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Theme 1: Basic Approaches and Challenges for Ensuring Transparency and Accountability

A contribution of the European Court of Auditors

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“The importance of enhancing accountability and transparency in
the struggle against the financial crisis, and the role of SAIs”

ABSTRACT: The global financial and economic crisis that started in 2007 has had major consequences for the European Union, including undermining the confidence and trust of citizens and financial markets in EU economic governance. Enhancing accountability and transparency arrangements will be key to restoring confidence in the medium to long term. Public auditors in the EU have an important role to play in helping policy makers to achieve this objective by carrying out audits, providing assurance and giving advice. In particular, the ECA considers that new measures taken in response to the crisis should respect the principle that where public funds are at stake there should be adequate arrangements for transparency, accountability and public audit. The ECA identifies cases where public audit arrangements arising from measures taken in response to the crisis are not adequate as well as issues of accountability and transparency that need to be reflected on by the competent institutions within the Union, in particular the European Parliament and Council.

Introduction

1. This paper sets out the contribution of the European Court of Auditors (ECA) to the 1st ASOSAI-EUROSAI Joint Conference. It addresses 'Theme 1: Basic Approaches and Challenges for Ensuring Transparency and Accountability'. The paper focuses on the importance of enhancing accountability and transparency in the struggle against the financial crisis. It draws on a recent position paper by the ECA entitled "Consequences for public accountability and public audit in the EU and the role of the ECA in the light of the current financial and economic crisis". That position paper as well as all the ECA's reports and opinions are available on its website at www.eca.europa.eu.

Restoring public confidence by enhancing transparency, accountability and public audit

2. The financial and economic crisis has had grave consequences in both the private and public sectors in Europe and across the world. What started in banking with the failure of Lehman Brothers in 2007, led on to a worldwide economic slowdown, and precipitated the current sovereign debt crisis that threatens the financial stability of the euro area.

3. Public trust and confidence have been undermined and the reputations of financial institutions, national governments, and the European Union have suffered. This reputational damage helps explain an important feature of the crisis, namely how confidence fell away so quickly and why it is proving so difficult to restore. Confidence is unlikely to be fully restored before national governments and the EU have had time to repair their reputations by implementing crisis measures and carrying out longer term reforms to improve economic governance.

4. ISSAI 20 identifies accountability and transparency as essential elements of good governance¹. Transparency is about ensuring that there is adequate information available to enable public scrutiny of the performance of public activities and for areas for improvement to be identified. Accountability means

that performance is judged, and where it is found to be insufficient the responsible bodies are required to take the necessary action to improve. Therefore, in the long run, establishing and maintaining good governance depends to a large extent on public activities being transparent enough for public accountability mechanisms to be able to operate effectively.

5. In this way, adequate arrangements for transparency and accountability can help create a virtuous circle, enabling improvement in governance to take place over time and to be publicly acknowledged. However, inadequate arrangements are unlikely to help restore public confidence as they limit the capacity for improvement and let improvements that are made go unnoticed.

6. Public audit has an important facilitating role to play in this context by helping to provide independent information and assurance about the use of public funds (transparency) that enables other public authorities, such as parliaments, to exercise their powers of scrutiny and control (accountability) for the benefit of citizens. In addition, it can provide advice to policy makers on how to improve transparency and accountability mechanisms.

7. In fact, providing advice of this type, it could be argued, is itself a core function for an SAI. As the Lima declaration makes clear, "audit is not an end in itself but an indispensable part of a regulatory system"². That regulatory system can be seen as being composed of mechanisms for holding the bodies responsible for public activities accountable for performance, economy, efficiency, effectiveness, legality and regularity. Furthermore, ISSAI 20 requires SAIs to conduct their work to ensure they "promote accountability and transparency over public activities"³ and sets out, as principles, that SAIs should report the results of their work publicly, including the following up given to recommendations, and communicate effectively with the media and public⁴.

8. It is therefore essential that public auditors in the EU, including the ECA, give due consideration to the serious issues of transparency and accountability that have been raised by the financial crisis and the response of EU policy makers to it as well as to the implications for public audit in the EU.

The public audit implications of the EU response to the crisis

9. Although there were many causes for the financial and economic crisis, weaknesses in the governance, transparency and accountability arrangements at both national and EU level were contributory factors. For example, at the European level, the crisis has revealed problems with the regulation of the financial industry, private and public sector accounting, and the functioning of Economic and Monetary Union. It has also revealed significant “gaps” in the EU’s economic governance model.

10. The EU’s response to the crisis has included measures for strengthening existing arrangements and for filling the gaps in economic governance. The measures aim to support the sustainability of the financial industry, to promote economic recovery and growth, to provide financial assistance to Member States in need, and to strengthen fiscal and economic policy coordination between Member States. The measures also have important implications for the use of public funds – taxes paid by EU citizens – in the EU as well as for transparency, accountability and public audit.

11. The ECA considers that these new measures should respect the principle that where public funds are at stake there should be adequate arrangements for transparency, public accountability and public audit. This principle can be seen as deriving from the Lima declaration which provides that “all public financial operations, regardless of whether and how they are reflected in the national budget, shall be subject to audit by Supreme Audit Institutions. Excluding parts of financial management from the national budget shall not result in these parts being exempted from audit by the Supreme Audit Institution.”⁵

Financial industry sustainability

12. The EU has taken a number of measures to encourage a sustainable financial industry, including the establishment of the European System of Financial Supervision. As regards micro-prudential supervision, a major development is the establishment of three new supervisory agencies, the

European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – operational since 1 January 2011. The ECA carries out the financial audit of these authorities⁶. In addition, the ECA is planning a performance audit in this area.

13. The problems of the financial industry also revealed weaknesses in private sector accounting and audit arrangements. In the area of international accounting standards, work is under way in order to achieve a single set of high quality global accounting standards. The European Commission is in the process of trying to formulate policy in this area. To this end, it launched a consultation process on the international audit standards in October 2010 by publishing a Green Paper on Audit, which asked for the stakeholders' views on various subjects including the introduction of International Standards on Auditing (ISAs) in the EU. ISAs provide an important source of inspiration for the standards applied by public auditors. The ECA will use its expertise in this area to consider how to contribute to the public debate, and to the development and implementation of the International Public Sector Accounting Standards in the European Union.

Recovery and growth

14. In November 2008, the Commission's Communication on a European Economic Recovery Plan⁷ set out ideas on how the Member States and the EU could "support the real economy and boost confidence". The EU budget played a role in this initiative by providing an additional EUR 5 billion to address the challenge of energy security and to bring high-speed internet to rural communities, as well as through additional advance payments under cohesion policy amounting to EUR 11 billion. Moreover, the European Investment Bank (EIB) has boosted its SME lending possibilities by EUR 15 billion.

15. The Europe 2020 Strategy⁸ develops these ideas further, presenting a strategy for exiting the crisis and achieving smart, sustainable and inclusive growth which will guide spending from the EU budget. The ECA will audit the

expenditure in the EU budget as a part of its normal audits. There is also scope for cooperation with Member States' Supreme Audit Institutions.

Financial assistance to EU Member States in need

16. The economic crisis resulted in the need for the EU to provide financial assistance to some Member States in the form of loans. For non-euro area Member States, the EU was able to use an existing instrument, the Community medium-term financial assistance facility, which operates as balance of payments assistance with an EU budget guarantee.

17. The legal base for this instrument gives the ECA the "right to carry out, in the Member State receiving the Community medium-term financial assistance, any financial controls or audits that it considers necessary in relation to the management of that assistance."⁹ The ECA is planning to carry out an audit covering loans approved by the Council.

18. The EU created two temporary instruments to assist Member States of the euro area. First, the European Financial Stabilisation Mechanism (EFSM) was set up in 2010 to grant Union financial assistance with EU budget guarantees. For the first time it enables the Commission to contract borrowings on the capital markets or with financial institutions in order to provide financial assistance to Member States. So far, assistance has been granted to Ireland and Portugal.

19. The legal instrument establishing the EFSM¹⁰ gives the ECA 'the right to carry out in the beneficiary Member State any financial controls or audits that it considers necessary in relation to the management of that assistance.' The ECA intends to audit the reliability of loan disbursements in its audit of the implementation of the EU budget for the 2011 financial year (DAS audit).

20. Secondly, the European Financial Stability Facility (EFSF) was established by euro area Member States to provide assistance to its member countries. The European Financial Stability Facility is a private company (société anonyme), with 100 % sovereign ownership, incorporated under national

(Luxembourg) law. The EFSF can issue bonds backed by the guarantees of these sovereigns in order to raise the necessary funds. It has a volume of up to EUR 440 billion. The Framework Agreement¹¹ between the euro area Member States and the EFSF itself has no provision for external public audit (a private auditor has been appointed).

21. The European Council has agreed to replace these two temporary instruments in 2013 with a permanent European Stability Mechanism (ESM)¹² to be established by a treaty among the euro area Member States as an intergovernmental organisation under public international law. A significant role is foreseen for the Commission in the activation of financial assistance, programme monitoring and follow up. In November 2010, at an early stage in the process, the ECA sent a President's letter i.a. to the Presidents of the European Council and the Commission to inform them of the ECA's position on audit and accountability arrangements for the proposed ESM. How to divide the work in this area between public and private audit as well as between European Institutions and Member States SAIs is an important question. The ECA's aim is to contribute to a transparent structure safeguarding sufficient public audit.

Fiscal and economic policy coordination

22. In September 2010, the Commission submitted proposals concerning enhanced surveillance of Member States' fiscal policies, macroeconomic policies and structural reforms. The European Council supported this initiative and agreed on the Euro Plus Pact aiming at better quality of economic policy coordination. A new procedure has already been approved to coordinate ex ante Member States' policies i.e. the European Semester. The ECA will take up a discussion with EU Member States' SAIs on how to audit this policy area.

23. Two other issues worth further reflection on the European level concern the European system of central banks and the new set of rules to shape national fiscal policies. The extent to which these two policy areas fall under the scope of public review or public audit varies. In the case of the central banks, the reason for further reflection at this stage is the large financial risks

now taken up, which could ultimately fall on the European taxpayers, and the new macro-prudential tasks now given to the European Central Bank. When it comes to fiscal policy, the issue is the need for an effective and independent follow-up of the policies pursued in Member States, a task similar to that pursued in some Member States by "Fiscal Councils".

Conclusion

24. The financial crisis has raised new challenges related to public audit in the European Union. Within its mandate the ECA will carry out audits in relation to new supervisory authorities, assistance mechanisms with EU budget guarantee and – to the extent possible – the Commission's activities in the European Semester. However, the ECA also identifies cases where public audit arrangements are not adequate. For example, the ECA considers that the Treaty establishing the European Stability Mechanism should include provisions for public external audit. Finally, the ECA notes a number of cases where accountability and transparency issues need to be reflected on by the competent institutions within the Union, in particular the European Parliament and Council. They concern accounting/audit standards, central banking activities and the follow-up of fiscal policies under the new set of rules being established. Addressing these issues and ensuring that there are adequate arrangements for public audit are essential for restoring the confidence and trust of EU citizens following the crisis.

¹ See ISSAI 20 – Principles of Transparency and Accountability – Endorsed 2010, Page 4, paragraph 1

² See ISSAI 1 – The Lima Declaration – Endorsed 1977, Part I, Section 1, paragraph 1

³ See ISSAI 20 – Principles of Transparency and Accountability – Endorsed 2010, Page 3, paragraph 1

⁴ See ISSAI 20 – Principles of Transparency and Accountability – Endorsed 2010, Principles 7 and 8

⁵ See ISSAI 1 – The Lima Declaration – Endorsed 1977, Part VII, Section 18, paragraph 3.

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- ⁶ See, for example, Article 64 of the Regulation 1093/10 establishing the EB A
- ⁷ COM(2008) 800 final of 26.11.2008
- ⁸ COM(2010) 2020 final of 3.3.2010
- ⁹ Article 9a of the Regulation 333/2002 (amended by Regulations 1360/2008 and 431/2009)
- ¹⁰ Regulation 407/2010
- ¹¹ EFSF Framework Agreement of 7 June 2010, Execution Version
- ¹² EUCO 10/1/11 REV1 of 20 April 2011