

# European Court of Auditors



*JOURNAL*

Cour des comptes européenne

2013

DECEMBER  
DECEMBRE

N° 11

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Brussels, 05 November 2013



Mr Vítor Caldeira, ECA President

Europe's citizens have the right to know how their money is being spent and whether it is being used properly. They also have a right to know whether it is delivering value, particularly at a time when there is such pressure on public finances.

The Commission is the prime manager of EU funds. It must provide information in the EU accounts and other reports on the use of those funds, on the regularity of financial operations and on the results achieved.

The Court's role is to provide an independent assessment on those three elements of EU financial management in accordance with the Treaty and professional audit standards and good practices.

The Court presents the results of its assessment of the implementation of the EU budget in its annual report in order to assist the European Parliament in the discharge procedure.

Chapter 1 of the Court's annual report provides the statement of assurance on the reliability of the accounts and on the legality and regularity of the financial operations underlying those accounts. Chapters 2 to 9 provide specific assessments for revenue and the main areas of expenditure. Finally, Chapter 10 is about 'Getting results from the EU budget'.

### **So what is the Court's assessment of EU financial management in 2012?**

The overall picture is broadly similar to that presented in last year's annual report. But there are a number of specific points in the annual report that I would like to draw to the attention of the members of the committee. Those points relate to:

- the legality and regularity of payments;
- financial corrections and recoveries;
- the pressure on EU finances; and
- finally, the need to create a performance culture over the period of the coming financial framework.

I will start with the overall picture:

- The EU accounts are reliable, as they have been since 2007. Revenue and commitments underlying the EU accounts are legal and regular in all material respects but payments continue to be materially affected by error.
- As regards 'getting results from the EU budget', the Commission is not in a position to provide sufficient, relevant and reliable evidence on what the EU's policies have achieved in a way that is suitable for the purposes of the discharge procedure.

The Court's opinion on the legality and regularity of payments has remained broadly the same because it reflects an underlying reality that has not significantly changed.

The Court issues its adverse opinion based on the audit evidence it obtains from assessing supervisory and control systems and testing samples of transactions.

As in previous years, the supervisory and control systems the Court examined are only partially effective in ensuring the legality and regularity of payments when EU expenditure is incurred.

### **The error rate**

Based on testing of samples of transactions, the Court's estimate for the most likely error rate for expensed payments underlying the EU accounts is 4.8 %. The Court is 95% confident that the rate of error in payments lies between 3% and 6%.

Those errors are not confined to any specific area of the budget. All policy groups covering operational expenditure are materially affected by error. Administrative expenditure is the only area where no material level of error was found.

The Commission's own reports confirm this overall picture. The Commission acknowledges that errors occur across the budget and that the overall level is likely to be material. 14 directors-general of the Commission make reservations in their annual activity reports in respect of the legality and regularity of expenditure and the synthesis report puts the amounts at risk of error at between 1.9% and 2.6% of total payments – a figure the Commission itself recognises as likely to be an underestimate.

As can be seen from Chapter 1, the Court's overall estimate of the most likely error rate has increased from 3.9% in 2011 to 4.8% in 2012.

The Court's estimates of the most likely error rates for agriculture, regional policy, rural development and employment and social affairs all show increases compared to 2011.

Rural development remains the most error-prone spending area with an estimated error rate of 7.9%, followed by regional policy with an error rate of 6.8%.

There are also increases in the error rate estimated for policy groups *research and other internal policies* and *external relations, aid and enlargement*.

### **Two methodological improvements**

In these latter cases, part of the increase can be attributed to two methodological improvements the Court has introduced for the 2012 audit.

The Court's samples of transactions in these areas no longer include advance payments made during the year. In other words, they comprise interim payments, final payments and advances that were cleared during the year.

This change is in line with the principles of accrual accounting, thus providing – the Court believes – a better picture of the underlying reality of EU financial management.

The second methodological improvement relates to the treatment of serious failures to apply procurement rules. From 2012 EU institutions and bodies are treated in the same way as Member States authorities and other international organisations.

These changes improve comparability between different policy groups and they will improve comparability over time. Together they add 0.3 percentage points to the Court's overall estimate of the most likely error rate in 2012 compared to 2011.

### **Where and how errors occur**

The Court's 2012 annual report includes many illustrative examples of the errors found and considerable analysis. Together, they provide some insight on where and how errors occur and why they matter. To give a few examples of the analysis provided:

- First, over two thirds of the estimated error rate pertains to the ineligibility of claims for payment and serious failures to respect procurement rules.
- Second, the highest contribution to the error rate comes from the areas where most money is spent, namely regional policy, agriculture, rural development and employment and social affairs.
- Third, The Court's testing of transactions shows that the proportion of transactions affected by error is high in these policy groups, ranging from 35% up to 63%.
- Fourth, the Court's transaction testing shows that over half of the errors the Court found under shared management could have been corrected by national authorities before submitting claims for reimbursement to the Commission.

But the Court's findings do not suggest that errors are confined to specific Member States. In fact, the Court's assessments of supervisory and control systems it examined showed there to be weaknesses at a wide range of national and regional authorities.

Nor are errors confined to expenditure which is jointly managed by Member States. The Court calculates that the estimated rate of error on shared management expenditure was 5.3% compared to 4.3% on all other forms of operational expenditure.

The errors that the Court finds matter because they represent cases where EU funds were not used in accordance with the relevant legislation and thus not in accordance with the wishes of Parliament and the Council, as legislator and budget authority.

They also matter because errors represent money that should not have been paid out. It is sometimes possible to get that money back. This brings me to the issue of financial corrections and recoveries.

### **The impact of financial corrections and recoveries**

The Court devotes a number of paragraphs in the 2012 annual report to this topic. It is a complex subject which the Court and the Commission approach from differing but complementary perspectives.

The Commission seeks to protect the budget from the effects of irregularity; the Court is obliged to report on whether transactions are legal and regular.

In the 2012 annual report, the Court explores the effect of financial corrections and recoveries on Member States, on beneficiaries and on the statement of assurance.

The impact of financial corrections depends on the regulations applicable. For agriculture most financial corrections do not lead the Member States concerned to recover payments from beneficiaries, while for cohesion most corrections are flat rate corrections which do not lead to detailed correction at project level.

So, in effect, most financial corrections fall on national taxpayers.

The Court emphasises this point because the annual report is also addressed to national parliaments and national authorities.

In seeking to improve EU financial management, we cannot afford to ignore the mounting pressure on public finances at EU and national level.

### **Increasing pressure on the EU budget for payments**

The Court highlights the signs of the growing pressure on the EU budget for payments in the 2012 annual report.

As you know, in 2012, the Commission was already finding it difficult to meet all requests for payment.

The pressure on payments was also reflected in the increase in the amount of outstanding commitments. By the end of 2012, they represented more than two years of total EU budgeted payments.

The Commission will also need to fund payments to meet liabilities in the Union's balance sheet. At the 2012 financial year end, the outstanding commitments and liabilities needing to be funded together amounted to around 313 billion euro.

In the Court's opinion, the Commission should plan for its future cash-flow requirements by preparing and publishing a long-range cash-flow forecast.

It is not always the actors who are to blame for the quality of the performance, sometimes the problem lies with the script they are given.

### **Focusing on performance in the new financial framework period**

Current legal frameworks for spending do not do enough to encourage better spending.

The new financial framework period provides a chance to change that. The Court agrees with the Commission that there is a need to create a performance culture.

That will mean addressing the weaknesses the Court finds in the current performance management and reporting system, for example:

- spending programmes do not consistently use SMART objectives and suitable indicators;
- performance data are not good enough; and
- projects financed by EU spending are too often not sustainable.

The Union needs to address these issues if the next generation of spending programmes are to deliver – and be seen to deliver - added value to Europe and its citizens.

The Court recommends a focus on performance in the coming programming period. This requires laying down clear objectives, relevant indicators, and expected results.

EU institutions will need to work together to improve EU performance and accountability in the coming years.

The Court and its annual reports have – and will continue to have - an important contribution to make to the success of that collective endeavour. We look forward to playing our part alongside this parliament and the other EU institutions.

# MONSIEUR HENRI GRETHEN, MEMBRE DE LA COUR, PRÉSENTE LE RAPPORT ANNUEL DE LA COUR DES COMPTES EUROPÉENNE RELATIF À L'EXÉCUTION DU BUDGET DE L'UE POUR L'EXERCICE 2012, à Luxembourg, le 5 novembre 2013

By Rosmarie Carotti



De gauche à droite: M. Marc Hostert, Chef de cabinet, M. Henry Grethen, Membre de la CdCE, M. Marc Gengler, Président de la Cour des comptes luxembourgeoise



M. Marco Stevenazzi, Secrétaire général et agent de liaison de la Cour des comptes luxembourgeoise

En même temps que le Président de la Cour présentait au Parlement européen à Bruxelles le rapport annuel 2012 de la Cour des comptes européenne, le Membre luxembourgeois de la Cour, Monsieur Henri Grethen, en résumait à Luxembourg les principaux messages aux membres du collège de la Cour des comptes luxembourgeoise et à la presse. La Cour des comptes luxembourgeoise était représentée notamment par Monsieur Marc Gengler, Président, et Monsieur Marco Stevenazzi, Secrétaire général et agent de liaison. Assistait à la réunion aussi le Membre hongrois de la Cour des comptes européenne, Monsieur Szabolcs Fazakas.

Puisque nous venons de publier dans la présente édition du Journal le discours du Président Caldeira avec les principales données qui ressortent du rapport, notre attention sera centrée sur les commentaires de Monsieur Grethen en tant que Membre luxembourgeois.

Depuis octobre 2013 Monsieur Grethen est Doyen de la Chambre II de la Cour (Politiques structurelles, transports et énergie). En tant que Membre-rapporteur, il a été responsable pendant les dernières années pour un certain nombre de rapports et en charge du chapitre 5 «Politique régionale, énergie et transports» du rapport annuel de la Cour.

## Les principaux messages du rapport annuel

Après une introduction sur le rôle de la Cour des comptes qui aide le Parlement européen et le Conseil dans la procédure de décharge, Monsieur Grethen résume les principaux messages du rapport annuel. Les paiements affectés par un niveau significatif d'erreur sont passés d'un taux d'erreur le plus probable de 3,9% en 2011 à 4,8% en 2012 pour l'ensemble du budget de l'UE.

Selon les estimations de la Cour obtenues grâce aux tests réalisés sur des échantillons d'opérations, le taux d'erreur affectant les paiements se situe entre 3,6% et 6%. Mais erreur ne veut pas dire fraude, seulement que des règles n'ont pas été respectées.

Le taux d'erreur le plus élevé est en matière de marchés publics où en gestion partagée, où la plupart des erreurs sont commises par les autorités nationales qui auraient pu en détecter à peu près deux tiers.

Monsieur Grethen critique notamment l'accumulation d'engagements inutilisés équivalant à deux ans et trois mois (217 milliards d'euros fin 2012), qui entraîne une pression sur le budget pour les crédits de paiement et souligne que déjà cette année la Commission est dans une situation où elle n'est pas en mesure d'honorer un certain nombre d'engagements.

Pour ce qui est d'obtenir des résultats avec le budget de l'UE, la Commission n'est pas en mesure de fournir des éléments probants suffisants, pertinents et fiables sur ce que les politiques de l'UE ont réalisé.

Dans un grand nombre de domaines du budget de l'UE, le cadre législatif est complexe et la performance n'est pas suffisamment prise en considération. Les propositions pour la période de programmation 2014 – 2020 restent encore principalement axées sur les dépenses et centrées sur la conformité aux règles plutôt que sur la performance.

En ce qui concerne les recettes du budget de l'UE, la Cour a vérifié les calculs qui sont à la base du revenu national brut et publiera d'ailleurs sous peu un rapport spécial sur ce sujet.

Monsieur Grethen ajoute que pour le Luxembourg, la contribution est calculée sur la base du revenu national brut, parce que si elle était calculée sur le produit intérieur brut, la contribution luxembourgeoise serait de 40% supérieur à ce qu'elle est actuellement.

Dans le cadre des aides directes aux agriculteurs, la seule politique qui actuellement est entièrement communautaire, le taux d'erreur le plus probable est de 3,8% et les opérations affectées par des erreurs se situent à 41%. L'erreur la plus fréquente est la sur-déclaration de la surface, mais Monsieur Grethen précise que souvent il ne s'agit pas de fraude mais d'erreur ou omission. Aussi, les règles de conditionnalité, qui disent quelles règles l'agriculteur doit respecter pour bénéficier d'une subvention, sont complexes.

Des manquements graves aux règles applicables en matière de passation de marchés publics ont été détectés. À titre d'exemple, un appel national a souvent été lancé alors qu'il aurait fallu lancer un appel européen, mais il y a aussi d'autres cas où la Cour est de l'avis qu'il y a derrière l'erreur une intention manifeste. Une pratique, par exemple, consiste à séparer les marchés de façon à ce qu'un appel à candidature européen ne soit pas nécessaire. Mais il n'y a pas un pays en particulier que l'on puisse montrer du doigt.

La Cour d'ailleurs n'est pas en mesure de faire des statistiques par pays mais Monsieur Grethen souligne que, dans l'ensemble, les systèmes ont suffisamment bien fonctionné au Luxembourg. D'une façon générale, on devra toutefois se poser à l'avenir la question, si continuer avec le système actuel d'échantillonnage ou si procéder à des contrôles périodiques.

En ce qui concerne la coopération avec l'organisme anti-fraude OLAF, la Cour a signalé huit cas dans la dernière année. Ces signalisations sont en même temps communiquées aux autorités nationales.

### **Vers un deuxième mandat**

Pour terminer, Monsieur Grethen revient sur ce que le Cabinet luxembourgeois a réalisé dans les dernières années. Son mandat a débuté le 1<sup>er</sup> janvier 2008 pour se terminer le 31 décembre 2013 mais le gouvernement luxembourgeois sortant a proposé Monsieur Grethen pour un deuxième mandat. L'audition au Parlement européen se tiendra le 7 novembre 2013. Même si l'avis du Parlement européen n'est que consultatif, Monsieur Grethen souligne d'ores et déjà que si le Parlement ne donnait pas un avis favorable à sa candidature, il se désisterait d'un deuxième mandat car il est intimement convaincu que sans la confiance du Parlement européen, qui représente le citoyen européen, un mandat de Membre de la Cour des comptes ne peut pas être exercé correctement. Les Membres de la Cour des comptes luxembourgeoise sont d'ailleurs nommés par le Parlement et le budget de la Cour des comptes luxembourgeoise fait partie du budget national mais dépend du Parlement. Dans une société anonyme, les auditeurs sont nommés par l'Assemblée générale ; au niveau européen le Traité veut que les Membres de la Cour des comptes soient nommés par le Conseil sur avis du Parlement européen.



Mr Hans Gustav Wessberg,  
ECA Member

## Briefing sessions

Subsequent to the publication of the 2012 Annual Report Mr Wessberg held the following briefing sessions to key Swedish stakeholders:

- 6 November 2013 to the EU Affairs Committee and the Finance Committee of the Swedish Parliament;
- 7 November 2013 to representatives from the Finance Ministry, the Swedish National Financial Management Authority (ESV), the Swedish Economic Crime Authority at the Finance Ministry;
- 8 November 2013 to the Swedish National Audit Office.

Mr Wessberg also presented the Annual Report at the Centre for Business and Policy Studies (SNS):

- 11 November at the SNS office in Stockholm;
- 13 November at the SNS office in Brussels.

In addition, Mr Wessberg will present the Annual Report to the director-general of ESV on 26 November.

In December, he will also give a presentation to the Prime Minister's office.

## Questions from the audiences

During the presentations which have already taken place, a common concern raised was the issue of an increasing estimated error rate, 2012 being the third year running which saw an increase. Not surprisingly, many of the questions from the audiences came to focus on the possible reasons for this and what should be done to reverse the trend.

On the development of the Court's audit sampling approach, Mr Wessberg explained the impact of excluding pre-financing. He made it clear that, while the impact was notable in the areas of external actions and research and other internal policies, the overall contribution to the estimated error rate was marginal. He also explained the conceptual difference between the Commission's financial corrections and the Court's error rate, and that the former does not cancel out the Court's estimated error.

The Swedish audiences were, of course, eager to know about any specific observations or examples relating to Sweden. However, the fact is that Sweden is only sparsely mentioned in this year's Annual Report. Indeed, only the chapter concerning rural development spending includes observations of substance. On this point, Mr Wessberg nevertheless clarified that this is not to be interpreted as EU spending in Sweden is error free. Indeed, he mentioned that eligibility errors related to EU spending programmes are reported in both the national declaration and in the audits of EU programmes carried out by ESV. Moreover, the nature of findings coincide with those found by the Court in other Member States.

In his concluding remarks, Mr Wessberg repeated the need for further simplification of EU rules and that Member States must ensure that existing national supervisory and control systems are applied more effectively under shared management.

# PRESS CONFERENCE GIVEN BY DR HARALD WÖGERBAUER AT THE EUROPAHAUS IN VIENNA on 6 November 2013

By Dr Harald Wögerbauer, Member of the ECA

## Annual Report 2012



Dr Harald Wögerbauer,  
Member of the ECA

After the presentation of the development of error rates in recent years, and developments in specific policy areas in 2012, a discussion arose between the speakers, the Commission's representative, journalists, and a Member of the European Parliament about the press statements released by the European Court of Auditors and the Commission. The headline of the European Court of Auditors' press release had stated that the Court had signed off the EU's accounts for 2012. The Commission had picked up on this statement and claimed that this meant that it had consistently received a clean bill of health from the European Court of Auditors every year since 2007.

Dr Wögerbauer pointed out that the ECA's press release had only stated that the accounts had been deemed reliable. Since the error rate was greater than 2 %, the 2012 DAS was negative, as it had been in all previous years. In addition to this, the statement in the headline of the Commission's press release to the effect that the management of the EU budget was improving was not accurate: in the last three years, the error rate had increased (by 12 % in 2010, by 5 % in 2011, and by 23 % in 2012). Dr Wögerbauer noted positively that the financial corrections which would be applied by the Commission for 2012 amounted to €3.7 billion.

With regard to Austria, the issue of the Alpine pastures was discussed once again. Area data submitted about agricultural land in previous years had been incorrect, and overpayments were now being reclaimed. Dr Wögerbauer stated that financial corrections would be applied to Austria at a rate of only 0.1 %.

Many people attended the press conference, which was featured in several press articles. A report was also included in the 1.00 p.m television news (Zeit im Bild) – the report, which included an interview and lasted around two minutes, was the first item of news shown on the programme. It was repeated directly after the main news story on the 7.30 p.m. prime time news broadcast (Zeit im Bild).

Interview with **Mr Ioannis SARMAS**, the Greek judge whose mandate as a Member of the Court of Auditors expires on 31 December 2013. Mr Sarmas will take up the post of Vice-President of the Court of Audit in Greece.

By **Rosmarie Carotti**



Mr Ioannis SARMAS, Member of the ECA

**R. C.: Mr Sarmas, now that the time has come to look back, what can you claim to have done for your country, Greece?**

**Mr Ioannis Sarmas:** Right from my first hearing before the European Parliament's Committee on Budgetary Control, I have stated that I am not representing Greece in the European Court of Auditors and therefore I am not the agent of Greece at the ECA.

Nevertheless, I have tried to acquire sufficient experience and know-how of the methodology of the European Court of Auditors to transfer back to Greece now that I will be continuing my career as Vice-President of the Hellenic Court of Audit.

Meanwhile, I have written a number of articles and a book in Greek on audit methodology. On several occasions I have also presented the ECA annual report to the Hellenic Court of Audit.

**R. C.: The methodology of the European Court of Auditors is constantly evolving. What part have you played in this?**

**Mr Ioannis Sarmas:** Firstly, the ECA is a collegiate body and no one has the right to claim a role to the development of the Court's methodology.

For the first few years of my mandate I worked as the Member responsible for the agencies. We did not have sufficient human resources to carry out classical performance audits, so we had to find a new economical method to audit performance.

The method we applied involved not evaluating ourselves the agencies' sound management, but asking them to demonstrate to us that their management was indeed sound.

**R. C.: Did other parts of our institution also follow this approach?**

**Mr Ioannis Sarmas:** Later, in my role as Member of the CEAD Chamber, I was tasked with presenting to the Court what was then chapter 8 and is now chapter 10 which focusses on performance issues.

The annual report has been fully absorbed by DAS, the statement of assurance. Thus it was simply a report on the reliability of the EU accounts and the legality and regularity of the underlying transactions. There was nothing on performance. The Court had then decided to introduce a chapter on sound financial management. We named this chapter "getting results". In fact we used the same methodology applied to the agencies. Mainly we ask the Commission to demonstrate to us the results it has obtained through its management.

**R. C.: Would this approach, which could be used by the European institutions and bodies as well, also work for a national auditee?**

**Mr Ioannis Sarmas:** From the moment when the national authorities start to manage EU funds, they are subject to rules which govern the management of EU expenditure.

**R. C.: Is this the response that the man or woman in the street wants to hear? What about anti-corruption measures?**

**Mr Ioannis Sarmas:** The Court distinguishes between five different audit categories. The first is the auditing of accounts, the traditional audit. Then, there is the audit on legality and regularity. The DAS is identified with this audit. The third category is what we call performance audit. The fourth audit category is computer audit. The final audit category is the audit which consists of assessing systems to prevent fraud and corruption.

**R. C.: How might the Court's mandate be broadened in terms of fraud prevention?**

**Mr Ioannis Sarmas:** The auditor's role is definitely not to detect fraud and instances of corruption. This is OLAF's role. However, our audit could be extended in order to assess fraud prevention systems. For the time being, we limit ourselves in auditing whether the systems are capable of producing acts in conformity with the applicable legal provisions. We do not assess the capability of these systems when it comes to preventing acts of fraud.

In order to broaden the ECA's role in terms of fraud prevention, inspiration can always be drawn from an American institution. I am among those who think that the Governmental Accountability Office (GAO) should be a model for Europe's audit institutions.

In the United States, GAO produces a "high-risk areas" document, which identifies four major risks, and it makes periodic attempts on a rotational basis to submit for evaluation the systems which administer the public funds. Instances of fraud and corruption are among these four major risks.

Of course one should bear in mind that the nature of the relationship changes if the auditee starts to regard the auditor as an investigator who might instigate criminal proceedings against him. We treat our auditees with a degree of professional scepticism, but this should not be converted into suspicion.

**R. C.: In actual fact, we do not even have the possibility of imposing sanctions. How have you experienced this restriction as a magistrate of the Greek Court of Audit?**

**Mr Ioannis Sarmas:** I felt very much at ease with the reports produced by the European Court of Auditors, which are not binding. They create neither rights nor obligations and their legal force is purely informative. But this is enough for us at the European level, because the reports have a very wide audience.

I think that the ECA's annual report with the DAS has been the driving force behind financial reforms for fifteen years. And, as far as the major reforms of expenditure policy are concerned, i.e. the Structural Funds, the Common Agricultural Policy, if you examine the reforms which the Commission has ushered in and compare these with the related ECA special reports over the same period, you will notice that many reforms were inspired by the recommendations and conclusions in ECA reports.

**R. C.: Where do you see the risks for our Court in the years ahead?**

**Mr Ioannis Sarmas:** I will surprise you, but I think that the Court of Auditors should not over-emphasise on its role as EU external auditor. External auditors do not only exist in the public sector. Private companies are also external auditors. We need a distinctive feature to fully separate us, as a public institution, from private undertakings.

The ECA has tended, for a few years, under the guidance of President Caldeira, to develop its role for what is termed as accountability office. Indeed, I think we should be identified as the public accountability institution. It is not by chance that the US sister institution does not call itself an audit institution, but the "Governmental Accountability Office".

This will make us extend our audit to cover not only the spending power of the Commission but also its regulating power, the power called in the United States as the 'police power' (the capacity to regulate behaviour and enforce rules).

Let me give you an example: in 2011, we issued the Special Report "Do the Commission's procedures ensure effective management of State aid control?". This was not an audit of public expenditure, but on management of the 'police power' of the Commission.

The current challenge for the ECA is being able to widen the audit in such cases. Recently, with the 6 Pack, the 2 Pack etc., the Commission has been provided with a raft of new powers. However, these are not expenditure powers, but monitoring powers in respect of the Member States.

The Court of Auditors at present is contemplating how it can audit this new area of powers. I think that the ECA's role is, firstly, to develop new methods, always with the idea that it is not merely an external auditor, but also the institution which asks administrators to be accountable on how they exercise their administrative power.

### **R. C.: Would this not entail a change to the Treaties?**

**Mr Ioannis Sarmas:** No. The way for us to understand and justify this extension is to say that the Commission's services tasked with enforcing the rules are funded by the budget. We are still auditing expenditure, but "functional" expenditure, not "operational" expenditure.

### **R. C.: Do you have any other suggestions for the work of our Court?**

**Mr Ioannis Sarmas:** Observing that there is a problem with a transaction is not enough, we also need to look at the causes behind it which produce the irregularity and poor performance. We need analysts for this. The European Parliament and public opinion expect us to indicate the causes. The ECA has already identified as a cause of errors the complexity of contract legislation and recommended the simplification of the applicable provisions.

### **R. C.: With regard to the financial crisis, what possible contribution can the Court of Auditors make?**

**Mr Ioannis Sarmas:** The Member States which decided to introduce the euro knew that it alone was not enough. Thus, they adopted the stability pact: a system of rules guaranteeing that the Member States should not behave in a way to endanger the euro.

The Commission's role was to ensure the correct enforcement of the stability pact. However, either the pact itself had failed to provide the Commission with the necessary means, or the Commission failed to exercise its powers correctly. In any case though, we would have avoided the crisis of 2009-2010 if the initial stability pact had been correctly enforced or fit for purpose.

The ECA is empowered to audit the Commission. ECA's powers should be widened in the knowledge that we do not simply audit the "spending power" of the Commission, but also its "police power", i.e. the power to enforce the rules, the power of regulating behaviour. And the new stability pact provides such power to the Commission.

### **R. C.: Mr Sarmas, thank you for talking to the Journal.**

**Mr Ioannis Sarmas:** Permit me to end by thanking all my colleagues and collaborators for their invaluable help over so many years.

## TOWARDS BETTER AUDITING OF HUMANITARIAN AID

By Torielle Perreur-Lloyd and Gaston Moonen, secretariat of the INTOSAI Working Group AADA



Part 1 of questions to **Mr Gijs DE VRIES**, Member of the ECA, who chaired the INTOSAI Working Group on Accountability for and the Audit of Disaster-related Aid (WG AADA) (Part 2 will be published in the January Edition of the Journal)

Mr Gijs de Vries, Member of the ECA

### **Q.: Why is disaster-related aid something we should pay attention to?**

**Gijs de Vries:** Disasters are becoming more frequent and because of population growth and associated changes in demographics, their impact is growing. Between 1992 and 2011, disasters killed 1.3 million people, affected 4.4 billion and resulted in economic losses of USD 2 trillion. The total humanitarian response in 2012 was USD 17.9 billion, of which governments contributed USD 12.9 billion. Auditors are called upon to give assurance to taxpayers and victims alike that disaster-related aid is reaching the intended recipients and having the required impact.

### **Q.: Where does INTOSAI stand on auditing disaster-related aid?**

**Gijs de Vries:** At the end of October 2013, at its 21<sup>st</sup> triennial Congress in Beijing, INTOSAI approved five ISSAIs in a new 5500 series on auditing disaster-related aid and INTOSAI GOV 9250 on the Integrated Financial Accountability Framework (the IFAF).

### **Q.: How did INTOSAI get involved in this?**

**Gijs de Vries:** On 26 December 2004 a massive tsunami hit 14 countries in South East Asia, killing 230,000 people and causing huge human and economic damage. This was one of the deadliest natural disasters in recorded history and prompted a worldwide response with more than USD14 billion donated in humanitarian aid. The aid flowed in quickly from a vast number of donors to many different recipients. As we have again observed following tropical storm Haiyan which hit the Philippines in November, the impact of major disasters is often exacerbated because of inadequate preparation for disasters and lack of coordination of the relief effort. This was the case on a huge scale following the South-East Asia tsunami.

In 2005, INTOSAI put together a Task Force of SAIs to see what public sector external auditors could do to give assurance on the accountability of the aid related to the tsunami disaster. The Task Force could not trace aid flows from donors to recipients and found that the same aid payments were often reflected differently in the financial reports of recipient entities. It also found a lack of coherence between SAIs auditing disaster-related in recipient countries and in donor countries.

In 2007, INTOSAI created the Working Group on Accountability for and the Audit of Disaster-related Aid (WGAADA) to produce guidance and good practice for SAIs auditing disaster-related aid and to find a solution to the inadequacy of transparency and accountability arrangements.

### **Q.: How did ECA become involved?**

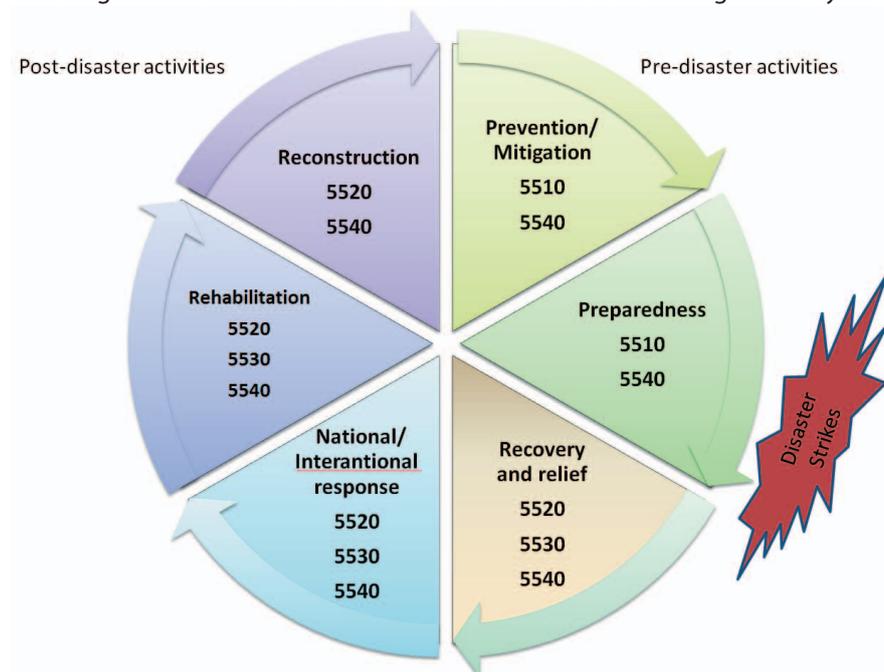
**Gijs de Vries:** The European Court of Auditors was invited to chair WGAADA. From 2008-2010, Maarten Engwirda, who was then Member of the Court, chaired the Working Group, and since 2011, I have been its chairman. Chamber III provided the secretariat of the Working Group for the whole of this period. Torielle Perreur-Lloyd, the ECA project manager of the Working Group, and Gaston Moonen, my head of cabinet, have done the bulk of this work over the past three years.

WGAADA established a work programme of tasks to meet the mandate set by INTOSAI and divided these tasks up amongst its 23 members<sup>1</sup>. ECA was active in researching and preparing the ISSAIs and in the conception and testing of the IFAF. ECA also played a strong coordinating role, taking on the bulk of the drafting and editing of the ISSAIs and the INTOSAI GOV. Once finalised, ECA translated the six pieces of guidance into French, German and Spanish.

**Q.: How do the five ISSAIs in the new 5500 series fit together?**

**Gijs de Vries:** The ISSAIs cover auditing the different phases of the disaster management cycle. ISSAI 5500 is an introductory ISSAI. ISSAIs 5510 and 5520 cover the audit of pre- disaster and post-disaster activities respectively, ISSAI 5530 tackles the issue of fraud and corruption and ISSAI 5540 addresses the use of Geospatial Information Systems in auditing disaster-related aid.

The diagram shows how the ISSAIs fit into the Disaster Management Cycle.



**Q.: Are SAIs obliged to comply with these ISSAIs?**

**Gijs de Vries:** As is the case for other INTOSAI auditing standards, the 5500 series of ISSAIs is not mandatory. The ISSAIs build upon INTOSAI's Fundamental Auditing Principles and standards promulgated by other standard setting organisations with which INTOSAI has a cooperation agreement, such as the International Federation of Accountants. Depending on the legal and regulatory framework and the mandate of the SAI, the ISSAIs on disaster-related aid can be used for audits at all levels of government. Auditors of private entities such as NGOs receiving and managing public funds may also find the 5500 series of ISSAIs relevant to their work.

These ISSAIs on auditing disaster-related aid reflect current good practice. They make reference to the guidance on general audit methodology and procedures in the third and fourth level ISSAIs, especially those on financial audit, performance audit and compliance audit. They also include examples and propose practical solutions for auditing disaster-related aid.

**Q.: What is Disaster Risk Reduction and how can auditors use ISSAI 5510?**

**Gijs de Vries:** "Disaster Risk Reduction" is about reducing disaster risks by analysing the causes of disasters, reducing exposure to risks identified, devising measures which prevent disaster striking or mitigate their impact

<sup>1</sup> In 2013, the following SAIs were members: Austria, Chile, China, the European Court of Auditors, France, Georgia, India, Indonesia, Jamaica, Japan, Kenya, Korea (Republic of), the Netherlands, Norway, Pakistan, Peru, the Philippines, Romania, Russian Federation, Sri Lanka, Turkey, the Ukraine and the United States of America.

if they do happen, preparing people and property for potential disaster and giving people adequate warning when disaster is on its way.

ISSAI 5510 gives advice to auditors to help improve preparedness and reduce the overall cost of disasters through their audits. It provides examples of good practice taken from a parallel audit of disaster risk reduction carried out by 10 SAIs as well as from other SAIs consulted and it includes an example of an audit programme for auditing disaster risk reduction.

Auditors can, for example, compare the cost of paying for disasters after the event to savings which could have been made if appropriate disaster risk reduction measures were in place. The United Nations Development Programme has said “Every dollar spent on preparing for disasters saves around seven dollars in economic losses”. Auditors can ask whether enough of humanitarian aid is spend on disaster risk reduction. A 2012 study by the OECD and Islamic Relief showed that in 2010 disaster risk reduction accounted for only 4.2% of humanitarian aid. To give another example, auditors can assess the effectiveness of institutions set up to prepare for potential disaster: In a widely publicised performance audit report published in May 2013, the Comptroller and Auditor General of India concluded: “Despite considerable progress in setting up institutions and creating funding arrangements, there are critical gaps in the preparedness level for various disasters.”

The Court has not yet audited disaster risk reduction, but the issue is closely related to that of climate change and environmental protection. The Special Report on Climate Finance to developing countries, currently in its final stages of adoption is a good example of auditing climate risk mitigation and adaptation.

**Q.: Why is disaster-related aid different from other development aid or humanitarian aid and what does ISSAI 5520 tell us about auditing it?**

**Gijs de Vries:** Disaster-related is humanitarian aid as well as aid made available in disaster situations which may be, for example, to protect wildlife after forest fires, which is obviously disaster-related but not humanitarian. The objectives of humanitarian aid are to save lives, alleviate suffering and maintain human dignity during and in the aftermath of man-made crises and natural disasters, as well as to prevent and strengthen preparedness for the occurrence of such situations. Humanitarian aid is not the same as development aid, which focuses on removing the root causes of poverty and vulnerability.

ISSAI 5520 explores the challenges faced by auditors of disaster-related aid. In a disaster situation, individuals, communities, governments and international agencies act very quickly. Assistance and aid flow toward the affected area. The emphasis is on saving lives, alleviating poverty and hardship and maintaining human dignity. Throughout the emergency response, relief, rehabilitation and reconstruction activities of the post-disaster phase, order has to be maintained and normality has to be regained. SAIs have a vital contribution to make in keeping governments and others managing disaster-related aid accountable to parliaments and citizens for the use of resources. The issue of accountability is fundamental to the legitimacy of the state and the continued operation of the political system.

The ISSAI outlines the approaches to auditing disaster-related aid provides guidance to auditors of expenditure on relief, recovery, rehabilitation and reconstruction expenditure. It includes examples of good practice and demonstrates that SAIs can learn from each other by sharing experiences.

When auditing post-disaster aid, auditors can, for example, examine whether post disaster relief and rehabilitation aid arrived quickly enough. The Court carried out an audit of Hurricane Mitch in Central America and found that the European Union’s rehabilitation aid had been useful but too slow. We can, of course, check the legality and regularity of post-disaster expenditure. When auditing relief aid following the 2004 tsunami, the Auditor General of Sri Lanka found waste and corruption. We can also audit the effectiveness of post-disaster aid: for example, the French Court of Auditors found that disaster aid after the 2010 floods was not spent effectively. And the Court found in its audit following the earthquake in the Italian Abruzzi region in 2009 that emergency preparedness measures needed updating and improvement to adequately address the design and implementation of emergency projects.

**Q.: ISSAI 5530 is about fraud and corruption. Why is it important and how does this guidance fit in with the Court's approach in this area?**

**Gijs de Vries:** The fight against corruption is one of INTOSAI's five strategic priorities in the 2011-2016 strategic plan. The risk of fraud and corruption is high across all areas of disaster aid, but especially so in the emergency phase immediately following the disaster. This can be explained by the large interjection of resources, scale-up of activities and need to deliver aid rapidly during the emergency phase which puts pressure on weak or damaged institutions and on human resources. Disasters emphasise and accentuate pre-existing weaknesses within countries, such as inadequate internal control systems, weak or vulnerable political and legal systems or great humanitarian inequality. Furthermore, there may already be endemic corruption and fraudulent and corrupt activities may be seen as "normal business practices" within the disaster-affected country.

ISSAI 5530 includes lists of 'red flag' indicators of fraud and corruption and examples of fraud and corruption. It provides guidance to auditors on how to can adapt their audit procedures to take account of the risk of fraud and corruption. It proposes, for example, that auditors can adopt a risk based audit approach, including taking account of whistle-blowing: such as with the US's "FraudNet", Norway's "Tip-Channel" and the UK's "Whistleblowers' Hotline".

ISSAI 5530 urges auditors to draw up a list of red flag indicators appropriate to disaster-related aid expenditure, for example, absence of physical inspections, staff not taking leave due over a long period of time, checks on payments made but anomalies not followed up. The guidance also emphasises that SAIs should ensure that procedures for reporting and follow-up are adequate.

ECA has paid close attention to the issue of adapting audit procedures to ensure adequate attention is paid by auditors to the risk of fraud and corruption. This experience is reflected in ISSAI 5530.

**Q.: What are Geospatial Information Systems and is this fifth ISSAI relevant to ECA?**

**Gijs de Vries:** Geospatial information is computerised data about a specific location. Geospatial information about a village in Luxembourg could include its name, the number of people living there, the presence of an industrial area, the characteristics of the surrounding area (soil type, gradient, use to which land is put), etc. Geospatial Information systems are used by disaster managers to help prepare for and mitigate the effects of potential disasters. This data can also be used to locate victims during emergency recovery and relief operations, as well as during reconstruction.

ISSAI 5540 shows how, auditors of disaster-related aid can check the use of GIS by disaster managers or use it themselves to audit disaster-related aid. For example, we can look at whether GIS is used by disaster managers and if so, whether the GIS selected are appropriate and employed effectively.

The guidance explains how auditors can examine whether we can use the GIS tools of managers to conduct our audit. For example, we can use GIS to check compliance by auditees with rules. The SAIs of the Netherlands and Indonesia used GIS to check whether authorities rebuilding after the 2004 tsunami respected the restrictions placed on them by the government.

GIS can also be used by auditors in areas other than disaster-related aid. For example, it is also used by auditors in Chamber I when auditing agricultural measures or environmental consequences of big infrastructural projects.

**Q.: You describe how GIS has been tried out by auditors and used in practice. How about the other ISSAIs?**

**Gijs de Vries:** The SAIs of Turkey and Indonesia, which took the lead on ISSAIs 5510 and 5520, carried out surveys of SAIs and conducted coordinated audits with other SAIs to test and enrich the guidance. The results of the consultations, surveys and parallel audits can be consulted on the website of the Knowledge Sharing Committee.

<sup>2</sup> [http://intosaiksc.org/default\\_a.php?syn=2&e=0](http://intosaiksc.org/default_a.php?syn=2&e=0)

**Q.: What is happening with the ISSAIs now that they have been adopted? Will the ISSAIs be used?**

**Gijs de Vries:** Whilst working on the ISSAIs we consulted organisations ranging from UN organisations, the Organisation for Economic Cooperation and Development, the European Commission, governments, NGOs concerned with humanitarian aid and transparency and other stakeholders as well as other SAIs. There was a two-way flow of information: we received information which helped us to reinforce the guidance and we were able to promote the use of our guidance and to raise awareness of other organisations about INTOSAI and the Working Group.

Earlier this year, I presented the new series of ISSAIs to the heads of African SAIs at the AFROSAI-E Governing Board meeting. I represented INTOSAI and explained the role of SAIs in getting governments to adequately prepare for disaster (ISSAI 5510) in the Global Forum on Disaster Risk Reduction, organised by the United Nations to prepare for the second Hyogo Framework for Action. In the context of ISSAI 5530, I participated in the International Forum on the United Nations Convention against Corruption in Santiago de Chile in 2011 and the International Anti-Corruption Conference in Brasilia in 2012. When we went to INCOSAI we spoke with other SAIs and INTOSAI working groups and committees such as the INTOSAI Development Initiative (IDI), the Capacity Building Committee, regional groups, the Working Group on Environmental Audit (WGEA), etc. We urged them to use the ISSAIs for their audits and for capacity building and training purposes.

Regional Committees have been invited to make proposals to IDI for training using the 5500 series of ISSAIs on disaster-related aid in the coming months. The WGEA is managing a database of disaster-related aid audits which is available to all SAIs on their website. ASOSAI has already organised a seminar on auditing disaster-related aid, at which we are represented. EUROSAI's Task Force on the Audit of Funds Allocated to Disasters and Catastrophes was also represented on WGAADA.

**Q.: How have the ISSAIs been received by INTOSAI and stakeholders in humanitarian aid?**

**Gijs de Vries:** As part of the procedure of creating an ISSAI, drafts are exposed to international review and comment for three months by publishing them on the INTOSAI Professional Standards Committee website. During this exposure draft period, we received many comments from SAIs and international organisations. A few examples:

*Valerie Amos, Under-Secretary-General for United Nations Humanitarian Relief and Emergency Relief said that in her view they were: "extremely thorough, and will be of great use to supreme audit institutions once they are formally approved."*

*Brian Atwood, chair of the OECD Development Assistance Committee said they provided: "clarity on the auditors' responsibility to highlight gaps in government disaster policy and action, and this is particularly welcome. Improving government performance in this area could be instrumental in saving lives and reducing economic losses from disaster."*

*The Humanitarian Accountability Partnership said the guidelines would: "help to promote more effective, accountable and transparent aid delivery to affected communities."*

SAIs are well-placed to promote good governance in the administration of humanitarian aid. The challenge before us is to help governments and their partners maximise the impact of aid – its economy, efficiency, and effectiveness – while minimising the risks of fraud and corruption, to the benefit of the victims of humanitarian disasters. This goes beyond being a professional challenge; it is above all a moral obligation.

The 5500 series of ISSAIs can be downloaded here:  
<http://www.issai.org/4-auditing-guidelines/guidelines-on-specific-subjects/>

# THE MUSHROOMING OF EUROPEAN AGENCIES AND THE COURT'S AUDIT CHALLENGE

By Friedemann Zippel, Head of unit, Community agencies and other decentralised bodies (SDB)

## INTRODUCTION

1. Mention the word 'Agencies' to our colleagues and you may be on the receiving end of a number of interesting reactions: 'Too many deadlines' or 'too many missions'. Well there are as many deadlines as there are agencies and with approximately 8 missions a year, the Agencies and Decentralised Bodies (ADB) auditors are a well-travelled bunch. However the work undertaken by the ADB within Chamber IV comprises some very dynamic and relevant audit work that it is worth exploring.

2. Always good to first consider the legal and historical context. According to the Treaty, the Court has the mandate to audit the annual accounts of the European agencies and the legality and regularity of the transactions underlying them. The first two agencies were created in 1975. A considerable time lag followed and then the 1990s saw the creation of a further ten. Most of the existing agencies were established in the past decade, including six new agencies which received their financial autonomy in 2011 and 2012. For the financial year 2012, the Court's ADB unit audited the accounts and underlying transactions of 31 decentralised agencies, 6 executive agencies as well as the Euratom Supply Agency, the European Institute of Innovation and Technology (EIT) and the EUROPOL Pension Fund.

3. Why have European agencies been created in the first place? Why do they farm out work that can, in theory, be done by the Commission directorates? The main reason is to allow the Commission to concentrate on policy-making and on the cooperation between the EU and national governments. One (perhaps unintended) consequence has been to increase the visibility of the European Union, particularly but not only by having agencies that are located in the various EU Member States rather than being solely clustered in Brussels.

4. Decentralised agencies play a crucial role in implementing EU policies and particularly have tasks of a technical, scientific, operational and/or regulatory nature. It is these decentralised agencies that are located in various cities across the EU. Executive agencies on the other hand are entrusted with tasks relating to the management of one or more Community programmes and are set up for fixed periods of time. Five executive agencies are located at the seat of the Commission in Brussels while one is hosted by Luxembourg.

## THE RISK

5. The agencies accounted for some €1.6 billion or about 1.2 % of the 2012 EU general budget. Approximately €1 billion comprises direct transfers from the Commission and the rest is income from fees and other sources. Currently financial risk is thus relatively low compared to the total EU budget. On the other hand, agencies employ some 6 100 permanent and temporary officials or 13.2 % of total EU officials and an additional 2 500 contractual or seconded agents. As far as the executive agencies are concerned, the Commission intends to widen the scope of their activities considerably under the multi-annual financial framework 2014-2020 and plans to increase their budget from €5.8 billion in 2013 to more than €14 billion in 2020. The Commission envisages that staff of executive agencies will increase by around 900 over the same period.

6. Reputational risk is high. The same visibility that brings the European Union and its work closer to the minds and perceptions of her citizens also carries the corollary risk of being in the news when things go wrong. Agencies exert significant influence on policy and decision making as well as programme implementation in areas of vital importance to European citizens, i.e. health, safety, security, freedom and justice. Some of the most well-known agencies are the European Medicines Agency, the European Aviation Safety Authority, the European Food Safety Agency, the European Chemicals Agency and the European Agency for the Management of Operational Cooperation at the External Borders (FRONTEX). Special Report 15/2012 on "Management of conflict of interest in selected EU Agencies" was extensively discussed by Parliament, press and NGO's, showing stakeholders' interest in agency related audit results.



EASA



ECHA



EFSA



FRONTEX



EMA

## ANNUAL FINANCIAL AND COMPLIANCE AUDITS

### *The audit approach*

7. For the annual agency audits, the approach taken by the Court comprises analytical audit procedures, direct testing of statistical samples of transactions and assessments of the agencies' internal controls. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations. In order to address the particular risks involved, special emphasis is placed on the effectiveness of agencies' internal control arrangements related to grants.

### *2012 audit results*

A detailed overview is provided in the "Summary of results from the Court's 2012 annual audits of the European Agencies" which is not public.

### **Opinions on the reliability of the accounts**

8. Some of the agencies' provisional accounts for the financial year 2012 originally showed material misstatements which were flagged in the Court's preliminary findings. These were corrected in time for the preparation of the final accounts and the Court concluded that the final accounts of all agencies present fairly, in all material respects, their financial position and the results of their operations and cash flows.

### **Opinions on the legality and regularity of the transactions underlying the accounts**

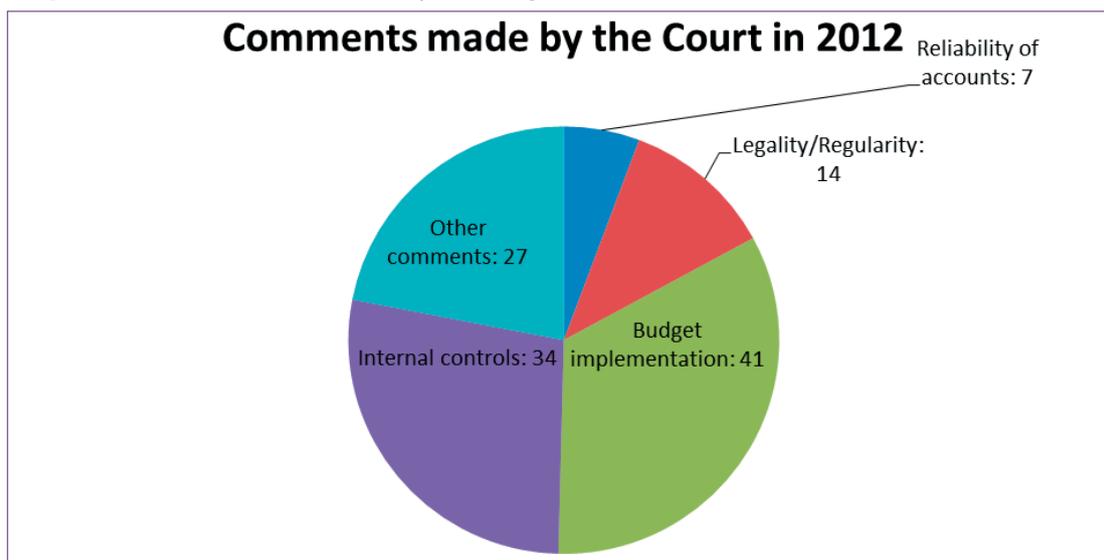
9. The Court also concluded that the transactions underlying the annual accounts for the year ended 31 December 2012 were legal and regular in all material respects for all agencies except for EIT and FRONTEX.

10. A qualified opinion was issued for EIT. The Court concluded that ex-ante verifications on grant transactions provided only limited assurance which could not be fully compensated by the ex post verifications in place. The same situation existed in FRONTEX, but given the pervasiveness of likely effects the Court in this case issued a disclaimer to its opinion.

**Comments not calling the Court's opinions into question**

11. Without calling its opinions into question, the Court made a total of 123 comments affecting all agencies with the exception of two in order to highlight matters of importance and to indicate room for improvement. Comments were made regarding the reliability of accounts, the legality and regularity of transactions, internal controls, budget implementation and other matters such as sound financial management.

**Graph 1 – Number of comments by heading**



Source: Specific reports on the agencies 2012 annual accounts

12. Accounts related comments highlighted omissions in the validation of accounting systems by the responsible accountants which may indicate not fully functioning and/or reliable accounting systems.

13. Comments on the legality and regularity of transactions mainly related to irregularities in the area of public procurement, carry-overs that were not accompanied by a financing decision or legal commitment (contract) and irregular contributions towards school fees of staff's children.

14. As regards internal controls, a matter of particular concern is that ex-ante and ex-post verifications in relation to grant management often are not fully effective. Apart from EIT and FRONTEX, the Court concluded for five more of the ten agencies that provide grants to beneficiaries from their own budget<sup>1</sup> that verifications are only partly effective. Incompletely implemented internal control standards and weak asset management also remain areas of concern.

15. In the area of budget implementation, instances of high cancellations of budget carry-overs from 2011 indicated that in a number of cases related 2011 commitments were made on the basis of over-estimated needs or were otherwise not justified. Although high levels of carry-overs were again found in 2012 for many of the agencies, they usually resulted from events beyond the agencies' control (e.g. invoices or cost declarations that were not received by the year end) or were justified by the multi-annual nature of operations, procurement procedures or projects.

16. The audits found no irregular recruitments. However, comments were made frequently on the transparency of recruitment procedures and the equal treatment of applicants.

<sup>1</sup> Grants managed by executive agencies on behalf of the Commission and financed from the Commission's budget are not covered by the specific annual audits for these agencies, but by the Court's annual DAS

### **Follow-up of previous year's comments**

17. The 2012 specific annual reports provide an overview of follow-up actions taken by the agencies in response to the 139 comments made by the Court for the financial year 2011. Corrective action was completed in 67 cases, while recommended actions to be implemented were on-going in 55 cases and outstanding in another 10 cases (no corrective action was required for 7 comments made in 2011).

### ***Change is in the air***

18. Auditing the agencies represents a considerable challenge in terms of bringing together the necessary resources. ADB's 16 auditors are working full-time on the now 41 (as at the end of 2013) agency audits to be carried out. In addition, support by additional auditors from other units is needed during the peak period (February to June). Given the limited share of the EU Budget represented by the agencies combined expenditure, the audits place a disproportionate burden on the Court's resources. For this reason ways of lightening this burden and creating a more efficient annual audit framework have been discussed for some time.

19. Article 208 of the new Financial Regulation provides for an independent external auditor (private auditor) to verify the annual accounts of the agencies before consolidation in the Commission's final accounts. The Court, when preparing its specific annual reports for the agencies, is expected to consider the private auditors' work and the action taken in response to their findings. However, what in principle sounds promising cannot yet be put in practice. While there is a common understanding between Court and Commission that only the accounts would be subject to the private auditors' work and that the Court would continue to audit the transactions (i.e. the legality and regularity aspect), discussions on the contracting arrangements and the financing of private audit firms services are still ongoing. However, it is deemed crucial that the number of private auditors be kept to a minimum to ensure knowledge transfer and reliability of audit results, e.g. through having a framework audit contract. Otherwise the risk is high that the application of the single audit concept will fail, that no efficiency gains will be made and that total cost of the audits will increase.

20. Another recent development is DG BUDG's proposal to centralise (on a voluntary basis) the agencies' treasury management and/or accounting. This could further improve the quality of the agencies' provisional accounts and permit the reduction of resources required for audit. However few agencies have shown interest in the idea.

### **PERFORMANCE AUDITS**

21. To date, there have not been many instances when it has been possible to deploy additional resources for audit work concerning the Agencies outside of the Specific Annual Reports. Special Reports 5/2008 "The European Agencies: Getting results" and 13/2009 "Delegating implementation tasks to executive agencies: a successful option?" reported on agency related performance management. In 2012, ADB unit prepared Special Report 15/2012 on "Management of conflict of interest in selected EU Agencies". Other special audits related to agencies are carried out by Chamber IV's performance audit unit PRF. The on-going audit of the European External Borders Fund has included FRONTEX within its scope and the on-going Carbon Footprint audit covers several agencies such as the European Environmental Agency, the Office for the Harmonisation of

the Internal Market, the European Aviation Safety Agency and the European Medicines Agency. A special audit of the European Banking Authority will be finalised by the end of the year. In response to Parliament's continuing interest in the agencies, other performance audits on procurement, grant management and innovation as well as on the functioning of the two other financial market supervisory authorities (European Insurance and Occupational Pensions Authority and European Securities and Markets Authority) are included in Chamber IV's Annual Work Programme 2014.

## CONCLUSION

22. This snapshot of the Court's agency audits serves to give a flavour of what these audits represent in terms of work and gives an indication of some of the challenges that lie ahead. The importance and visibility of the agencies' tasks as well as the projected increase in their budget will continue to raise stakeholders' attention. The use of private auditors' work may help to free audit resources and to focus more on performance matters. Meanwhile for an auditor working at the Court, the agencies represent a great opportunity to obtain an unparalleled experience and knowledge of their operational and financial structures and of the different dynamics that drive agencies forward in the fulfilment of their objectives. Not a bad thing to put on an auditor's CV.



The audit unit

SPECIAL REPORT N°10/2013



ARTICLE 68 OF COUNCIL REGULATION (EC) NO 73/2009 WELL DESIGNED AND IMPLEMENTED?

As a derogation to the general principles of decoupling and simplifying the payment regime for farmers, Article 68 allows Member States to retain part of their national ceilings to provide specific support to certain activities, notably through direct coupled payments, in clearly defined cases.

In this report, the Court notes that the Commission has little control over the justification for such cases and that Member States have a large degree of discretion. There is insufficient evidence that the measures introduced under Article 68 are necessary or relevant in terms of needs, effectiveness of their design and the levels of available aid.. The Court also pointed out weaknesses in the administrative and control systems, sometime despite management and control burdens already heavy.

SPECIAL REPORT N°12/2013



CAN THE COMMISSION AND MEMBER STATES SHOW THAT THE EU BUDGET ALLOCATED TO THE RURAL DEVELOPMENT POLICY IS WELL SPENT?

For the 2007-2013 programming period, the EU has allocated almost 100 billion euro to achieve its rural development objectives. In this report, the Court finds that there is a lack of assurance that the money has been well spent: the Commission and Member States have not sufficiently accounted for their performance in achieving value for money with the EU's budget. Despite support from the Commission, Member States' monitoring and evaluation has not been reliable, consistent and relevant enough to show what has been achieved in relation to the policy objectives. The available information has not been used to make the rural development measures more effective and efficient, with the focus being on spending the budget rather than efficiently achieving results. Ultimately, the current framework has failed to provide the information needed in time to inform decisions on the most effective and efficient measures for the 2014-2020 programming period.

IN DECEMBER 2013 THE COURT SAYS:

HELLO TO

PESCE	Paolo
SEIBERT	Charles
NEGOITA	Isabela
ELENKOVA	Daniela
GABRIČ	Nejc

GOODBYE TO

LE BRIAND	Patricia
SANA	Giorgio
MELLINGER	Justin

DÉCÈS



Nous avons le regret d'annoncer le décès de **Monsieur Chris KOK**.

De nationalité néerlandaise, Chris Kok est arrivé à la Cour en septembre 1980. Il a d'abord travaillé en tant que Chef de Cabinet auprès de M. Middelhoek, Membre de la Cour.

À partir de juillet 1995, il a occupé les fonctions de Directeur de la Traduction, puis, à partir d'avril 1999, de Directeur des Relations extérieures. Il a pris la retraite en décembre 2007.

## THE ROLE OF EUROSTAT IN THE MEASUREMENT OF DEFICIT AND DEBT OF MEMBER STATES...

... In the light of the recent developments in the EU governance framework. Key speaker was **Mr François LEQUILLER**, Director at EUROSTAT, responsible for Government Finance Statistics. The conference took place on 10 October 2013 and was organised by the Training Unit in cooperation with Dr Louis Galea, Member of the ECA.

By Rosmarie Carotti



François LEQUILLER, Director at EUROSTAT, responsible for Government Finance Statistics

From left to right: Dr Louis Galea, ECA Member, Mark Crisp, Director, Chamber 4 and François Lequiller, Director at EUROSTAT, responsible for Government Finance Statistics

Introducing the conference, Dr Galea briefly outlined some of the initiatives taken by the ECA in recent years related to Eurostat and European statistics.

The ECA has undertaken performance audits and published special reports on different aspects of Eurostat's work. One of them is the report on Eurostat's role in the compilation of European Statistics (SR 12/2012) titled *"Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?"*

This report looks in particular at the implementation of the Statistical Code of Practice in Member States (a set of rules which are intended to provide the basis for the credibility and integrity of national statistics provided by Member States, and the integrity of the statistical offices responsible for producing such information).

The ECA is also at the stage of finalising a second report related to the verification by Eurostat of GNI statistics upon which the relative contribution by Member States towards the EU budget is based.

The work of the ECA was referred to in the process of parliamentary adoption of the Commission's legislative proposal<sup>1</sup> to the European Parliament and the Council. The Court followed these proposals closely, both in terms of accountability structures involved, as well as in terms of financial and performance management provisions.

Concerning the financial crisis, Dr Galea noted that deficiencies in the national accounts of some Member States had been in part the underlying cause. National accounting systems had failed to present the true

<sup>1</sup> COM(2012) 167 final of 17 April 2012 'Proposal for a regulation of the European Parliament and of the Council amending Regulation (EC) No 223/2009 on European statistics'

fiscal position of certain Member States which when properly disclosed revealed highly unsustainable fiscal positions in the aftermath of the shocks of the financial crisis.

Indeed one of the dimensions of the EU response was to reinforce the process of national accounting and orient it towards accruals accounting based on IPSAS (International public sector accounting standards) and possible EPSAS (European public sector accounting standards). These are important developments which would also affect both the ECA and Supreme Audit Institutions (SAIs) in Member States in the future.

The financial crisis also highlighted the need to strengthen the EU's fiscal and economic co-ordination functions - the surveillance and dialogue processes necessary to ensure that Member States adhere to basic principles of sustainable fiscal policies and deliver on their pledges to undertake the necessary structural reforms.

Mr François Lequiller, Eurostat Director responsible for Government Finance Statistics (GFS) described Eurostat's commitment to this subject. A Directorate for GFS was established for that purpose after a review launched in 2011 of Eurostat's structures and processes.

Government Finance Statistics play a key role in EU economic monitoring. They include in particular the data on government debt and deficit reported under the Excessive Deficit Procedure (EDP). EDP is an action launched by the European Commission against any European Union Member State that exceeds the budgetary deficit ceiling imposed by the EU's Stability and growth pact legislation.

On behalf of the Commission, Eurostat is responsible for assessing the quality of the EDP statistics transmitted by Member States and for providing the statistics to be used for EDP. It has the sole competence for the methodology underlying these statistics.

This methodology is based on the European System of Accounts (ESA), which has the status of an EU Regulation, and on Eurostat's Manual of Government Deficit and Debt (MGDD), as well as Eurostat's decisions and guidance notes. This methodology has been elaborated based on a broad consensus of the EU statistical community.

In order to communicate the results of its assessment, Eurostat is committed to publish a bi-annual press release on Member States' notifications of deficit and debt; to publically communicate any "qualified" positions it takes as regards Member States' data on deficit and debt; maintain a GFS website which includes detailed EDP tables, supplementary notes, methodological notes and reports on EDP visits.

It is important to note that Eurostat is not in a position to certify accounts of individual entities, nor take responsibility in cases of deliberate misreporting by national reporting authorities or other reporting entities, errors committed by national reporting authorities, or accuracy of forecasts of general government deficit and debt.

In order to reduce the frequency of revisions of deficit/surplus and debt and their magnitude, all Member States should converge in the medium term towards the current median of observed revisions (0.3% of GDP between first and third notification, 0.2% between the third and last notification), and in the longer term to the median of the ten best countries in terms of revisions.

In closing the conference, Dr Galea remarked that, from ECA's audits, it has to be noted that Eurostat has two roles to cover. First of all, it is a facilitator of a network of Member States' National Statistical Authorities (NSAs), and in this context it depends by and large on the spirit of co-operation and on the resources and abilities of this network. However, Eurostat must also take on the role of a moderator/ a quality controller/ a regulator if you may, of the European statistics provided through the network of NSAs. It is these statistics which are being used as the basis for different policy evaluations and to trigger different actions and sanctions in various policy domains.

# OFFICIAL VISIT TO THE ECA OF MR YIANNAKIS L. OMIROU, PRESIDENT OF THE HOUSE OF REPRESENTATIVES OF THE REPUBLIC OF CYPRUS

By Rosmarie Carotti



From left to right: Mr Vítor Caldeira, ECA President, Mr Yiannakis L. Omirou, President of the House of Representatives of the Republic of Cyprus and Mr Lazaros S. Lazarou, ECA Member

**Mr Yiannakis L. OMIROU**, President of the House of Representatives of the Republic of Cyprus, is also the President of the Movement of Social Democrats EDEK since 2001. EDEK is a member of the Party of European Socialists.

European Court of Auditors' (ECA) President Caldeira welcomed Mr Omirou, President of the House of Representatives of the Republic of Cyprus, to an extraordinary meeting of the ECA on 17 October 2013.

Mr Omirou was accompanied by Mrs Vassiliki Anastassiadou, Secretary General of the House of Representatives, Mr Antonis Koutalianos, Director, President's Office and Mrs Evie Hadjiyianni, Director, International Relations Service.

After a meeting at which Mr Omirou discussed the economic and political situation in Cyprus with President Caldeira, Mr Omirou addressed the College of the ECA.

## **The importance of the relationship between the ECA and National Parliaments**

President Caldeira referred to the importance of the relationship between the ECA and National Parliaments. This relationship derives from the EU legal framework and the arrangements for raising and spending EU funds. Up to 80% of the EU's budget management, is shared with the Member States' national or regional authorities.

The ECA's audits and reports are designed to assist not just the European Parliament but also National Parliaments to meet their responsibilities with respect to the oversight of EU funds.

The Lisbon Treaty now makes this explicit. Protocol 1 of the Treaty introduced a requirement for the Court to send its annual reports to National Parliaments, thus formalising an existing practice.

The ECA also believes that developments in European governance have important implications for public accountability which make strengthening its relations with national parliaments a priority.

In responding to the crisis, the EU institutions and Member States are in the process of developing new European financial, fiscal and economic frameworks.

A common feature of the measures planned as part of further moves towards economic and monetary union is that they involve coordinated action by authorities at EU and national level.

The European and National Parliaments will need to work together closely. That also implies a need for the ECA and its national counterparts to cooperate to provide a full audit picture of the performance of new arrangements.

President Omirou addressed the Court underlining the contribution of ECA to public oversight and the excellent relations between the House of Representatives of the Republic of Cyprus and the ECA, which he looks forward to strengthening further.

He continued his address with critical words about how Cyprus had been treated by Europe. He felt that the painful stability programme for Cyprus lacked any force for development, as it relied uniquely on debilitating austerity and rigid financial discipline. It had, so far, irreversibly damaged the banking system, raised unemployment, particularly among the young, above the lenders' already gloomy forecasts, and brought a sharp economic recession and a dramatic contraction of the real economy, and it was rapidly and inevitably leading to the devaluation of social and labour victories.

But the citizens of Cyprus, despite the difficulties facing them both in the economic sphere and in the context of their national cause, remain optimistic for the future. Cyprus looks forward to an upgrading of the EU's role in finding a settlement to the Cyprus problem.

Mr Lazaros S. Lazarou, Member of the ECA, warmly thanked Mr Omirou for his visit to the ECA which *"is a great honour for us as is the high appreciation of the House of Representatives for the ECA and our work. Our aim is to continue, even more effectively to contribute to parliamentary oversight"*.



Mr Vitor Caldeira, ECA President, Mr Yiannakis L. Omirou, President of the House of Representatives of the Republic of Cyprus

# VISIT OF MME BIEŃKOWSKA, POLISH MINISTER OF REGIONAL DEVELOPMENT

By Katarzyna Radecka, Private Office of Mr Kubik



From right to left: Minister Elżbieta Bieńkowska and deputy Adam Zdziebło, Mariusz Pomiński, Head of Private Office



From left to right: Mariusz Pomiński, Head of Private Office, Adam Zdziebło, Deputy, Elżbieta Bieńkowska, Minister, David Bostock, ECA Member, Augustyn Kubik, ECA Member, Gareth Roberts, Head of Private Office

On 25 October a delegation from Polish Ministry of Regional Development visited the Court. Mr Kubik was the host Member, and his cabinet was responsible for the organisation of the visit.

Minister Elżbieta Bieńkowska and her deputy Mr Adam Zdziebło came to Luxembourg to meet the Court's Members, Mr Henri Grethen and Mr Lazaros Lazarou, responsible for auditing the structural funds. Polish guests also met Mr David Bostock who was representing the Court on behalf of President Caldeira.

The purpose of the meetings was to exchange views and share experience of intensive audit-related contacts between the ECA and Poland - the Member State which is one of the biggest beneficiaries of cohesion and structural policies. The starting point for the discussions were the results of recent Court audits, both financial and performance ones. The Court's Members, accompanied by their cabinets and Mr Martin Weber, Head of Unit responsible for ERDF DAS, presented selected observations and emphasised that the Polish system for the funds management is one of the best and most effective systems within the EU. In response Min. Bieńkowska stated that Court's reports are useful for her services and often provide examples of best practice.

This visit was just one of a series of events organized between the Court and Poland. The Polish Member, Mr Kubik, maintains regular cooperation with his home country, cooperation which

beneficial both for the Court and for Poland. The Polish administration is constantly interested in the Court's methodology of financial and performance audits. The ECA responds regularly to this demand. For example, in November 2013, with the great help of Polish auditors of the Court - Ms Kamila Lepkowska and Mr Rafal Czarnecki, the Polish Member and his cabinet are organizing a workshop on the performance audit for the Polish SAI as well as a series of methodological presentations for the Polish administration. Needless-to-say, thanks to such events, The Court's auditors may get a better understanding of the national perspective and the perception of the ECA.

Mr Kubik and his cabinet would like to thank all those who have contributed to excellent cooperation between the Court and Poland.

# INTERVIEW WITH DR HANS-GERT PÖTTERING, FORMER PRESIDENT OF THE EUROPEAN PARLIAMENT

By Rosmarie Carotti



**Dr Pöttering MEP** is a member of the European People's Party (Christian Democrats) and Chairman of the Konrad Adenauer Foundation. On 6 November the Foundation hosted a lecture in Luxembourg on the role of interreligious dialogue in Europe and the European neighbourhood. The Archbishop of Luxembourg, the Chief Rabbi of Luxembourg and the Imam of the Muslim community in Luxembourg also took part.

**R. C.: The discussion tonight focused on religion, but human rights were also discussed. You mentioned Ukraine and the case of Yulia Tymoshenko.**

**Dr Hans-Gert Pöttering:** A historic decision will be taken at the end of November about whether Ukraine should be granted a treaty of association with the European Union. That is to say, whether Ukraine and the European Union should have a special relationship below the level of membership.

I am in favour of such an association with Ukraine, since it will constitute a historic decision by Ukraine about whether it should orient itself towards the European Union or towards Moscow, thus promoting structures that we do not see as pro-European.

However, we still need to clarify the question of what is happening to former Prime Minister Yulia Tymoshenko and others who have been imprisoned for political reasons. This is not acceptable, and a solution needs to be found.

**R. C. It appears that accession negotiations with Turkey, which have been ongoing for the past eight years, are back on track. What you think about this?**

**Dr Hans-Gert Pöttering:** Basically, my position with regard to the accession of Turkey is that we would be politically, culturally, financially and geographically overwhelmed if we let Turkey into the European Union. But as I have said, it has been decided that negotiations will take place. *Pacta sunt servanda* – agreements must be complied with. I am therefore in favour of further negotiation.

But if the negotiations reach a conclusion and an accession treaty is signed, it must not be approved automatically. Instead, all of the national parliaments of the countries of the European Union, together with the European Parliament, must also be able to decide freely whether to say yes or no, or to propose a different relationship with Turkey.

Personally, I am in favour of a privileged partnership between the European Union and Turkey, not for a full membership.

**R. C.: A new European Parliament will be elected in 2014. What changes would you like to see to the powers of the Parliament in the future?**

**Dr Hans-Gert Pöttering:** The European Parliament has come a long way since 1979. The Parliament had no legislative powers in 1979 but now legislates on an equal footing with governments in most areas of European lawmaking. There are only a few fields, such as tax law, where decisions are taken

solely by the Council of Ministers and the Parliament is not yet involved. The Parliament can issue recommendations in these areas, but it does not take part in the decision-making process.

I believe that the European Union, while still not perfect, is democratic, and this is based on the parliamentary values of a strong European Parliament. Today we can say that the goal of a democratic European Union has been achieved, but of course there is always room for improvement.

Thanks to the Treaty of Lisbon, it is now possible, by collecting a million signatures, to start European Citizens' Initiatives concerning matters on which the Commission and the European Parliament are to act. This mechanism still needs to be reinforced, but we have succeeded in increasing the strength and influence of the European Parliament.

**R. C.: The European Parliament complains, though, that it only plays an advisory role in the appointment of the Members of the European Court of Auditors, the decision itself being made by the Council alone. Does this constitute a lack of democracy?**

**Dr Hans-Gert Pöttering:** This question merits a great deal of thought. Crucially, the European Parliament scrutinises the work of the European Commission. The President of the Commission is elected by the European Parliament; the Members of the Commission have to go through a tough Parliament's hearing. One could consider the question of whether European institutions should also derive their legitimacy from the European Parliament. I am open to the idea of such a debate, and I think it is one which we should have sooner rather than later.

**R. C.: A lot was said tonight about Christian values. In my view, it is a pity that the Treaty of Lisbon did not make sufficient reference to these Christian values.**

**Dr Hans-Gert Pöttering:** I don't agree. Today we have the European Charter of Fundamental Rights. Christian values such as human dignity, the welfare of older people, the protection of children, and the right to life, are incorporated into both the European Charter of Fundamental Rights and the Lisbon Treaty. And our Western values, such as human rights, freedom, the rule of law, democracy and peace, these values are all enshrined in European law, together with the principle of solidarity and subsidiarity.

I would recommend to all politicians and social groups that we should not just see the European Union as an economic and financial community, but also as a community of values which is unique in the world.

These values are at the very core of our integrated European Union, with its 28 States and over 500 million citizens.

# I SHARE ALFRED NOBEL'S OPINION THAT THE SOLUTION TO OUR PROBLEMS IS LARGELY A MATTER OF SCIENTIFIC ADVANCES

By Rosmarie Carotti



Dr Lars Heikensten, Executive director of The Nobel Foundation and former Member of the ECA from 2006 to 2011

**Dr Lars HEIKENSTEN**, Executive director of The Nobel Foundation and Member of the ECA from 2006 to 2011, was the keynote speaker at the official celebration of the 10<sup>th</sup> anniversary of the University of Luxembourg on 12 October 2013. His views on research, the Nobel Prize, and the EU's contribution to research are summarised in the following article.

## Advances and challenges

Lars Heikensten's speech was a plaidoyer for everyone's responsibility in facing the major challenges of the world as a whole, but also those of our own continent Europe.

Lars Heikensten recognises the outstanding progress that has been made in terms of networked information and market internationalisation, the striking improvements in living standards that have taken place in large parts of the world. Societies have become more open, and democracy has taken root in more and more places. There have also been important advances in life sciences.

Yet, despite the advances, there are reasons to argue that humanity has never faced bigger challenges than today. Nor are the challenges only a matter of nature. People are only now gradually getting out of the most severe economic crises the world has suffered, and the decisions needed to prevent future crises are still absent. Meanwhile the core of Western democracies is threatened by xenophobia and decay.

## Alfred Nobel's contribution

The era in which Alfred Nobel lived had similarities to ours. It was an era of major scientific advances, improved communications, rapidly increasing trade and growing international enterprises, and it was also an era of great social tensions in the wake of industrialisation and of obvious threats to peace.

By endowing prizes to those who have made breakthroughs in science, written good literature and contributed to peace, Nobel wanted to contribute to a better world. This was the idea behind his prizes.

By highlighting the most outstanding research –that which leads to scientific breakthroughs – the Nobel Prize helps lifting science in general and path-breaking research in particular. Through its universal character the Nobel Prize also underscores that knowledge exists for the benefit of all. It focuses the spotlight on shared responsibility for advancing knowledge and development.

One important aspect of the prize is the independence of the prize-awarding institutions. Hitler prohibited Germans from receiving the prize. And the Soviets did the same when it was awarded to people the regime did not like, such as Alexander Solzhenitsyn. But this in no way stopped the prize-awarding institutions from doing their work.

### **Research, the intellectual environment and Europe**

Lars Heikensten went on to discuss the achievements of Europe in research. He noted that Europe had lost ground. In the sciences – physics, chemistry and medicine – Europe was very dominant before the Second World War. For several decades, Germany alone had more Laureates than the United States. During the post-war period, however, the picture is completely different. Based on the countries where Laureates were born, the US today has a total of 183 Laureates in the three sciences, compared to 68 for the United Kingdom, 65 for Germany and 30 for France. If we look at the country where the prize-awarded research took place, the dominance of the US is even greater. In that case, during the past 112 years the US has had far more laureates than all of Europe combined. Also worth noting is Japan's advances in recent years. So far, 15 Japanese have received one of the scientific prizes. And in Asia, interest in cutting-edge research and in the Nobel Prize is enormous. Various countries, including Japan and Korea, have research policy targets connected to the number of Nobel Prizes.

The picture given based on Nobel Prizes is in line with other indications; Europe is losing ground. This largely reflects the spending on research. Today the US and several Asian countries are devoting larger resources to basic research. Joint European research programmes also often consist of covert aid to industry rather than serious research efforts; only a small proportion of EU research money goes towards basic research.

Having said this, Lars Heikensten underlined that many other things besides the amounts invested in research play a role for the results. The intellectual environment is, in a broad sense, important. Most important for research policy are clear-cut goals and consistent expectations of scientific quality. International benchmarking should always have an important role. In general, the health and standing of the research system and its environments need to be a central concern across the political spectrum.

The establishment of the European Research Council represents a major step in the right direction. It is embraced by the research community and today helps in establishing norms and principles that are of great significance also for the national research systems. It is a model to build on.

Alfred Nobel thought that science was important for solving the problems the world was confronted with. That is true today as well. Europe should take its role in financing and developing breakthrough research. Despite all of today's economic worries, Europe is the richest continent in the world after North America. This gives Europe a special responsibility.

# MY EXPERIENCE OF CREATING AN AUDIT AUTHORITY IN A WESTERN BALKAN COUNTRY

By **Dr. Ivan Ignjatov**, Assistant General IPA Auditor and Authorized State Auditor "Audit Authority for auditing Instrument of Pre-Accession (IPA)" of the former Yugoslav Republic of Macedonia



Dr. Ivan Ignjatov

*Mr Ivan Ignjatov has a PhD in Economics in "The Audit of EU funds – IPA". He is a Certified State Auditor with over 13 years of experience, including 11 as State Auditor (financial and performance audits), Head of the IPA Audit Authority, Advisor to the General IPA Auditor, Acting Assistant General IPA Auditor and Assistant General IPA Auditor. In 2007-2011, he served as Head of the IPA Audit Authority and established the IPA Audit Authority in the former Yugoslav Republic of Macedonia. Mr Ignjatov organised and hosted two international IPA Audit Authority conferences in 2010/2011 (Veles and Ohrid). He was the first representative from the former Yugoslav Republic of Macedonia to hold an internship in the audit of EU funds at the European Court of Auditors in Luxembourg (Audit Chamber III – External Relations). As the authorised representative of the SAI of the former Yugoslav Republic of Macedonia, Mr Ignjatov was responsible for organising and participating with the European Court of Auditors in the EU/CARDS 2001-2006 Programme joint audit in the former Yugoslav Republic of Macedonia in the area of Justice and Home Affairs. He has wide-ranging experience as a trainer/lecturer at CEF Ljubljana and universities in the former Yugoslav Republic of Macedonia, specialising in: "Financial reporting for IPA projects", "Audit of IPA Projects", "IPA System Audit", "Tasks and responsibilities of the IPA Audit Authority", "Performance audit", "Establishment and strengthening SAI capacities for Performance Audit", "IPA actors and structures", "IPA audit methodology", "Audit of IPA funds (2007-2013) – how to manage and monitor EU funds (challenges and possibilities)", and "Performance Auditing".*

## ABSTRACT

The European Court of Auditors' support for the Audit Authorities in the Western Balkan Countries is especially important for sharing common experience and further improving the capacity for an effective and efficient implementation of EU assistance in the beneficiary countries.

This cooperation has a double impact – on the European Court of Auditors, as well as on the Audit Authorities.

The added value for the European Court of Auditors is that, by supporting the Audit Authorities, it can gain assurance as to the capacities, audit approach and methodology used by the national Audit Authorities in auditing EU funds and transfer this on to future cooperation on the audit of EU funds in that country or for joint audit activities.

The added value for the Audit Authorities is to gain experience of the Court's audit methodology so as to improve their national institutions in line with EU requirements and internationally accepted auditing standards, to build their own capacity as part of the improvement of their administrative capacities, acting as a watchdog and ensuring that the EU funds will be implemented according to the EU rules and procedures. Having a professional, reliable, solid and independent Audit Authority is a precondition for giving European added value to improve the effective functioning of the overall IPA system. By giving timely, appropriate and clearly understandable audit recommendations, the Audit Authorities participate in the process of improving the functioning of the management and control system used for the implementation of EU funds, which directly leads to a greater absorption capacity for the beneficiary country and helps overcome challenges in the process of achieving the status of a full member of the European Union.

### **My experience of creating an Audit Authority in a western Balkan country**

The State Audit Office in the former Yugoslav Republic of Macedonia is a Supreme Audit Institution established by the Parliament under a State Audit Law in 1997, to protect the interests of the state and its citizens, as well as to support Parliament in carrying out its role by identifying irregularities, the misuse of funds and cases of possible corruption and fraud. The practical functioning of the State Audit Office started at the beginning of 1999, by organizing a regularity audit (financial and compliance audit) to assess the proper use of the budget and other public funds. In 2005, the State Audit Office started to conduct performance audits (value for money) to assess the use of funds in terms of economy, efficiency and effectiveness.

One of the SAO's priorities is to monitor permanently new developments in the field of state audit and continuously upgrade and improve the skills and capacities of the auditors. In order to fulfil this task, the SAO has established fruitful cooperation with other SAI's in the region, the European Court of Auditors and professional national and international audit bodies and associations. Cooperation between the SAO in Skopje and the ECA in Luxembourg has been established, and auditors from the SAO now have the possibility of participating in the ECA's internship programme. The first internship agreement between our two institutions was signed in July 2006 and I was the first representative from my country at the ECA. I did a five month internship from 1 October 2006 until 28 February 2007. During this period, I was assigned to the sector responsible for expenditure in CEEC and CIS countries (then Audit Group III), which was, for example, responsible for conducting financial and performance audits in the Central and Eastern European Countries under previous pre-accession programmes.

Immediately after my arrival at the European Court of Auditors, I joined the audit team responsible for the performance audit of EU – CARDS programmes in the Western Balkan countries, regarding the utilisation of EU funds for the 2001-2006 period in the area of justice and home affairs, which resulted into Special Report No 12/2009. Mr Jussi Bright was assigned as my team leader for this audit, and was also appointed as my mentor during the internship programme; I became directly involved in the audit activities with regular meetings with the team. These discussions guided me into the Court's audit approach. More specifically, my task was to analyse the main strategic documents, annual programmes and European partnership documents, as well as association and stabilisation documents for all the countries that were covered by this audit i.e. the former Yugoslav Republic of Macedonia, Serbia, Bosnia, Herzegovina and Albania. As part of the audit team, I had the opportunity to participate in the audit visits to the European Commission in Brussels (DG Enlargement and DG Justice, Freedom and Security) and the Council of the European Union (DG External Relations – Police Unit), as well as to benefit from the audit team's brainstorming meetings, in which we discussed the financial documents, project documents relating to annual programs and specific documents connected with each project selected for this audit.

In February 2007, one of the highlights of my internship was an audit visit to my home country. The aim was to assess the results and impact of EU funds. In order to give an independent audit opinion concerning the effective utilisation of the EU funds, we performed management and control system checks as well as visiting projects on the spot. During the audit mission, we had an intensive agenda with meetings at the now-closed European Agency for Reconstruction, the Delegation of the European Commission in Skopje, the State Audit Office and various Ministries. In addition, we put the new ECA performance audit manual into practice. I have to admit it was an enlightening experience to audit your own non-member country from the ECA perspective. It is always useful to share knowledge (e.g. I shared my local knowledge with the audit team) and the audit approaches of different institutions. Cross-cultural dynamics play their part in these kinds of circumstance. One thing I learnt during my internship was the recognition of different audit cultures. I appreciated and enjoyed the cultural diversity at the ECA very much.

I was also impressed by how much the European Court of Auditors pays attention to the process of the continuous learning and professional development of its auditors, by organizing professional training and workshops. As an intern, I had the opportunity to participate in numerous training sessions and seminars for newcomers. I received training on the Court of Auditors' audit approach, its audit documentation system, the EU budget and financial legislation. I understood how "Ethics matters".

It is not always clear to an outsider how the Court decides what to audit. Therefore, Audit Group III's annual workshop, in which I participated, was a useful experience. Everyone was invited, i.e. the Members, their private office staff as well as all the other employees from the group. There was an open and honest discussion about the Group's mission, policies and requirements. We were looking into the past (lessons learned) and the future. All types of professional experience were appreciated and, for example, I presented my country's EU audit activities to the workshop participants. At the end of the internship program I had the opportunity to have a meeting with the then President of the European Court of Auditors, Mr Hubert Weber, in which we discussed the experience that I had gained from the internship programme, as well as the possibilities for future cooperation in the area of the audit of EU funds. I told him that I felt privileged to be the first representative from my country's SAO to participate in the ECA's internship program.

Experience gained at the European Court of Auditors, gave me the opportunity, once I returned home, to implement the audit approach and methodologies for auditing EU funds in practice. The timing of my internship was perfect, bearing in mind that, in January 2007, the European Commission had introduced new instruments for pre-accession assistance for the candidate and potential candidate countries<sup>1</sup>. The IPA's main objective is to assist the beneficiary countries in a progressive alignment with the standards and policies of the European Union, including, where appropriate the 'acquis communautaire', with a view to membership. It replaced the previous Phare, ISPA, SAPARD and Turkey pre-accession instruments, as well as the CARDS instrument.

### **IPA**

IPA addresses the ultimate political goal - EU accession, by supporting beneficiary countries in:

- managing EU funds properly and effectively,
- improving their financial management systems,
- increasing ownership of EU assistance, and
- gradually preparing candidate countries to manage structural and cohesion funds upon accession.

In October 2007, the former Yugoslav Republic of Macedonia signed a Framework Agreement between with the Commission on the rules for co-operation concerning IPA and concerning the rural development arm of IPA, IPARD.

According to the IPA implementing regulation (718/2007), the beneficiary country must designate the following bodies and authorities:

- a National IPA Coordinator (NIPAC)
- a Strategic Coordinator for the regional development component and the human resources development component (SC)
- a Competent Accrediting Officer (CAO)

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<sup>1</sup> Establishment of the new instrument for pre-accession assistance had already started in 2006, with the Council Regulation (EC) No 1085/2006, and in June 2007, the European Commission had adopted Regulation (EC) No 718/2007, implementing Council Regulation (EC) No 1085/2006 establishing an instrument for pre-accession assistance (IPA).

- a National Authorizing Officer (NAO)
- a National Fund (NF)
- an Operating Structure by IPA component or programme (OS)
- an Audit Authority (AA)

Beneficiary countries must also ensure that an appropriate segregation of duties applies to the designated bodies and authorities, and that the Commission confers management powers on the beneficiary country only after the bodies and authorities referred to have been designated and put in place.

Before, the Commission used to measure the success of its assistance by focusing solely on contracting and disbursement rates. However, more than ten years ago (since 2002) it started aiming for a sustainable capacity development of institutions, which is, of course, more difficult to measure. The western Balkan countries prepared themselves for a decentralised implementation system of assistance (known as DIS). The first step of decentralised implementation is the national accreditation of the beneficiary authorities on the basis of capacity assessments. The next step is the conferral of management from the Commission to the recipient country. The conferral of management indicates a sufficient level of management capacity and readiness for decentralized implementation of EU funds.

### **Audit Authority**

Regarding the establishment of an Audit Authority in January 2007, there was a proposal from the Ministry of Finance that our Supreme Audit Office should take on the role of the Audit Authority in the IPA system. The SAO agreed, but recalled that this issue must be subject to additional assessments and evaluations by the Commission.

In May 2007, a working group was established with the objective of setting up a functionally independent Audit Authority. Just back from Luxembourg, I become the chairman of this working group. An internship at the ECA does not come without a "punishment" in my country!

In the working group, there were four possible options for establishing an Audit Authority:

1. Within the State Audit Office;
2. Within the Ministry of Finance as a part of Central Internal Audit Unit;
3. A new independent institution to undertake this activity;
4. An independent audit institution that would perform the activity under a contract (i.e. outsourcing the audit task).

All the above-mentioned options have some positive and negative aspects, and after a detailed assessment, it was decided that the best possible option for us was to establish the Audit Authority within the general platform of the State Audit Office. In July 2007, the Government appointed me as the first Head of the Audit Authority. I approached this new challenge with great enthusiasm and energy although it completely ruined my holidays in 2007. Of course, for me, this was great opportunity to put all my previous knowledge and experience into practice by establishing a new Audit Authority within the EC requirements. I do not think I would have got this important post without my ECA experience.

I spent the summer of 2007 drafting, re-drafting and re-re-drafting the necessary documents. The first step was to establish a proper legal basis to show the IPA Directorates-General at the European Commission

that the Audit Authority was really independent from the SAO and all other IPA bodies and structures and that we were complying with internationally accepted auditing standards. For this purpose, in August 2007, a Memorandum of Understanding was signed between the General State Auditor (appointed by Parliament) and the Head of the Audit Authority (appointed by the Government). The key provision was that the overall functioning of the Audit Authority was exclusively the responsibility of the Head of the Audit Authority. Unfortunately this was not good enough for the Commission. They concluded that, in the short term, the Audit Authority could be established in the SAO, but in the long term, it should be established outside the SAO as an independent audit body. Therefore, back to the drawing board. Bearing in mind the Commission DG's requirements, the Audit Authority started work on drafting the proposal for the new Audit Authority Law, which was expected to provide:

- A higher level of functional independence:
  - The AA was to be established as an independent legal entity outside the SAO, independent of all participants in the management and control system for pre-accession assistance;
  - The AA needed to have an independent reporting line to the European Commission, CAO and NAO;
  - Independent status for employees (IPA auditors).
- Financial independence
  - Parliament needed to adopt a separate budget for the Audit Authority, which is part of the overall country budget.

### **The new law for auditing**

Second time lucky. The new law for auditing the Instrument for pre-accession assistance (IPA) was officially adopted by the Parliament of the former Yugoslav Republic of Macedonia in May 2010 and published in Official Journal No 66/2010. According to the new law for the IPA, the Audit Authority was registered in June 2011 as an independent legal entity – outside the SAO, the function 'Head of the Audit Authority' was replaced with the term 'General IPA Auditor', new internal acts of the Audit Authority were adopted and new contracts were signed with employees, who have the status of IPA auditors.

The Audit Authority's main responsibilities are to verify:

- The effective and sound functioning of management and control systems and
- The reliability of the financial information sent to the Commission.
- Each year, the Audit Authority prepares and submits the following documents:
  - An annual audit work plan
  - An annual audit activity report
  - An annual audit opinion
  - An audit opinion on any final statement of expenditure submitted to the Commission by the national authorizing officer, for the closure of any programme or any part thereof.

Its audit work includes audits of an appropriate sample of operations or transactions and an examination of procedures. The Annual Audit Work Plan is submitted to the National Authorizing Officer and the Commission before the start of the year in question.

### **The reporting**

The Audit Authority must also prepare the Annual Audit Activity Report, the Annual Audit Opinion and an opinion on any final statement of expenditure submitted to the Commission by the National Authorizing Officer, for the closure of any programme or any part thereof.

An annual Audit Activity Report must be prepared following the model to be found in the Framework Agreement, setting out the resources used by the Audit Authority and summarizing any weaknesses found in the management and control system or the transaction findings from the audits carried out under the annual audit work plan during the previous 12 month period, ending on 30 September of the year concerned. The Annual Audit Activity Report must be sent to the Commission, the National Authorizing Officer and the Competent Accrediting Officer by 31 December each year.

The Annual Audit Opinion follows the model set out in the Framework Agreement as to whether the management and control systems function effectively and conform to the requirements of EC Regulation 718/2007 and/or any other agreements between the Commission and the beneficiary country. The Annual Audit Opinion is addressed to the Commission, the National Authorizing Officer and the Competent Accrediting Officer; it covers, the same period and has the same deadline as the Annual Audit Activity Report.

An opinion on any final statement of expenditure submitted to the Commission by the National Authorizing Officer, for the closure of any programme or any part thereof, must address the validity of the final payment application and the accuracy of the financial information, and, where appropriate, be supported by a final audit activity report

This Opinion should be sent to the Commission and to the Competent Accrediting Officer, at the same time as the relevant final Statement of Expenditure is submitted by the National Authorizing Officer, or at least three months from the submission of that final Statement of Expenditure.

### **Three types of audit**

The Audit Authority plans and conducts three types of audit: System audits, audits of operations and financial audits. It is important to know that the Audit Authority acts as the Commission's sole interlocutor for all questions relating to IPA as regards its functions and responsibilities and submits Annual Audit Activity Reports and Opinions directly to the responsible IPA DGs at European Commission as well as to the CAO and NAO. According to our risk assessments, the main risks / challenges in the IPA system are connected with:

- Delays in implementation - leads to the cancellation of funds (n+3 rule);
- Administrative capacity to prepare and implement projects;
- Compliance with Manuals and Procedures (accreditation package);
- Further strengthening of the institutional and management structure;
- Sufficient number of employees for managing EU programs;
- Continuous training on the implementation and monitoring of projects;
- Horizontal cooperation between stakeholders;
- Ensuring timely co-financing of programs/projects from the national budget;

- Strengthening local government units, non-profit and business sectors for the management and implementation of projects.

### **For an effective utilization of EU assistance**

For the effective utilization of EU assistance, it is highly recommended that beneficiary countries should establish networks with the other beneficiary countries which are implementing the same instrument, for exchanges of experience regarding possible risks and challenges, as well as the audit approach and measures implemented to mitigate risks. Bearing in mind that the European Commission (the IPA DG's) is the direct recipient of the Audit Authority's Annual Audit Reports and Opinions, it is very important that Audit Authorities establish smooth communication with the European Commission.

A properly established Audit Authority means that, on the national level, there is an independent professional audit body that acts as a safe-guard to ensure that the funds are implemented according to the Commission's rules and in accordance with the recommendations given in the Audit Reports; the Audit Authorities contribute towards improving the functioning of the management system established for the proper use of IPA funds, which will also lead to better absorption capacity on the part of the beneficiary country and help overcome the challenges in the process of approaching and obtaining status as a full member of the European Union.

During the audit activity, when the audit authorities find cases of irregularities or possible fraud, it is very important for them to react immediately and inform the authorities responsible. The audit authorities have the role of the external, independent auditor in the system of utilization of IPA funds at a national level, and it is very important that they should be properly set up in order to safeguard their functional, financial and professional independence. In the period before 2007, it was a general approach that audit authorities should be within the Ministries of Finance, but from the assessment performed in the IPA beneficiary countries (from 2007 onward), it can be concluded that the best possible solution for establishing Audit Authorities responsible for auditing EU assistance through IPA funds, is to establish them within the Supreme Audit Institutions of the beneficiary countries or as a totally independent legal entities (Agencies).

### **Future challenges**

In the forthcoming period, IPA beneficiary countries will be faced with challenges to improve their own capacities, especially bearing in mind the new 2014-2020 programming period, during which the European Commission will continue to support candidate and potential candidate countries in the process of receiving the status of member states.

Timely and continuous activities for improving the capacities of the Audit Authorities are also very important, bearing in mind that the (n+3) implementation rule is a characteristic of the 2007-2013 programming period (IPA I), which means that, IPA beneficiary countries will still be implementing projects from the 2012-2013 programming period in the coming years and will need to perform ex-post administrative and on-the-spot checks with a view to confirming the long-term maintenance of the investments, and, from 2014, will need to plan and perform audits covering the 2014-2020 programming period (IPA II).

Cooperation between the European Court of Auditors and the Audit Authority of the former Yugoslav Republic of Macedonia is an on-going activity, involving the sharing of knowledge and experience in the regional conferences of the Audit Authorities that have been organized from 2010 onwards. In the context of improved cooperation and the sharing of experience in the area of the audit of IPA funds, I had the pleasure, in 2010, of organizing the first regional conference of the IPA Audit Authorities in Veles, in which

the heads of the Audit Authorities and other IPA bodies from IPA beneficiary countries participated, as well as representatives from the European Court of Auditors and the European Commission (DG Enlargement and DG REGIO).

Good cooperation with the European Court of Auditors continued in the following years, and in 2011, Mr Hubert Weber – the former President of the ECA, participated in the Regional Conference held in Ohrid.

### **CONCLUSION**

ECA support for the Western Balkan countries is very important, bearing in mind that the Audit Authorities in candidate and potential candidate countries act as external independent audit bodies at the national level, responsible for auditing the proper utilization of EU funds and safeguarding both EU tax payers and national interests.

Bearing in mind the joint area of responsibility – the audit of EU funds, continuous cooperation between the European Court of Auditors and the IPA Audit Authorities enhances the effective functioning of the management and control systems established in the beneficiary countries for the proper implementation of EU assistance, as well as the reliability of the financial information sent to the European Commission.

The possibility of representatives from IPA beneficiary countries' joining the European Court of Auditors' internship program, organizing regional Audit Authority conferences with participation of ECA representatives and organizing joint audit activities in the field of auditing EU funds is very important for the IPA beneficiary countries. With this approach, the Court is directly supporting the Western Balkan countries and is giving added value to strengthen their capacities and, in the long term, establish proper Audit Authorities responsible for auditing EU funds.

My experience at the European Court of Auditors as the first participant from the SAI of the former Yugoslav Republic of Macedonia provided me with a remarkable added value and supported me in the process of my further professional development. How do you establish an Audit Authority? I have been asked many times. Well, how do you eat an elephant? One bite at a time. The act of starting and getting beyond the preliminary stage, where everything feels awkward, is 80% of the battle. I grabbed the opportunity. Working at the Court in the unit dealing with pre-accession assistance opened my eyes and increased my understanding of the Commission's needs regarding a properly functioning Audit Authority. Therefore, I would once again like to use this opportunity to thank personally my colleagues from the European Court of Auditors for their professional, communicative, constructive and open-minded attitude. They always had a positive attitude and a readiness to discuss and share their knowledge and practical experience during my internship period. I am glad this cooperation has continued until today.

# «CONTROL POWER” OF THE STATE AND THE ROLE OF THE AUDIT IN ADDRESSING THE CURRENT ECONOMIC CRISIS

By Associated Professor JUDr. Ladislav Balko, PhD., Member of the European Court of Auditors



at the Plenary session of the first annual international academic conference **BRATISLAVA LEGAL FORUM 2013** held on **10 and 11 October 2013** at the Comenius University and the University of Economics in Bratislava under the auspices of Mr. Robert Fico, Prime Minister of the Slovak Republic, dealing with the topic “The Role of the State and Law in Dealing with the Current Economic Crisis”.

Professor JUDr. Ladislav Balko, PhD., Member of the European Court of Auditors

## Introduction

Constitutional scientists might perhaps feel a little bit uncomfortable about the “control power”, which is in the headline of my speech and which also plays its role in these difficult times of crisis, but I will discuss this later on. To exercise control, the states create control mechanisms which, if they are to be meaningful, must be separated from direct state power, and this not only in a formal way (institutionally). It is not an easy task in real life.<sup>1</sup> For this reason, I formulate my reflections here about control power as a part of public power, in order to give a more accurate picture of legitimacy and the position of control and audit of states in finding the ways out of the crisis which we all have been experiencing for six years already, and which is significantly influencing the activities and functioning of states and their policies.

## When the crisis started

When discussing the position and the role of the state and of the law in addressing the current economic crisis, it is useful to say what in fact happened six years ago when the crisis started as a financial crisis and then grew into the economic crisis resulting in the current general debt crisis.

Although we are in the centre of the crisis events and we know many things about them, we often ask what had actually happened. What had happened in the area of finance and capital (because those are the main crisis areas) and thereby also in the functioning and behaviour of the states, and on the side of the politicians when searching for new policies and ways to get out of the current global disfunction? A malfunction has occurred. A malfunction in the workings of economic life in individual states and in the international community of states as well. A malfunction in the functioning of the capital, goods and labour markets. These economic forces, when balanced, keep the economy in equilibrium. This equilibrium is the result of the functional interconnection of all the mentioned markets – the capital market as well as the market of goods and the labour market, whereby all these markets are interdependent - they can't live one without the others, or more precisely, each one influences the others. But life and, especially, market oriented life (which is most often the building brick of today's world) is not so simple. So, it can happen, and it has happened, that the balance between these three markets was broken. Already in 1947, University Professor of Law, Minister of the Czechoslovak government and first Governor of the National Bank of Slovakia and later Dean of the Faculty of Law in Bratislava, Professor Imrich Karvaš (this conference takes place on the occasion of the 110<sup>th</sup> anniversary of his birth) very accurately named this phenomenon in his two-volume treatise “Fundamentals of Economic Science”. According to him, “**malfunctions in equilibrium are called crises**”<sup>2</sup>. And he goes

<sup>1</sup> <http://www.europeum.org/cz/integrace/34-integrace--12/837-stat-v-reflexii-europskeho-myslenia-pravny-stat-a-jehopiliere-na-prahu-21-storocia>

<sup>2</sup> Karvaš, Imrich.: Fundamentals of Economic Science, 2<sup>nd</sup> volume, Matica Slovenská, Turčiansky Sv. Martin, 1947, pp.159 and following

on: “The problem of the crisis can be observed from two perspectives. First, we must clarify the essence and nature of the crisis from the theoretical point of view, and then we study the appearance of the crisis also from the causal-historical point of view. The theory explains us the relations between the economic parameters and the changes in these relations, and it does so in an abstract way. Specific changes, their intensity, as well as the search for the causes are the subject of causal-historical exploration”.

### **The causal-historical point of view**

This could be a challenge for contemporary economists and lawyers - to point out the underlying relationships from the current point of view and explore them from the causal-historical point of view. Because the crisis will pass, but the social and economic phenomenon will always exist and without any doubts will reoccur in the future. So, there should be a historical obligation of the contemporaries to record our vision of the current crisis and to not only reflect the specific economic and legal events when dealing with the crisis, but also to give instructions on how to get out of it. But once again I would like to go back to the insights of Professor Karvaš that are still topically relevant. “Theoretically, the infringement of equilibrium may lead to an increase or decrease in economic activity. **We speak about a crisis when equilibrium in the economy is shifted.** We know that there is a mutual dependence between prices and production, between prices and consumption, between production and revenues, between prices and the creation of capital, etc. One economic relationship fits into another and thus a change in one causes a change in all other relationships. Primary changes, i.e. those which caused the disbalance in economic relations, cause secondary changes, i.e. those which occur later in other markets. However, in turn these secondary changes then influence the market with the primary changes. This two-way influence of changes results in the levelling of the economic balanced powers. The on-going tendency towards the economic balance is the basic element of the individual-focused economy”<sup>3</sup>. This way of characterising the crisis, albeit of an older time, represents today’s situation of this social and economic phenomenon<sup>4</sup>. There is no doubt that it is the states, with the help of the law, who have to fight this social and economic phenomenon, willingly or not.

### **But today’s crisis is also a social crisis, a crisis of trust, of morality and of values, i.e. a crisis of civilization.**

That is why its solution will be more difficult, longer and more painful. The moral hazard of most states and specific measures they have adopted can be regarded as a huge danger. Especially those which emerged after the beginning of the crisis, in an attempt to solve the situation immediately. In its first package of measures, the USA directed roughly \$ 800 billion for the solution of the banking and financial crisis. The first package was followed by others. Where are those billions of dollars or any other currency today? It looks as if they have evaporated. The old EU Member States, Russia, China, Japan, Switzerland etc. acted and keep acting accordingly. With little effect as well. This example can be used to formulate a hypothesis that the pumping of money, in the form of the governments’ packages of measures, into the banking and financial system followed only one goal. To change toxic and practically worthless bank assets into real and guaranteed assets of the state. The reason is clear, i.e. to change the virtual, unreal and valueless profit of the banks into real profit covered by the state assets. This will be paid by the citizens<sup>5</sup>.

<sup>3</sup> Karvaš, Imrich.: Fundamentals of Economic Science, 2<sup>nd</sup> volume, Matica Slovenská, Turčiansky Sv. Martin, 1947, pp.159 and following

<sup>4</sup> Professor Karvaš mentioned the financial and economic crisis also in other works, e.g. ‘Currency Problem’, Bratislava, 1929; ‘State Revenue and Boom of the Economy’, Bratislava, 1931; ‘The impact of Cartels on the Boom in the Economy’, Bratislava, 1932; ‘Harmonisation of the Production Conditions in the Czech Territory and Slovakia’, Prague, 1933, and ‘Time Issues in the Economy Theory’, Bratislava, 1937

<sup>5</sup> Bonko, Anton.: in: [http://dolezite.sk/Kriza\\_ekonomiky\\_alebo\\_spolocnosti\\_priciny\\_vyvoj\\_dosledky.html](http://dolezite.sk/Kriza_ekonomiky_alebo_spolocnosti_priciny_vyvoj_dosledky.html)

**Human beings were able to find solutions for many different crisis phenomena in the past. Undoubtedly, it will also happen now. Though the question is how and when?**

Firstly, it is the states that have to look for the solution. Fortunately, in today's global and mutually interdependent world, the mutual effort of the states' communities also counts. It is also the case of the European Union, as a typical representative of a community of European states, which, based on a treaty, must inevitably proceed in a unified manner in an effort to overcome the crisis. And this even if the crisis doesn't affect all the states in the same way. Also, there are different opinions of the anti-crisis proceedings today. Should the states act in a unified manner or separately? These questions were also asked, for example, during the Great Depression eighty years ago. According to opinions of those times<sup>6</sup> “the reason for differences in the plasticity of the crisis lies in the fact that many states care only for themselves when dealing with difficulties, when solving the crisis they rely more on their own forces than on attempts to find a worldwide solution, which failed, as we can find out from unsuccessful world conferences. Opinion prevails that the world crisis resulted from mistakes of individual states, and the best way to overcome it will be if the states persevere independently curing the illnesses of their own economies. Solving the crisis independently in individual states, and the acquired knowledge, will simplify and make the solution to the crisis worldwide easier. **By solving the crisis by their own means in individual countries, the countries will come to an overall solution.**”

**The need for proceeding jointly**

Although nowadays individual states search for solutions inside their territory, the states' representatives realise the need for proceeding jointly. In a resolution adopted in October 2008, the European Parliament highlighted the significance of European macroeconomic policies reacting quickly with the aim of retrieving worldwide economic growth in such a way that the stability and growth policies would not be infringed. It called for further coordinated interventions aimed at regaining the trust of the markets<sup>7</sup>.

Because we are at a conference about the role of the state and law, any insights regarding the state and law and their role in dealing with crisis impacts and how to find a way out, without mentioning the constitutional work by Baron Montesquieu, would be a serious mistake. Three and a half centuries ago, his “De l'esprit des lois” defined the three branches of government – legislative, executive and judiciary. Based on the position of the state and law at that time, it could hardly predict something that I think should be explored and scientifically explained by constitutional science. Namely, the heading of Chapter 12 of the Constitution of the Kingdom of Sweden: The control power. And not only the heading of this chapter of the basic law of one of the most democratic countries. The phenomenon of the control comes to the fore more and more, and there are already opinions which consider it as the fourth branch of government. It is not really a contemporary phenomenon. The Emperor Qin Shi Huang, who unified China, was the first sovereign in the world to understand that a huge administration system is a breeding ground for corruption, against which a well-functioning control system could help. Therefore, he had an edict on the establishment of the independent state control carved in a stone stele. This stone ‘document’ can be seen today in the residential city of the first Chinese Emperor in Siam<sup>8</sup>.

**What sort of control should we consider as the fourth branch of government?**

Is it not a too brave a consideration? Naturally, when someone hears the word ‘control’, he thinks of control in the area of finance. If we look at control from the point of view of the features of the individual branches of the state power, one basic postulate emerges. States need a solid and

<sup>6</sup> For the Economic Restoration of the State, Ústřední dělnické knihkupectví, Prague, 1935, page 7 and following

<sup>7</sup> [http://www.europarl.europa.eu/news/expert/infopress\\_page/004-40027-294-10-43-901-20081020IPR40025-20-10-2008-2008-true/default\\_sk.htm](http://www.europarl.europa.eu/news/expert/infopress_page/004-40027-294-10-43-901-20081020IPR40025-20-10-2008-2008-true/default_sk.htm)

<sup>8</sup> <http://www.europeum.org/cz/integrace/33-integrace--11/794-fungovani-nejvyssich-kontrolnich-instituci-v-zahranici>

reliable material foundation for them to work. Money. Although the state has great powers, it can't simply print money. But it is the state and as such it can do anything. Or can it? But the state can obtain the necessary resources by its own means, through exercising its powers. In particular, the legislative and executive powers. The law obliges any economically active entities, including citizens, to give to the state a part of their property. Money, as a statutory compulsory payment. Hence, the state partially deprives its citizens of a part of their property by adopting tax laws. We are all aware that the property is sacred. If the state deprives its citizens of their own property through the law, then the end of this process, i.e. the use of this property, must be properly protected or guarded, or still better, controlled. If Baron Montesquieu named the adoption of laws as legislative power, and the management of the state as executive power, why should the control of finances, its specific mechanisms, rules, systems and institutional structure not be as well a separate branch of state power since the state withdrew it by force from its citizens? But it can be objected that the control does not possess the attributes of power. Power, simply said, is the possibility to give orders and be able to coerce to the fulfilment of the orders. Is it also the case of the control? Every state has developed a mechanism of control of the public power management as well as a supreme audit institution whose independence is normally assured in a constitutional manner. It is undisputed that state activity affects all areas, especially the social and economic, and thus we cannot speak only about the financial framework of such control. This is a deep seepage of audit institutions' activities into certain aspects such as: the proper and effective use of public funds, the evaluation of efforts aimed at a reliable management of the economy as well as the proper conduct of administrative activities by the state. Control has become a part of the system of state governance whose aim is to detect any deviations from the adopted norms, violation of the principles of legality, effectiveness, efficiency and the economy of managed resources so as to be able to adopt rectification measures in a timely manner, to hold those liable to account, to claim damages, or to amend legislation in order to prevent the defects from recurring. Control is not a toothless tiger and so it is not powerless. In most cases its findings are just recommendatory, but it may have an impact on legal amendments, or it may even result in holding relevant authorities to account. This was also the case of the findings contained in the Commission's report led by Dutch auditor Paul van Buitenen at the end of the 1990s, when the whole Commission led by Jacques Santer had to resign. The European Parliament adopted a new 'Financial Codex' of the EU – the new Financial Regulation.

### **National Supreme Audit Institutions**

A uniform worldwide control model does not exist and thus it is up to the states to decide on how they deal with this issue. In any democratically-oriented state there are independent external financial control bodies (outside the system of entities under control). These are the Supreme Audit Institutions (SAIs), whose task is to inform the public (that is, those from whom the state power comes) and parliaments about how the individual state bodies and institutions, as well as public and private entities deal with state and public funds entrusted to them, and which come from the citizens as I have already mentioned<sup>9</sup>. Six decades ago these control institutions, as bodies of UN Member States, associated themselves in the world International Organisation of Supreme Audit Institutions (INTOSAI), which is nowadays made up of almost 200 Supreme Audit Institutions<sup>10</sup>. Despite the fact that these institutions differ in powers, organisation, function, etc. there are in fact four basic types of national Supreme Audit Institutions.

- Germanic-Scandinavian control, which is characterised by close ties to the Parliament; however, these institutions don't have the power to issue binding orders – this is the case of the SAI in the Czech and Slovak Republics.

<sup>9</sup> <http://www.europeum.org/cz/integrace/34-integrace--12/837-stat-v-reflexii-europskeho-myslenia-pravny-stat-a-jeho-piliere-na-prahu-21-storocia>

<sup>10</sup> <http://www.europeum.org/cz/integrace/34-integrace--12/837-stat-v-reflexii-europskeho-myslenia-pravny-stat-a-jeho-piliere-na-prahu-21-storocia>  
<http://www.europeum.org/cz/integrace/33-integrace--11/794-fungovani-nejvyssich-kontrolnich-instituci-v-zahranici>

- Court of Auditors of the French legal sphere with the judicial control over accountants; the Court of Auditors decides by judicial decisions.
- Chief Comptroller of the English legal sphere with close ties to the Parliament based on common law system which is different from other legal cultures.
- Latin-American accounting control institutions with close ties to the Parliament. In some countries, they are established as a court or besides the control institution there is also an accounting court of justice which conducts the legal proceedings on the basis of initiative of the control institution<sup>11</sup>.

Through three types of audit, the control power and audit signals, monitors, reviews and offers its point of view on all issues of the management of public finances which are the most affected by the crisis and from which the solution to exit the crisis is expected. Therefore, the control can effectively help states, but also other entities such as the EU, deal with a complex of complicated relationships caused by the crisis. It can do so through financial audit, compliance audit and performance audit. The first two evaluate the reliability of public accounts, legality and regularity of financial transactions, the last one - performance audit - is three-E-oriented – economy of the management of public finances, efficiency and effectiveness.

### **The European Court of Auditors**

A specific body for external financial control, the European Court of Auditors, carries out its tasks within the institutional system of the European Union, as a public entity. When it came into existence, the President of the European Court of Justice, Mr Hans Kutcher, called it the financial conscience of the EU. It is exclusively the external audit body of the EU, and there are no hierarchical relationships between it and the national Supreme Audit Institutions. It does not have any judicial powers. It consists of 28 Members appointed by the Council of the European Union after a secret vote in the European Parliament. Due to the Protocol on Privileges and Immunities, the Members enjoy the same status as judges of the European Court of Justice. The Members participate in the work of the Court through college meetings and also in five specialised Chambers. During the meetings, they do not only adopt the audit findings but they also express their general views and specific remarks about the individual audited European policies. When performing their duties they shall not seek or accept instructions from any government or other authority.

The main mission of the Court is to determine whether all financial operations were carried out in compliance with the law and in accordance with the principles of sound financial management. When carrying out the audit, it is vested with broad powers based on the Treaty on the Functioning of the EU which grants it the access to the premises and documents of not only all EU bodies but also of every EU-money beneficiary. Thus, it can exercise its power in the territory of both Member and non-Member States of the EU. This way the Court helps the Council of the EU and especially the European Parliament to carry out efficient political control of financial management while providing them with a highly professional foundation. With this aim, it provides the European Parliament and the Council with a statement of assurance (DAS), which represents the main basis for Parliament's granting budgetary discharge to the Commission. Furthermore, the Court issues around twenty Special Reports annually as a result of performance audits on specific issues of EU financial management. These Reports provide specific conclusions and in particular recommendations for the Commission, other institutions and bodies, and often indirectly also for the Member States. The Court expressed its intention to fight against the crisis in 2009 already when it created a working group which then drafted a document (Position Paper) under the title '**Consequences for public accountability and public audit in the EU and the role of ECA in the light of the current financial and economic crisis**'. This document stressed that "the financial crisis raised new issues related to public audit in the European Union. Within its mandate the Court will carry out audits in relation to new supervisory authorities, assistance mechanisms with EU budget guarantee and – to the extent

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<sup>11</sup> <http://www.europeum.org/cz/integrace/34-integrace--12/837-stat-v-reflexii-europskeho-myslenia-pravny-stat-a-jeho-piliere-na-prahu-21-storocia>

possible – the Commission’s activities in the European Semester. However, the Court also identifies cases where public audit arrangements are not adequate. For example, the Court considers that the Treaty establishing the European Stability Mechanism should include provisions for public external audit. Finally, the Court notes a number of cases where accountability and transparency issues need to be reflected on by the competent institutions within the Union, in particular the European Parliament and Council. They concern accounting and audit standards, central banking activities and the follow-up of fiscal policies under the new set of rules being established”<sup>12</sup>.

### **The Court’s audit future**

In terms of the Court’s audit future, we can distinguish three different types of activities. They share some common elements and also some significant differences. It is the EFSM and the Balance of Payments Facility which are managed and administered by the European Commission and guaranteed by the European Union. The European Court of Auditors has full audit rights as well as the obligation to carry out the financial audit of these operations within the annual statement of assurance. The second type of instruments in terms of the Court’s audit rights consists of the Greek Loan Facility and EFSF. Here ECA’s audit rights do not result from the Treaty on the Functioning of the European Union, at least not directly. However, the European Commission and the European Central Bank play a key role in the operation of these instruments, e.g. setting loan conditions and monitoring compliance. But as the Court shall audit the use of administrative expenditure of the EU institutions (as well as the operational efficiency of the ECB), it has the possibility in this way to audit these instruments as well. Finally, there is the ESM, which is the newest permanent mechanism. The ECA does not have the right to audit the ESM as an institution. However, it has the right to appoint one out of the five members of the ESM Board of Auditors.

The Member States’ Supreme Audit Institutions form an integral part of the control system of the management of the EU funds. Control of the EU funds is the area where the competences of the SAIs and the Court meet. As a result of an increasing decentralisation of the EU management and power delegation to the Member States’ bodies, the main focus of control moves from the Court of Auditors to the Member States. Thus, cooperation between the ECA and SAIs is no longer only a legal obligation but it becomes a necessity resulting from a closer intertwining of competences of the Union bodies and the Member States’ bodies. Although the individual SAIs communicated with each other and shared information on a regular basis, it proved necessary to develop and harmonise the audit approaches of relevant institutions and ensure the greatest possible compliance with international auditing standards. The cooperation between the Supreme Audit Institutions of the EU Member States and the European Court of Auditors is performed mainly through the Contact Committee of the SAIs of the Member States, composed of the Presidents of the SAIs (including the President of the Court of Auditors), the Liaison Officers’ Committee and the Working Groups for different audit areas. During the cooperation, the principles of independence and the constitutional mandate of each institution are adhered to. The Contact Committee encourages cooperation and puts into practice common initiatives for the development of methodologies and the strengthening of functional efficiency of the institutions’ work.

### **The cooperation ECA/SAIs**

This cooperation became more dynamic when dealing with issues related to the crisis. The course of the crisis confirms that states are capable of dealing with the crisis mainly through public finances. Their efforts cannot be borderless. Even in the times of crisis the “rules of the game” for the use of public finances must be adhered to. In October 2011, the SAIs of the Member States including the Court of Auditors reiterated the requirement to further develop transparency, accountability and public audit.

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<sup>12</sup> <http://eca.europa.eu/portal/pls/portal/docs/1/12868760.PDF>

In May 2013, the heads of the European Court of Auditors and European Union Member States’ Audit Institutions addressed the President of the EU, Mr Van Rompuy, in connection with the search for further ideas and other efficient ways out of the crisis. They invited the European Council to enact legislative measures that strengthen audit and accountability within EU economic governance<sup>13</sup>. The Supreme Audit Institutions of the EU Member States and the European Court of Auditors closely follow the developments connected with the Economic and Monetary Union and EU economic governance, with particular attention given to the associated audit and accountability arrangements. They have called for policy and legislative measures that strengthen audit and accountability when completing the Economic and Monetary Union, the banking union, and the strengthened coordination of EU economic policy<sup>14</sup>. They emphasise the principles which are to be respected when dealing with public finances, mainly through:

- **building a coherent accountability and audit framework**, where the respective roles of the European Parliament and national parliaments in the legislative and accountability processes, and their mutual relations in this respect, are indispensable and should be preserved;
- **recognising the importance of public external audit in EU legislation**, when an independent and adequate external audit at the EU and national levels is paramount for providing legislators and citizens with assurance and information on the legal, effective, efficient and economic use of public finances and implementation of policies;
- **strengthening audit arrangements in respect of the banking union** which provides sufficient audit coverage of prudential supervision of credit institutions within the proposed banking union;
- **incorporating audit arrangements in the area of fiscal discipline** so that the role of external public audit in the field of enhanced fiscal discipline is considered;
- **improving transparency and audit coherence of the financial stabilisation instruments** through efficient, transparent and comprehensive public external audit arrangements for the different European financial stabilisation funds.

Certainly, there are many more discussions, plans and also final decisions. However, all of them prove that the ‘control power’ has its meaning, mission and significance, and that in the public power structure it is becoming a very effective and reliable tool in the interest of democratic governance. Without any doubt, in the course of time the states and the law will explain the control power and its position in the governmental structure not only practically but (as we are at a university) also scientifically.



13 <http://eca.europa.eu/portal/pls/portal/docs/1/22574802.PDF>

14 <http://eca.europa.eu/portal/pls/portal/docs/1/22548778.PDF>



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