

# "European Court of auditors: from legality and regularity audits to evaluation of efficiency and effectiveness of EU projects and programmes. the special reports as a useful instrument for the legislator"

hearing of the Committee on Budgetary Control of the European parliament,  
Brussels, 25 September 2013



## Speech of Vítor Caldeira, President of the ECA

honorable members of the Committee,

let me thank you for the opportunity of addressing this committee on a very important topic for the Court. The title given in the programme to my intervention is

### **"Compliance audit versus performance audit, seen from the perspective of the ECA".**

it echoes a remark of a distinguished speaker at a previous hearing on a similar subject. on that occasion, professor levy finished his expert submission with a question: which is more important – performance or compliance?

#### **A dangerous question**

i think it is a dangerous question because it risks setting up a false choice. it is not a question of one or the other: compliance or performance. for the Court's audits, it has to be both - for a number of reasons.

The first reason is legal. the treaty on the functioning of the European union requires the Court to *examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound.*

The financial regulation on the implementation of the EU budget defines sound financial management as applying the principles of economy, efficiency and effectiveness.

The Court's mandate mirrors the Commission's responsibilities for managing the implementation of the budget. the treaty requires the EU budget to be used in accordance with the principles of sound financial management and the relevant EU legal instruments.

Similarly, the European parliament is required to give discharge on the basis of both elements, regularity and sound financial management. To make that possible, the Commission must provide EU accounts showing how resources were raised and spent and – since the Lisbon treaty – an evaluation report based on the results achieved. in addition, the Court prepares its annual and special reports – they act as a complementary independent source of information and assurance.

How the Court should meet its audit and reporting obligations is a matter for the Court to decide itself, applying the principle of institutional independence.

this leads me to the second reason why we need to be careful not to make too much of the compliance versus performance distinction. the reason is professional.

### **The obligations of the Court**

the Court is a recognized supreme audit institution, like the gao of the united states and the French Cour des comptes.

that means it is obliged to respect the framework of international standards for supreme audit institutions, known as "issues". these standards provide a basis for the Court to interpret its mandate and to carry out its audit tasks under the treaty.

the issue framework identifies three types of audit: financial, compliance and performance. F i nancial audit covers the reliability of financial reporting. Compliance audit covers regularity. and performance audit assesses economy, efficiency and effectiveness.

it is worth noting that compliance audit can be carried out on its own, or in combination with financial audit or performance audit.

Reflecting the provisions of the treaty, the Court takes the combined approach. the Court's das audits are an example of compliance audits carried out as part of an audit of financial accounts. the Court's performance audits almost always include criteria which reflect compliance with the provisions of legislation.

so, from a theoretical perspective, i think we need to be careful not to focus too strongly on the differences between the three types of audit. they are tools that are best used together.

the third reason for not over-emphasizing their difference is more practical.

### **Interrelation between compliance and performance issues**

in reality, the compliance and performance issues associated with implementing the budget are interrelated. our auditing and reporting tries to reflect this fact.

The Court's das audit shows that errors of regularity are very often cases where spending did not hit the target or was used sub-optimally. typical errors in our annual report include payments for expenditure which was ineligible or for purchases without proper application of public procurement rules.

The Court uses the results of its das work, which covers the whole budget, to identify specific areas where performance might be at risk.

The Court also carries out performance audits that lead to observations in our special reports which highlight regularity issues that have implications for economy, efficiency and effectiveness.

In this way, performance audits then provide a basis for recommendations in special reports – or in opinions on legislative proposals - on how to improve legal frameworks in order to reinforce performance.

This brings me to the final – and perhaps the most relevant – reason, which is public interest.

### **Ensuring effective accountability to EU citizens**

We do not carry out our das and performance audits simply because we must. we do it also because it contributes to ensuring effective accountability to Eu citizens for every euro raised and spent in the EU budget.

our strategic objective for the 2013 to 2017 period is to maximize the value of the ECA's contribution to improving EU public accountability.

our priority is to focus the ECA's products on achieving that goal. from our perspective, that means producing a balanced portfolio of reports and opinions based on our audits which best address the needs of our stakeholders, in particular this parliament and the citizens you represent.

EU citizens have a right to know: what their money was spent on; whether it was used as intended; and whether it was used wisely.

That requires effective management and control arrangements in the EU capable ensuring EU accounts are reliable, its financial rules are respected, and results are achieved as efficiently as possible.

As regards the EU accounts, the Court has found them to be reliable for a number of years now. The Court's work contributed to this outcome. we advocated introducing a modern accounting framework based on accruals. we then audited its implementation, making recommendations on how to improve the accounting systems.

As regards regularity, the picture is mixed. despite significant improvements in internal controls in recent years, the Court has continued to find a material level of irregular payments.

In 2011, the Court estimated the error rate to be 3.9%.

As regards the results achieved with the EU budget, it is impossible to provide an overall picture. the first two editions of the evaluation report have demonstrated that the building blocks are not yet in place for it to be an effective tool for public scrutiny.

Our performance audits help explain why. Many spending programmes and schemes still lack clear objectives and targets and have weak monitoring and evaluation arrangements.

### **The Commission's administrative reforms**

The current state of EU financial management and control is largely explained by the pattern of developments that have occurred since the Commission launched its administrative reforms. The Commission began by reforming its own internal management and control arrangements, including introducing an accruals-based accounting system.

It then turned its attention to developing and implementing an "integrated internal control framework". again the Court's and performance audit work helped us to contribute to the development and implementation phases.

Our audit experience was the basis of our opinion on "the single audit model" in which we set out our ideas on what such an internal control framework should look like. and we have audited many aspects of its operation in recent years.

Up until now, the Commission's focus has primarily been on controlling the regularity of payments. its stated aim has been to reduce the level of irregular payments made from the EU budget to below 2%, the materiality level used by the Court in its work.

The Court's estimate of the overall error rate shows that it has fallen since 2006. But as you know, the Court warned that at a certain point, the marginal cost of increased controls begins to outweigh the benefit of reducing the error rate.

Therefore, we have also encouraged EU policy makers to re-consider the design of certain spending programmes and schemes.

it is from this perspective that the Court welcomed the spending review and its conclusion that the EU budget needed to be more “focused on results”.

in its contributions to that review and the preparations for the next financial framework, the Court stressed that a new “focus on results” should not be allowed to undermine the regularity of EU spending.

### **The Court's opinion**

That is why - in early 2010 - the Court issued an opinion calling on the Commission to prioritize improving the quality of spending over the next financial framework period.

In the Court's view, good quality expenditure respects the rules and achieves results. Compliance and performance are two sides of the same coin.

That has important implications for internal control, external audit and public oversight. in particular, the “focus-on-results” needs to be reflected in:

- management roles and responsibilities,
- the objectives and targets to be achieved,
- the payment conditions for receiving funds, and
- the requirements for recording, checking and reporting on results.

That would represent a major change of mind-set for public policy-makers and financial managers.

The new programming period provides an important opportunity to make progress in improving accountability for results.

Indeed, the proposals for programmes and schemes after 2013 contain a number of elements designed to bring more focus on results.

we have provided opinions on the main proposals.

### **Opportunities for positive change**

As you know, the Court's view is that a number of opportunities have already been missed at the highest level of legislation to further clarify objectives, simplify programmes and schemes, link payments more closely to results, enhance monitoring and evaluation arrangements, and make internal control systems more output oriented.

Nevertheless, many opportunities for positive change remain at lower levels of legislation and when programmes and schemes are implemented.

Under the new financial framework, the funding provided from the EU budget will still be largely grant based. in the Court's view, a key way to improve Eu spending would be to link the eligibility criteria for receiving grants more closely to outputs – payment by results.

If that were the case, the distinction between compliance and performance would be even less pronounced than it is now.

## Conclusion

Chairman, honorable members,

the Court considers that financial, compliance and performance audit are all indispensable tools. they assist those responsible for political oversight of the EU's finance to hold to account those responsible for their management.

for the Court, that means we need to work with this parliament. we need to carry out audits and produce reports that assist the parliament to meet its responsibilities. we hope that parliament, for its part, will make optimal use of the full range of the Court's products.

there will be major audit and accountability challenges ahead, for example the introduction of new financial instruments.

We will endeavor to support this parliament by providing position papers, landscape reviews and opinions which analyze the implications of such developments for financial management, audit and accountability.

However, we do not audit in a vacuum. What we will be able to audit in the future, and how, will depend on how the internal control framework develops.

it is clear that the pyramid of assurance on the EU budget still needs to be completed – it must be built from the bottom up.

if the Commission was in a position to provide sufficient and appropriate information on the error rate, their figures could become a major input to the das.

similarly, performance targets need to be in place as a management tool before they can serve as audit criteria. with such building blocks in place the Commission's evaluation report under article 318 could serve as a starting point for public scrutiny of performance. indeed, that evaluation report could become auditable.

We recognize that an integrated internal control framework also provides opportunities for the ECa to cooperate with national sais. this is an avenue we are actively exploring with our national counterparts in the Contact Committee.

with them, we also recognize that cooperation between sais will be crucial in order to deal with the challenges of developments in European governance.

the single supervisory mechanism and the financial and economic surveillance in the European semester are two examples of cases where cooperation is required between sais in order to give parliaments and citizens a full audit picture of performance.

Chairman, honorable members

Better accountability for the use of EU finances is needed in order to strengthen democratic legitimacy and foster citizens' trust in the EU. The Court will continue to use its audit work as best it can to assist this parliament and the other EU institutions to achieve that goal.