02 Special Report 17/2014: Can the EU’s centres of excellence initiative contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU?
Interview with Karel Pinxten, ECA Member
By Rosmarie Carotti

04 Special Report 14/2014: How do the EU institutions and bodies calculate, reduce and offset their greenhouse gas emissions?
By Ladislav Balko, ECA Member

06 The EU: from the outside looking in
H.E. Urs Hammer, Swiss Ambassador to Luxembourg explains the nature of the Swiss direct democracy and Switzerland’s relations with the EU
By Rosmarie Carotti

09 THE 20TH ANNIVERSARY OF THE COURT OF AUDIT OF THE REPUBLIC OF SLOVENIA
Watching over the trail of public spending
By Tomaž Vesel, President of the Court of Audit of the Republic of Slovenia

12 2004 TEN YEARS ENLARGEMENT 2014
From Euphoria to Fuzzy Accountability and back to New Hope: a Bumpy Decade in an Enlarged EU
By Alar Karis, Auditor General, National Audit Office of Estonia, Ines Metsalu, Head of Financial Audit Department and Urmet Lee, Advisor to the Auditor General

17 Presentation of the 2013 Annual Report and discussion about ways of enhancing the cooperation between the ECA and the Hungarian State Audit Office
By Szabolcs Fazakas, ECA Member

18 Presentation of the 2013 Annual Report to Austrian authorities and stakeholders
By Margit Spindelegger, head of private office

20 Promoting the ECA’s visibility in Poland
By Mariusz Pomierski, formerly head of private office

21 FOCUS
- Special reports Nos 17, 19, 20 /2014
- Adoption of a UN resolution strengthening Supreme Audit Institutions
- Back to School: Our colleagues help youth across the EU better understand the role of the EU and the ECA

25 The use of financial instruments in European Structural and Investment funds - what are the improvements in the legal framework for the 2014-2020 programming period from an audit perspective?
By Dennis Wernerus, formerly auditor in Chamber II and Rares Rusanescu, auditor in Chamber II
Can the EU’s centres of excellence initiative contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU?

Interview with Karel Pinxten, ECA Member

By Rosmarie Carotti

This report was presented to the European Parliament by Karel Pinxten, ECA Member, on 22 January 2015.

R. C.: CBRN stands for chemical, biological, radiological and nuclear risk which can be of criminal, accidental or natural origin. After the Chernobyl disaster the EU contributed with the TACIS programme to offset nuclear risks. In what way is the CBRN action plan different?

Karel Pinxten: The Chernobyl disaster occurred in 1986 and raised concerns in the European Union about nuclear facilities, nuclear waste, and unemployed former nuclear scientists.

In 1991, the Commission launched the TACIS programme to provide technical assistance to thirteen countries of the New Independent States (NIS) in Eastern Europe and Central Asia.

The TACIS programme had some flaws. The approach was predominantly ad-hoc rather than forming part of a longer-term strategy. It was supply driven and the Commission provided a wide range of technical assistance. There was very limited ownership from the countries concerned.

With this new Initiative the accent was put on tackling chemical, biological, radiological and nuclear risks outside of the EU. The Initiative, which involved the creation of regional Centres of Excellence, was taken to protect the EU from threats emanating from the lack of control of nuclear and chemical materials, illegal trafficking etc.

The difference with the TACIS programme is that the course of action is not dictated by the Commission. It is demand-driven and bottom-up although that does not exclude that in some cases the Commission can take the initiative.

Secondly, the Initiative forms part of a long term strategy. The ECA shares the Commission’s view that a focused regional approach is appropriate.

The Instrument for Stability (IFS) was launched in 2006 by the Commission and aimed at maintaining stability at the border of the European Union. The Centres of Excellence Initiative, which comes under the IFS, was started in 2010 and allocated a budget of 100 million for the period 2010-2013.

R. C.: This does not sound much. Who else contributes? And what bodies play an important role at European and national level?

Karel Pinxten: The Instrument for Stability allocation for the whole period 2007-2013 for both short and long-term components amounts to €1.8 billion. With a budget of €100 million for three years the Initiative is the single biggest measure of the long-term component of the Instrument of Stability.

There is also some logistical support from individual countries but it is mainly the European Union which provides the financing. The United Nations are involved through UNICRI, the UN Interregional Crime and Justice Research Institute. The Commission considered it useful to involve UNICRI because it can bring countries together and get them on board.

The Atomic Energy Agency in Vienna also takes a number of initiatives in the area of CBRN risk management but is not directly involved in the Centres of Excellence Initiative.

The European External Action Service (EEAS), the body responsible for the EU foreign policy, determines the strategic orientation of the Initiative through the indicative programmes of the IFS.
EuropeAid, the Commission’s department for development aid, is the decision-making body and is responsible for the implementation of the actions. It monitors the work of the implementing bodies, the Commission’s Joint Research Centre and UNICRI.

Then there are structures in each of the Member States. Partner countries – of which there are over 40 – cooperate through regional secretariats. Each partner country appoints its national focal point to coordinate the work done by the CBRN stakeholders in their country.

R. C.: Is this not an overly cumbersome and bureaucratic way of handling such risks and emergencies?

Karel Pinxten: If you look at the structure, one has to agree that it is rather complicated. There are regional secretariats, focal points, governmental teams and non-governmental NGOs. But it would be very difficult to have a simple structure to enhance regional co-operation. Focal points, for example, were created to reduce bureaucracy as otherwise regional secretariats would have to deal with a surfeit of national institutions.

There is another aspect, which is very delicate. Many of the countries have rather tense relations with their neighbours and are reticent to share knowledge with them. However by taking part in the initiative they have to do so to a certain extent. This is where the UN plays an important role.

R. C.: What is really meant by “regional”?

Karel Pinxten: The Commission defines what constitutes a region. For the Middle East, for practical and political reasons Iraq, Jordan and Lebanon were put together. For Central Asia, Kyrgyzstan, Tajikistan and Uzbekistan were taken together.

We say in the ECA report that there is need for more focus. It would be beneficial if the Commission, for the implementation of the programmes in the future, focused on the areas of most relevance to EU security.

R. C.: The ECA carried out the audit between October 2013 and January 2014. The ECA can only judge the work done by the European Commission, the External Service, its delegations and other services. But was there any feedback from the outside, from other stakeholders?

Karel Pinxten: We consulted with a wide group of concerned parties outside the Commission. We carried out two missions to Rabat and Amman and discussed the concerns of the regional secretariat staff, country representatives and United Nations staff.

R. C.: How does the system work in case of a real accident? Did the system operate correctly in the recent Ebola outbreak? What has been achieved in terms of non-proliferation?

Karel Pinxten: At the time of the ECA audit there were seven regional centres and one more is under negotiation. Once the regional centres are informed about a problem, a nuclear accident or the outbreak of a disease, they know exactly what to do and what plan of action to follow.

Concerning the Ebola outbreak, there is a regional centre in place in western Africa which provided the platform for a number of useful initiatives.

Regarding non-proliferation, again, there is a structure in place: a regional centre with one person appointed by the local government and an assistant appointed by the UN.

I personally went with my head of private office to the regional centre of the Middle East in Amman. The Initiative tackles a serious problem there in a very volatile region very close to the European Union borders.

We think that more staff are needed for the regional centres. And there is room for improving the co-operation with the delegations of the Commission which in our view should have played a more important role.

R. C.: What were the main deficiencies and gaps between the planned and real output of the Initiative?

Karel Pinxten: These are the early days of the Initiative. The ECA points out that progress has been slow and that the original implementation plan could not be fully applied. Key elements such as the needs assessments had not yet been completed before projects were selected.

The ECA nevertheless considers this to be a promising Initiative that needs to be carefully nurtured in order to achieve its potential. It aims to curb safety risks by tackling the problems in areas of the world that are in the frontline of the fight against CBRN risks. By helping these countries cope with risks on their doorsteps it is hoped that these threats will not escalate.

The European Parliament, in its resolution, fully backs what the ECA says in this report.

As regards a subsequent audit of the effectiveness of the Initiative no decision has yet been taken. However such an audit may well be included in a future work programme of Chamber III of the ECA.
Special Report 14/2014: How do the EU institutions and bodies calculate, reduce and offset their greenhouse gas emissions?

By Ladislav Balko, ECA Member

For the European Union's climate policy to be credible, the EU institutions and bodies need to lead by example when it comes to reducing greenhouse gas emissions in order to prevent climate change. By reducing their so-called ‘carbon footprint’, public administrations throughout Europe can contribute significantly to the EU’s reduction targets for emissions. This audit examined how the EU institutions and bodies are tackling the challenge to contribute to the EU 2020 objective of reducing emissions by at least 20% below the level of 1990. In other words, the Court assessed whether we, as EU institutions, follow, and live up to, our own advice given to the national authorities, businesses and citizens within and outside the EU. We looked at all EU institutions and bodies with more than 500 staff in 2012, plus the European Environment Agency because of its specific tasks directly related to the audit topic. In total 15 EU institutions and bodies were covered.

The Court examined whether these EU institutions and bodies:

(a) calculated their GHG emissions, reduced those emissions and compensated for residual emissions through offsetting;

(b) made full use of the environmental management tools promoted by the Commission to help reduce emissions, namely the European eco-management and audit scheme (EMAS) and green procurement.

So what are our main findings?

First, some EU institutions and bodies have taken important steps but overall they did not establish and implement a common policy for contributing to the Union's 2020 goal of reducing GHG emissions by 20%. In 2013, more than half of the audited EU institutions and bodies had not set any quantified targets for reducing their emissions. In the Court’s view, setting such quantified reduction targets and making them public is important for planning and ensuring the sustainability and the credibility of the institutions’ environmental management.

Second, the 15 audited EU institutions and bodies have no common approach for monitoring their GHG emissions. Six of them did not report their emissions. Those who did report did not calculate or disclose the full extent of emissions. This is also partly due to the fact that binding EU legislation on calculating the carbon footprint of public administrations does not exist. Consequently, the full carbon footprint of the EU institutions and bodies is not known, and the patchy information that is available risks undermining the credibility of the reporting and mitigation efforts.

Third, efforts to mitigate emissions have produced tangible results. After 2005, the EU institutions and bodies managed to reverse the trend of increasing emissions related to their buildings. But the reductions achieved so far are largely attributable to the purchase of electricity generated from renewable sources. By the time of this audit, all audited EU institutions and bodies covered all, or at least a significant share, of their external electricity supply with green electricity. Such electricity generally counts as a zero emission in carbon footprint calculations. It is a one-off measure which allows a quick and visible reduction in emissions. But green energy alone is not enough, in addition measures are needed to reduce the overall energy demand related to buildings.

Fourth, the EU institutions and bodies do not pay sufficient attention to emissions caused by mobility. Due to our specific nature as international institutions emissions from travelling, and in particular from travelling by plane, tend to be more
significant than is the case with the majority of administrations in Member States. However, the data available are so limited that it was not possible to make a trend assessment over a meaningful time span.

Fifth, the audited EU institutions and bodies have made only limited use of voluntary offsetting. This is a mechanism to compensate for your own emissions by paying for an equivalent carbon dioxide saving made elsewhere in the world. In the Court's view, using high-quality offsets in addition to emission reduction measures (and not instead of such measures) would appropriately address the concerns raised by managers in those institutions and bodies which do not currently offset their emissions, such as that offsetting is premature as long as all possibilities to reduce emissions have not been exhausted, or that quality of offsets is not always sufficiently guaranteed.

Sixth, the EU institutions and bodies do not make full use of the environmental management tools promoted by the Commission.

As regards EMAS, progress in introducing it has been slow – registration has been possible since 2001 and 13 years later, in June 2014, only seven of the fifteen audited EU institutions and bodies were registered, while five others were preparing for registration. EMAS at the Commission had significant scope limitations, but, in November 2013, the Commission undertook to apply EMAS to all its activities and sites within the European Union in due course.

As regards green procurement, i.e. procurement of goods, services and works with a reduced environmental impact throughout their life cycle, this is treated as an option rather than an obligation and only a few EU institutions and bodies used it systematically. The Court found that more than half of the 160 relevant procurement procedures examined included only weak environmental criteria or no such criteria at all. The issue of green procurement is addressed again in the Court's opinion, adopted last week, on the proposed amendments to the EU Financial Regulation. The opinion specifically refers to paragraph 80 of this Special Report and to the fact that the legal obligations imposed on EU institutions with regard to green procurement are currently less demanding than those imposed by EU legislation on Member State authorities. As regards the Commission's standards for better energy performance, we found that these voluntary standards are not systematically used for new buildings and major renovation projects, in particular not for buildings in Brussels. Finally, the audit found that none of the audited EU institutions and bodies had signed up to the voluntary European Code of Conduct for Energy Efficiency in Data Centres.

Based on its above findings and conclusions, the Court makes several recommendations, of which the first is addressed specifically to the Commission and the remaining ones to the EU institutions and bodies in general.

1. The Commission should propose a common policy for reducing the carbon footprint of the administrative operations of the EU institutions and bodies, which should include a quantified overall absolute reduction target for greenhouse gas emissions for the year 2030

2. The EU institutions and bodies should introduce a harmonised approach for calculating and reporting their carbon footprint. In addition to direct emissions the reporting should include also all relevant indirect emissions and allow progress in achieving reduction targets to be measured.

3. The EU institutions and bodies should develop a common approach through EMAS to compensate for their residual greenhouse gas emissions on a voluntary basis. When offsets are used, they should be of high quality, verified under recognised schemes, and targeted on projects which contribute also to sustainable development in terms of benefits for the local population concerned.

4. All EU institutions and bodies should register with EMAS and implement it while progressively reducing any scope limitations. They should also consider signing up to the European Code on Data Centre Energy Efficiency.

5. Green procurement should be used by the EU institutions and bodies, wherever possible. The financial rules and/or the procurement rules applicable to the EU institutions and bodies should provide the tools for contributing to the protection of the environment and sustainable development, while ensuring that they can obtain best value for money for their contracts.
The context

This presentation was one of a series aimed at providing the staff of the European Court of Auditors with an overview of how the European Union is perceived by external countries. It was a joint initiative of President Vítor Manuel Caldeira, Eduardo Ruiz Garcia, Secretary General and the professional training of the ECA.

The Swiss Confederation is surrounded by countries belonging to the European Union. In 2013, Switzerland was the second largest market for EU goods (after the US) and ranked number four among the most important trading partners (after US, China and Russia). Despite its geographical situation, Switzerland attaches a high importance to sovereign decision-making process.

The Swiss perspective is unique, said President Caldeira. Switzerland shares with the EU history, languages, tradition and values; it has integrated acquis communautaire and runs projects with the EU. But it has not joined the EU.

The EU from a Swiss perspective

1992 was a decisive year for the relations of Switzerland with the EU because 50.3% of the Swiss voted against joining the European Economic Area (EEA), even though the government and all the major parties except for the Swiss People’s Party and the Green Party were in favour. As a consequence of the system of direct democracy exercised through the instruments of referenda and popular initiatives, it sometimes happens that a majority of the voters take other decisions than those proposed by government and parliament.

Shortly before this vote, the Swiss government had deposited a request in Brussels to negotiate Switzerland’s accession to the European Communities.

Since then Switzerland’s request to open negotiations for an accession to the EU has become obsolete. Switzerland remained a member of EFTA and has had to find alternative ways to handle its relations with the EU.

After several years’ negotiations a first package of agreements was signed, other bilateral agreements followed. In 2005, the association to Schengen/Dublin was accepted by a majority of 54.6%. Switzerland is also associated with Europol and Eurojust, and some European agencies and programs like Galileo. On the whole, there are more than one hundred bilateral agreements with the EU.

Due to its geographical location, Switzerland also often takes over the acquis communautaire on an autonomous basis. At present, Switzerland and the EU are in negotiations regarding the electricity dossier, institutional questions, and Switzerland’s participation in the EU’s cultural promotion program, tax issues and emissions trading schemes.

The economic and financial crisis

As a consequence of the economic and financial crisis, Switzerland was confronted with a massive revaluation of the Swiss Franc and in 2011 a
minimum exchange rate of 1.20 against the € was fixed which was only lifted very recently. In order to enforce this minimum rate, the Swiss National Bank purchased large amounts of foreign currency, indirectly contributing to the stabilisation of the euro. At the same time, tourism as well as export-oriented industries in Switzerland have suffered from the high exchange rate.

**The issue of immigration**

Since 1992 Switzerland has applied the so-called bilateral approach which has been confirmed regularly by the Swiss population. It is considered an appropriate instrument to keep a balance of interests with the EU and a solid political consensus within Switzerland. The goal of the government is to consolidate and develop further this bilateral approach through new agreements in areas of common interest. The EU, on its side, showed a strong interest in simplifying the whole construction of bilateral agreements by means of a new institutional framework. On this issue some progress has since been made in the negotiations with the EU on an agreement providing an institutional framework for the acquis take-over, interpretation, surveillance and dispute settlement for both existing and future market access agreements. However, certain questions still remain to be solved.

After Luxembourg, Switzerland has with 23% the highest rate of foreigners in all Europe. In 2014 free movement of persons was fully implemented for 25 EU member states. A transitional regime is applicable to Bulgaria and Romania until 2016.

On 9th February 2014, the Swiss accepted by 50.3% an initiative against mass immigration. One consequence is that the Protocol concerning the enlargement of the agreement of free movement of persons to Croatia remains unsigned by Switzerland.

As an immediate consequence, the EU froze the negotiations on the association of Switzerland to Horizon 2020 and to Erasmus+. In December 2014, Switzerland and the EU signed an agreement on partial association to Horizon 2020, which will initially run until the end of 2016. Its continuation beyond 2016 depends on a solution found to the free movement of persons and its extension to Croatia.

**Recent developments**

Just recently the EU Ministers of Foreign Affairs declared that they would not enter into discussions on the principle of the free movement of persons. But also the EU is interested in finding a way out of the impasse.

A joint statement on business taxation was signed on 14th October 2014 in Luxembourg where Switzerland reafirms its intention to abolish certain tax regimes within the framework of the Swiss Corporate Tax Reform III, particularly those that provide for different treatment of domestic and foreign revenue (ring-fencing).

In October 2015, there will be parliamentary elections in Switzerland.

**Future relationship CH-EU**

As a result of the vote in February 2014, Switzerland is committed to an autonomous management of immigration but at the same time wants to preserve and strengthen the bilateral approach and to continue the stable relationship with the EU. The rejection of the “Ecopop” Initiative on 30th November 2014 proposing that the permanent population of Switzerland should not increase by more than 0.2 percent annually as the result of immigration was, with 74.1%, a strong statement in this respect. The opening of the 57 km long Gotthard base tunnel in 2016 will be a milestone, and also contribute to a change of paradigm from transport by road to transport by rail.

The Federal Council intends to submit the legal basis for an automatic exchange of information in tax matters (AEI) for consultation and conclude first agreements with partner countries by 2015. The first information exchange could take place in 2018.

Switzerland is also contributing to the cohesion of the EU with a contribution of around 1.3 billion Francs (including 45 million for Croatia). These are autonomous bilateral programmes Switzerland with all the EU member countries that have joined the Union since 2004, including Bulgaria, Romania and Croatia.
What could be an alternative to a bilateral approach?

Becoming a member of the EU is not a realistic alternative because there would not be a majority for that, says H.E. Urs Hammer. Not being an EU-member, Switzerland today cannot contribute to the future evolution of the *acquis communautaire*. On the other hand, to become a member of the EU, Switzerland would possibly have to modify its system of direct democracy and accept to become a net contributor.

Asked whether Switzerland could serve as a model for future countries which want to have closer ties with the EU, H. E. Urs Hammer answers that to his knowledge, apart from some discussions in the UK, Switzerland has not been quoted as a model for other countries. Looking at the EU with its eurozone and non-eurozone member countries and agreements like Schengen with countries outside of the EU, he sees as a possibility an evolution based on variable geography which could serve as an option for Switzerland to co-operate more closely.

What could be the lessons learnt from the Federal system of Switzerland to improve the functioning of the EU?

It is the principle often referred to in the EU, subsidiarity which Switzerland applies from federal to cantonal and to communal level, says H. E. Urs Hammer.

ECA President Caldeira noted that although the EU is not a federal state, the European Citizens' Initiative - one of the major innovations of the Treaty of Lisbon - aims at increasing direct democracy in the European Union by giving the opportunity to citizens to request the European Commission to make a legislative proposal.

Both H. E. Urs Hammer and ECA President Caldeira concluded by agreeing that challenges should be addressed jointly by the EU and Switzerland.
THE 20th ANNIVERSARY OF THE COURT OF AUDIT OF THE REPUBLIC OF SLOVENIA

Watching over the trail of public spending

By Tomaž Vesel, President of the Court of Audit of the Republic of Slovenia

In modern democratic societies, the appropriate institutionalisation of control over public spending is an exceptionally important aspect of the democratic order. This is because citizens, whose taxes and other statutory contributions to the public purse enable the State to deliver tangible public benefit, are not indifferent to the way their money is spent or how public resources are ultimately used. The paths taken by public spending show whether the State’s activity, through its governing and management structures, is reliable, and this cannot be monitored by individuals acting alone. Notwithstanding numerous recent attempts to improve access to information of a public nature, it is not possible for individuals to obtain a full overview of government spending, even at local authority level. Hence the need for an institution that is separate from all other branches of government, completely independent and qualified to monitor all public expenditure, while at the same time adequately protected from influences of any kind that could call into question the impartiality of its judgement and findings.

An increasingly important role

In recent years, particularly since the onset of the economic crisis, the importance of the role played by the Slovenian Court of Audit in connection with the use of public funds has come even more clearly into focus. The Court’s mandate is not only to verify the regularity of the operations of bodies charged with spending from the public budget, but also to ascertain that public resources are used effectively.

To boost a country’s competitiveness and economic growth, it is necessary, among other things, to bring government activity into line with the principles of efficient and effective management. Many approaches have been developed around the world to this end, but what they all have in common is that they seek to steer countries towards efficiency by reference to certain basic objectives: openness and transparency, accountability, and operational efficiency and effectiveness. Given that the State or public administration is a key catalyst for national and local development, since it must provide a high-quality institutional environment to support the economy, it should be constantly modernising and gaining in efficiency. To achieve all this, however, it is essential that there be strong political will for transparent and rational action in all areas of national and local government.

The Court of Audit, which is celebrating its 20th anniversary, therefore continues to strive to inform the public in a timely and objective way about the main findings and conclusions of performance audits of State bodies and other users of public funds, while at the same time advising those State bodies and other users how to improve their operations and make savings which can help to balance the public accounts.

Continuous improvement

For these efforts to succeed, it is crucial that the Court of Audit and the general public share an awareness that the tasks which are invested in the Court by law, and which it discharges in an independent, professional, accountable, objective, timely and ethical manner, are essential in order to achieve the most effective use of public funds. This means not only that the Court of Audit must not cease to make improvements and bring new insights to its own work, but also that it must guide, admonish and inspire those in authority to demonstrate greater accountability. Another part of this process entails drawing attention to inadequacies, shortcomings and, at times, the rigidity of the rules which confront the spending authorities in their work – both as they arise and subsequently through our audits.

The Court of Audit bears a good deal of responsibility, in particular when taking decisions...
on the selection of auditees, the circle of which has been steadily expanding during the past year in the wake of legislative changes (it now includes political parties, companies in which the Republic of Slovenia is indirectly a majority shareholder and the Bank Assets Management Company). In the first instance, selection is also shaped by the requirements of the Law on the Court of Audit (regularity audits of the implementation of the State budget and pension and health funds, as well as an appropriate number of urban and other municipalities and of the operations of economic and non-economic public services), which significantly affects the time available to the Court for audits in any given year. In addition, each year the Court receives several hundred audit initiatives from members of the public, interest groups, diverse civil society organisations and government bodies. Unfortunately, due to objective constraints only a few of these can be taken up. This creates a very real expectation gap with various segments of the public, who are hoping for a prompt and reliable assessment of the operations of thousands of public entities.

**Extending the scope of audit**

Although the Court of Audit does not sit in judgment, through its audit positions and advisory activity it is becoming an important arbiter of the correct application of numerous regulations, which often go beyond a purely fiscal framework. Public spending authorities are subject to a number of procedures, and the same is true of other bodies in all legal relationships. The legality of their conduct (in the sense of legislative compliance) is negatively affected by the nature of specific sectoral arrangements, which are characterised by responsible authorities providing multiple divergent clarifications, expert bodies whose technical support often functions poorly, and different levels of validity and application of the rules. Add to that the ever-increasing number of EU rules, which, quite apart from any direct relevance they may have, often also contribute to interesting legislative solutions, and the term ‘auditing’ takes on a substantially different and wider meaning. It then refers to far more than just the auditing of accounts or financial statements, but extends to the auditing of programmes, the way tasks are carried out, data and environmental protection – all of this in connection with a great many rules that are subject, as it were, to the menace of constant amendment and the likelihood of a lively legislative career.

The audit of public spending is becoming an essential feature in the case of social organisations, the diversity of which makes it impossible for the ‘provider’ of funding, acting alone, to verify the recipient’s activity. As there is always the possibility that the recipient might act against the interests of the funding-provider, their relationship is built on mistrust. In such circumstances, auditing is a practice that restores trust, provided that the auditor is professionally competent and independent. A side benefit that should by no means be overlooked is the provision of real-time information, to government and legislators, about the degree of compliance with and realism of the various rules and, above all, the effects of reform efforts and the implementation of various policies and guidelines.

It is desirable that the work of the various independent institutions should lead to reflection about a quantitative approach to legislative change in Slovenia. Usually only the most vocal critics’ voices are heard or, as a rule, taken into account, with blind obedience to the argument that EU legislation must be accepted rather than weighing up the elegant practical solutions reached by individual users and enacting legislative change following a thorough analysis of the situation. Unfortunately, another reason for not considering pragmatic solutions lies in the belief that public spending authorities are not to be trusted. Legislative amendments should be made on the ‘optima legum interpres consuetudo’ principle – or ‘custom is the best interpreter of law’ – although what is customary must, of course, be duly identified and assessed. This too, as well as its monitoring the trail of public spending, is part of the mandate of the Court of Audit.

**A wide range of powers**

As it enters its third decade, the Court of Audit has numerous responsibilities, the scope of which places us among the supreme audit institutions with the widest powers. Because of this, and given in particular the high level of public trust our work enjoys, the public finance challenges and the changes in our society, it is to be expected that the expectation gap shall widen. Simply, it became
impossible to meet all the expectations of the public-at-large with regard to our responsiveness to their initiatives. It is also almost impossible to ignore the impression that, in most publicly exposed cases, the Court’s audits are expected to confirm the suspicions. This may indeed be the expectation of many public groups or civil society, but the same should not be the case for the representatives of government or other supervisory institutions. Such expectations exert a form of influence on the work of the Court of Audit and, together with the limits constantly placed on the availability of funding and by the unbearable lightness with which our obligations are increased, they may also serve as an effective obstacle to our efforts. And yet even our (omni-)presence will be unable to change the awareness of auditees on the necessity of implementing corrective measures and recommendations or even more the awareness of those in authority of the importance of right timing in the decision-making processes. Namely, untimely and ill-considered solutions only generate a greater need for advice which increases the work load of the Court of Audit in its consultative capacity. A greater problem than the fact that the impact of our findings and assessments, with our auditees depends on their interests and beliefs, is the constant pretence, by some of them at least, that this is not the case.

Looking to the future

The Court of Audit is entering a new era, with a new strategy that is aligned with the development goals of the Republic of Slovenia and the new financial perspectives of the European Union. It has amended its guidelines for carrying out audits, is equipped with manuals covering the various types of audit and sound knowledge in all areas of public spending, and is thus ready for future challenges. Through its audits, its advisory role and its opinions on regulations, it shall contribute to the development of our society. Increased emphasis will be placed on monitoring the implementation of corrective measures and drawing attention to the commitments already entered into by the State and local authorities – in cooperation with law enforcement authorities and, where support has already been shown, with the National Assembly. The ever-increasing scale and different forms of public spending offer opportunities for the use and misuse of public money. Monitoring the many channels of spending will contribute to public trust in the work of government; more than that, however, it will also have an impact on our competitiveness and the quality of life for all.

Milan Martin Cvikl, ECA Member, attended the celebrations on the occasion of the 20th Anniversary of the Court of Audit of the Republic of Slovenia on 9 December 2014 in Ljubljana.
The last decade of the enlarged EU has at the same time been an opportunity as well as a challenge for supreme audit institutions (SAI). In retrospective the accession of Estonia to the EU seems very natural and logical. The same applies to joining of the National Audit Office of Estonia (NAOE) to the community of EU SAIs. For the NAOE, now almost a 100 year old institution, this has been a rapid period of development in terms of organisation build-up but even more importantly in terms of expertise and capacity growth. The decade has been a journey for us that started with focusing more on domestic issues with finding the best solutions how the work of the NAOE can contribute to the development of Estonia, and continued with learning how the EU policy making processes and funding impact national politics as well as policy implementation.

The NAOE primary focus regarding the EU related issues has commonly been on money and on the local context. For us it is important to question: how does EU affect the local taxpayer? Since day one of membership the EU money and so called “own” money was seamlessly integrated in Estonia at least in the context of budgeting. The strategic and operational planning along with budgeting considers all resources regardless of their origin as the means for achieving the fulfillment of government goals. This is so in theory. In reality the source of money along with the rules that apply to the use of those resources as well as the goals set for the use do have effect on outcomes and auditing.

**EU is more than funds**

In Estonia the EU funds count for about 12% of total government spending in 2015 (figure 1). This is not too much but when 75% of the total government revenue is already fixed with certain spending obligations and of the remaining 25% of revenues for flexible spending the EU funds count for nearly half, then the EU money becomes significant (figure 2). This phenomenon is also known in other smaller post-communist countries. In other words a lot of spending to boost the development of the country relies currently on EU funding. Then again the fixed spending in the budget is also designed to achieve certain policy goals and in this respect one tenth of the total spending is not too much. This consideration has risen and still raises a lot of questions for planning our audits. Administrative burden caused by the use of EU funding with heavily regulated application and usage procedures, with levels of local and external control and auditing starting from institution’s own internal audit and ending with the ECA’s audits is a very important issue especially for a small country like Estonia. The NAOE itself can also contribute to this burden by simply doing audits and that calls for very cautious approach when launching yet another audit to check the use of EU funds. For that reason the NAOE has positioned itself towards auditing of EU funds as provider of more complex view and usually the EU funding is dealt within the scope of a particular performance or a financial audit of an institution. Anyway, the accession to EU brought the EU funds to the picture and thus complicated the quest of supreme audit institutions to make users of public funds accountable.
The developmental impulses to the NAOE given by the accession of Estonia to the EU cannot certainly be underestimated and the effects keep emerging. Ten years ago nobody imagined how interlinked the EU member states’ economies will be, especially during the recession. Nobody provided risk assessments to national parliaments about the fiscal behavior of another member state. It is now clear that often this is as great threat for national well being as a fraud or poor performance of domestic policy programs. Also those local problems of poorly performing policies affect everybody else in the union as well. Today this is a reality. This reality goes further than member states just coordinating economic and employment policy or sharing competences with European Commission in the areas like transportation, agriculture or energy. A number of other policies like taxation, most of social affairs, education, healthcare etc. which are considered solely a national realm even according to new Lisbon treaty are today causing pan-European challenges. And very particular problems to member states like Estonia be it labour migration or financial obligations taken in the framework of ESM or making industry more competitive. These developments should make auditors in the EU to ask from ourselves how can we give fair and complete opinions when we only look at the part of the picture?

2 Estonian Ministry of Finance, 2014, Explanatory Note to the draft 2015 National Budget Law, page 50
Who is responsible?

A very simple question, a basic one for establishing accountability but in reality very difficult to answer. It is difficult in a domestic context let alone in the context of today’s EU28 with multilayered structure of governance and parallel lines of accountability. The latest landscape review from the European Court of Auditors (ECA) on accountability stated that “In most policy areas covered by the EU treaties, the competences are shared between the EU and its Member States. For example, various EU policies depend in large part on Member State budget resources (the EU budget represents less than 1 % of GDP compared to 49 % of EU GDP spent by governments in 2017); achieving broad treaty objectives through strategies and targets (for example Europe 2020 targets) depends mainly on Member States’ actions financed by their national budgets; the new EU fiscal and economic coordination arrangements cover the totality of public spending in the EU, but all actions in this area are subject to a complex system of cooperation. In such cases, coordinated action by the EU is required in order to achieve common objectives.”

The answer the NAOE has to the EU accountability puzzle is international co-operation with EU and other SAIs. Over the last decade there have been a number of successful undertakings in different forms where the NAOE has had an opportunity to participate. Among them were secondments of national experts at the ECA and various activities with EU member state SAIs like the Netherlands, United Kingdom, Denmark, Finland, Lithuania and many others or with countries like Canada, Norway, the United States, or Russian Federation. These undertakings have indicated the benefits as well as the bottlenecks of international cooperation projects. Most importantly, they have demonstrated that this is only the beginning of how the future audits will be done.

Very clearly and undisputedly the problems of natural environment, which have acquired the growing attention of the international audit community, have been a priority also to the NAOE. The nature does not stop at the borders and neither does the NAOE. This has driven our commitments in chairing the INTOSAI Working Group on Environmental Auditing (WGEA) and most recently in taking the lead in the EUROSAI WGEA. It only remains to be seen whether the issues of social security or health care or education or taxation will also gain such a prominence as to call for more coordinated actions from EU SAIs. The level of European integration is most of all the expression of political will and not a technical exercise. So, SAIs cannot lead the way here but we can be ready when that happens. The NAOE does that in coming years by allocating extra funding for international cooperation and trying to internalize international relations amongst the auditors as a norm in the standard process of auditing.

Do more with less, paperless!

The first part of this slogan is the very nature of performance improvement everywhere. The NAOE has often called Estonian public administration to do just that. But in return the NAOE itself must provide a good example. The big challenge for SAIs is that audit environment is becoming more complex and complicated but at the same time the funding of SAIs in many EU countries is negatively affected by austerity policies. The answer the NAOE has to those developments is technology – IT technology. All the vast amounts of data that are created digitally by the government are a resource for us. We need to understand it and we must be able to process it. In this way we can achieve a saving in audit costs as well as improve the accuracy of our input data. The NAOE has made very good progress in making financial auditing paperless and increased significantly the use of e-solutions in performance and compliance auditing as well.

Author: Urmas Nemvalts from “Postimees”
Our ambition to introduce paperless audit goes further than merely introducing audit software and preparing working papers and audit reports electronically. In the NAOE, paperless audit is understood as intelligent use of all advantages of digital society.

The bases for paperless auditing are possible mostly because of the government’s IT development projects over the last 20 years. Many of which were supported from EU funds. These projects created the main building-blocks of e-services in Estonia e.g. decentralized IT-system linked with a unique X-road solution and electronic identification based on e-ID cards. Through offering e-services the state collects data about its activities and transactions. This data is also used by state agencies to understand the financial impact of its conduct and by the NAOE for auditing purposes.

The “toolbox” of e-s

The service called e-Tax is Estonia’s most popular e-service and important register for gathering information about the state’s tax revenues. The information saved in the register of taxable persons creates the basis for online accrual data about tax revenues. The electronic system for declaring taxes means changes and improvements for the NAOE in checking tax revenues in financial audits. On one hand, it makes life easier since we know that the completeness of the data is embedded to the system and the accuracy of the data collected cannot be manipulated. On the other hand, there is a new task - we must get assurance that IT systems are working properly and without systematic errors.

Another important tool for us is e-Procurement. In e-Procurement all phases starting with preparing the contract documents, submitting the contract notice, submitting the tenders, processing the tenders and signing the procurement contract are taking place electronically without presenting any papers. In 2012 only 15% of all procurements taking place in the public sector were carried out as e-Procurements. In 2013 approximately 50% of all public procurements were taking place in the e-Procurement environment. It is a powerful database for auditing the use of public money including EU funds. Thanks to the e-Procurement the NAOE can get detailed information about all procurements done by public sector entities. This leads to better planning of audits and more cost effective auditing since we have more precise information about the expenditure and investments of state agencies and local governments.

Along with the IT systems there are IT-driven government initiatives that enable paperless accounting and auditing. One of them is centralized accounting. It means that all public sector institutions are using a unified reporting system and accounting software. The use of common accounting software SAP by auditees has direct effect to our financial audits. The NAOE has access to the SAP data that allows us to monitor both accounting and budgeting, on transaction as well as on reporting level. This means that a number of audit procedures can be carried out from distance without leaving the audit or home office.

A part of paperless accounting is the electronic processing of invoices. An e-invoice is not an invoice which has been scanned as a pdf-file but a complete system for automatic processing of billing information. The system was introduced in 2011 and by now around 50% of state agencies are processing their invoices not on the paper but using the e-invoice system. The e-invoice system has also made the work of auditors more efficient, as the accounting source documents can be now audited by using the access to e-Invoices.

Last but not least, the financial reporting process is unified through a web-based database. All public sector accounting entities prepare reports that are based on the common chart of accounts and are inserted to the database in the form of a special unified report on monthly basis. For auditors this
database simplifies the conduct of audits as we have access to financial reports on the detailed level of all audited entities as well as to the consolidated reports of different sectors.

These improvements in making the auditing cheaper, use of public funds more transparent and financial behaviour of civil servants more responsible, are real life examples of what is possible and not only in “test-site” Estonia. These experiences could be utilized also in EU wide context. Being a part of the EU is not just redistribution of development funding. It is also an integration of intellectual potential of every person of every member state.

Conclusion: e-State Charter\(^5\) for e-citizens and e-auditors

In order to improve the situation with the development and implementation of Estonian e-services, the NAOE decided to write down the principles of delivering good public services in digital environment. The document is called the e-State Charter and it is aimed to be used as a national standard for e-services. Using the charter people can assess whether their rights have been considered in the provision of digital public services. More than this, the charter can also be used as a set of criteria for conducting audits in the field of e-services.

We, at the NAOE, look forward to the next decade with enthusiasm. There are still opportunities in the context of EU integration which we have not fully realised and utilized. Integrated and prudent use of e-data collected on the European as well as member state level for improving the auditing is certainly one of those. Building on the work of INTOSAI and EUROSAI IT working groups and cooperation framework of the Contact Committee should more actively deal with the issues of IT and e-data use in audits. This means solving the problems of cross border data sharing between EU SAIs, access to EU databases, using pan-European Big-data opportunities for auditing and development of paperless auditing in all areas of auditing. The free movement of data between EU SAIs is a viable alternative to joint or parallel audits when we must ensure to our constituencies full and fair judgements on the issues that have significant pan-European connotations. The NAOE would like not only to promote this idea but to take real steps in the Contact Committee framework to implement those ideas and thus improve auditing the EU related issues.

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Presentation of the 2013 Annual Report and discussion about ways of enhancing the cooperation between the ECA and the Hungarian State Audit Office

By Szabolcs Fazakas, ECA Member

During his Christmas holidays, Szabolcs Fazakas, the Member of the European Court of Auditors paid an official visit to the Hungarian State Audit Office following an invitation from its President, László Domokos. Fazakas handed over the Court’s 2013 Annual Report as preparation for its official presentation to the relevant committees of the Hungarian Parliament and discussed with the President of the Hungarian SAI the opportunities for improving and enhancing further cooperation between the two organizations.

Szabolcs Fazakas provided an overview of the main findings and conclusions of the report by stressing the need to place more emphasis on achieving results with the EU funds rather than simply spending them. He pointed out that the Court’s 2013 Annual Report indicates that there is still significant room for further improving how the EU funds are spent. It is not a matter of choosing between spending the money, complying with the rules, and getting results, it is about managing to do all three at once. This is the only way to protect the public’s financial interests, promote a climate of trust, and ensure that EU funds are used in the best possible way. The discussion also covered the development of the error rate over the last years, and the responsibility of the Member States in connection with errors that occurred in the field of shared management.

The President of the Hungarian State Audit Office expressed his firm interest in this new approach and reform of auditing the implementation of the European Union’s budget. Regarding the official presentation of the Court’s Annual Report 2013 they both agreed that a suitable date should be carefully chosen taking into account the political sensitivity of this public presentation in the current Hungarian political circumstances.

László Domokos emphasized his appreciation of the active cooperation between our institutions. He recalled with satisfaction the recent common efforts aiming to develop the methodology of risk analysis, which was carried out in collaboration with the delegated expert of the European Court of Auditors. He confirmed his intention to participate in the knowledge sharing session in mid-February, organized with the Hungarian and Swiss SAIs in order to elaborate on issues related to ongoing reform of the European Court of Auditors.

The Hungarian State Audit office issued an official press communication about the visit.
Presentation of the 2013 Annual Report to Austrian authorities and stakeholders

By Margit Spindelegger, head of private office

Oskar Herics, Austrian Member of the European Court of Auditors since March 2014, presented the Court’s 2013 annual report at a press conference in Brussels (on 5 November 2014), at a stakeholders’ conference at the Haus der Europäischen Union in Vienna (on 6 November 2014) and to the members of the Bundesrat EU affairs committee (on 3 December 2014) in Parliament in Vienna.

There was great interest in the key messages of the Court’s 2013 annual report at the press conference in Brussels on 5 November 2014, attended by Austrian and German media representatives. Oskar Herics reported on the adverse audit opinion issued by the Court, as in previous years, on EU spending in 2013, emphasising that the error rate of 4.7% significantly exceeded the tolerance level of 2%. He explained the specific characteristics of the individual areas of expenditure under shared management using the example of frequently occurring errors.

The Court’s inclusion, for the first time, of each Member State’s error frequency for the period 2009-2013 at the European Parliament’s request drew particular attention. Austria’s comparatively high error frequency was widely reported in the Austrian press. On the same day, the Austrian Broadcasting Corporation (ORF) broadcast a story on the 2013 annual report on the Zeit im Bild primetime news programme, featuring an interview with Oskar Herics.

On 6 November 2014, a stakeholders’ conference was held in the Haus der Europäischen Union in Vienna, in cooperation with Johann Sollgruber, the interim Head of the European Commission Representation in Austria, and Georg Pfeifer, Head of the European Parliament Information Office in Austria. It was attended by numerous stakeholders from institutions managing and controlling EU funding and from external audit bodies at national and regional level. This presentation, too, focused on those 2013 annual report findings, which were of particular relevance to Austria in terms of the effectiveness of EU spending.
The intense discussion that followed covered error rates as a measure of legality and regularity, the nature and frequency of the errors found, financial corrections, the appropriateness of control costs, increased use of performance audits, the Court’s role in tackling fraud and the need to strengthen cooperation between external audit institutions. Amongst other things, Oskar Herics stressed the importance of avoiding serious errors in the first place, and of better aligning the legislation applied in parallel in Austria for co-financing and simplifying this legislation as far as possible.

Oskar Herics cited improving the follow-up and learning from the Court’s report findings at national level as a future goal. He suggested that debates in the Austrian Parliament and greater information exchange with national management and supervisory institutions could make a significant contribution in this regard.

On 3 December 2014, the EU affairs committee of the Bundesrat (the second chamber of the Austrian Parliament) focused its attention on the Court’s activities. Oskar Herics’ invitation to a committee meeting in the Austrian Parliament was a first for a Member of the Court. As well as on the 2013 annual report, the lively discussion focused on the publication, for the first time, of the overview of EU spending on agriculture and cohesion for the period 2007-2013. Oskar Herics stressed that, in the area of shared management in particular, financial management of EU funding does not yet meet the (admittedly high) standards required. He also demonstrated examples of typical errors and possible ways to avoid these.

The committee members present positively acknowledged the Court’s method, which is based largely on random audit samples with audits all the way down to the final recipients. Due to the high level of interest in continuing this lively exchange, the idea was raised of conducting such a dialogue on an annual basis in future.
Promoting the Court’s visibility in Poland

By Mariusz Pomienski, formerly head of private office

In 2014 Mr Augustyn Kubik and members of his private office participated in a number of events, co-hosted by Poland’s Supreme Audit Institution, whose aim was to present the ECA’s role in the EU governance and to promote the Court’s visibility in Poland.

Presentations were made to local authorities (beneficiaries of the EU funds) and to professors and students of universities in Krakow, Katowice, Rzeszow and Zielona Gora. The presentations pointed at the ECA’s work contributing to the improvements of the management of the EU funds and focused on the different products delivered by the Court to its stakeholders and to European taxpayers.

Particular focus was placed on the performance audits carried by the Court. Both the audit approach and the results of selected audits were discussed. It does not come as a surprise that most interesting were audits which included visits to Poland. The participants of all meetings seemed convinced that the effective, efficient and economic spending of the European funds must be the main driving force of the new financial perspective.

In December 2014 Mr Kubik presented, as usual, the annual report to our Polish partners including:

- The government departments responsible for the management and audit of the EU funds,
- Supreme Chamber of Audit (Poland’s supreme audit institution),
- Journalists representing most popular and opinion-making newspapers in Poland (Gazeta Wyborcza, Rzeczpospolita, Dziennik Gazeta Prawna).

A particular feature of this year’s presentation was an interest of the participants not only in the 2013 Annual Report but also in the Overview of the EU spending 2007-2013 in agriculture and cohesion. The members of parliament and the government representatives wanted to understand the messages included in the latter document, especially those which referred to Poland. They were naturally interested to learn how Poland performed in the 2007-2013 both in absolute terms and in comparison with other big recipients of the EU money.
Can the EU’s Centres of Excellence initiative contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU?

The European Union launched its Chemical, Biological, Radiological and Nuclear (CBRN) Centres of Excellence Initiative in May 2010. The Initiative is designed to strengthen the institutional capacity of non-EU countries to mitigate CBRN risks which, if not countered, may constitute a threat to the EU.

The Court’s audit assessed whether the EU CBRN Centres of Excellence Initiative can contribute effectively to mitigating risks of this kind from outside the EU. It concludes that the Initiative can contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU, but several elements still need to be finalised. The Court makes a number of recommendations which the EEAS and the Commission should take into account to further develop the Initiative and ensure its sustainability.

This report was published on 3 December 2014 (see page 2)

EU Pre-accession Assistance to Serbia

This report evaluates whether the EU support - about € 1.2 billion over the 2007-13 period - was effective in preparing Serbia for EU membership. The audited projects delivered their planned outputs although they suffered from weaknesses regarding their design, implementation and sustainability. Overall, the Court concludes that the Commission is putting increasing emphasis on governance issues in planning its assistance to Serbia, and that the EU support helps effectively Serbia to implement structural reforms and improve governance.

This report was published on 13 January 2015

Has ERDF support to SMEs in the area of e-commerce been effective?

In recent years, the EU has co-financed e-commerce projects in the context of its cohesion policy with the support of the European Regional Development Fund. In this report, the European Court of Auditors assesses whether e-commerce projects were successful in supporting ICT uptake by SMEs by auditing a sample of EU co-financed e-commerce projects in Greece, Italy, Poland and the United Kingdom.

The Court concludes that the ERDF support to e-commerce projects contributed to increasing the availability of business services online. However, it also concludes that shortcomings in the monitoring made it impossible to assess to what extent it contributed to the achievement of the EU and Member States’ ICT strategies as well as SMEs’ development objectives.

This report was published on 7 January 2014
ADOPTION OF A UN RESOLUTION STRENGTHENING SUPREME AUDIT INSTITUTIONS

On 19 December 2014 by the 69th United Nations General Assembly adopted a resolution on 'Promoting and fostering the efficiency, accountability, effectiveness and transparency of public administration by strengthening supreme audit institutions.

The General Assembly:

1. Recognizes that supreme audit institutions can accomplish their tasks objectively and effectively only if they are independent of the audited entity and are protected against outside influence;

2. Also recognizes the important role of supreme audit institutions in promoting the efficiency, accountability, effectiveness and transparency of public administration, which is conducive to the achievement of national development objectives and priorities as well as the internationally agreed development goals;

3. Takes note with appreciation of the work of the International Organization of Supreme Audit Institutions in promoting greater efficiency, accountability, effectiveness, transparency and efficient and effective receipt and use of public resources for the benefit of citizens;

4. Also takes note with appreciation of the Lima Declaration of Guidelines on Auditing Precepts of 1977 and the Mexico Declaration on Supreme Audit Institutions Independence of 2007, and encourages Member States to apply, in a manner consistent with their national institutional structures, the principles set out in those Declarations;

5. Encourages Member States and relevant United Nations institutions to continue and to intensify their cooperation, including in capacity-building, with the International Organization of Supreme Audit Institutions in order to promote good governance at all levels by ensuring efficiency, accountability, effectiveness and transparency through strengthened supreme audit institutions including, as appropriate, the improvement of public accounting systems;

6. Acknowledges the role of supreme audit institutions in fostering governmental accountability for the use of resources and their performance in achieving development goals;

7. Takes note of the interest of the International Organization of Supreme Audit Institutions in the post-2015 development agenda;

8. Encourages Member States to give due consideration to the independence and capacity-building of supreme audit institutions in a manner consistent with their national institutional structures, as well as to the improvement of public accounting systems in accordance with national development plans in the context of the post-2015 development agenda;

9. Stresses the importance of continuing international cooperation to support developing countries in capacity-building, knowledge and best practices related to public accounting and auditing.

The ECA, as the EU’s external auditor, promotes the values addressed by the resolution. The ECA is a member of the International Organisation of Supreme Audit Institutions (INTOSAI) which promotes the exchange of ideas and experience in the field of government auditing at a worldwide level.

The strengthening transparency of public finances and accountability for public financial management is an important condition for sustainable development. The adoption of the resolution is a further important step in the framework of INTOSAI’s intensive efforts to anchor the role of Supreme Audit Institutions in the UN’s post-2015 development agenda.
The Millennium Development Goals – which have provided a framework for guiding and promoting development over the last 15 years – will conclude at the end of 2015. In 2015, the preparations for the next set of goals to which Point 7 of the Resolution refers will come to an end, with their adoption planned for September.

The new goals are expected to be as follows:

1. End poverty in all its forms everywhere
2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. Ensure healthy lives and promote well-being for all at all ages
4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Achieve gender equality and empower all women and girls
6. Ensure availability and sustainable management of water and sanitation for all
7. Ensure access to affordable, reliable, sustainable and modern energy for all
8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. Reduce inequality within and among countries
11. Make cities and human settlements inclusive, safe, resilient and sustainable
12. Ensure sustainable consumption and production patterns
13. Take urgent action to combat climate change its impacts
14. Conserve and sustainably use the oceans, seas and marina resources for sustainable development
15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. Strengthen the means of implementation and revitalize the global partnership for sustainable development
Back to School: Our colleagues help youth across the EU better understand the role of the EU, and the ECA

By Damijan Fišer, press officer

Throughout 2014, 20 colleagues from the ECA - auditors, administrators, assistants, a director and an ECA Member - joined the staff from other EU institutions in the Back to School project by returning to their secondary schools across Europe, where they acted as the "EU’s ambassadors" for a day. The EU’s Back to School project helps secondary school students to better understand the role and work of the EU’s institutions through the personal testimonies of those that work for them.

Colleagues that have returned to their secondary schools unanimously agree that the experience is of great value and very rewarding, whereas the participating schools have also highly appreciated this personal way of raising awareness of Europe among students.

Every year the aim is to encourage EU staff, particularly those from the two Member States holding the Council presidency, to return to their secondary schools. In 2014, 750 staff from across the EU institutions participated in the project, of which 20 from the ECA. The lion’s share represented the EU staff from Greece and Italy. However, the ECA - and other EU institutions - also give the possibility to staff from other Member States to participate. Last year our colleagues went to eight Member States. The Back to School project will continue in 2015, with our colleagues returning to their secondary schools across Europe, particularly in Latvia and Luxembourg.

The visits of our colleagues frequently appear in local media and on social media.

In February 2015 the Court says:

Hello to:
Raffaella MISSIO
Thierry LAVIGNE

Goodbye to:
Stephan ARENS
Clairette RICCI
The use of financial instruments in European Structural and Investment funds - what are the improvements in the legal framework for the 2014-2020 programming period from an audit perspective?

By Dennis Wernerus, formerly auditor in Chamber II and Rares Rusanescu, auditor in Chamber II *

This article was first published in the *European Structural and Investment Funds Journal* (EStIF Journal (Volume 2, Number 3)) in November 2014 and is also accessible via the link: [http://www.lexion.de/en/zeitschriften/fachzeitschriften-englisch/estif.html](http://www.lexion.de/en/zeitschriften/fachzeitschriften-englisch/estif.html). Its publication in the ECA journal has been possible with the kind permission of EStIF.

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The increasing use of financial instruments (FIs) has been one of the major innovations in European Structural and Investment (ESI) funds in recent years. Equity, guarantee and loan instruments are more and more used instead of grants to provide public support. This article provides some background information in relation to the difficulties of implementing financial instruments in the 2007-2013 programming period. It also assesses to what extent the legal framework for using these instruments in the 2014-2020 programming period may address the weaknesses identified by the European Court of Auditors.

Introduction

What are EU financial instruments?

"Financial instruments" is a generic term for contracts which provide their holder with a claim on an obligor. In other words, unlike traditional grants, these are repayable instruments. The EU provides for three possible types of FIs: equity, loan and guarantee instruments 1. Equity or loan instruments are contracts between an investor and an investee or between a lender and a borrower. Guarantees are contracts where a guarantor guarantees the rights of an investor or a lender.

How are EU financial instruments implemented?

Under Cohesion policy, ESI funds support instruments providing equity, loans and guarantees by making payments to FIs from the budgets of the operational programmes (OPs). ESI funds eventually provide financial support to final recipients (i.e. an investee in the case of equity instruments, a borrower in the case of loan instruments or an entity whose operation is guaranteed in the case of guarantee instruments) 2.

From the perspective of the borrower or the investee, EU FIs do not differ from other financial instruments available from banks, development banks, equity funds, infrastructure funds, loan funds or microfinance institutions. What makes these instruments different though, is that they are public policy tools subsidised by the taxpayers, up to 100%, as is often the case under Cohesion policy.

This public support is justified by the existence of a financing gap that the private sector has so far been unable to bridge. For banks or fund managers, the price of this support dwells in the public policy and reporting requirements, most notably transparency in management and accountability towards the EU institutions and the Member States who set the main parameters of that support.

Management of the OPs is shared between the European Commission and the Member States.

Member States decide which OPs will have priority axes earmarked for FIs and how many euros will flow into which type of FI (equity, loan and

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1 According to Article 2(p) of the Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012, EU financial instruments “may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, any may, where appropriate, be combined with grants.”

guarantee) and in which regions. Above all, it is the Member States who will select the managers of these FIs and in practice they will influence the structure of the FIs (e.g. governance structure, setting up a new holding fund, working with an existing holding fund or with none at all). However, the Commission remains ultimately responsible for ensuring the sound financial management of the implemented EU FIs3.

Increasing use of financial instruments since 2000

The use of FIs to implement the ESI funds has significantly increased over the last three programme periods:

For the 2000-2006 programme period, the EU contributed €1.5 billion from the ERDF to set up financial instruments (in holding funds and specific funds) in 15 out of the then 25 Member States4. This was less than 1 % of the total ERDF budget for the period. During that period, FIs were used exclusively to provide SME financing.

For the 2007-2013 programme period, a total of €8.4 billion of the EU budget was paid into financial instruments of holding funds and specific funds in 25 of the then 27 Member States. The use of ESI funds for FIs was extended to all types of companies, but with a focus on SMEs, urban development funds and energy efficiency funds. This represented around 4 % of the ERDF and ESF budget.

For the 2014-2020 programme period, using FIs will be an option for every OP under all the ESI funds and all eleven thematic objectives defined in article 9 of the Regulation N° 1303/2013. An increase in the use of FIs is expected both in terms of the value of the endowments allocated to the funds and as a percentage of the total budget available under the ESI funds5. However, as Member States are currently preparing the ex ante assessments of their financing gaps, meaningful figures are unlikely to be available before October 2016.

Rationale of using financial instruments as a form of public-private partnership

FIs are in effect public-private partnerships (PPP), meaning that public and private resources are shared, with the parties in such partnerships sharing the risks according to those they are most suited to bear. FIs must therefore be sufficiently attractive in terms of expected returns to financial intermediaries (e.g. banks, risk or venture capital funds and microfinance institutions). As ESI funds tend to operate where the market has so far been less than optimal, it therefore makes sense that financial intermediaries are appropriately rewarded through a combination of returns, management fees and an appropriate level of preferential treatment. However, these benefits can only be justified if FIs are actually performing and the performance risk borne by the private sector is proportionate to its rewards.

Indicators to measure the performance of financial instruments and problems identified in ECA’s audits

There are four main indicators to measure the performance of EU FIs, namely:

1. Disbursement rate
2. Leverage effect
3. Revolving nature
4. Portfolio-at-risk (default rates)

4 Before 2000, within the ERDF, the use of FIs was piloted only in two Member States (Portugal and the United Kingdom).
5 See the conclusions of the European Council (24/25 October 2013): “The programming negotiations of the European Structural and Investment Funds (ESIF) should be used to significantly increase the overall EU support from these funds to leverage-based financial instruments for SMEs in 2014-2020, while at least doubling support in countries where conditions remain tight. These instruments should be designed in a way which limits market fragmentation, ensures high leverage effects and quick uptake by the SMEs. This will help concentrate the funds adequately and expand the volume of new loans to SMEs.” (EUCO 169/13).
The disbursement rate to recipients is the most straightforward performance indicator for assessing whether FIs are successfully implemented, because it can be measured at the level of the EU and the Member State. It shows how much of the funds made available to the FIs have actually reached the final beneficiaries. Unlike grants, payments from the OP into FIs are not disbursements. Such payments are legally-speaking advances which become eligible expenditure only insofar as disbursements are made to the final recipients.

The European Commission has actively promoted the use of FIs in recent years. Within Cohesion policy, 70 holding funds and 870 specific funds have been created, most of them towards the end of the 2007-2013 programme period. By the end of 2012, only 37% of the funds had reached any final recipients. In 17 Member States (see Figure 1), the situation is particularly acute as 50% or more of the ESI fund contributions to FIs were not yet disbursed in the form of amounts paid to final recipients.

Figure 1: FIs disbursement rates in selected Member States (2007-2012).

Note: Member States where total payments from ESI funds to final recipients represented less than 50% of operational programme resources paid into FIs, expressed by the disbursement rate. Source: DG REGIO, “Summary of data on the progress made in financing and implementing financial engineering instruments co-financed by Structural Funds - Programming period 2007-2013, Situation as at 31 December 2012”.

In five Member States in particular (Greece, Italy, Poland, UK and Germany), the risk that large amounts paid to FIs will not be disbursed is high. However, Figure 2 also shows that some Member States, probably with less experience in disbursing EU FIs, are also at risk of not using FIs as they were intended (e.g. Slovakia, Bulgaria).

FIs can make use of their initial endowment until December 2015, a date which is dangerously close. Member States should, therefore, be more knowledgeable than ever about the European Commission’s guidance in relation to FI legislation during the 2007-2013 programme period, and about the issues identified by the European Court of Auditors.
FIs have been designed to generate a **leverage effect**\(^6\) and to be **revolving**. Hence, their performance should be measured from that angle too. Whereas leverage is reached when FIs attract private funding in order to harness public policy and funding, FIs revolve over time by re-using their net proceeds (reimbursements plus dividend, fees or interest). Thanks to the leverage effect and the revolving of funds over multiple periods, FIs have an edge over grants: FIs benefit more projects with the same amount of money. FIs are also seen as a form of public support which potentially adds more value than grants since borrowers or investees are less likely to become dependent on a recurrent flow of subsidies than grant-seekers.

Rules setting minimum provisions on leverage and revolving funds in the 2007-2013 programming suffered from considerable shortcomings. For the 2014-2020 programme period, the Regulation N° 1303/2013 and the Commission Delegated Regulation N° 480/2014 set requirements in terms of leverage for guarantee funds\(^7\) and the revolving of funds has been clarified\(^8\), though in reality, depending on the FI, this only applies in cases where proceeds are being re-used for the first time. Indeed, neither the Regulation nor the Delegated Regulation, offer additional clarity on the re-use of proceeds beyond the eligibility period. Consequently, the measurement of the leverage effect and the revolving nature of the high number of FIs co-financed by ESI funds remains, and will remain, problematic.

Likewise, the **portfolio-at-risk** is actually the measurement of the default rate at the level of the portfolio, i.e. the percentage of loans in a guaranteed loan portfolio or a loan portfolio that are defaulting. This information is crucial because, in order to attract private funding and revolve funds over time, an FI should be viable. At the same time, low default rates can indicate a risk-averse approach, which will not meet a public policy objective of reaching socially excluded micro-entrepreneurs, for instance. In both cases, it measures the performance of the bank or fund manager in receipt of ESI funds and acts as an early-warning sign of whether a fund will be able to revolve or should be discontinued. The portfolio-at-risk is currently not information FIs routinely provide to the Commission and the Member States’ managing authorities.

**Effective implementation of financial instruments hampered by structural shortcomings**

The rules according to which FIs were set up and operated during the 2007-2013 programme period were set out in the Regulations\(^9\). Certain legal clarifications were provided in 2011, addressing a number of previously-identified weaknesses\(^10\). A comprehensive guidance note on the use of FIs was adopted by the Committee for the Co-ordination of Funds (COCOF) in February 2011\(^11\). It is to be noted, however, that such guidance is still not legally binding.

In July 2011, the European Commission published a “Common audit framework”\(^12\). The manual describes audit procedures to be performed at different stages of planning for the set-up and implementation of financial instruments. Although this was intended as an audit manual for audits of financial engineering instruments for use by its own departments or by national audit authorities, in practice it was used as a guidance document by various parties involved in the implementation of these instruments.

Against this background, the Court identified the following problematic issues for the effective implementation of FIs during the 2007-2013 programme period:

- Initially the Regulations required the justification for and intended use of the

\(^6\) The leverage effect is the amount of funding received by final recipients (e.g. SMEs) divided by the total public contribution, as is the case of joint EU and Member State co-financing, which is the predominant model in the ESI funds.

\(^7\) Article 8 mentions an “appropriate multiplier ratio” between the amount set aside to cover losses and the value of corresponding disbursed loans or other risk-sharing instruments.


\(^12\) Financial Engineering Instruments in the context of the Structural Funds, DG REGIO, 31 July 2011.
contribution from the funds to the FI to be specified in a mandatory business plan.  
In practice, this requirement proved to be ambiguous and the need for FIs was in many cases not properly analysed before setting up the funds allocating money to them. Inadequate needs assessments at the programming stage are a key factor in the low disbursement rates, which is why the requirement for an ex ante assessment – mandatory in the 2014-2020 programme period – is so important.

Many FIs implementing loan instruments did not make appropriate provisions to cover expected or unexpected losses, which has strained the sustainability of these instruments in the event of such losses and raises questions about the commitment of the Member States concerned to the use of revolving FIs.

The exit and winding-up provisions in funding agreements were unclear or non-existent, and the provisions on the re-use of proceeds beyond the eligibility period were vague or not drafted in line with the Regulations. As a result, the revolving nature of FIs, i.e. their capacity to be re-used in more than one cycle, has been affected.

The setting-up of several FIs within one Member State (each linked to a specific OP) has resulted in a scattering effect where the critical mass of the individual FIs was not sufficiently large. An example of this effect has been highlighted in Box 1. This has been partially addressed in the 2014-2020 programme period, since financial incentives are provided to manage FIs centrally under one OP priority. In particular, in such a scenario the EU contribution can make up the entirety of the fund endowment.

**Box 1 – Sub-critical mass One**

Member State and the EIF signed a Framework Agreement in December 2008 which specified the principles under which ERDF funding was to be implemented using resources from five different OPs. Only in October 2009 had a Funding Agreement been concluded between a Ministry of the Member State concerned and the EIF to implement the Framework Agreement, but for a value of less than €30 million for one of the Operational Programmes. In September 2010, the ERDF funding had still not been transferred to the capital of the FI, a Special Purpose Vehicle. Furthermore, neither the Holding Fund Agreement, nor the Shareholders’ Agreement had been signed. The Member State authorities certified the expenditure in the form of a money transfer to the EIF’s fiduciary account as legal and regular in December 2009. As the amount of the funds allocated had been certified to the Commission in December 2009 before those funds were actually made available to the SPV’s share capital, according to Article 78.6 of Regulation 1083/2006, the transfer made by the Managing Authority to the account was irregular. In addition to that, the FI funds are still not operational. Remaining commitments to the Special Purpose Vehicle remain under the responsibility of four other Ministries and the funds have not reached any final recipients.

**Monitoring and reporting obligations for Member States on the use of EU FIs: A story of lack of governance**

Until 2012, the European Commission did not have a monitoring and information system at its disposal in relation to FIs. In its Special Report 2/2012, the Court found that monitoring and information systems were ill-equipped to inform on and monitor the sound financial management of the funds co-financed by the ERDF. The Commission strengthened reporting requirements for financial instruments co-financed by the ERDF or the ESF in 2011. Since then,

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14 European Court of Auditors’ Special Report 2/2012, paragraph 116 to 118.
15 European Court of Auditors’ Special Report 2/2012, paragraphs 71 to 77; European Court of Auditors’ Opinion 7/2011, paragraph 49 in Part I and Part II.
16 European Court of Auditors’ Special Report 2/2012, paragraph 121.
by 30 June of each year managing authorities must provide the European Commission with a description of the financial instruments and implementation arrangements, an identification of the entities, the amounts of assistance paid to the financial instruments and the amounts paid from the financial instruments to the final recipients.

The Regulation for the 2014-2020 programme period has added to these reporting requirements\(^\text{18}\): managing authorities must send the Commission a specific report covering financial instruments but also additional information (such as the FIs' progress in achieving the expected leverage effect). The data underlying the European Commission's reporting, however, is still provided by the managing authorities and is not based on the actual funding agreements governing the financial instruments\(^\text{19}\). As the Commission has no direct and systematic access to all the funding agreements, reporting is not always reliable and is still insufficient, for instance, as regards investment and exit strategies, leverage, revolving fund provisions and winding-up provisions.

**Future legislation: A better deal?**

The Commission Delegated Regulation N° 480/2014 (delegated act) sets out key aspects of the legal framework applicable to FIs during the 2014-2020 programming period\(^\text{20}\).

As regards the substance, the main changes in the Regulation supplemented by its delegated act can be summarised as follows\(^\text{21}\):

- During the 2014-2020 programme period, the support of FIs is to be based on an ex ante assessment establishing evidence of market failures, including an estimate of additional public and private resources to be potentially raised, the lessons learnt from similar instruments and the expected results of the instrument\(^\text{22}\). This is substantially different from the previous period's requirements.

- The possibility of combining FIs with other forms of aid, in particular with grants, as part of a single operation has been clarified\(^\text{23}\).

- The EU contribution to the instruments will be paid gradually, based on defined thresholds, provided that the funding is also disbursed to the final recipients\(^\text{24}\). This requirement was not in place for the 2007-2013 programme period. As a result, significant amounts of EU contributions were effectively parked in the accounts of financial intermediaries, without being used.

- Managing authorities can make a financial contribution to existing FIs\(^\text{25}\), even if they have been under-performing. They may also implement FIs in the form of loans or guarantees directly without the funds being managed by a financial intermediary. This means that managing authorities, irrespective of past performance, could manage guarantee or loan funds, set up new funds (with or without legacy funding from the previous programme periods) and compete directly with private funds.

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\(^{19}\) European Commission, Summary of data on the progress made in financing and implementing financial engineering instruments, situation as of 31 December 2012, DG REGIO, 1 October 2013.

\(^{20}\) Delegated acts are provided for under the Treaty on the Functioning of the EU (TFEU) and deal with non-essential elements of EU legislation. Legally speaking, the main difference from the situation in the previous periods is that the rules set out in the delegated act are legally binding, while a COCOF note is not. See article 290 of the TFEU.


\(^{22}\) Articles 37.2 and 37.3 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council.


Financial instruments may be set up at Union level and managed directly or indirectly by the Commission (presumably through EIB or another fund manager). They can also be set up at national, regional, transnational or cross-border level\textsuperscript{25}. The management costs and fees charged by the fund managers will be determined on the basis of performance criteria, such as disbursements of funds, resources paid back or the contribution of the financial instrument to the objectives and outputs of the programme.\textsuperscript{26}

The changes in the legal basis relevant for the 2014-2020 period compared to the previous period should result in improvements in the use and management of the financial instruments for all the parties involved.

<table>
<thead>
<tr>
<th>Change in the legal basis</th>
<th>Mainly beneficial for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction of the ex-ante assessment – this should result in a better estimation of the instrument size and the needs it addresses</td>
<td>Commission, managing authorities, financial intermediaries</td>
</tr>
<tr>
<td>Possibility of combining FIs with other forms of aid (such as grants) – this will provide the final recipients of the funds with a greater flexibility in managing their projects and with additional sources of finance</td>
<td>Final recipients</td>
</tr>
<tr>
<td>Gradual payment of the EU contribution – this should avoid the situation where EU contributions paid to the funds remain unused for a long period of time</td>
<td>Commission, managing authorities</td>
</tr>
<tr>
<td>Financial instruments which may be set up at Union level – this could result in increased efficiency in managing large fund contributions</td>
<td>Commission, managing authorities</td>
</tr>
<tr>
<td>Management costs and fees charged determined on the basis of performance criteria – this should result in a more efficient use of the contributions which cover these costs and perhaps in a fairer calculation of these amounts</td>
<td>Managing authorities, financial intermediaries</td>
</tr>
</tbody>
</table>

**Use of FIs in different parts of the EU budget**

The EU budget also contributes to FIs in other policy areas, such as transport and energy policy. The Commission manages its budget for transport and energy policy directly, but for special investment vehicles in which the Commission may take the role of a junior-ranking investor it is subject to their rules.

In this area, the number of instruments financed is much lower than for ESI funds, but the EU contribution per instrument (and the scale of individual projects receiving financial support from these FIs) is significantly higher. For instance, the EU contribution to the Loan Guarantee Instrument for TEN-T Projects (LGTT) alone is 250 million euro. Figure 2 shows key differences between FIs for transport and energy policy as compared to cohesion policy.


\textsuperscript{26} Article 12 of the Commission Delegated Regulation (EU) No 480/2014.
Figure 2: Differences between cohesion policy and transport and energy policy

<table>
<thead>
<tr>
<th>Element</th>
<th>Cohesion (ERDF/CF and ESF)</th>
<th>Transport and Energy</th>
</tr>
</thead>
<tbody>
<tr>
<td>EIB/EIF as fund manager</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Holding fund structure</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Commission as a direct shareholder in the Fund</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Durations of the instruments</td>
<td>Duration of the OP (i.e., up to nine years, 2007 to 2015) or longer</td>
<td>For direct equity investments much longer durations (i.e., 20 years)</td>
</tr>
<tr>
<td>Type of undertaking being the ultimate beneficiaries</td>
<td>Primarily SMEs</td>
<td>Not necessarily SMEs</td>
</tr>
<tr>
<td>Financial size at the end of 2012 (source: Commission)</td>
<td>Approx. EUR 8.4 billion (paid)</td>
<td>Approx. EUR 1 billion (committed)</td>
</tr>
<tr>
<td>Number of instruments at the end of 2012 (source: Commission)</td>
<td>940</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: European Court of Auditors.

A key difference between the FIs implemented in the two areas relates to the governance structure: according to the legal framework for period 2007-2013, the European Commission cannot be a shareholder in a fund set up under the Structural Funds. This is not the case in those areas of the budget which are directly managed by the European Commission, like transport and energy, where the European Commission is frequently a shareholder in the fund, often together with private-sector investors.

Final remarks

The new legal framework for FIs in the 2014-2020 programme period addresses several weaknesses and should make it easier to use equity, loan and guarantee instruments to provide financial assistance to recipients. At the same time, however, the closure of the 2007-2013 programme period must be completed by 2017 at the latest\(^{27}\).

At that point, a controversial issue will need to be addressed: namely, what will happen to those funds which have not made full use of their endowments by the end of 2015? Currently, these funds will have to be returned to the EU budget\(^ {28}\).

During the 2014-2020 period, FIs could become one of the main channels for the delivery of cohesion, transport and energy policies:

- the revolving nature of FIs is particularly attractive to Member States in a period of budgetary difficulty since public money can be used more than once; and

- the experience gained by actors at all levels (i.e. European Commission, EIF, Member States and regional authorities, and financial intermediaries), during the 2007-2013 programming period and the simplification of the legal basis concerned will be helpful in setting up new FIs more quickly than in the past.

At this stage, it is too early to credit EU FIs with success. For 2007-2013, their performance has been limited and varied strongly across managing authorities. For 2014-2020, it is to be hoped that lessons will have been learnt.

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Main Contents

02 SPECIAL REPORT 17/2014: INTERVIEW WITH KAREL PINXTEN, ECA MEMBER
04 SPECIAL REPORT 14/2014
06 SWISS DIRECT DEMOCRACY AND SWITZERLAND’S RELATIONS WITH THE EU
09 THE 20TH ANNIVERSARY OF THE COURT OF AUDIT OF THE REPUBLIC OF SLOVENIA
12 TEN YEARS ENLARGEMENT: ESTONIA
25 USE OF FINANCIAL INSTRUMENTS IN EUROPEAN STRUCTURAL AND INVESTMENT FUNDS

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