

APRIL 2015

NO.

04



EUROPEAN  
COURT  
OF AUDITORS

# Journal

## European Court of Auditors



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Mise en page, diffusion / Layout, distribution : Direction de la Présidence - Directorate of the Presidency

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- Krystyna Bednarska, UNDP; Barbara Pesce Monteiro, UNDP Director and UN Secretary-General representative;  
- Danièle Lamarque, ECA Member

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# An auditor's view on the proposal for the European Fund for Strategic Investments

By Arjen Lok, attaché in the private office of Lazaros S. Lazarou, ECA Member responsible for the statement of assurance

## **An investment plan and a proposal**

Commission President Juncker set out as his first priority to strengthen Europe's competitiveness and to stimulate investment for the purpose of job creation<sup>1</sup>. On 26 November 2014 he presented an 'Investment Plan for Europe'<sup>2</sup>.

The intervention logic supporting the investment plan is that *'Europe has plenty of investment needs and economically viable projects in search of funding. The challenge is to put savings and financial liquidity to productive use in order to support sustainable jobs and growth in Europe'*<sup>3</sup>. The investment plan should not weigh on national public finances or create new debt. The Commission expects, when the plan is implemented in full, to create 1 to 1.3 million new jobs over the coming three years.

The investment plan is built around three main strands (see Graph 1):

- the creation of a new European Fund for Strategic Investments (EFSI) to mobilise over the next three years (2015 - 2017) at least € 315 billion of additional (mainly long-term) investment;
- the establishment of a project pipeline coupled with an assistance programme to channel investments where they are most needed;
- a roadmap to make Europe more attractive for investment and remove regulatory bottlenecks.

Following this plan and its endorsement by the European Council<sup>4</sup>, the Commission introduced a proposal on the European Fund for Strategic Investments<sup>5</sup>. The EFSI addresses the first two elements of the investment plan.



Commission President Juncker announcing the investment plan to the European Parliament on 26 November 2014<sup>2</sup>



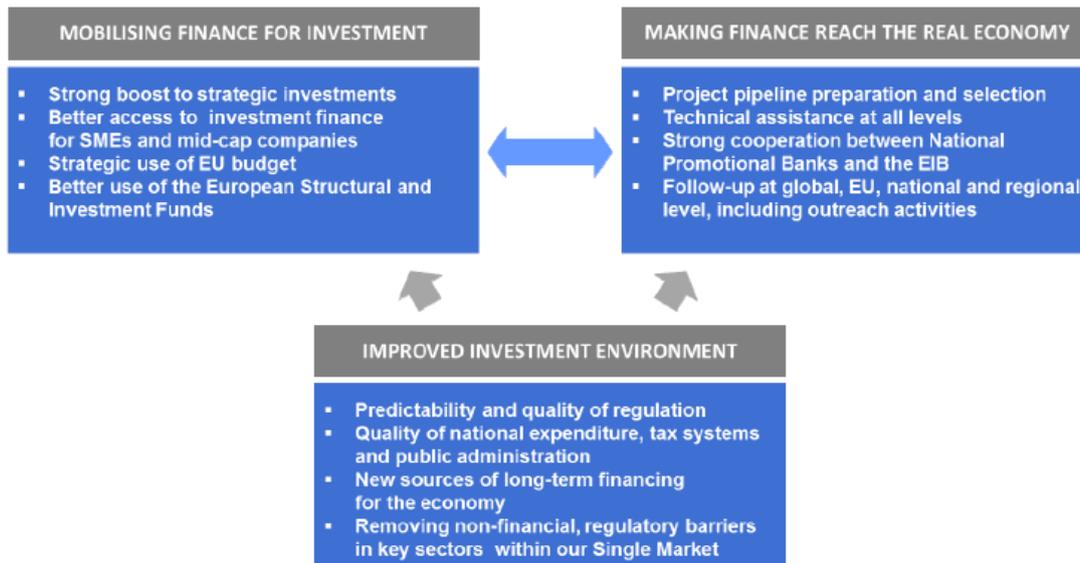
The EFSI activities will be performed by the European Investment Bank (EIB) under a guarantee a €16 billion provided by the Commission, funded from the EU Budget. The EIB will contribute at least € 5 billion.

Part of this € 21 billion (€ 2.5 billion) will be used for funding the European Investment Fund, in particular for financing of small and medium sized enterprises.

Other EFSI finance activities will be initiated by the EIB, subject to its rules.

The Commission and the EIB expect to participate in financing projects, together with other investors, to a total amount of € 315 billion.

**Graph 1 – The Investment Plan for Europe**



Source: COM(2014)903 final of 26 November 2014, page 5.



Lazaros S. Lazarou, reporting Member for opinion 4/2015 on the EFSI proposal

### ***ECA's opinion on the proposal***

The EFSI proposal significantly changes spending for competitiveness<sup>6</sup> and introduces a new fund and other new bodies, such as the European Investment Advisory Hub. The ECA, in view of the importance of the EFSI and the potential implications for the discharge authorities and the ECA in monitoring the EFSI, decided to issue an opinion on the Commission's proposal.

The ECA appointed Lazaros S. Lazarou, Member of the CEAD Chamber to draft the opinion on the Commission proposal. A team led by Gabriele Cipriani, Principal Adviser, gathered contributions from across the ECA in February. This allowed Mr Lazarou to present the opinion in time for adoption by the ECA<sup>7</sup> in order to have an impact on the stakeholders' decision-making processes. Mr Lazarou would like to take the opportunity to thank ECA Members, Mr Cipriani and ECA staff for their support and contributions in preparing and adopting the opinion.

There are high expectations from the Commission's initiative. Aiming to contribute to the success of this initiative, in its opinion the ECA draws attention to the following issues :

- governance and legislative framework;
- accountability and external audit arrangements; and
- financial liabilities for public finances.

(see: A summary of the opinion 4/2015)

The opinion indicates that ECA's Treaty mandate does not need to be specified. It is our role to assist the legislative/budgetary authorities in the oversight of EU spending, including spending through the EFSI.

The full text of the opinion is available on ECA's website: [www.eca.europa.eu](http://www.eca.europa.eu)<sup>7</sup>.

### **A summary of the opinion 4/2015**

- **Governance and legislative framework.** The draft Regulation leaves to a future agreement between the Commission and the EIB a number of essential aspects, such as the establishment of EFSI as a separate guarantee facility within EIB accounts, its governance and internal audit arrangements as well as the performance assessment of its interventions. The Court considers that these essential elements of the initiative should remain in the hands of the Legislator and be dealt with in the Regulation itself. Furthermore, the unexplained exclusion of the application of the Financial Regulation's provisions on financial instruments in favour of EIB's own rules risks creating legislative loopholes.
- **Accountability and external audit arrangements.** The Commission will be responsible for the management of the EU guarantee only. The actual financing activities guaranteed by EU funds will be delegated to the EIB and reported on the basis of its own standards. Such a framework will inevitably have repercussions on the effectiveness of the EU budget discharge procedure.

Moreover, the draft Regulation (Article 14) provides that the Court has the right to audit 'the EU guarantee and the payments and recoveries under it that are attributable to the general budget of the Union'. The Court observes that its audit mandate is set by the Treaty on the Functioning of the European Union, according to which the Court enjoys unrestricted access to any document or information it considers 'necessary to carry out its task' (Article 287(3) TFEU, second sub-paragraph). Therefore, Article 14 of the draft Regulation should be replaced by the following text: *"The external audit of the activities undertaken in accordance with the EFSI Regulation is carried out by the European Court of Auditors in accordance with Article 287 TFEU"*.

- **Financial liabilities for public finances.** Most of EFSI's financial risks may have to be covered by the EU budget. The main financial liability is represented by the EU guarantee (up to € 16 billion). In addition, the EU budget will be liable for the yearly costs of up to € 20 million related to the European Investment Advisory Hub (until 31 December 2020). Finally, the EU budget will be liable to pay unspecified additional costs when the EIB provides funding to the EIF on behalf of EFSI. However, EFSI projects may be at the source of further national public debt. This will be notably the case when Member States' contribution will be provided by borrowing the necessary funds. In this respect, the option of providing counter-guarantees to EFSI will only delay a potential risk to contracting new debt. Finally, projects guaranteed by EFSI may need additional public funding beyond the completion of the project (due to maintenance, for example).

### Further reading

The ECA Journal of March 2015 ([http://www.europa.eu/Lists/ECADocuments/JOURNAL15\\_03/JournalMarch2015-web-complet.pdf](http://www.europa.eu/Lists/ECADocuments/JOURNAL15_03/JournalMarch2015-web-complet.pdf)) included two articles on the EFSI and Juncker plan (page 3: *The European Fund for Strategic Investments*, Interview with Wilhelm Molterer, Vice-President of the European Investment Bank and page 6: *The Juncker Plan and the role of the European Investment Bank*, Invitation of the Konrad Adenauer Foundation and the CDU /CSU Freundeskreis Luxembourg to a dinner-conference with Wilhelm Molterer, Vice-President of the EIB).

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1. Opening Statement in the European Parliament Plenary Session President-elect of the European Commission Candidate for President of the European Commission Strasbourg, 15 July 2014 [http://ec.europa.eu/priorities/docs/pg\\_en.pdf](http://ec.europa.eu/priorities/docs/pg_en.pdf)

2. COM(2014)903 final 26 November 2014, [http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe\\_com\\_2014\\_903\\_en.pdf](http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/an-investment-plan-for-europe_com_2014_903_en.pdf)

Video registration of the speeches in the European Parliament <http://www.europarl.europa.eu/ep-live/nl/plenary/video?debate=1416989299087>

3. COM(2014)903 final of 26 November 2014, page 4.

4. EUCO 237/14, [https://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/146411.pdf](https://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/146411.pdf)

5. COM(2015)10 final of 13 January 2015, [http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/proposal\\_regulation\\_efs\\_i\\_en.pdf](http://ec.europa.eu/priorities/jobs-growth-investment/plan/docs/proposal_regulation_efs_i_en.pdf)

6. Within multi-annual financial framework heading 1a amounts are shifted from the Connecting Europe Facility and Horizon 2020 to the EU guarantee for the European Fund for Strategic Investments.

7. Opinion 4/2015 adopted on 12 March ([http://www.europa.eu/Lists/ECADocuments/OP15\\_04/OP15\\_04\\_EN.pdf](http://www.europa.eu/Lists/ECADocuments/OP15_04/OP15_04_EN.pdf))

# Did the European Commission manage the 2013 EU budget well?

## The annual discharge procedure

By Helena Mäki-Korvela, chief institutional relations officer



Ingeborg Gräßle, Chair of EP's Budgetary Control Committee (CONT); Vítor Caldeira, ECA President



Kristalina Georgieva, Vice-President of the EU Commission for EU Budget & Human Resources

This is the key question asked by the European Parliament throughout the annual discharge procedure that was launched on 5 November 2014 when the ECA President Vítor Caldeira presented the Annual Reports on the implementation of the 2013 EU budget to the EP Committee on Budgetary Control (CONT) in Brussels. On 12 November 2014 the European Parliament held a plenary debate on the Annual Reports and the President Caldeira also presented them to the ECOFIN Council on 9 December 2014. Mr Caldeira acknowledged that while the EU accounts were correct, the ECA again found a material level of error in the underlying payments. The management of the EU funds is not good enough, as the EU budget system is too focused on getting funds spent and needs to place more emphasis on achieving results. Accordingly, Mrs Ingeborg Gräßle (EPP), the CONT Chair and rapporteur for the discharge of the EU general budget, called for the EU accounts to measure the performance of the use of EU funds rather than payment errors.

### The Commission promises further simplification and recoveries

In the presence of the reporting ECA Members responsible for the different EU spending areas, the CONT Members cross-examined Vice-President Kristalina Georgieva, the Budget Commissioner, and other Members of the European Commission responsible at individual public hearings organised in December 2014 and January 2015. Mrs Georgieva promised simplification and harmonisation of rules and requirements across the EU budget as well as imposing interruptions of payments,

recoveries and financial corrections in order to reduce payment errors and to provide incentives to improving the shared management of EU funds. Mrs Gräßle emphasised the importance of reliable and transparent control systems and data from the Member States' control bodies. Member States could have detected and corrected a large proportion of the errors found by the ECA if their controls were effective. MEPs enquired, among other things, how the absorption of available EU funds by Member States could be increased and how the Commission plans to evaluate the performance of the spending. The CONT Members also questioned the Secretaries-General of the other institutions and the top management of the agencies and joint undertakings regarding their financial management, including their translation, staffing and real estate policies.

### The Council calls for a better balance between costs and benefits of controls

The representatives of the EU Member States examined the ECA's 2013 Annual Report at the Budget Committee meetings starting on 4 December 2014. As a result, the ECOFIN Ministers adopted the Council recommendation regarding the discharge for the financial year in question on 17 February 2015. The President of the ECOFIN Council, Mr Jānis Reirs, presented the recommendation to the CONT Committee on 23 February 2015. He recalled the particular importance that better spending and sound financial management of EU funds have for the public perception of actions financed from the EU budget, and underlined the importance of

increasing the effectiveness of control systems, while ensuring an appropriate balance between the costs and benefits of controls. CONT rapporteur Grässle called for actions for dealing with the worst performing Member States, who should prevent, detect or correct the sources of errors.

### **CONT rapporteur Grässle deplors the deficiencies of the Member States' control procedures**

In February 2015, the reporting CONT Members presented their draft reports covering the EU general budget managed by the Commission, the European Development Funds (EDF), the functioning of the European Parliament and the other EU institutions, agencies and joint undertakings. Mrs Grässle deplored the persistent weaknesses in the controls put in place by the EU Member States in the shared management areas of agriculture and rural development, regional policy and employment and social affairs and the lack of reliable and transparent control data. She called for better spending in the first place rather than recoveries years later, as well as for a new culture of performance inside the Commission. The inefficient use of financial engineering instruments is also a matter of concern, partly due to their complexity which makes public scrutiny difficult. The Commission should also improve its controls and monitoring of the external actions spending.

Mrs Dlabajová (ALDE), CONT rapporteur for EDF, would like to see the EDF strategy to be accompanied by a system of appropriate financial instruments, such as EIB tailor-made investment facilities and blended finance schemes, and see the EDF incorporated into the EU general budget in the long run. Mr Pargneaux (S&D), CONT rapporteur for EP, congratulated the European Parliament's Secretary-General for recent savings made, including with translation and interpretation costs and meeting arrangements, but called for better gender balance in management posts. Mr Czarnecki (ECR), CONT rapporteur for other EU institutions, agencies and joint undertakings, recommended that the Council discharge be postponed due to their lack of responsiveness to specific questions raised by CONT.

### **EP plenary debate and voting ahead**

Amendments to these draft reports will be voted by the CONT Members at their meeting of 23-24 March 2015, while taking into account the opinions of the relevant specialised EP committees. Finally, the entire European Parliament will be debating prior to voting at its plenary session on 29 April 2015 in Strasbourg on the key question on whether the Commission and the individual EU institutions, bodies, agencies and joint undertakings responsible will be discharged of their duties on the implementation of the EU budget for the 2013 financial year. This process demonstrates the importance and impact of the ECA's work, both annual reports and the many special reports produced during the year.

Vítor Caldeira, ECA President, and Lazaros S. Lazarou, Member responsible for the statement of assurance, in cooperation with the Professional Training Unit, addressed ECA staff on the ECA's 2013 annual report and the road ahead.

By Rosmarie Carotti



Lazaros S. Lazarou, ECA Member and Vítor Caldeira, ECA President



President Caldeira stressed that the messages of the ECA 2013 annual report, which had been presented to the European Parliament's budgetary control committee on 5 November 2014, had been very well received by all stakeholders and better understood and more fairly reported in the media than in the past. He then briefly recalled what those messages were.

The financial management of the EU is not yet good enough overall. The EU managers must not only spend money but they must also ensure that it is spent in compliance with the rules and achieves results. And it must do all three at the same time.

The EU succeeded in spending its budget and the expenditure was properly accounted for in 2013. The ECA could sign off the accounts and provide a clean opinion on the reliability of the accounts, as it has done since 2007. But the ECA found room for managing European cash flows better. That is important because the financial obligations of the European Union grow faster than the funds are available to settle them.

The ECA recommended that the Commission prepares cash flow forecasts for the budgetary authority to highlight this risk. The 2013 annual report also lists a number of cases where the

funding is provided long before the need for money arises.

Too many payments from the budget still do not comply with the EU rules. In 2013 the estimated error rate was around 4.7%. This is similar to 2012 and remains persistently above the materiality threshold of 2% applied for the statement of assurance. This led to an adverse opinion on the budget as a whole.

But the situation is not the same in all areas of spending. The expenditure managed directly by the Commission is less affected by error than the 80% spent under shared management of the Commission and the Member States. Member States authorities could have done significantly more to prevent or detect and correct the errors in the first place. If they had used the information available to them, the ECA estimates that for example in rural development, environment, fisheries and health the most likely error would have dropped from 6.7% to 2% (see 2013 annual report paragraph 4.8).

To improve the financial management of the EU, the ECA also called for more focus to be put on getting results. In the ECA's view that is the element where there is the greatest scope for improvement.

The major problem is that the financial rules and management systems have not been designed or implemented with this objective in mind.

To get better results from the EU budget, there needs to be, in the first place, a genuine commitment at EU and national level. Secondly, it needs suitable targets, reliable information and effective monitoring of results. Thirdly - and most importantly - the right incentives need to be in place, to reward good performance but also to sanction poor performance.

In its 2013 Annual Report, the ECA welcomes strongly the Commission's statement of intent to foster a culture of reform. And the ECA also calls for the Commission to improve visibility to citizens and in particular the visibility of the added value and performance of the EU budget and the progress made towards the goals of Europe 2020.

In this context, President Caldeira also noted that the ECA has recently discussed how to put more emphasis on performance issues in its annual report, not least by drawing on the results of performance audits.

With this in mind, President Caldeira also informed those present about the recent presentation he had given to the Budgetary Control committee of the European Parliament on the ECA's work programme for 2015, in particular the plan to produce more special reports based on performance audits in 2015.

Around 30 special reports are planned. Key themes to be covered are European added value and the EU's efforts to strengthen growth, employment, and public finances, which are at the heart of the Europe 2020 strategy and top priorities of the Commission. EU action on climate change and the environment is also a priority. For example the ECA is currently auditing the EU's emissions trading scheme.

President Caldeira also drew attention to the audits planned on emerging issues or recent EU development, such as financial assistance to Ukraine, energy security and the new Single Supervisory Mechanism as well on financial management issues such as grant management in agencies, microfinance for SMEs, and financial engineering instruments in rural development. Overall, it is an ambitious work programme.

### ***A new multi-annual financial framework – a new set up of the annual report***

Following this presentation on the 2013 annual report, Lazaros S. Lazarou outlined the future prospects for the annual report. Mme Lamarque, Mr Otbo and Mr Lazarou forming a working group which proposed different options to the CEAD Chamber and Court. The envisaged changes will affect the structure as well as the content of future annual reports.

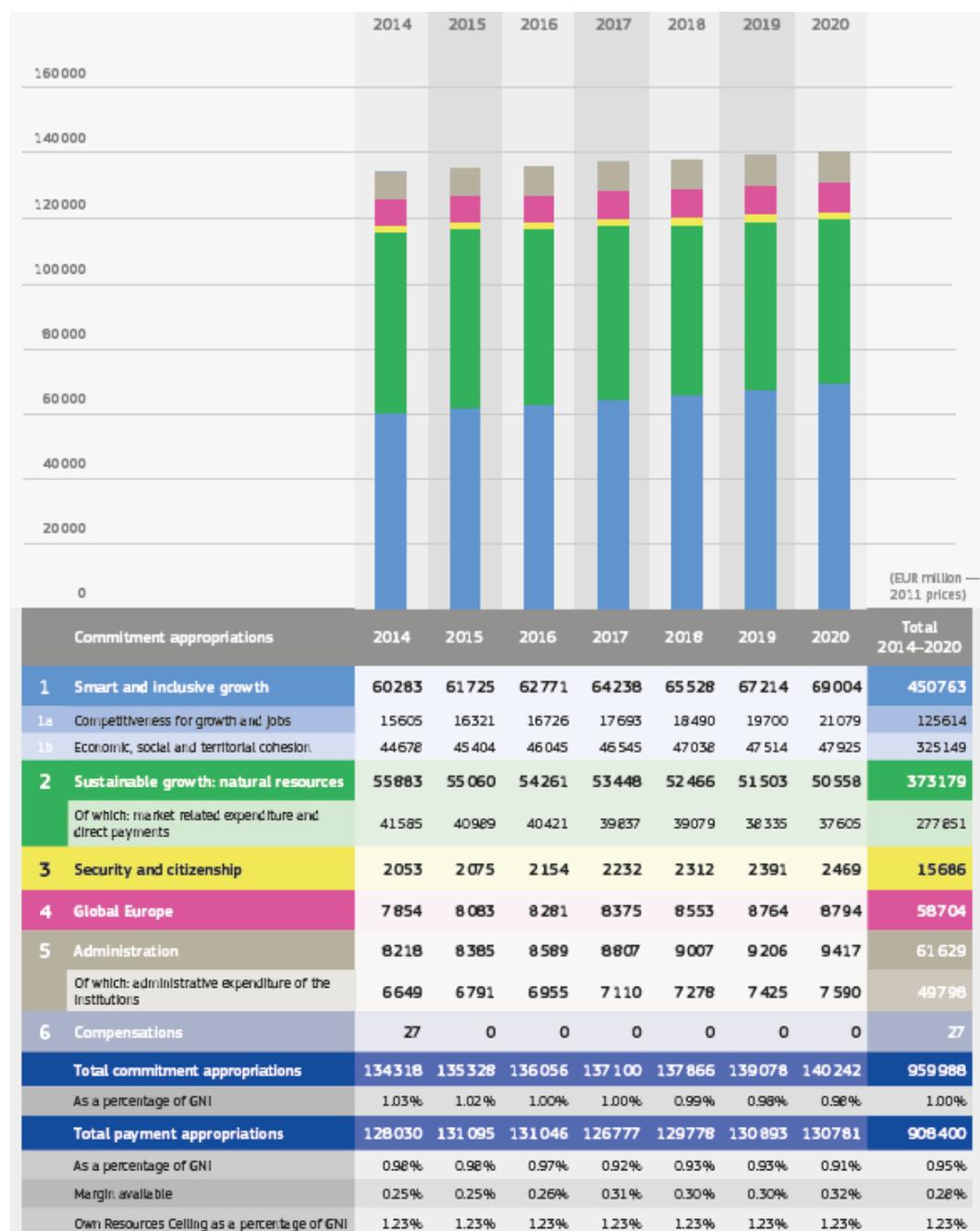
The 2014 annual report is the first to report on spending of the 2014-2020 multi-annual financial framework (see **Figure 1**). The annual report structure will be aligned with the headings of the multi-annual financial framework (MFF). In addition suggestions have been made to enrich the annual report with additional budgetary, financial and performance information. To emphasise this, the chapter on performance ('Getting results from the EU budget') which was chapter 10 in the 2013 annual report will become chapter 2. The ECA's observations on budgetary and financial management will be included in a separate chapter (chapter 3).

Going forward, the Court is considering applying rotation between MFF headings 1a (competitiveness), 3 (security and citizenship) and 4 (global Europe). This rotation could lead ECA towards a baseline approach in 2019. For the baseline approach, the entire spending from the EU budget is taken as a whole and the transactions tested are distributed accordingly.

For the 2014-2020 period, legislation has been upgraded. ECA notes that this allows for opportunities for the Commission to act upon this. There will for example be an aligned yearly closure for most shared management spending. It is up to the Commission to ensure good quality of that annual closure information, so that it can produce more reliable information in the annual activity reports.

Meeting stakeholders' needs is imperative. The steps taken should address closing any gaps between stakeholders' expectations and the ECA's work. Therefore an exchange of views with the Budgetary Control Committee of the European Parliament and the Council will be held in addition to ECA's follow up on the discharge recommendation of Council and the resolutions of the European Parliament.

**Figure 1 – Multi-annual financial framework 2014-2020 in 2011 prices**



Source: Commission publication *Multiannual financial framework 2014-2020 and EU budget 2014 – The figures*  
[http://bookshop.europa.eu/en/multiannual-financial-framework-2014-2020-and-eu-budget-2014-pbKV\\_0413055/?CatalogCategoryID=mpgKABstFogAAAEjbiUY4e5K](http://bookshop.europa.eu/en/multiannual-financial-framework-2014-2020-and-eu-budget-2014-pbKV_0413055/?CatalogCategoryID=mpgKABstFogAAAEjbiUY4e5K)

# The UN-EU Partnership 2013

## “Saving and Improving Lives”

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The information session was introduced by Eduardo Ruiz Garcia, ECA Secretary General, with the participation of Danièle Lamarque, ECA Member.

10 March 2015

By Rosmarie Carotti



From left to right: Anna Hysbergue, UNDP; Laura Beke, UNDP; Krystyna Bednarska, UNDP; Barbara Pesce Monteiro, UNDP Director and UN Secretary-General representative; Danièle Lamarque, ECA Member; Pierre Harzé, Deputy Director UNDP; Eduardo Ruiz García, ECA Secretary General

A delegation led by Director, Barbara Pesce-Monteiro, who is also the UN Secretary-General's representative towards the EU, presented on 9 March 2015 the ninth annual UN-EU partnership report entitled “Saving and Improving Lives”. The report outlines the results of collaboration with the European Union, covering the full thematic and geographical scope of their joint initiatives worldwide.

In 2013, the UN and the EU worked together in over 110 countries. As the report demonstrates, this partnership continues to save and improve the lives of millions of people in the developing world each year. For example, the UN provided life-saving assistance to 12 million refugees worldwide, and helped over 233 million people to register to vote in elections held in ten countries. The UN-EU relationship enables more work on the ground than each one of the world players could do on their own. Synergy which is inspired by common values like impartiality and neutrality is triggered.

There are even more similarities: behind the work of both, the UN and the Commission, are a great number of agencies and DGs which have different tasks but complement each other. Multilateralism is another feature in common.

The EU funding to the UN was € 1.4 billion per year in the period 2000-2014. This is the amount channelled through the UN system by the EU to achieve its objectives. This is the foundation of the EU-UN relationship, as the EU gives money to the UN for specific projects which are defined in its agenda and meet the common values of both bodies. The Commission is a major partner for the UN.

The UN-EU partnership does make a difference. Krystyna Bednarska, from UNDP (United Nations Development Programme) Representation Office in Brussels discussed more specifically the cooperation with the Commission's DG ECHO, which provides emergency assistance and relief to the victims of natural disasters or armed conflict outside the European Union and with DG DEVCO, the Commission's Development and Cooperation Directorate-General.

2015 is a pivotal year for EU-UN cooperation, with a new EU Commission and a new European Parliament. There will be a high level UN policy meeting with the Commission in April on the post 2015 agenda, which is a universal agenda for a future global framework for poverty eradication and sustainable development.

At the moment negotiations about the goals are taking place in the Member States and in the UN General Assembly. The UN hopes to engage positively with the Council members in in the second half of the year and reach an agreement on the 17 proposed goals. For the first time, there will be goals on governance, in terms of rights for democratic governance. Policies and the way to support the national governments in implementing them also need to be reviewed.

Danièle Lamarque, ECA Member informed that in October 2015 the ECA will host an important conference on the EU policies for development but that it was still too early to give further details.

The conference was followed by a technical workshop organised by Karel Pinxten, ECA Member, on the follow-up to the Financial and Administrative Framework Agreement (FAFA) between the European Union and the United Nations.

# The role of the Court of Auditors in modernising the accounting system of the European Institutions 12

By Eduardo Ruiz García, ECA Secretary-General

September 2013

Translated into English by Michael Pyper and revised by Mark Smith

The views expressed in this article are solely those of the author. The article was published in the journal of the Spanish Court of Auditors (*Revista Española de Control Externo*, Vol. XV, Mayo 2013, N.º44)



Eduardo Ruiz García, Secretary-General of the ECA

## Abstract

*The European Court of Auditors issued an opinion on the reliability of the European Union's accounts for the 2011 financial year, without reservations or adverse comments. This positive opinion was the result of a process to modernise the accounting system launched by the European Commission in 2002.*

*Since it was founded in 1978, the European Court of Auditors has contributed to this modernisation process. The Court's reports revealed the shortcomings of the accounting system and procedures in place, in particular the lack of assurance regarding the European Union's financial position as presented by the annual accounts. The Court underscored the need to launch an in-depth reform aimed at applying international standards and generally accepted accounting principles. Since the first statement of assurance issued in 1994, the Court has developed its accounting "doctrine", stressing the need to introduce an accounting framework based on the accrual principle and establishing adequate consolidation procedures for all the EU institutions and bodies. The Court monitored the design and implementation of the modernisation plan and issued several recommendations aimed at improving transparency and accountability.*

## **Introduction**

On 12 November 2012, the Court of Auditors published its Annual Report concerning the implementation of the budget for the 2011 financial year<sup>1</sup>. Chapter 1 contained the statement of assurance on the accounts for the financial year. Paragraph VII reads:

"In the Court's opinion, the consolidated accounts of the European Union present fairly, in all material respects, the financial position of the Union as of 31 December 2011, and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the Commission's accounting officer".

This favourable and unqualified opinion as to the reliability of the accounts reflects the quality of the European Union's accounting system and procedures. This is in contrast to the first opinion issued by the Court in its statement of assurance for the 1994 financial year which, although positive, contained numerous reservations and qualifications. It is also in contrast to the adverse opinion of the Court as to the legality and regularity of the transactions underlying the accounts.

The change in the Court's opinion as to the reliability of the accounts is the result of the far-reaching reform and modernisation of the accounting system undertaken by the Commission. This modernisation was first outlined in 2000, began to take shape in 2002 with the adoption of an action plan and culminated in 2005 with the submission, for the first time, of the accounts for the financial year that were prepared in accordance with the new accounting framework and principles.

The European Court of Auditors played a major role in this development. Its observations and criticisms highlighted shortcomings in the accounting system

<sup>1</sup> Official Journal of the European Union (OJ C 344, 12.11.2012).

and the procedures used, as well as stressing the urgent need for far-reaching reform. The Court's recommendations and advice during the design and implementation of the reform contributed to its successful outcome.

This article sets out the Court's role in the reform and modernisation process. It considers the following phases: (1) *Initial observations on the accounts (1977-1993)*; (2) *The Court defines its "doctrine" (1994-1999)*; (3) *Towards an accruals-based accounting system (2000-2002)*; (4) *Towards an unqualified opinion (2002-2011)*.

### 1. Initial observations on the accounts (1977-1993)

The European Court of Auditors was established by the Treaty of Brussels in 1975 and became operational in 1977 following ratification of the Treaty. In 1992, the Maastricht Treaty extended the Court's powers by requiring it to present an annual report on the reliability and regularity of the accounts.

The Court's first report was for the 1977 financial year<sup>2</sup>, while the first statement of assurance was issued in respect of the 1994 accounts<sup>3</sup>. During this initial period, when it was consolidating its position as an institution and fine-tuning its doctrine, the Court immediately demonstrated its commitment to audit and its interest in the Community's accounts. In its first Annual Report on the 1977 financial year, the Court expressed its position, under the heading "General Accounts"<sup>4</sup>, that the accounts submitted did not provide any assurance as to the financial position (assets and liabilities) of the institutions and that there was no documentation describing their accounting systems and practices.

From 1977 to 1993, all of the Annual Reports contained a chapter or section dedicated to the accounts and the accounting system. During this period, the Court did not issue an 'audit opinion' in the sense required by the auditing standards (it would not do so until it issued the statement of assurance in 1994). However, it did make a number of negative observations and express a critical view of the accounts and the accounting system used. In

<sup>2</sup> OJ C 313, 30.12.1978.

<sup>3</sup> OJ C 352, 30.12.1995.

<sup>4</sup> OJ C 313, 30.12.1978 (paragraph 11.3).

so doing, it set out the shortcomings that needed to be addressed and that would make up large part of the future accounting reform to be launched by the Commission at the beginning of the twenty-first century. Let us recall the main problems found.

Firstly, the Court warned that it was impossible to ensure with certainty that the balance sheet accurately presented the European Community's financial position. Numerous assets and liabilities were not recorded comprehensively or accurately. One of the problems identified – and one which would become persistent – was the recognition of revenue as "negative payments".

The reports criticised the poor quality of the accounting information. Some items came from information outside the accounting system and were included in the balance sheet without adequate checks. Information on many items was lacking, particularly on fixed assets and bank accounts. Furthermore, the notes to the financial statements were inadequate.

The Court also highlighted the lack of documentation on accounting principles and procedures and the way they were organised. The 1989 Annual Report criticised the fact that, "To a large extent, the organisation of the general accounts relies on the individual memories of the officials working in this department"<sup>5</sup>.

Two major shortcomings would be identified: incorrect procedures for consolidating the institutions' accounts and incorrect treatment of transactions concerning payments on account and advances. Both issues would be central to the future reform.

The Court attributed the incorrect consolidation of the accounts and balance sheets of the institutions primarily to the lack of common methodology and procedures, the different schedules for closing the accounts, the partial adjustment of reciprocal accounts between institutions and inadequate plausibility checks and reconciliations.

As regards the incorrect recording of payments on account and advances, the Court noted that it was impossible to identify which payments and expenditure were final and which were outstanding. These shortcomings highlighted the difficulties

<sup>5</sup> OJ C 313, 12.12.1990 (paragraphs 1.118-1.119).

faced by the accounting system in allocating transactions to the correct financial year and in accordance with generally accepted accounting principles. Similar problems were observed in the treatment of recoverable duties and taxes, arrears and revenue to be received or allocated. One of the central pillars of the reform thus appeared on the agenda: the introduction of accruals-based accounting and the application of the accruals principle. In the 1988 Annual Report, the Court referred to a study by an independent consultant which confirmed the shortcomings in the accounting system as identified by the Court and highlighted *“the absence of any clear basic concept in the Community regulations (the present basic concept is merely a compromise between cash-based and accruals-based accounting)”*<sup>6</sup>. This study also stressed the lack of any official publication of the accounts, the omission of all non-budgetary operations from the consolidated accounts and the inadequate nature of the explanatory notes annexed to the annual accounts.

In 1990, a new computerised accounting system known as SINCOM came into operation. The Court considered the system neither integrated nor reliable, since data collection was based on many manual and computer checks<sup>7</sup>. Other major shortcomings concerned control procedures: registration of third parties, interfaces with local subsidiary systems in the Commission Directorates-General, validation of transactions against the rules, etc. The Court found that the regulations and financial and accounting practices were very complex, and that there were too many exceptions. This all represented an obstacle to the computerisation of budgetary and accounting management. These observations also made a significant contribution towards shaping the future accounting reform by highlighting the need to review procedures while at the same time building a truly integrated computerised management system.

In summary, the conclusion is that the Court of Auditors made important observations concerning the Community accounting system during this period (1977-1993). However, these comments did not elicit any decisive response from the

<sup>6</sup> OJ C 312, 12.12.1989 (paragraphs 2.57-2.58). See also European Court of Auditors Opinion No 1/89 (OJ C 72, 20.3.1989).

<sup>7</sup> Annual Report concerning the 1991 financial year. OJ C 330, 15.12.1992 (paragraphs 16.115-16.116).

European Commission or the legislature (the European Parliament and the Council). None of the numerous changes made to the financial regulations remedied the major shortcomings. The only significant legislative development that would have any impact over the years was the Maastricht Treaty's introduction of the statement of assurance on the accounts. However, during these years, the Court fine-tuned its accounting “doctrine”, defining it more clearly by issuing the statement of assurance and an opinion in accordance with auditing standards. The “doctrine” set out the main accounting issues to be resolved.

## The Court defines its “doctrine” (1994-1999)

In 1995, the European Court of Auditors published its first statement of assurance as to the reliability of the 1994 accounts<sup>8</sup>. The Court found that the accounts gave a true and fair view of the Union's revenue and expenditure, as well as its financial position. However, it expressed a number of reservations and qualifications, and stressed that the accounts should be made more informative in several important respects. Such favourable but qualified opinions would be a constant feature until 2007. From that year onwards, the Court expressed a number of reservations and qualifications. However, these would not feature at all in the opinion on the 2011 accounts.

The reservations concerning the revenue and expenditure account for 1994 included the main shortcomings previously identified by the Court: entry in the accounts of revenue and expenditure as negative transactions, presentation of advances and payments on account as final, non-application of the principle of annuality and accounting commitments that no longer met legal requirements.

The reservations concerning that year's consolidated financial balance sheet stressed the lack of data uniformity due to insufficient harmonisation of the accounting methods and standards applied by the various institutions.

In the years that followed, the Court expressed other reservations due to inadequate recording of fixed assets, incomplete recording of debtors and potential receivables, incomplete identification of financial intermediaries managing EU funds,

<sup>8</sup> OJ C 352, 30.12.1995

reliance on data outside the accounts and the poor quality of information generated by these data, the impossibility of distinguishing between administrative and investment expenditure, and the incomplete scope of consolidation of the accounts (which did not include all European agencies and bodies).

The statement concerning the 1996 financial year marked a turning point<sup>9</sup>. The Court did not limit its criticism to the accounts themselves, but extended its analysis to accounting standards, policies and procedures. In one section of the report devoted to this analysis, the Court stressed the need for the Commission to prepare a document clearly setting out accounting principles and policies. It found that the fundamental principles of the revenue and expenditure account should be indicated (i.e. cash or accruals basis), the applicable principles for valuing balance-sheet items should be defined (providing for depreciation of fixed assets) and a framework should be established to ensure proper reconciliation between the two accounts. Even more significantly, the Court required the Commission to base its accounting on the directives applicable to businesses and the accounting standards issued by the competent international bodies, particularly those applicable to public accounts. Similarly, the Court clarified what the accounting system's objective should be: to provide a basic framework of financial information that meets users' (mainly the budgetary authorities') needs, increases transaction transparency and gives a clearer indication of the financial position.

This was a major step forward for the Court. Not only did it present the shortcomings that necessitated reservations in its opinion on the accounts, but it stipulated the objective and the conceptual basis that should underpin the accounting system: documented standards and procedures based on generally accepted international principles.

The Commission presented a proposal to amend the Financial Regulation at the end of 1997. The Court's mandatory opinion<sup>10</sup> severely criticised the state of the Union's financial management and accounting and the limited scope of the Commission's proposed reforms. The opinion reiterated the shortcomings in the Union's

accounts: negative revenue and expenditure, an excessive system of exemptions, a lack of accounting principles in legislation, no defined objectives, a lack of accounting methods common to the institutions, confusion between payments on account and advances, inadequate information in the notes to the financial statements, etc. The Court's findings were categorical: "The proposal for an amendment to the Financial Regulation presented by the Commission is not likely to solve the problems"<sup>11</sup>. The opinion denounced "the absurd situation in which the institution entrusted with drawing up the regulatory framework for the private accountancy profession in Europe is not itself in a position to abide by generally accepted accounting principles"<sup>12</sup>.

The Court stressed the need to undertake a further-reaching reform. Firstly, a basic accounting framework needed to be defined that was suitable for the public sector and conformed to the standards issued by INTOSAI<sup>13</sup>. Secondly, the accounting principles for preparing financial statements needed to be adopted, following the Fourth Council Directive for reference. Lastly, detailed standards and accounting methods needed to be laid down for recording transactions in accordance with the accounting framework and principles. The Court deemed it essential to codify these provisions in a way that was appropriate and consistent with the Financial Regulation and its implementing rules.

One of the main obstacles identified was that the system worked on a joint cash and accruals basis, giving rise to uncertainties in the recording of transactions. The corollary was obvious: to opt for an accruals-based accounting system. A declaration of intent in every respect, Section 3 of Opinion No 4/97 was entitled "Towards an accruals-based accounting system".

Opinion No 4/97 presented what might be described as the *corpus* of the Court of Auditors' accounting doctrine. As we will see below, this document would be one of the main points of reference in the process that the Commission would launch three years later to modernise the accounting system.

<sup>9</sup> OJ C 348, 18.11.1997

<sup>10</sup> Opinion No 4/97 OJ C 57, 23.2.1998.

<sup>11</sup> Opinion No 4/97 OJ C 57, 23.2.1998 (paragraph 16).

<sup>12</sup> Opinion No 4/97 OJ C 57, 23.2.1998 (paragraph 1.48).

<sup>13</sup> International Organisation of Supreme Audit Institutions.

In the statement on the 1998 financial year<sup>14</sup>, the Court stressed that its main source of reservations regarding the reliability of the accounts was the lack of an adequate and complete accounting framework to ensure consistent and correct treatment of consolidated financial statements. The urgent matters to be resolved were reiterated: interim payments (advances and payments on account), receivables and the scope of consolidated financial statements. In its statement the following year, the Court would refer to how non-accounting inventories used for allocating and recording transactions in the budgetary and general accounts were having a negative impact on information quality.

The Court's insistence on the need for an accounting framework started to bear fruit in 2000. That year, in its reply to the Court's observations on the 1999 financial year<sup>15</sup>, the Commission acknowledged the lack of an appropriate accounting framework and announced an action plan to remedy this. The Commission noted the evolution of public accounting at international level and stated its willingness to follow suit. It also reported that it had undertaken a methodological analysis of its accounting systems with the assistance of high-level experts<sup>16</sup>. However, the Commission called for caution and predicted that the plan would be a long-term project, since it would require a detailed analysis of the proposals, amendments to the Financial Regulation and changes to the accounting procedures and the IT system.

## **2. Towards an accruals-based accounting system (2000-2002)**

The timeframe for implementing the accounting modernisation plan would not be particularly long. Although the project did not start until 2002, the new accounting framework was in operation by 2005, and three years later the Court issued an opinion on the reliability of the accounts without any reservations (albeit with some qualifications). Various factors contributed to this development: the quality of the proposals made, good project

organisation and the work of those in charge of the project. The support of the Court of Auditors, which made comments, criticisms and suggestions throughout the design and implementation phase of the plan, also played a significant part.

One key to success was the Commission's political will and the Parliament's decisive impetus to improve financial management and control. A very severe political crisis and crisis of confidence had led to the resignation of the Santer Commission. A number of corruption, mismanagement and nepotism scandals had emerged (Leonardo, ECHO, TAIEX, MED Programme, etc.) – and all this with the prospect of a historic enlargement of the EU in 2004 to include 10 new countries, with higher management and control risks on the horizon.

The Court of Auditors continued to issue qualified statements of assurance on the accounts. Its opinion on the legality and regularity of payments was unfavourable, and it was also highly critical of the poor results yielded by EU policies and expenditure.

The new Prodi Commission embarked on a process of in-depth reform of its financial and accounting management. The reform drew inspiration from the New Public Management ethos and the more recent experiences of some national administrations. The modernisation of the accounting framework started to take shape in 2000, coinciding with the publication of the White Paper on reform<sup>17</sup>.

In January that year, a first meeting took place between representatives of the Commission and of the team responsible for carrying out the preparatory study for accounting modernisation. A Court of Auditors representative attended the meeting as an observer. The Commission's accounting officer, J.P. Vandersteen, stressed that the Court's observations and recommendations were one of the main inspirations for the modernisation plan. The preparatory study was completed in mid-2003<sup>18</sup>. At the same time, the Commission held various meetings with the accounting officers of several national authorities<sup>19</sup>,

<sup>14</sup> OJ C 349, 3.12.1999

<sup>15</sup> OJ C 342, 1.12.2000 (Commission replies to paragraphs 8.35-8.38).

<sup>16</sup> Team led by Professor Vicente Montesinos of the University of Valencia.

<sup>17</sup> COM(2000) 200 final, 1.3.2000.

<sup>18</sup> Montesinos, V. (ed.) 2000. Study on the preparation and the presentation of the consolidated accounts of the European Union. European Commission, Brussels.

<sup>19</sup> The United Kingdom, France, Sweden, Spain and the Netherlands.

organised a seminar on public accounting and proposed a new Financial Regulation.

In 2001, a draft accounting framework was submitted, based on international standards and generally accepted accounting principles<sup>20</sup>. The framework set out the accounting objectives and principles, established a dual accounting system (“cash” for budgetary accounting and “accruals-based” for accrual accounting), proposed clear allocation and valuation methods, and defined the consolidation scope and standards. It also called for an integrated computer system, known – very significantly – as ABAC (*Accrual-Based Accounting*). In June of the same year, the Commission discussed a first draft of the modernisation action plan with the Court of Auditors.

The plan reached cruising speed under the leadership of the European Commissioner for Budget, Ms Schreyer. The new Financial Regulation was adopted in June 2002<sup>21</sup>. This largely addressed the shortcomings in the previous proposal criticised by the Court<sup>22</sup>. The Regulation required the new accounting framework and system to be fully operational by the 2005 financial year. Article 125 required the financial statements to be prepared in accordance with the principle of accrual accounting. In December 2002, the Commission published a communication on the modernisation of the accounting system,<sup>23</sup> definitively setting out the path to be taken. The communication offered a detailed proposal for an accounting framework and the applicable principles, with a particular focus on accruals-based accounting. An action plan was also put together, containing the project’s organisational structure, required resources and schedule.

The modernisation plan finally adopted by the Commission took full account of the Court’s opinion. The Commission communication made several references to the Court, its reports and its observations. For example, the introduction mentioned the Court’s statement of assurance

<sup>20</sup> International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants (IFAC) or, in their absence, international standards issued by the International Accounting Standards Board (IASB).

<sup>21</sup> Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002).

<sup>22</sup> Opinion No 2/2001 (OJ C 162, 5.6.2001).

<sup>23</sup> COM(2002) 755 final, 17.12.2002.

on the 2001 accounts, which stated that “*The Court considers that urgent in-depth action in the Commission’s departments to cope with the risks arising from the shortcomings in the accounting system is required*”<sup>24</sup>. The communication went on to refer to the Court in other sections: to justify the need for certain measures proposed and to identify shortcomings needing to be addressed as a matter of priority. Annex C explained in great detail how the actions proposed under the reform responded to the observations made by the Court of Auditors between 1994 and 2000.

Throughout this design phase of the modernisation plan, the Commission consulted the Court of Auditors and carefully considered its views. Many meetings took place between the departments concerned, exchanging knowledge and information. Court officials participated as observers in meetings of the various working groups finalising the plan. At the invitation of the Commission, Court representatives - in the capacity of observers - joined the plan’s monitoring committee and the advisory committee for accounting standards. This involvement helped to bring the Court’s professional experience and know-how to the plan. It also provided very detailed knowledge of the progress made, the problems faced and the specific proposals launched. This enabled the Court critically to monitor the entire implementation phase of the modernisation plan, of which it gave a detailed account in its annual reports.

### **3. Towards an unqualified opinion (2002-2011)**

During the 2002-2008 period, the reports in support of the statement of assurance contained a paragraph with the Court’s conclusions about the implementation of the accounting modernisation plan. The reports also provided a detailed table monitoring the impact of the plan on the accounting reservations and qualifications expressed by the Court.

In the 2002 and 2003 reports, the Court mainly drew attention to the timeframe. The Court considered the timetable too ambitious, and believed that the Commission risked restricting itself to making gradual partial adjustments rather than undertaking a thorough rationalisation of its

<sup>24</sup> 2001 OJ C 295, 28.11.2002 (Statement of Assurance, IV).

information and accounting management systems. It also highlighted the need to allocate sufficient human resources to the modernisation plan.

In 2005, the Court launched an audit covering the crucial stages of the new accounting system's implementation. The results were presented in the annual reports for 2004, 2005 and 2006. The main objectives of the audit were: (i) to verify compliance with the provisions of the Financial Regulation, and (ii) to ensure that the system could generate reliable financial statements.

The report concerning the 2004 financial year<sup>25</sup> analysed the preliminary phase of transition from one system to another, addressing three key issues. Firstly, it analysed the compliance of the accounting standards with the Financial Regulation and international standards. In particular, it evaluated the standards relating to financial statements, expenses and payables, pre-financing and provisions, and contingent assets and liabilities. The Court found that the four standards were compliant, although some clarification was needed in relation to guarantees and pre-financing. The second issue addressed concerned the identification of missing data in the final accounts for 2004. These data were needed in order to determine the opening balance for 2005 in accordance with the new standards (pre-financing, guarantees, invoices/payment requests and legal entities – “third-party file”). The auditors found several problems that could affect the presentation and content of the information provided and, consequently, the opening balance sheet for 2005. The problems concerned provisional amounts awaiting validation, overstatements and delays in assembling the “third party file”. Thirdly, the Court analysed the Commission accounting officer's validation of local financial management systems, noting delays and the use of some systems despite their risks. The report concluded by noting that, due to the shortcomings found, the opening balance sheet for 2005 was not available at the close of the 2004 financial year.

The Court presented its audit findings for the transition year in its 2005 report<sup>26</sup>. The Court's audit focused on the Commission's management of the transition from cash to accruals-based accounting, and on verifying the accuracy of various elements in the accounts. The report assessed whether the standards had been applied correctly and whether

the Commission had taken steps to guarantee the reliability of the accounts. The Court went on to analyse the validation basis for the 2005 opening and closing balances, the cut-off methodology used and the local accounting systems used by the Commission's Directorates-General. It confirmed that the Commission had made significant progress. However, persistent problems prevented some of the reservations concerning the reliability of the accounts from being lifted. The most important of these concerned delays in preparing the financial statements due to the late validation of opening and closing balances and due to lack of validation of some of local systems<sup>27</sup>. The Court identified errors affecting the financial statements, such as incorrect allocation of invoices, cost statements and pre-financing, and overstatement of short-term liabilities. It also confirmed the improvement in the ABAC IT system and drew attention to the need to adapt accounting standards in relation to the scope of consolidation, the structure and presentation of the balance sheet, and the treatment of pension rights.

The findings of the third phase of the audit - the consolidation of the transition - were published in the 2006 Annual Report<sup>28</sup>, the second report to use accruals-based accounting. The Court found that the Commission had made improvements: in particular, the scope of consolidation had been extended (from 16 bodies to 24), the accounts contained more detailed information on the recovery of expenses, the formalities for submitting the accounts had been established (signatures by the accounting officers of each body, and a declaration by the Commission's accounting officer) and the accounting standards had been revised. The Court's opinion on the reliability of the 2006 accounts expressed fewer reservations than in previous financial years. Errors had again been identified in invoice, cost statement and pre-financing amounts, leading to an overstatement of liabilities. Shortcomings were also found in the quality of information on the cut-off and on employee benefits.

The 2007 financial year was the third in which the accruals basis was used, and the Commission continued to make progress in its presentation of the accounts. In its annual report<sup>29</sup>, the Court noted that the scope of consolidation had increased

<sup>25</sup> OJ C 301, 30.11.2005.

<sup>26</sup> OJ C 263, 31.10.2006

<sup>27</sup> The Court did not actually receive the complete provisional opening balance for the 2005 financial year until 31 March 2006.

<sup>28</sup> OJ C 273, 15.11.2007.

<sup>29</sup> OJ C 286, 10.11.2008.

to 26 bodies, the information on the methods used for recovering undue expenditure had been consolidated, and the economic and budgetary outturn had been reconciled. The Court also confirmed that the Commission had taken a major step forward in terms of information quality, having developed a risk analysis for accounting, and had drafted specific manuals and documented cut-off files. However, in its opinion on the reliability of the 2007 accounts, the Court noted that there were problems with information quality in some Commission Directorates-General and in a number of decentralised bodies.

The Court's concerns about the reliability of the accounts gradually became more moderate, becoming limited to minor points such as the use of the *pro rata temporis* method in the cut-off procedure or the excessive frequency of some minor errors.

In the 2008 and 2009 statements of assurance<sup>30-31</sup>, the Court still had some objections due to specific weaknesses in the accounting systems of certain Commission Directorates-General. However, these did not affect the Court's overall favourable opinion. Pre-financing, the cut-off and invoices/cost statements were again the problem.

In the 2010 statement of assurance<sup>32</sup>, the Court's favourable opinion was marred only by an emphasis of matter drawing attention to a change in the Commission's accounting policy in relation to certain pre-financing payments.

In the statement of assurance for the 2011 financial year<sup>33</sup>, the Court finally issued a favourable and unqualified opinion. In the Court's opinion, "the consolidated accounts of the European Union presented fairly, in all material respects, the financial position of the Union as of 31 December 2011, and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of the Financial Regulation and the

accounting rules adopted by the Commission's accounting officer".

The Court of Auditors made its most recent recommendation in relation to the Commission accounts in Opinion No 6/10 on the Financial

<sup>30</sup> OJ C 269, 10.11.2009.

<sup>31</sup> OJ C 303, 9.11.2010.

<sup>32</sup> OJ C 326, 10.11.2011.

<sup>33</sup> OJ C 344, 12.11.2012.

Regulation<sup>34</sup>. The Court suggested stating explicitly in the Regulation that, when adopting the implementing rules, the accounting officer can, where necessary, deviate from internationally accepted accounting standards in order to safeguard the "true and fair view". The provision in question is one that allows the accounting officer to uphold the principle of a true and fair view. In such cases, the reasons for and extent of any deviation should be explained in a note to the financial statements.

### Conclusion

The Court's unqualified and favourable opinion as to the reliability of the 2011 accounts marks the successful culmination of the accounting modernisation process launched by the European Commission in 2002.

The Court of Auditors has made a crucial contribution towards this positive development. Since publishing its first annual report in 1978, the Court has pointed out the shortcomings in the accounting procedures and system, and identified the reasons for these shortcomings and the reforms required. Despite a limited initial response to its findings, the Court continued to reaffirm its position, which has been embodied since 1994 in an accounting "doctrine" with the development of the statement of assurance. Ultimately, the Court's "doctrine" was one of the main points of reference for the modernisation plan, which was launched by the Commission in 2002 and culminated in 2005 with the submission of the accounts prepared in accordance with the new accounting framework and principles based on international standards. The Court's advice and monitoring helped in the drafting and implementation of the plan.

The Court continues to fulfil its mission by producing the statement of assurance and observations and recommendations on how to improve the accounting system. In so doing, it promotes accountability and transparency in the European Union.

<sup>34</sup> OJ C 334, 10.12.2010.

# Special report No 23/2014

## Errors in rural development spending

20

By Rasa Budbergytė, ECA Member

The report takes an in-depth look at spending under the European Agricultural Fund for Rural Development, and in particular the compliance of this spending with the applicable rules. With almost €150 billion spent for the 2007 – 2013 programming period, this fund is the main instrument both for financing investments in tangible and intangible assets in rural areas, as well as for area-related aid, including encouraging farmers to adopt more environmentally-friendly farming practices.



From left to right: Aurelia Petliza, auditor, Annette Zimmerman, assistant, Marius Cerchez, auditor, Robert Markus, head of the unit, Maura McElhinney, attaché, Rasa Budbergyte, Member, Tomas Mackevicius, head of private office

### Why was this work undertaken?

For many years now, it has been recognized both by the ECA and its stakeholders that spending on rural development is particularly error-prone. This has been confirmed since 2011, when a new chapter of the ECA's annual report was devoted primarily to rural development, together with some other smaller policy areas. The estimated error rate for this new chapter has been amongst the highest of all chapters since its introduction. As a result, the ECA's stakeholders, particularly the budgetary control committee of the European Parliament (CONT), wanted to know the reasons for this high error rate, and what could be done to rectify it. While the Commission and Parliament had already undertaken some work on the root causes of such errors, these studies had a quite limited focus. The ECA therefore decided to make an independent in-depth analysis of a large sample of randomly-selected transactions, in order to identify the main causes of errors and to propose solutions.

### What are the main findings?

The report had a two-stage approach. First, there was the identification of the main causes of error in rural development spending. The auditors estimated that, for the three-year period 2011-

2013, the average error rate was 8.2%, which is more than four times the materiality threshold. For investments, the report finds that the source of errors is equally split between beneficiaries who breach the rules and paying agencies which are not effective in verifying the legality of the spending. For area-related aid, three causes of error have been identified: farmers have a low motivation to comply, because the costs of compliance are immediate and the effects on farms are long-term; secondly, there is a low control rate from the paying agencies; and finally, sanction rates are not dissuasive enough.

In the second stage, the report looked at the manner in which the Commission and Member States are addressing the causes of error, with the purpose of preventing and / or correcting such errors in the future. It was identified that, despite the Commission's initiatives in designing and implementing concrete action plans, Member States are rather reluctant and focus mainly on corrective actions for already identified problems, without sufficient attention being given to preventive actions that could have a system-wide effect. There are several positive developments in the new legal framework for the 2014 – 2020 programming period, but their effect can only be assessed later on.

### **What was the audit approach?**

This is an innovative report in terms of the audit approach. The intention from the outset was to produce a quick special report, which would be available in time to be considered by the CONT during its discharge process for rural development – only nine months from the start of the ECA’s audit work! Therefore, every effort was made to ensure efficiency and timeliness during the audit work, and to draw on the reflections of the ECA’s working group on streamlining, which made recommendations on, *inter alia*, quick special reports. These recommendations were that, for a quick special report to be feasible, there should be a narrowly-defined audit topic; no preliminary study or in-depth audit plan (audit planning memorandum or APM) should be produced; and no clearance letters (statements of preliminary findings or SPFs) should be issued to auditees, but that results should be communicated promptly to them.

In line with this approach, the audit topic was confined to those errors, and particularly quantifiable errors, already identified during the DAS (statement of assurance) work for the three years from 2011 to 2013. Thus, there was no need to carry out a preliminary study to understand the subject matter, which was already well-known. And the APM was a concise document, mainly used to identify the audit questions, audit scope and methodology to be used.

The identification of the causes of error, dealt with in the first part of the report, was entirely based on analysing the random sample of over 450 transactions audited for the three years 2011 to 2013. A database was built to gather information about all these transactions, which was then analysed to identify common patterns and explanations for the occurrence of errors. There was thus no need to carry out audit visits to Member States, as all relevant information was already available.

This approach allowed the team to work effectively in the office. To avoid time lost travelling, only a one-day visit was organised to the Commission in Brussels. Additional discussions with the Commission were held via video-conference.

Since all these transactions had been previously cleared with the Commission and the Member States for purposes of the DAS, no SPFs had to be sent to the Member States.

New audit evidence was collected by analysing the action plans implemented by the Commission and the Member States to address the causes of errors in rural development. For these aspects only, an SPF was sent to the Commission. The SPF was sent in time before the summer break, which meant that the clock was ticking on the Commission side during the relatively quiet summer break, thus saving additional time on the ECA side. However, as this new evidence was to be included in the special report, an adversarial meeting with the Commission was required. This added a considerable amount of time to the process, as the standard timeframe of 2.5 months for the adversarial procedure was needed by the Commission.

Apart from the adversarial procedure, all other elements of the set-up allowed a considerable amount of time to be saved, thus enabling the results to be delivered within the tight deadlines.

### **Speaking of deadlines ....**

Less than six months elapsed between the approval of the APM and the first reading of the report in the chamber, which enabled the report to be considered by the CONT during its discharge process. This short timeframe was coupled with a low use of resources: only 26 auditor-weeks for the delivery of the special report.

### **What particular lessons have been learned from this audit approach?**

One lesson was the use that can be made of the significant amount of information collected during the DAS work. This shows the great potential of information collected during the DAS work and gives an example of how such information can be further exploited and broken down in order to extract relevant insights about the performance aspects of spending.

Another lesson is that this audit confirmed that it is possible to deliver quick special reports when the audit topic is sufficiently focused and the planning and fact-clearance stages are streamlined as much as possible.

### **The audit team**

The entire audit team was from the audit unit which is responsible for the DAS work on rural development.

The core audit team was composed of only three members: two experienced auditors and the head of unit. All members of the audit team had been involved in the audit of rural development since the beginning of the period covered by the audit and had already visited a large majority of the Member States.

This meant that at the level of the team there was a significant amount of knowledge and experience, which was paramount to making the necessary in-depth analyses for this report.

### **Other parties involved**

Another explanation for this positive result was the constant intra- and inter-institutional cooperation.

From the beginning, the audit team was in close contact with my cabinet, which provided input when and where needed, from the stage of defining the audit approach to drawing conclusions.

Secondly, in order to ensure the consistency of messages from various ECA reports, the team communicated closely with colleagues in charge of the special report on achieving economy in rural development spending.

Thirdly, the team made a point of keeping the Commission counterparts constantly informed on the progress of the audit and cleared in an informal manner the main findings and messages of the report before they were put on paper.

However, the Commission insisted that the standard timeframe of 2.5 months for the adversarial procedure could not be shortened. As a result, the ECA did not achieve the objective to have this special report discussed, together with chapter 4 of its annual report, at the CONT 2013 discharge hearing, which it believed would ensure maximum impact. Nevertheless, the main observations in the special report were taken into account by CONT during the 2013 discharge process. In fact, significant use was made of these observations in the CONT's draft discharge resolution on the Commission's implementation of the EU budget.

### **Are these initiatives going to be expanded?**

Certainly. In fact, the audit unit concerned has already developed a dedicated checklist to test a sample of performance criteria during the DAS 2014

audit work. This makes very effective use of the time spent by auditors on-the-spot, who, with limited additional time, can collect a variety of information regarding the effectiveness, efficiency and economy of the spending.

The results of this work could be used, in the first instance, to provide several performance insights in the 2014 Annual Report, so as to complement the compliance aspects reported. This approach has been adopted keeping in mind the interests of our stakeholders, who will receive information not only on the compliance of spending, but also on the value for money achieved.

# Special report No 24/2014: EU support to protect forests and restore them after disasters not sufficiently well managed

By the private office of Nikolaos Milionis, ECA Member



From left to right:  
Felipe Andres Miguelez - team leader,  
Kristian Sniter - attaché of private office, Nikolaos  
Milionis - ECA Member, Ioulia Papatheodorou - head  
of private office, Ainhoa Perez-Infante - auditor, Da-  
vide Lingua - head of unit, Franco Radicati - auditor.

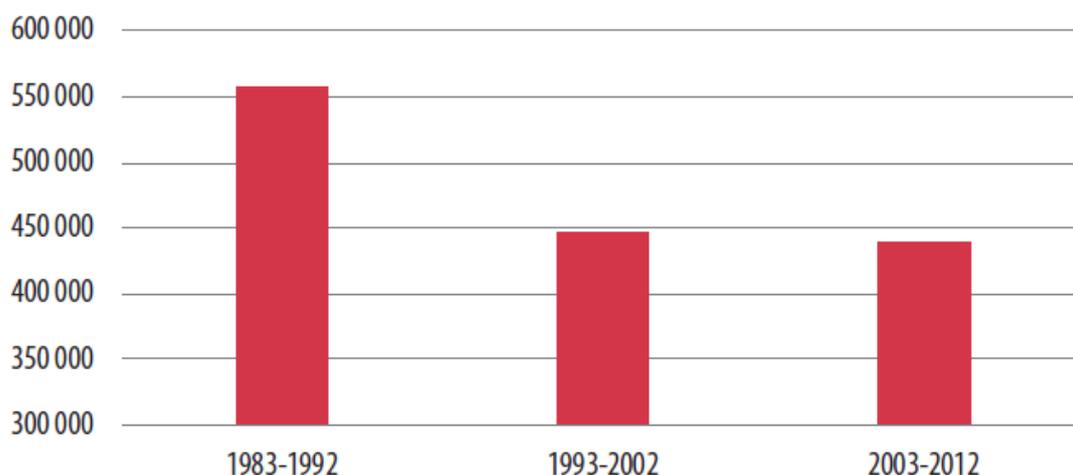
## Protecting forest against damages caused by fire and other natural disasters

In the EU the total area of forests and other wooded land accounts for about 180 million hectares, which is about 42.4 % of the total EU land area. Forests are multifunctional, serving economic, social and environmental purposes. The socioeconomic importance of forests is high: wood production and processing contributes to rural development and provides millions of jobs, often in medium and small rural enterprises. Forests also contribute to mitigating climate change, preserving biodiversity, regulating freshwater supplies, protecting soil and shaping landscapes.

European forests are threatened by fire, which is generally due to intentional or negligent human action, and by natural disasters including abiotic (windstorms, droughts, floods, avalanches, etc.) or biotic (pests, diseases) calamities. In the period 1983–2012 fires burned on average 480 000 ha of forest area in the EU every year. The average burnt area was significantly higher during the period 1983–92 than in the following decades, during which the improvement of forest fire fighting means in the Member States played an important role (see Graph 1). About 85 % of the total area burned by forest fires is located in the Mediterranean region and Portugal. Recent forest fires resulted in large burnt areas in Portugal in 2003 and 2005, in Greece in 2007 and in Spain in 2006.

Graph 1

## Average burnt area (ha) per year from 1983 to 2012



Source: Joint report of the Joint Research Centre (JRC) and the Directorate-General for the Environment, *Forest Fires in Europe, the Middle East and North Africa*, 2012.

### Measures taken at EU level

The EU has a long history of contributing to forest protection, in particular with regard to fire prevention. In the period 1986 to 2002 EU forests benefited from specific regulations devoted to forest fire prevention and since 2000 forest protection has been included in the rural development (RD) policy.

The RD policy for the programming period 2007–13 focused on three core objectives to be achieved by a series of measures grouped, for each objective, in a ‘thematic axis’ financially supported through the EAFRD:

- (a) improving the competitiveness of the agricultural and forestry sector (Axis 1);
- (b) improving the environment and the countryside (Axis 2);
- (c) improving the quality of life in rural areas and encouraging diversification of the rural economy (Axis 3).

In the period 2007–13 EAFRD support for restoring forest damaged by natural disasters and fire, as well as for introducing preventive actions, was available through measure 226 ‘Restoring forestry potential and introducing preventive actions’ under Axis 2. This measure has been included in 58 rural development programmes (RDPs) drawn up by 16 Member States.

At the end of 2012 the total EAFRD support planned for actions under measure 226 was around € 1.55 billion. EAFRD support covers a part of the total public support paid to beneficiaries by the national administration responsible. The EAFRD co-financing rate is set in each RDP. The total public support may cover up to 100 % of the eligible costs incurred by the beneficiaries of the measure.

### The audit approach

The main objective of the audit was to assess whether the EAFRD support measure for restoring forestry potential and introducing preventive actions has been well managed and whether the Commission and the Member States can demonstrate that the support achieved its intended objectives in a cost-effective way.

At the level of the Commission the audit work covered the design of the measure and the Commission management activities, including the approval of the RDPs submitted by the Member States and the monitoring of the implementation of the measure. The audit included visits to Austria, France (Aquitaine), Italy (Basilicata), Slovakia and Spain (Andalusia). These Member States together accounted for more than 85 % of the total declared expenditure for measure 226 as of 31 December 2012.

### The ECA found that:

*Preventive actions were not sufficiently targeted.*

The Court noted that while measure 226 targets forests at medium to high risk of fire, there is no common EU definition or criteria to identify them. Selection procedures in the Member States were deficient in different respects, lacking explicit selection criteria or an effective evaluation of proposed actions or neglecting some areas of risk. The environmental objectives were insufficiently prioritised at the selection stage and sometimes overlooked during the implementation. For instance, although a significant percentage of the Slovak forests are classified as protected forests (including Natura 2000) which have a high environmental value, they were not prioritised during the selection process, limiting the potential environmental impact of measure 226.

*Some actions were not appropriate to achieve the objectives of the measure.*

Even though by their nature (firebreaks, thinning, clearing, etc.) many of the co-financed actions reviewed generally contributed to the objectives of the support, the Court found cases not related to natural disasters or fire, but motivated by other economic or environmental objectives. For some types of the implemented operations key eligibility requirements could not be verified due to lack of documentation. The Court also found cases of forest roads used for the economic exploitation of the forests where the particular benefit for fire prevention was not demonstrated. The high density of the roads constructed could also have negative environmental effects.

*The cost-effectiveness of the actions financed was not adequately ensured.*

The Court found cases where the ceiling of public support was frequently modified without justification, where standard costs in a region were significantly higher than in another for similar actions and where manual work was prioritised rather than using machines, resulting in higher costs. For instance, the standard cost of manual clearing work for forest paths in Basilicata was € 7,81 per metre; while it was only € 3,58 in the Puglia region. There were also situations presenting risks of excessive public support when already completed projects were selected, where beneficiaries were able to finance operations on their own and where support went to agricultural parcels.

*Finally, the monitoring tools in place did not allow the Commission and the Member States to adequately assess the efficiency and effectiveness of the measure.*

In particular, the performance indicators established in the common monitoring and evaluation framework (CMEF) were insufficient and the evaluations available were of limited usefulness. It was not possible to draw conclusions on the effectiveness of the preventive actions because it had not been measured. The weaknesses identified are likely to persist in the period 2014–20 since the new proposed monitoring tools have not improved the monitoring framework for this specific support.

#### **The audit conclusion and recommendations**

Overall, the ECA concluded that the support was not sufficiently well managed and that the Commission and the Member States cannot demonstrate that the intended results were achieved in a cost-effective way.

Consequently, Member States should:

- select the prevention actions based on explicit criteria aligned with the needs and after a thorough and documented evaluation process;
- enhance the environmental protective impact of the support by prioritizing the most environmentally valuable forests such as Natura 2000 forest areas;

- ensure that the standard costs established for the actions supported are reasonable and justify the ceiling for support on the basis of the costs normally incurred;
- report back on the reductions achieved in the damages caused by fires/or natural disasters as a result of the actions funded.

The Commission should:

- set out common criteria for forest areas to be classified as at low, medium and high fire risk;
- verify that the Member States have established an appropriate control system;
- improve its monitoring to ensure that Member States spend the funding appropriately.

# Special report No 1/2015: Inland Waterway Transport in Europe

26

This report was adopted by Chamber II on 28 January 2015  
Questions to Iliana Ivanova, reporting ECA Member

By Rosmarie Carotti



First row: Erika Sövegés, Pietro Puricella, head of unit; Iliana Ivanova, ECA Member, Enrico Grassi, team leader; Tony Murphy, head of private office  
Second row: Mihail Stefanov, attaché, Christian Wieser, Erki Must, Di Hai

**R. C.: Please explain what the TEN-T programme of the Commission is. What is the link between the Trans-European Network for Transport (TEN-T) instrument and the Inland Waterway Transport (IWT) projects? What is the budget share?**

**Iliana Ivanova:** The Trans-European Networks were created with the aim of supporting the functioning of the internal market and the reinforcement of economic and social cohesion. The first steps for the development of a Trans-European Network for transport were made in 1996 with the adoption of guidelines aiming at connecting national networks of all transport modes. Since then, several documents have been adopted at EU level. For the previous programming period 2007-2013 the TEN-T programme had the objective of completing the TEN-T network, consisting of roads, railways and inland waterways, by 2020. Within this objective, the Commission has identified 30 Priority Projects of which two related to inland waterways: (i) one consisting in upgrading the Rhine – Danube connection from Rotterdam to the port of Constanta in Romania and (ii), one about the connection of the Seine in France with the Scheldt in Belgium linking Paris with Rotterdam. The TEN-T network consists of two layers- “core” network and “comprehensive” network. The “comprehensive” network will ensure full coverage of the EU and accessibility of all regions while the “core” will prioritize the most important TEN-T infrastructure to be fully functional by 2030. The “core” network includes inland waterways with a

length of several thousands of km. Inland waterway projects can be funded from different EU instruments such as the Structural funds, the Cohesion fund, or for instance the TEN-T own budget. The ECA audit has shown that, compared to other transport modes, project proposals for inland waterway transport were generally much less numerous than for other transport modes, especially rail. Indeed, inland waterway transport projects financed during this period totalled € 747 million representing 7.9% of the total TEN-T funding.

**R. C.: The message is clear: No significant improvements in modal share and navigability conditions since 2001. What is the value of such a statement after so many years? Is it correct to understand that the ECA findings will be useful for the Commission in order to reach the TEN-T objective of completing the core network by 2030?**

**Iliana Ivanova:** The objective of shifting traffic from roads to rail and inland waterways was formally set in 2001. It has remained a target in the intervening period during which the modal share of this latter mode of transport has not increased substantially. Since 2014, the Member States have a legal obligation to complete the “core” network by 2030. However, there is a considerable imbalance between the EU funding available and the cost of solving all bottlenecks, which will require additional national and private funding.

The findings of the audit and the related recommendations highlight weaknesses in this respect and could contribute to making a better use of the limited European financial resources. This may be achieved by prioritising projects on those rivers where benefits are higher and more immediate, thus increasing and anticipating the positive effects of inland waterways on these corridors and contributing to better conditions for the timely completion of the network.

**R. C.: The European Union aims at achieving the same standards for its entire trans-European network. What are these standards?**

**Iliana Ivanova:** To achieve an efficient and sustainable inland waterway transport it is key to ensure sufficient navigability conditions and therefore specific standards have been defined in the TEN-T Guidelines. They require the completion of a network including rivers and canals with sufficient navigability conditions to enable vessels of at least 80 m length and 2.5 m draught to navigate for at least 330 days per year. This implies that rivers have to offer minimum water depths for most of the year and a minimum bridge clearance of 5.25 metres to enable vessels to transit smoothly with high water levels. Within the network, there are rivers that have to offer even more favourable navigability conditions.

**R. C.: Are IWT projects also funded from other sources than the TEN-T budget?**

**Iliana Ivanova:** Yes, different funding options exist, and the choice is at the discretion of the Member State. For instance, in the eligible EU countries, IWT projects can also be financed by the European Regional Development Fund (ERDF) or the Cohesion Fund (CF), which provide far higher co-funding rates than those under the TEN-T budget. € 531 million was allocated from the ERDF and the CF to inland waterways representing 0.7% of the total Structural Funds allocation to transport for 2007-2013. For the period 2014-2020, the Connecting Europe Facility (CEF) has replaced the previous TEN-T budget and higher co-funding rates will be applicable.

**R. C.: Inland waterway transport is said to be energy efficient and cost competitive. What are the disadvantages compared to road or rail transport?**

**Iliana Ivanova:** Indeed, transporting goods on inland waterways can be advantageous, as cargo vessels have a loading capacity that is equivalent to hundreds of trucks, which could help save transport costs, reduce emissions and decongest roads. The audit found that in few Member States this mode of transport is certainly competitive with road or rail transport. In the Netherlands, for example, the modal share is close to 40%. In other areas, such as the Danube Basin, navigability conditions affect competitiveness, e.g. some inland waterways are not always navigable and/or vessels cannot always be fully loaded due to low water depth. The Commission has identified inadequate infrastructure, as a major obstacle to inland waterway navigation. For instance, insufficient lock capacity can lead to prolonged travel times or waiting times, while single chamber locks risk blocking the entire river if closed for maintenance. Other examples can be given such as, insufficient clearance of bridges or missing links between two waterways.

All these issues hinder the attractiveness of this mode of transport and, therefore, should be addressed by the Member States and the Commission.

**R. C.: Bottlenecks are a major obstacle to inland navigation. Which are they? Are there conflicting territorial competences?**

**Iliana Ivanova:** As already mentioned, the Commission has identified so called bottlenecks which are sections of a waterway which constrain the free flow of river traffic and can arise for various reasons. They can be caused by missing links, such as the previously mentioned connection between the Seine and the Scheldt that can be solved by the construction of a canal. In addition, there can be physical constraints, such as low bridges preventing the transit of vessels when water levels are high or restricting the number of layers of containers, making them less profitable. Bottlenecks can also occur due to sharp bends and narrow passages that reduce navigational safety and due to insufficient

lock capacity.

It is important to say that bottlenecks in one Member State may affect inland waterway transport in neighbouring countries and therefore it is crucial that national strategies are consistent and coordinated. However, the audit discovered that there were inconsistencies in the approaches of the different countries which affected the development of this mode of transport on the main European rivers.

The figures speak for themselves as only 5 of the 47 identified bottlenecks have been addressed since 2006.

**R. C.: The ECA considers that the failure to improve modal share and overall navigability conditions was due to the very limited number of projects proposed and executed by the Member States. Why was that so? Could private investors apply? What was the procedure to apply for EU money?**

**Iliana Ivanova:** Indeed, as already mentioned, only five of the 47 bottlenecks in the 2006 United Nation Economic Commission for Europe listing had been removed by 2012, meaning it would take around 60-70 years to remove them all at this rate of progress.

Inland waterway projects are identified, proposed and implemented by Member States. Therefore, their priorities are directly linked with the level of funding which is ultimately allocated to different transport modes.

In theory, private investors could apply, but in practice the audit has not come across projects with private investor involvement. The Seine – Scheldt canal has been conceived as a Public Private Partnership project, but at the time of the audit the competitive dialogue was still ongoing and the project was severely delayed with works possibly starting in 2017.

The procedure to apply for EU funding depends on whether the project is going to be financed by the TEN-T/CEF or by ERDF/CF. TEN-T and now the CEF envisages calls for proposals, following which project promoters may submit proposals via their Member State that may then be selected by the Commission. On the other hand, ERDF and CF projects are selected by Member States except for major projects that require the approval of the Commission.

**R. C.: Which were the weaknesses identified by the ECA in the EU strategies?**

**Iliana Ivanova:** The ECA has found that the EU strategies lacked analysis, focus and coherence. While funding is better spent on those rivers where inland waterway transport can rapidly develop with the right navigability conditions, the European Commission has decided to approve the upgrading of rivers without analysing the market potential of individual river segments. Without this analysis, river segments or corridors are not sufficiently prioritised resulting in a patchwork of projects that are not sufficiently connected and do not therefore maximise the potential increase in inland waterway transport. Finally, there was a lack of coherence as Member States along the same river, such as for instance the Danube, paid different levels of attention to this mode of transport whereas effective inland navigation would require reliable navigability conditions on the entire river.

# Meeting between ECA Chamber I Members and COMAGRI representatives

By Tomas Mackevičius, head of private office



Left to right: Martin Hausling (Green group coordinator, COMAGRI), Ville Itälä (ECA Member for Institutional Relations), Paolo de Castro (S&D coordinator, COMAGRI), Czeslaw Siekierski (Chair, COMAGRI), Rasa Budbergytė (Dean of Chamber I, ECA), Albert Dess (EPP coordinator, COMAGRI), Petri Sarvamaa (Vice-chair of BUDG and member of CONT), Nikolaos Milionis, Kersti Kaljulaid and Augustyn Kubik (Chamber I Members, ECA), Jan Huitema (ALDE, COMAGRI), Jim Nicholson (ECR coordinator, COMAGRI) and Kevin Cardiff (Chamber I Member, ECA). Other COMAGRI coordinators present at the meeting were Lidia Senra (GUE), Stuart Agnew (EFDD) and Jens Rohde (ALDE).

On 9 March in Strasbourg, the Members and Director of Chamber I, together with the Member for Institutional Relations met with the chairman and political party coordinators of the European Parliament's Committee on Agriculture and Rural Development (COMAGRI). Mr Sarvamaa, a vice-chair of the Parliament's Committee on Budgets (BUDG) and a member of the Parliament's Budgetary Control Committee (CONT), was also in attendance.

The powers and responsibilities of COMAGRI include the common agricultural policy (CAP), animal health and welfare, plant health, agricultural products quality, forestry and agroforestry. In addition to its legislative work, it also monitors the implementation of the CAP and other important issues such as food security.

The purpose of the meeting was to exchange views and gain insights into each other's work and activities, as well as providing an opportunity to explore means of mutually beneficial cooperation.

This first-ever such meeting between the two parties took place in a friendly and very positive atmosphere.

During the exchange of views, concern was expressed about the complexity introduced in the new CAP, especially the greening component, and the risk that this might increase the level of errors in the near future and pose difficulties for national administrations and farmers.

Both the ECA and COMAGRI expressed a desire for closer cooperation in the future, one aspect of which could involve the presentation by the Chamber to COMAGRI of its reports which are of particular relevance to the latter.

Special thanks go to the Court's Member for Institutional Relations, Mr Itälä, for arranging this interesting and fruitful meeting.

## The ECA's activity report 2014 to be published on 16 April 2015

By Fabrice Mercade, head of unit, Communications and Institutional Relations

On 15 April, President Caldeira, ECA Member H. Grethen and Secretary General Ruiz García will present the ECA's 2014 activity report to the Luxemburgish press at the ECA's premises. The report will be published on 16 April and available on our website.

### Activity report 2014 at a glance

#### ***Our activities***

- **Annual reports** on the EU budget and on the European Development Funds for the 2013 financial year;
- Fifty one **specific annual reports** on the EU's agencies, decentralised bodies and joint undertakings for the 2013 financial year, with two summary reports;
- Twenty four **special reports** on specific budgetary areas or management topics, ranging from European banking supervision to EU-funded airport infrastructures;
- Seven **opinions** and other outputs providing contributions on financial management issues, ranging from the reform of the EU's own resources to an analysis of potential savings of a single-site of the European Parliament;
- Two **landscape reviews**, one on challenges to EU accountability and public audit, and the other on risks to EU financial management;
- Organisation of a **high-level conference** on EU accountability and public audit;
- Hosting the **Contact Committee** of the Heads of the Supreme Audit Institutions of the EU Member States, focusing on enhancing cooperation between national SAIs and the ECA.

#### ***Our management***

- **Six new Members** – Alex Brenninkmeijer, Danièle Lamarque, Nikolaos Milionis, Phil Wynn Owen, Klaus-Heiner Lehne, Oskar Herics – joined the ECA in 2014. The college of Members re-elected Vítor Caldeira the ECA president for a third 3-year period and appointed Ville Itälä Member for institutional relations;
- The **2013-17 ECA strategy** was an impulse for change of the organisation: we set up an internal reform project aiming at streamlining our audit process and ensuring a more flexible organisation of our resources;
- Continued **improvement in administrative efficiency** based on the simplification of procedures and the redeployment of staff from support services to audit. We also implemented an equal opportunities plan.

## 5 May 2015 ECA energy conference

By Gareth Roberts, head of private office



Nuclear plant, Cattenom (France)

An ECA high-level conference on EU Energy Security will take place in Brussels on 5 May. The conference will provide a neutral, independent platform for exchange amongst stakeholders and also highlight how the ECA's products can make a contribution to improving the performance of EU regulatory frameworks and spending in this area. It will be structured around the themes of two ongoing audit tasks: the security of energy supply with a focus on the internal energy market and infrastructure financing; and EU assistance to Ukraine, which has an important energy component. A series of high-profile speakers have confirmed their participation, including ECA President Vítor Caldeira and Commission Vice-President for Energy Union Maroš Šefčovič.



## Commissioner Stylianides, Commissioner for Humanitarian Aid and Crisis Management, meets with ECA Chamber III

By the private office of Karel Pinxten, ECA Member



From left to right: Karel Pinxten, ECA Member, Christos Stylianides, Commissioner, Daniele Lamarque, Szabolcs Fazakas & Klaus Heiner-Lehne, ECA Members

Mr. Stylianides visited the ECA on the ninth of March to discuss with the Members of Chamber III the numerous challenges faced by the Commission in his area of responsibility. Among the subjects broached were the crisis in Ukraine, the difficulties coping with the increasing number of crisis situations and the importance of close cooperation within the Commission itself and with other donors.

He emphasised the importance he attached to continuing the good relationship between the Commission and the ECA. On behalf of the Chamber, Mr Pinxten thanked him for his visit and looked forward to an excellent working relationship with the Commissioner and between Chamber III and DG ECHO.

## Special Report N° 3/2015



## EU Youth Guarantee: first steps taken but implementation risks ahead

Youth unemployment is a huge challenge facing Member States across the EU. In this regard an initiative, the Youth Guarantee, was launched by the European Council in 2013. Under this scheme, all young people under 25 should receive a “good-quality” offer of employment, continued education, apprenticeship or traineeship within four months of becoming unemployed or leaving formal education. It will be financed partly from the EU budget and complementary national funding will be required.

With this report, the Court assessed whether the Commission has provided timely and appropriate support to the Member States in developing their Youth Guarantee Implementation Plans. In addition, the Court examined whether potential risks to the effective implementation of the scheme could be identified.



### The ECA says:

**Hello to:**

Liviu PACALA  
Alexandre TAN  
Zsuzsanna CSAK  
Elli-Anna TZORTZI  
Anna LUDWIKOWSKA  
Luis DE LA FUENTE LAYOS

**Goodbye to:**

Stephan ARENS  
Loulla PUISAIS-JAUVIN



### In Memoriam

Nous avons le regret de vous annoncer le décès de notre ancien collègue **François Meignant**, survenu le 8 mars 2015. Il a travaillé à la Cour de 1986 à 2000.

Nous avons le regret de vous annoncer le décès de notre ancien collègue **Jean Michels**, survenu le 12 mars 2015. Il a travaillé à la Cour de 1978 à 1987.

J'ai le profond regret de vous annoncer le décès de notre ancienne collègue **Monique Martin**, survenu le 14 mars 2015. Elle a travaillé à la Cour de 1987 à 1992.

By Branislav Hock<sup>1</sup>, 2 March 2015



The discovery of truth is prevented more effectively, not by the false appearance things present and which mislead into error, not directly by weakness of the reasoning powers, but by preconceived opinion, by prejudice. Arthur Schopenhauer

## I. Truth and Prejudice – what is the right standard?

To what extent is the European Court of Auditors (ECA) discovering the truth and to what extent is it bound by prejudice? Should normative viewpoints captured in regulation be taken for granted or can they be challenged as a potential source of unsatisfactory performance? And should the ECA be concerned with corruption? Whether it was the Quest for Quality, a preparatory stage of Audit Planning Memorandums (APMs) or a research on audit standards, these questions formed the background of my traineeship at the Court.

In the research centre at Tilburg University (the Netherlands), my fellow researchers and I often discuss the role of lawyers and economists in each other's fields. We ask, for example, whether a boundary for legal research should lay in the legal order, or if we should go further and assume that people are rational, as economists use that term. The problem is that if you always stay in the realm of the old "Newtonian world" determined by national legal concepts, it would be difficult to face topics such as regulation of internet or global economic crime. Therefore, certain problems just cannot be approached in the traditional way – one should search for a new starting point.

### New standard: behavioural insights

<sup>1</sup> Branislav Hock is a full-time PhD researcher at the Tilburg Law and Economics Center (TILEC). In his theses he focuses on the effectiveness of anti-corruption enforcement. He also teaches a master class on EU public procurement law. Between September 2014 and February 2015, he worked as a trainee in the private office of Alex Brenninkmeijer, ECA Member. Branislav holds a LLM in Research Master in Law (cum laude) from Tilburg University and a LLM in Law and Jurisprudence at Charles University in Prague. Branislav can be contacted via the following email: [b.hock@uvt.nl](mailto:b.hock@uvt.nl)

Even top level policy-makers are searching for new starting points. I had a chance to learn how they do that during a conference on "Behavioural Insights and new Approaches to Policy Design" which took place at the OECD in Paris, January 2015.<sup>2</sup> The fact is that, despite good intentions, we often do not do what is best for us. Whether saving money, eating healthy, exercising or smoking, our decisions are influenced by a number of factors such as what others do or how we feel. This fact has very important implications for public policy which, in order to be quality, should be based on information which are realistic. However, traditional economic studies, which lead policy-makers in their decision making, usually operate with assumptions that people are rational and make always good decisions. And that was exactly this problem which the use of the so-called behavioural insights, i.e. findings of behavioural economics and psychology about how people make decisions in every-day life, can solve.

These thoughts are in line with the research of Daniel Kahneman who challenges the established assumptions of human rationality, and was awarded a Nobel Prize in Economic Sciences in 2002.<sup>3</sup> Kahneman realised that behavioural insights can help to create more realistic economic models which would help policy-makers pass better regulation. It might seem too academic for some of us, but recently Obama's administration and Cameron's administration have established specialised behavioural teams, led by top academics and Kahneman's successors such as David Halpern and Cass Sunstein, to help them integrate these ideas into practice. These techniques might serve as an inspiration for the ECA in order to make more "informative choices" when searching for a starting point in its performance audits.

Just as in the Netherlands and the OECD, I experienced similar discussion at the ECA. The

<sup>2</sup> Author's note: program of the conference is available at [http://www.oecd.org/naec/NAEC\\_Behavioural-Insights-Programme\\_23-Jan.pdf](http://www.oecd.org/naec/NAEC_Behavioural-Insights-Programme_23-Jan.pdf).

<sup>3</sup> See for instance Kahneman, D. (2012). Thinking, fast and slow. London, Penguin.

question was whether audit work is about data collection, information gathering or knowledge building. Later elements of this discussion also emerged in practice during our work on APMs on innovation and on public procurement in Chamber IV. In this context I learned that, similar to the “Newtonian lawyer” and “informed policy-maker”, an external auditor should sometimes find a benchmark outside the legislation and established policy standards. This is particularly relevant in areas which are inherently plagued by corruption and other inefficiencies, such as the public procurement area. The following text elaborates on this example and claims that the ECA should have a more active role in the fight against corruption in public procurement because it is the ideal institution to do so.

## II. Corruption in Public Procurement: is the ECA a sleeping giant?

Corruption is considered as one of the most serious economic and societal threats which should be mitigated. It is meant to represent a significant barrier to economic growth and sustainable development of emerging economies, undermines the rule of law, government and institutions, and destroys societal values and fair business.<sup>4</sup> In this context public procurement is recognised as a key economic activity of public bodies that is particularly vulnerable to corruption.<sup>5</sup> Corruption in this area needs to be limited by both effective public procurement procedures as well as by anti-corruption policies and administrative tools. The EU institutions should also fight corruption and lead by example.

### The use of perception is the dead end

The problem is that the majority of EU citizens perceive the work of the EU institutions as something blocked by heavy and non-transparent

<sup>4</sup> See OECD (2013). Third Annual High-Level Anti-Corruption Conference for G20 Governments and Businesses, 25-26 April, Paris; OECD Working Group on Bribery: Annual Report 2013, OECD, pp. 1-8, See also Preamble to the OECD Anti-Bribery Convention.

<sup>5</sup> See for instance Pippidi, A. M. (2013). The Good, the Bad, the Ugly: Controlling Corruption in the European Union, Advanced Policy Paper for Discussion in the European Parliament; See also Identifying and reducing Corruption in Public Procurement in the EU, study prepared by PwC and ECORYS for the EU Commission. Available at <[http://ec.europa.eu/anti\\_fraud/documents/anti-fraud-policy/research-andstudies/identifying\\_reducing\\_corruption\\_in\\_public\\_procurement\\_en.pdf](http://ec.europa.eu/anti_fraud/documents/anti-fraud-policy/research-andstudies/identifying_reducing_corruption_in_public_procurement_en.pdf)>.

procedures, thus prone to corruption. Despite the fact that reality might be different, such a perception is very dangerous and can be even worse than “corrupt acts” themselves. Authors for instance claim that high levels of corruption perception undermine the trust in institutions, institutional stability and break individual and business relationships, which lead to high societal and economic costs.<sup>6</sup> For that reason, it is very important that the EU institutions improve their reputation and show to the citizens that the EU has effective mechanisms to fight corruption.

The EU Anti-Corruption report 2014 might be considered as an interesting attempt to improve the current situation.<sup>7</sup> Unfortunately, the report excludes the EU institutions and focuses only on the Member States. Furthermore, it presents rather perception based information, i.e. how corrupt public institutions are seen to be, and enumerates high damage caused by corruption. As the EU has not presented any other significant anti-corruption work, for instance it does not participate in the GRECO or OECD anti-corruption mechanisms; the EU anti-corruption approach is insufficient and needs to be completed.

Actually, approaches based on perception of corruption bring rather bad than good. Firstly, presenting “red numbers” can lead to further instability, distrust and high societal and economic costs.<sup>8</sup> Secondly, such quantitative measurement criteria incentivize inappropriate policy responses and provide only limited evidence about the effectiveness of EU and national anti-corruption efforts. For instance, if an anti-corruption reform would lead to more prosecution of government officials, the public might perceive public officials as even more corrupt than before the reform. Such a perception might incentivise the government

<sup>6</sup> Melgar, N., Rossi, M., & Smith, T. W. (2010). The perception of corruption. *International Journal of Public Opinion Research*, 22, 1, p. 120.

<sup>7</sup> Report from the Commission to the Council and the European Parliament: EU Anti-Corruption Report, COM(2014) 38 final, available at <[http://ec.europa.eu/dgs/home-affairs/e-library/documents/policies/organized-crime-and-human-trafficking/corruption/docs/acr\\_2014\\_en.pdf](http://ec.europa.eu/dgs/home-affairs/e-library/documents/policies/organized-crime-and-human-trafficking/corruption/docs/acr_2014_en.pdf)>; See also The European Court of Auditors' View on the Commission's Report on Anti-Corruption Measures, available at <[http://www.eca.europa.eu/Lists/ECADocuments/PL14\\_LETTER/PL14\\_LETTER\\_EN.PDF](http://www.eca.europa.eu/Lists/ECADocuments/PL14_LETTER/PL14_LETTER_EN.PDF)>.

<sup>8</sup> Melgar, N., Rossi, M., & Smith, T. W. *supra* note 6; See also Cobnam, Alex (2013). Corruption Perceptions, *Foreign Policy*; available at <<http://foreignpolicy.com/2013/07/22/corrupting-perceptions/>>.

to stop the reform because it is perceived as ineffective because of various corruption scandals which it helped to uncover. Consequently, the threat of corruption might lose momentum due to the citizens' lack of confidence combined with the tendency of politicians to overuse this topic.

Therefore, the EU should do more in the anti-corruption area and also change its current approach. It should move away from the perception-based approaches because they exaggeratedly undermine the reputation of the EU institutions, and might prevent them from designing effective anti-corruption policies. Rather, the EU should explain why corruption occurs, what its effects are and how it can be mitigated. These questions are addressed by new research methods which increasingly point to a shift from perception-based to administrative indicators – second-generation governance indicators.<sup>9</sup>

### **From perception to governance indicators**

The so-called second-generation governance indicators are designed in order to understand the complexity of corruption and assess the quality of government. They relate to several governance areas such as transparency, good management, prevention of misconduct, or accountability of those in charge by means of audit and public scrutiny (governance areas). In this context corruption is not a self-standing phenomenon but a complex organism with many sub-systems. Thus limiting corruption in a certain field, such as public procurement, is about eliminating corrupt elements which attack the whole organism. 'This strategy is equivalent to keeping a biological system in check when cells replicate, eliminating wrong and/or dangerous mutations; if the organism fails, then cancer ensues: the strategy to fight cancer is exactly that of limiting the complexity of cancer cell replication and interactions.'<sup>10</sup> Similarly, public activities generate dangerous mutations which need to be mitigated.

An effective way to fight corruption is to address the governance areas by specific governance tools.

<sup>9</sup> Karippacheril (2014), Measuring Corruption Risk; Fazekas, M., Toth, I. J. and King, P. L. (2013), Anatomy of grand corruption: A composite corruption risk index based on objective data, Working Paper, Corruption Research Center Budapest.

<sup>10</sup> Marco Arnone and Leonardo S. Borlini (2014). Corruption: Economic Analysis and International Law. Edward Elgar Publishing Limited, p. 8.

Importantly, the given institution needs to select and implement these tools according to its specific context, with all its strengths and weaknesses. So for instance in order to increase transparency and accountability, the given institution might use online procurement reporting. Another example might be a template for market study report defining realistic tender requirements, facilitating planning and budgeting and by that contributing to good management and effective prevention of misconduct.<sup>11</sup>

If corruption is seen from this perspective, the ECA can be extremely important in fighting it because it can assess whether the integrity tools are well selected, and whether they are implemented effectively. This strategy is particularly important in areas where most of the defects emerge in the shadow of the law, which is typical for public procurement.

### **a) Public Procurement – law vs discretion**

One important reason why the EU received a negative perception is because of its heavy public procurement rules. It is important to note that, from a legislator's perspective, EU public procurement is about the choice whether procurement procedures should be relatively complex or relatively simple. The complex procedures, on the one hand, might ensure more procedural guarantees that public buyers operate in public interest, i.e. follow basic principles of non-discrimination and equal treatment. The simple procedures, on the other hand, provide faster process and easier rules which offer flexibility and more discretion of public bodies. In order to improve the situation, the EU decided to change EU public procurement legislation in order to cut complex procedures and simplify rules. Simplification of rules, however, will not make public procurement easier.

The ability to choose how to act, i.e. identify specific needs and determine what and how it should be bought is essential, prior to the formal public procurement process. This, the so-called managerial discretion of public authorities, even increased because of the new legislation. The problem is that the performance management in the use of managerial discretion is one of the main reasons why public procurement is so vulnerable to corruption and other inefficiencies. Hence,

<sup>11</sup> See OECD Procurement Toolbox, available at <<http://www.oecd.org/governance/procurement/toolbox/>>.

institutions must be incentivised to develop effective processes, be transparent and justify what they are doing. Such incentives can be provided by “external” monitoring and control, but on what bases and by whom?

Firstly, what bases? There are no common standards of “good” use of managerial performance. Although the legislator might release various guidelines indicating how the discretion should be exercised, these are not binding. It is interesting to note that in the EU, at least 15 goals of public procurement have been identified: competition; efficiency of the procurement system; integrity; transparency; best value for money; environmental goals; promotion of SMEs; promotion of innovation etc.<sup>12</sup> Not all of them are equally relevant; some of them are even conflicting.

Secondly, by whom? Once the legislation has been simplified, the use of discretion must be now even more monitored, controlled and guided by “external guarantees” existing outside the public procurement legislation. However, the EU has not much experience with effective application of these guarantees; there is a gap which needs to be filled. The EU Anti-Corruption report 2014 can be seen as the first attempt to fill this gap, via for instance the above mentioned integrity tools, but the Report was rather disappointing as it is very general and does not provide any clear indication what should be done and by whom. It is exactly at this area the ECA’s special reports can be used as a reference for a proper management behavior on public procurement.

### **III. Conclusion: too easy rules for a tough game?**

Simplification is good, but what is the benchmark? I believe that public procurement is an area in which legislation and existing policies do not provide sufficient benchmark for measuring performance. Hence, simplification of public procurement rules does not change complexity of public procurement. In fact, easier rules and flexibility merely move “the tough issues” out of the legislation into the hands of public officials. Thus, the statement “I comply with rules” is far from being a sufficient benchmark of good public procurement performance.

The problem is that there is not a clear standard of good performance in public procurement. ECA’s special reports can be used as a reference to fill this gap. However, in order to be relevant, it must reach a meta-level by using for instance behavioural insights as were presented at the OECD level and which are frequently used in the US and the UK. Just as at government level, the ECA could benefit from having such knowledge and make more informative choices when setting a performance standard.

The need for a clear benchmark for good performance can be demonstrated in the example of corruption in public procurement. It is true that it might seem that it is not up to the ECA to say much about corruption. Most probably, this perception originates from the assumption that corruption is mainly about crime and criminal activity. Here indeed the role of the ECA is and should be limited. However, if you think about corruption as the good governance issue then the ECA has a lot of to say. In my view the auditor has the capacity to acquire more thorough knowledge of people’s behaviour and functioning of existing institutions. Auditors can use a number of governance variables as criteria for their performance audits, assess data and information which public bodies and the civil society cannot examine and ultimately provide recommendations focused on specific governance issues. Taking account of behavioural insights in audits would give the political leaders a better basis for decisions; thereby audit reports become more relevant. In this way, the ECA can have a substantial impact on the development of better regulation, improve performance and integrity of public institutions.

<sup>12</sup> Graells, S. A. (2011). Public procurement and the EU competition rules. Oxford , pp. 97 – 112.



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