

## **Developments in EU Funds Audit**

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I would like to thank the Czech Supreme Audit Office for the kind invitation to participate in this training seminar. I am very grateful for this initiative and I am particularly honored to address you today. I always feel at home both in this wonderful town of Prague and in a EUROSAI forum.

I will present the construction or the structure of internal and external control in the European Union and focus on some recent initiatives in these areas. My presentation will cover global issues of principle and in particular some developments in the area of internal and external control of EU funds. I believe that most of the points I will raise are relevant for all EUROSAI countries and not just the EU Member States. More detailed presentations on the audit of agriculture and structural funds will be given by other colleagues of the European Court of Auditors during the different workshops.

I will express opinions of the Court completed by some personal views.

First, it is necessary to describe briefly the internal and external control system of the European Union.

Concerning the **internal control**, according to the Treaty, the European Commission is responsible for the execution of the budget and the Member States are required to cooperate with the Commission to ensure that funds are correctly used.

Most of the community funds - about 80% - are implemented under a system of shared management involving national or regional administrations. It concerns mainly agricultural expenditure and structural measures. Shared management means that the Commission remains the ultimate responsible for the implementation but the Member States' administrations manage and control these funds as foreseen in Community laws. The Community system of shared management of EU funds is often more complex than the management systems at national level because a multitude of players are involved at different levels. Such a system makes it difficult to define a clear chain of responsibilities at all these levels. In addition, each Member State manages and controls these EU funds according to their specific administrative and institutional structures. This means that there is not one system of management but a multitude of models at national and regional level.

**External control** on the other hand is the sole responsibility of the European Court of Auditors. Its mandate is set out in the Treaty and in a lot of aspects it is comparable to the mandate of national supreme audit institutions: the Court gives an independent opinion on the financial management, on the financial statements and it can report on issues of sound financial management. Important in this context is that the Treaty obliges the Court to provide an annual statement of assurance on the legality of the transactions underlying the accounts as well as on the reliability of the accounts. This obligation is generally known by the name of DAS. As far as I know, this obligation is unique to the European Court of Auditors. Another important element foreseen by the Treaty is the requirement for the Court to cooperate with the national audit institutions of the Member States in a spirit of trust. The Treaty arrangements do not provide a framework whereby the national audit institutions and the European Court of Auditors have joint responsibility for external audit of EU revenue and expenditure. **There is therefore no shared responsibility for the audit of EU funds between the European Court and its national counterparts.**

However, in accordance with the Treaty provisions and international audit standards, the European Court of Auditors cooperates with national audit institutions in full respect of their respective independence. It is clear for all of us that the national audit institutions of Member States are external bodies within a national context: they fulfill the mandates attributed by their respective constitutions and report to their respective national authorities. This entails that they are independent from the European institutions. In most countries the laws do not require audit institutions to do specific work on EU funds. This is not so surprising when you look at the importance of EU funds within a national context: the EU budget represents about 2% of the total national budgetary expenditure in the 25 EU Member States.

I believe it is important to have this framework of internal and external control in mind because the complexity of the financial management and control of the European Union has led to many levels and types of checks both at EU and Member State level. The risk is that these basic principles may be affected when solutions are designed to cope with management problems.

Given the fact that our audits have so far not permitted to give a clean opinion on important parts of EU expenditure - in particular expenditure managed under shared management - , the European Parliament has called for a control framework involving a cooperation and coordination of the different internal control activities at all levels.

In practice this means that a control framework is established whereby the controller at each successive level relies on the work of the controller at the level below and does not duplicate it. It would work like a kind of a pyramid.

The European Court of auditors has issued an opinion on this so called "single audit" model which includes proposals for a Community Internal Control framework. The main idea is not to add controls but to make them more efficient.

The Court indicated in its opinion that a number of conditions must be met to set up a model where one level of control feeds the next level. I will limit myself to few key elements:

- first, it is necessary to define what control systems are required to do and to ensure that legislation is clear. On this last point a lot of work is still to be done. I could quote you some articles of the new CAP regulations which give some headaches even to specialists.
- second, controls should be efficient and there should be a balance between their cost and their benefit. This also means that an acceptable level of risk has to be defined because zero risk does not exist in real life ;
- finally it is necessary to have a clear definition of the roles and responsibilities of the various actors involved in the control chain. This exercise is not so easy. When we take the example of agricultural expenditure, a lot of different authorities are involved: a series of agencies in Member States which pay the farmers, bodies which certify the accounts, several ministries directly or indirectly involved in the implementation of measures and policies, specialized bodies for specific aspects (such as for organic farming), different services at Commission level for issuing legislation and for management and control.

In order to achieve this integrated control framework, the Commission has formulated a number of suggestions, in particular in its action plan presented in January this year.

I would like to mention few important proposals made by the Commission which are relevant for all of us:

1. The Commission suggests that Member States, represented by their Minister of Finance, should give assurance that the pyramid of controls of EU funds is in place in their country and works as intended. The Court has indicated in the past that any declaration has indeed the potential to improve control systems and provide additional assurance but the precondition is that their precise objective should be clarified as well as the work needed before signing the declaration. Indeed, the risk is that such declarations become empty boxes, or might not be issued at all in countries where Minister of Finance is not responsible for expenditure made by other ministries. I would add that if Ministers of Finance sign

these (management) declarations they would then have to discharge themselves before the European Council, acting as discharge authority. In this case there will be an evident conflict of interests. On the substance, they would implicitly become responsible for the management of those funds. But responsible to whom and under what terms is not clear in the Commission proposals: to the European Council? To the Parliament? To the Commission?

2. The declaration at national level to be signed by the Finance Ministers would be backed up by declarations from the director of each paying agency (in the context of the Common Agriculture Policy) and management authority (for the Structural Funds). These declarations are already foreseen in the Regulations for agriculture and will have to be provided from 2007 onwards. The Court has raised some questions about these declarations in its opinion on the regulation: what is their precise objective? How will they contribute to provide more assurance? What audit work has to be done to substantiate them etc? I understand that the paying agencies in the Member States have been raising similar questions.

During the discussions on the reform of the Financial Regulation, the Council has not accepted the proposal for a single national declaration to be signed by the Finance Ministers. Therefore, the Commission has proposed that *"Member States should designate a national coordinating body per policy area which can for example provide all stakeholders with an overview of the assurance available in respect of Community actions under shared and indirect management in their Member State"*(Action 5). In addition, there would be a summary at national level of all assurances given by managers and auditors at operational level.

This alternative is referred to in an inter-institutional agreement signed by the Commission, the Council and the Parliament and to which are annexed the Financial Perspectives for the period 2007-2013. It is also reflected in draft implementing rules of the financial regulation (which is to be decided by the Commission after consultation of the other institutions). Even though the form of this document has changed and even if such a document has the potential to contribute to the

accountability and assurance process in the European Community, the key questions I have raised before remain unanswered at this stage.

3. Another element in the Commission's ideas for an integrated control framework is related to the contribution it expects from the national audit institutions. The Commission considers that national audit institutions could be integrated in its integrated control framework (or single audit model). More concretely it considers that the national external audit institutions should survey the control framework or systems and report on any weaknesses in its design or functioning. The Commission further considers that national Parliaments should ask their SAIs to play an active role in the context of the Commission's integrated internal control framework. In addition, the Commission argues that national SAIs could also audit and report to European Institutions (mainly the Commission and the European Court of Auditors) on the ex-post declarations of assurance provided by the bodies responsible for the management of EU expenditure in the Member States. The Commission further considers that this additional assurance provided by national SAIs would enable the Court to conclude that a sound management of EU expenditure is in place and that a positive DAS can be given (a positive DAS in Commission's language means an unqualified audit opinion).

Several important aspects must be kept in mind in this context:

- firstly, the establishment of an integrated control framework concerns internal control only. The external auditor, the ECA and the national audit institutions in the EU context, are by definition and by their respective constitutional framework not part of the internal control systems. This principle is clearly stated in the Lima declaration of INTOSAI. As recalled by the Court in its opinion, external auditors should therefore not be integrated in the single audit model.
- secondly, the debate seems to take for granted the Commission's assumption that "if we have an integrated internal control and audit framework, then we will automatically achieve a positive DAS". It

thereby simply reduces the EU's financial management to a DAS problem. This confuses the issue of the responsibility for the quality of the EU's financial management with the role of its independent external auditor to provide objective opinions.

This misunderstanding should be avoided. The statement of assurance of the European Court of Auditors can only reflect the Court's audit findings on the reality of financial management in the large scale and complex environment of the EU. The Court audits reality not fiction.

- Thirdly, the European Court of Auditors has underlined in its opinion on the single audit model that the establishment of an effective internal control framework could increase the effectiveness of its work. This should however not be mixed up with the cooperation between external auditors. International auditing standards provide a framework for the relation between auditors and for using the work of other auditors. This may allow auditors to rely, where possible, on the work of other auditors. Such reliance is of course based on certain conditions, in particular compliance with professional standards and availability of audit results within the timeframe required. If an SAI in a Member State accepts this EU mandate, or if legislation compel them to participate in this EU audit framework they would have to respect these requirements and, in particular, provide their opinion in the short timeframe of the DAS work. They would also have to open their working papers underlying their opinion to the scrutiny of EU institutions. As you can see, some of these Commission's proposals can have far reaching consequences which must be discussed and clarified first.

In conclusion, the establishment of an effective and comprehensive system for internal controls of EU funds should be handled as a priority in the context of the protection of the financial interests of the European Union. It is recognized that it is a complex, but important task, which involves all actors in the internal control system in the Commission and in the Member States. It should be achieved within the framework of existing constitutional and legal provisions and

should abide by internal and external control standards. It is the interest of the external auditors, namely the ECA and the National Audit Institutions, that such an effective system be in place and be functioning and that the respective roles of internal and external control be unambiguous. It will request intensive efforts and commitments of all actors involved and it would serve a common purpose for the benefit of the citizens of the EU.

I thank you for your attention