effectiveness, efficiency and economy of the process is to be increased. Security, because the Commission must have an additional guarantee that the management and control systems are in place and that they are conform to the minimum requirements defined in the regulation before being able to proceed with the first interim reimbursement, through an initial assessment of the system which will be established by an independent auditor of the Member state, previously agreed, and transmitted at the same moment as the description of the systems.

The Commission has also proposed that the extent of its involvement in the checks should be proportionate to the assessed level of risk of irregularities. Accordingly, its proposal provides that where it has assurance on the existence and smooth functioning of the national management and control systems, it may legitimately base its assurance of the legality and regularity of the expenditure declared on the results of the national checks, and so reduce its own checks to exceptional situations.

Using the same approach based on risk assessment, the Commission has proposed that the degree of Community intervention in the management and control procedures should also depend on the size of the Community contribution to the assistance. The principle followed is that the Community rules lay down a common threshold of minimum conditions to which all management and internal control systems involved in the management of the Community Funds must conform in any event, while at the same time it allows the Member States to apply their own rules and management and inspection structures where part-financing is mainly national and the Community contribution is below a certain threshold. These arrangements would in any case apply only if the Commission received assurance on the reliability of the national management and inspection systems.

Against this general background, the more specific guidelines on the division of responsibilities which guided the Commission in drawing up its proposals should be described.

#### **A. The Commission's responsibilities**

The Commission is obliged to propose legislation which clearly defines the responsibilities and obligations of both parties in shared management and the arrangements for their cooperation.

These include firstly the definition of essential minimum standards which national management and inspection systems must meet and the financial corrections to be applied where irregularities revealing the non-compliance of these systems are detected.

Clear legislation should also stipulate that the role of the Commission, from the point of view of budgetary management, is to supervise the existence and smooth functioning of the national management and inspection systems and must describe how these will operate to prevent irregularities.

The result is that, as regards audit, the Commission will continue to concentrate on evaluating management and control systems and on the procedural and management weaknesses identified by risk analysis, without giving up its right to inspect individual operations where necessary, for example when a Member State fails to follow up an irregularity.

#### **B. The Member States' responsibilities**

The role of the Member States should concentrate on their obligations to:

- provide the Commission at the beginning, before implementation of a programme and before being able to make interim payments, with adequate assurance, delivered by an independent body approved by the Commission, attesting the quality and conformity of their management and control systems in terms of defined standards, and certifying that their accounting system is correct. Where necessary, this assurance is to be accompanied by reservations and an action plan. If the assurance is with reservations, the Member State will have to present a corrective action plan to be implemented. Only the satisfactory implementation of the corrections of the management and control system foreseen in the action plan will allow the Commission to make the interim payments.
- provide annual assurance delivered by an audit authority on the expenditure declared and the correct operation of the management and control system and/or the detection and correction of the weaknesses identified by on-the-spot checks on the use made of the Structural Funds.
- provide a declaration of the validity of the amounts certified on closure of the operational programmes on the basis of the audits and checks on the operations carried out during programming.

Application of the financial corrections to the beneficiaries of the Funds who do not comply with the conditions governing the grant from the Structural Funds is primarily a matter for the Member States, who will deduct the expenditure concerned from the declarations to the Structural Funds.

### **C. Consequences of non-compliance**

As stated in the Third Report on economic and social cohesion, application of the principle of efficiency and a greater simplification in management and financial checks should be accompanied by heavier penalties and measures to ensure rapid recovery in the event of irregularities or fraud. The rules should provide for clear consequences, particularly in terms of financial flows, where principles and minimum standards are not respected when a programme starts or a weakness in national inspection systems is detected which may result in irregularities or frauds in the implementation of the programme, which has not been corrected by the Member State.

The rules should also include arrangements for the Commission to make financial corrections if a Member State does not take adequate steps to comply with its obligations.

Nor should the Commission hesitate to make use of procedures under Articles 226 and 228 of the EC Treaty where it considers that Member States have failed to fulfil their obligations.