

About...

the European Court of Auditors

The European Court of Auditors was established in October 1977 in Luxembourg with the mandate of auditing the revenue and expenditure of the European Union. To all intents and purposes, therefore, the Court of Auditors acts as the EU's "financial watchdog" on behalf of all EU citizens. It ensures that European public funds are spent as intended. This implies that the Court of Auditors not only verifies that the EU budget is correctly disbursed, but also seeks assurance that funds are used wisely and effectively. In this way it contributes indirectly to improving the EU's policy instruments and programmes. As well as being qualified auditors, lawyers or economists, the staff come equipped with GPS devices, gumboots and safety glasses.



The building K2 is one of the five buildings of the European Court of Auditors
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"EU wasting billions" was the title of an article in the *Frankfurter Allgemeine Zeitung* shortly after the Court of Auditors presented its annual report for 2007. Dr Manfred Kraff, director at the Court of Auditors, is never happy to read headlines like these. Not only because he and the rest of the Court of Auditors' staff work day in day out to ensure that EU money is not wasted, but also because it goes against the grain for him, a convinced Europhile, that the results of his work are used, as he perceives it, to cast the EU in a negative light. Imagine the work of Kraff and his colleagues at the much lower, more parochial level of a village club: he is the auditor called in to inform the membership (European Parliament and Council

Grand Duchy of Luxembourg

Capital: Luxembourg

Form of government: constitutional monarchy

Neighbouring countries: Germany, Belgium, France

Area: 2,586 km²

Population: 483,800 inhabitants, of which 205,900 are foreigners

Population density: 187 inhab./km² (2008)



The Court of Auditors is a body which acts collectively and is composed of 27 members from the different Member States
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of the European Union) whether the books are in order so that they can give clearance to the committee (European Commission). The auditors' work is based on three audit approaches: financial audit, compliance audit (legality and regularity audit) and performance audit.

Financial audit

Every year the Commission presents the EU budget, consisting of expenditure forecasts in all policy areas, such as agriculture, cohesion policy, research, transport and development aid. At the end of the budget year, just like a private company, the Commission publishes a financial statement and a balance sheet. It is then the Court of Auditors' task, in the framework of its audit of the accounts, to determine whether the picture given by the Commission in its balance sheet corresponds to reality. Is the EU's financial situation really as shown on the balance sheet, and have the books been kept correctly – i.e. in accordance with the applicable accounting rules? Given the budget of 120 billion euros and the millions of transactions in-

volved, this really is a mammoth task. In 2007, for the first time ever, the Court of Auditors gave an unqualified assurance that the Commission's financial statements accurately reflected the financial situation of the EU.

Compliance audit

Compliance audit in particular is a fascinating and, "what is more, eminently political" field of work, says Kraff, who has been working for the Court of Auditors for over 20 years. Compliance testing is the second stage of the financial audit. It goes beyond simply examining the accounts and focuses on whether the transactions entered in the accounts satisfy the applicable rules and treaty obligations.

The European Regional Development Fund alone – one of the Structural Funds that the EU uses as its main cohesion policy instrument to finance, say, road construction or vocational training programmes – currently provides funding for around 700 000 different projects, says Kraff. Were all these projects eligible for EU

funds – in other words, did they meet the prescribed conditions for financing? And were they then actually carried out so that the money was spent as promised in the grant applications?

This question is pertinent not only in connection with Structural Fund expenditure; the auditors ask it in all policy areas that entail EU spending, from agriculture and fisheries, research and transport to development aid. Kraff finds the subject enthralling, as for him what appears to be superficial juggling with numbers conceals real life situations. For example, an audit in the field of research might focus on an order for work on the Galileo satellite navigation system.

Performance audit

As the Court of Auditors is also charged with ascertaining that EU funds are spent wisely, it is empowered, alongside its compulsory financial and compliance audits, to carry out performance audits as well in the different areas of expenditure. “People often confuse this with simply saving money,” says Kraff, who began his career managing expenditure at the Commission – before changing sides. It is not at all a matter, he says, of just spending as little as possible, but of verifying that money is used effectively. Have the funds been spent in such a way that the objectives of policy decisions taken by the Commission, the Council of the European Union and the Parliament have been achieved? For example, has an application for Structural Fund support led to the creation or safeguarding of jobs?

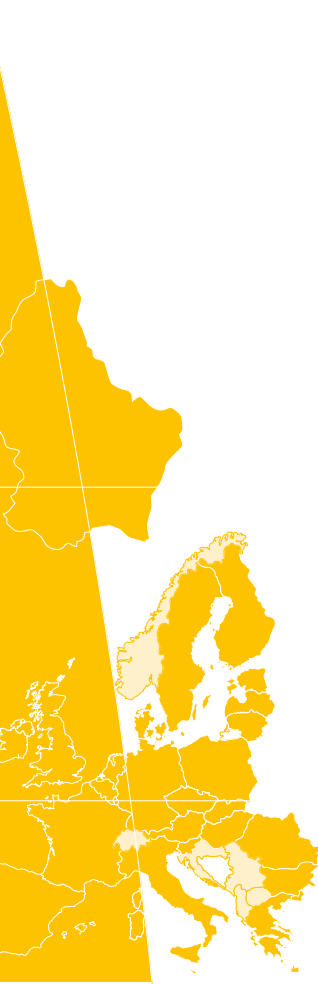
According to Kraff, it is considerably more difficult to carry out a performance audit than other forms of audit, as the necessary indicators are not automatically available and must first be explored. This is done in cooperation with the Commission. Joint discussion therefore often begins with the question: “What was supposed to be achieved?” To take, once again, the example of the Structural Funds and the goal of job creation: how can the auditors ascertain whether new jobs are attributable to EU assistance or, say, to an economic upturn?

Error not the same as fraud

The Court of Auditors found that around 11 % of the Structural Fund budget for the 2007 financial year had not been correctly spent. Kraff stresses, however, that this must not be understood to indicate fraud. Far more often it is the case that applicants wrongly apply the rules or simply fail to understand them. The EU civil servant does not necessarily blame the applicants for this. In his view, the fault lies more with the complexity of the rules. Drawing on his many years of audit work, he cites the example of a small German firm which had applied for funds so that it could purchase new machinery and, subsequently, take on new hands. The firm used the grants awarded to do just that, and the auditors duly found both machines and employees. However, the audit revealed that the firm had bought some of the new equipment before formally applying for financial support. Unfortunately, under national law, strictly speaking, this made the firm ineligible for aid, as the relevant rules stipulated that funds could be assigned only to investments made following a grant application. During preliminary talks the competent authority had failed to draw the firm’s attention to



An auditor in the context of an inspection of a farm in Spain
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the legal situation. The company directors were therefore unaware that they were at fault, but this in no way altered the fact that the money had been irregularly disbursed. “Cases like this would be included in the 11% error rate to which we objected,” says Kraff. However, the authority was called to account for its blunder and the firm was not obliged to return the money. “The notion that huge EU sums are being creamed off in shady deals is entirely false,” adds Kraff, who says that genuine fraud is rare.

In its reports the Court of Auditors has repeatedly called for procedures to be simplified as much as possible. Since to err is human, the Court of Auditors does not advocate zero-tolerance. The EU civil servant again: “It is plainly unrealistic to believe error can be wholly excluded.” This realisation led to the introduction of the “materiality threshold”: error rates of under 2% are tolerated by the Court of Auditors. However, the auditors consider rates of more than 2% to be unacceptable.

The audit trail

A special software programme is the explanation why the auditors stumbled upon the small German firm mentioned above. The Court of Auditors has access to the computer that the Commission uses to make payments. A special application uses precise search criteria to take a representative sample of payments for testing. This

enables conclusions to be reached about all the payments. Explains Kraff: “We define a so-called ‘hit-euro.’” This coin is painstakingly tracked. The auditors check in Brussels whether the necessary supporting documents are available to justify the payment and everything is in order. They literally follow their ‘hit-euro’ down the audit trail. “We trace it from the Commission, via the Member State, the concerned country or region, to the local authority and ultimately to the final beneficiary, who, say, wants to buy machinery in order to create jobs. Or he might be a farmer receiving premiums for the cattle in his sheds.” At every stage they examine invoices and forms, and finally they arrive at the applicant’s door. If necessary, wearing gumboots in which to pace out a farmer’s fields, GPS in hand, and determine whether the area matches the claim in the grant application. Or they might visit the cattle shed for a headcount. The auditors may also don safety glasses and overalls to inspect a firm’s new machines and the relevant invoices as well as check the corresponding jobs and the contracts of employment of the new workers.

The audit trail takes the Court of Auditors’ staff not only to the 27 EU Member States but also well beyond their borders. Everywhere, in fact, that EU funds are sent. In the Palestinian territories, for example, auditors will interview the participants on an EU-funded training programme in order to establish that they really have been attending the classes declared.



Auditors during a work session in Luxembourg
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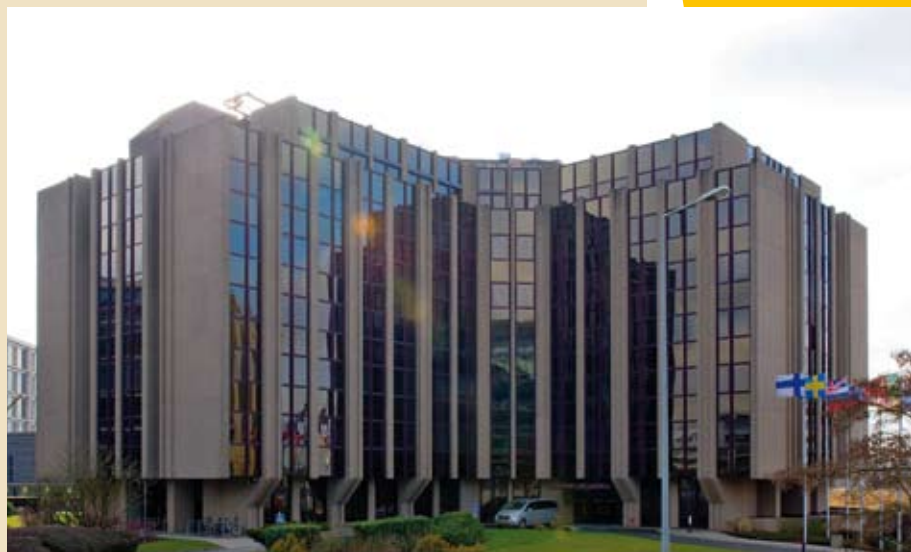
European Court of Auditors

The decision to relocate the European institutions concerned with the financial system to Luxembourg goes back to 1965. The European Court of Auditors was established in 1975 by the Treaty of Brussels. It started work in Luxembourg City in 1977. The Court of Auditors' buildings are located in rue Alcide De Gasperi on the Kirchberg plateau. In 1992, under the Maastricht Treaty, the European Court of Auditors was elevated to the rank of an EU institution, on a par with the European Commission, the Council of the European Union, the European Parliament and the Court of Justice.

The Court of Auditors is headed by its members. Under the 2001 Treaty of Nice, each EU Member State appoints one member, and there are currently 27. The Court of Auditors has around 860 members of staff, of whom nearly 310 are auditors. The members have a six-year renewable term of office. They elect a president from their midst, giving him/her a three-year term of office, also renewable.

The Court of Auditors is divided into seven organisational entities. These are the Presidency, the Secretariat-General, four sector-specific audit groups with responsibility for audits in the various areas of expenditure, and one audit group with responsibility for coordination and quality assurance.

In 2008 the Court of Auditors had a budget of around 133 million euros. The same year, the EU budget, which it is the Court of Auditors' mandate to audit, came to 120 billion euros.



The main building of the Court of Auditors
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Structure of the Court of Auditors

In line with the various areas of expenditure, the Court of Auditors is divided into seven organisational departments. The Presidency ensures that the Court of Auditors is fulfilling its mandate and oversees external relations. The Secretariat-General deals with internal administration. The members of the Court of Auditors, coming from the Member States, are divided among five groups, four of which are sector-specific audit groups aligned with the policy areas of the EU. Manfred Kraff works in the CEAD Group, which is responsible for

coordination, communication, evaluation, quality assurance and development. He is one of around 860 members of staff, who include approximately 165 translators and 310 auditors.

Interview with Vítor Manuel da Silva Caldeira



The president of the Court of Auditors is elected by the members for a three-year renewable term of office
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As President, why do you consider the work of the European Court of Auditors to be important?

The origins of the Court of Auditors, which was established over 30 years ago, lie in the European Coal and Steel Community, which already had an auditor. In today's world it is essential that public finance be monitored by an external institution. This is the role of the European Court of Auditors within the EU: we are the external auditor and thus the guardian of the financial interests of EU citizens. More specifically, we examine all processes and transactions arising in the framework of the EU budget, which accounts for about 1 % of the European Union's gross domestic product. This we do, so as to retain the trust of the citizens of Europe, in accordance with the strictest international audit rules. We examine, firstly, whether funds have been used legally and, secondly, whether they have been implemented wisely and efficiently. Although at first glance the EU budget may appear significant, in reality the financial resources are relatively modest. It is therefore important that funds be used in such a way that

they also genuinely contribute to the social development and economic growth of the EU. We seek to help the legislative authorities by providing them with a basis for further refining the policy instruments that they have established. The Court of Auditors is also one of the five European institutions that are enshrined in the Treaties. In this sense it plays a direct role in the construction of Europe. With the other institutions, under the Treaties, it shares responsibility for promoting and consolidating the European idea. The key point here is that the Court of Auditors is entirely independent in its work of auditing the European Commission, the Council of the European Union and the European Parliament.

The Court of Auditors' reports often come across as abstract. They highlight problems but do not necessarily state where they arose or what actually occurred. Why this reticence, given that it is the Court's task to watch over the European public's financial interests?

Our annual report concerns the EU budget. Most of the funds in the European budget are transferred by the European Commission to the Member States, which make payments to the final beneficiaries. In this context, our examination focuses on the payments made by the Commission and its services to the Member States. It is our task to provide a uniform overview of the Community budget, not to draw attention to problems in individual Member States. This is why we only cite countries or regions by name if doing so is necessary to bring out a concrete problem.

But your reserve could also be interpreted as meaning that your input is not always welcome and the results are open to dispute.

External auditors are always outsiders. They are only welcomed if their proposals enable the auditees to attain their objectives more effectively. However, this does not put us off, and neither does it influence our decisions about what to make public. Auditors always work towards the aim of delivering a final objective assessment of the situation. In order to do so, they must

be able to work independently and free of any pressure so that they can present both positive and negative findings. Where necessary, they must also propose ways of correcting deficiencies. In this sense, their work has an educational side, in that problems are revealed, the necessary recommendations are formulated and positive developments are described. However, conflict must be avoided, as auditees will only act on recommendations that they agree with.

In 2007, for the first time, the Court of Auditors gave the European authorities top marks for their internal financial management. So are your and your colleagues' recommendations having an effect?

We are getting there. Not very fast, perhaps, but we are getting there. For example, we have noted improvements in the EU's application of international accounting standards. To a large extent, the measures that the European Commission has been implementing since 2006 in favour of an integrated internal financial control system, as well as simplified administrative rules for the European agricultural funds or the Structural Funds, can be traced to recommendations by the Court of Auditors. In this sense the Court has been behind a great many reforms. And sometimes success is more swiftly apparent. For example, two years ago we produced a report on the implementation and effectiveness of the common fisheries policy in which we revealed significant shortcomings in the collection of catch data, the observance of quotas and the sanction of violations. The European Commission took account of many of our proposals in the fisheries policy reform which was agreed shortly afterwards. Auditors love that kind of success.


The statement of assurance and the annual report

As head of CEAD Directorate B, Manfred Kraff is responsible for the statement of assurance, the Court of Auditors' opinion as to whether the balance sheet presented by the Commission corresponds to reality and the underlying transactions are legal and regular – or not. This opinion is based on the results of the Court of Auditors' on-the-spot checks of representative samples. The Court of Auditors uses these findings to draw up an annual report which it presents to the Parliament and the Council of the European Union in the context of the annual discharge procedure. The MEPs and ministers, who are charged with granting the Commission discharge for the preceding budget year, can read the statement of assurance drawn up by Kraff and his colleagues – and adopted by the 27 members of the Court of Auditors – in the opening pages of the annual report.

For 2007, the opinion on the reliability of the accounts read as follows: "In the Court's opinion, the 'Annual Accounts of the European Communities' present fairly, in all material respects, the financial position of the Communities (...)" In contrast, the compliance audit opinion was more circumstantial. For example, around 11 % of expenditure for the 2007 Structural Funds was



In the context of the annual discharge procedure, the Court of Auditors presents an annual report to the European Parliament and the Council of the European Union
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not legal and regular, while the Court of Auditors found practically no errors in the administrative expenditure of the EU institutions and agencies.

Another significant factor in the Commission discharge are the findings of the performance audit, which state whether EU funds have been spent economically, efficiently and effectively. However, these findings do not appear in the annual report but are published in special reports.

In 2007, the discharge procedure was a tense affair, because the Parliament thought long and hard about ways of resolving the problems surrounding the Structural Funds. The MEPs withheld approval until the Commission had supplied additional information and delivered a firm undertaking that the situation would soon be improved.



The Court of Auditors regularly publishes special reports on various subjects
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Interview with Henri Grethen

Mr Grethen, on 1 January 2008 you replaced François Colling as Luxembourg's representative at the European Court of Auditors. Have you taken over his activities? What are your duties?

The Court is a body of 27 members acting collectively. In order to master its many tasks, some years ago – as laid down in the Treaty of Nice – the Court divided into a number of working groups. I belong to audit group II, which deals with EU budget expenditure on the Structural Funds, research, transport and energy, because I had previous experience in these areas. When the members are assigned tasks no account is taken of their nationality. My personal view is that, as far as possible, one should avoid taking part in audits in one's home country. At present I am coordinating the preparation of three performance audits in our group's field of responsibility.

What are the themes?

One report concerns an audit of health programmes initiated by the Commission. We are seeking to determine whether these programmes achieved their stated objectives. Another report is an examination of railway infrastructure or, more accurately, the construction of long-distance transfrontier railway networks. Here too we are looking into whether the EU's transport programmes have been as successful as hoped. Projects co-financed from EU funds include the TGV-Est line and the Eurocap-Rail link from Brussels to Strasbourg via Luxembourg City. The third report concerns the impact assessments that the Commission has been carrying out. To clarify, as part of the Lisbon Strategy to make the EU the most competitive economic area in the world, it was decided among other things to simplify the European legislative process. Since then, each time a Commission department plans a new directive

it has been required to make an impact assessment. Is the new law really necessary, or would an information and awareness-raising campaign suffice? It is our task to examine the impact assessment procedure in the legislative field in order to determine how efficient the system is and what practical decisions have been taken since it was introduced. Wherever necessary, our reports also always contain proposals for improvements.

But your mandate is not limited to the preparation of reports.

No. As I said earlier, the Court is a collective body. It votes on all reports before they are published. What this means is that the responsibility for a report is borne jointly by all the members. Much of our work therefore lies in reading the views of the other members. This is the members' highest and most important task, and they all lead a team of officials who help them to carry it out. The subject of a report – including the three to which I am contributing – is a result of the strategy established collectively by the members. In this sense there is a portfolio of themes which are to be addressed alongside our regular tasks, such as the opinion on discharge and the annual report, and from which we draw.

What goals have you set yourself for your term of office?

It is difficult to set personal goals when one belongs to a collective body. However, it is my goal that the Court of Auditors will continue to be a reliable and assertive European institution and that the quality of its reports will speak for the institution. One of our mottoes is "Count on us – we count for you". At bottom, whenever the Court examines both the legality and appropriateness of EU spending it represents the financial interests of every single EU citizen. I should like to contribute to this. I also see it as my duty to keep

the people of Luxembourg, my home country, better informed about the Court of Auditors' work, which is less familiar, in the main, than that of the other European institutions.



The Luxembourgier Henri Grethen has been member of the Court of Auditors since January 2008
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Useful addresses

European Court of Auditors

European Court of Auditors
Communication and Reports Unit
12, rue Alcide De Gasperi
L-1615 Luxembourg
Tel.: +352 43 98-45377
www.eca.europa.eu

European Organisation
of Supreme Audit Institutions (EUROSAI)
www.eurosai.org

International Organisation
of Supreme Audit Institutions (INTOSAI)
www.intosai.org

European Union

Europa – Gateway to the European Union
www.europa.eu

European Parliament
www.europarl.europa.eu

- European Parliament Committee on Budgets
www.europarl.europa.eu/activities/committees/homeCom.do?body=BUDG&language=EN
- European Parliament Committee on Budgetary Control
www.europarl.europa.eu/activities/committees/homeCom.do?body=CONT&language=EN

Council of the European Union
www.consilium.europa.eu

European Commission
www.ec.europa.eu

- European Commission, Activities – Budget
www.europa.eu/pol/financ/index_en.htm

Court of Justice of the European Communities
www.curia.europa.eu

European Ombudsman
www.ombudsman.europa.eu

European Navigator (multimedia database
of the history of European integration)
www.ena.lu

Maison de l'Europe
(European Information Centre)
European Commission Representation
in Luxembourg
7, rue du Marché-aux-Herbes
L-1728 Luxembourg
Tel.: +352 43 01-34925
www.ec.europa.eu/luxembourg

Working for the European institutions

European Personnel Selection Office (EPSO),
which selects staff for all the EU institutions

European Personnel Selection Office
Candidate contact service
Office C-80 00/40
B-1049 Brussels
Tel.: +32 (0)2 299 31 31
www.epso.europa.eu

Site plan

The different buildings of the European Court of Auditors at Kirchberg

