

**Report to the Oireachtas Joint Committee on European
Affairs**

from

Advisory Group on role of the European Court of Auditors

October 2003

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SECTION ONE

EXECUTIVE SUMMARY OF RECOMMENDATIONS

The following is an executive summary of the recommendations of the Group in the areas of the management of the European Court of Auditors; the competencies of executives of the ECA; collaboration with NAOs, IAS and OLAF; staffing; and professional standards.

The recommendations fall into two categories:

- a) those requiring Treaty Change, which we recommend should be considered at the earliest possible opportunity by Intergovernmental Conference (indicated below as *)
- b) those that do not require Treaty change, which we recommend be progressed with immediate effect with an implementation target of twelve to eighteen months.

1 Management of the ECA

- 1.1 We recommend that the system of appointment of the executive of the European Court of Auditors be changed from a system of one Member from each Member State to a professional grouping of five Auditors General, supported by a supervisory body of twenty-five. *
- 1.2 The five Auditors General should be selected by international competition based on identified competencies (see below), using the most current methods of professional leadership selection. *
- 1.3 We recommend that the name of the Institution should reflect the reality that the European Court of Auditors is not a court in the way that many Member States' courts of auditors are, with judges holding judicial powers. We would suggest the name be changed to 'European Audit Office'. *
- 1.4 We recommend that, in order to maintain the communication lines with Member States, the EAO should host meetings with representatives of the Member States' European Affairs Committees each year, to inform on the work of the ECA, highlight developments, present the annual report and to answer any questions.

2 Competencies of Auditors General

2.1 We recommend that each Auditor General should have the competencies marked thus: ◇. The other competencies recommended below should be present among the five appointees.

- Professional auditing qualification and experience at world-class level, ideally with undergraduate qualification in a non-business field, such as engineering, philosophy, medicine etc.
- IT and Computer Audit qualification and experience (incorporating knowledge of the audit of computerised accounting information systems and the use of computer based audit tools)
- Statistics qualification and experience
- Risk analysis and risk management experience
- Legal training and experience
- Excellent communication skills (including cultural sensitivity, willingness to participate, ability to listen and a knowledge of corporate communication) ◇
- Fluency in at least English and French ◇

- Understanding of the political sensitivity of certain situations ◊
- Understanding of economics
- Understanding of public finances ◊
- Knowledge of the workings of the European institutions
- Excellent management skills (including change management, financial management, organisational skills and human resource management)
- Strategic and analytical thinking
- Problem solving
- Common sense ◊
- Independence ◊
- A good sense of ethical values ◊
- Willingness to participate in personal CPD and developmental review ◊
- Integrity and the capacity to command the respect of the staff and the international audit and public finance communities ◊
- Ability to motivate
- Self-efficacy ◊

2.2 A comprehensive programme of CPD should be implemented to ensure regular updating of the skills and competencies of the Auditors General.

3 Collaboration with National Audit Offices, Internal Audit Service and European Anti-fraud Office

It is not desirable that the work of managing the economies of the Member States be impeded by an unnecessary burden of duplicated auditing. Therefore, we recommend a managed movement towards better collaboration between the ECA, the NAOs and the IAS. This would involve:

- 3.1 a commitment to internationalisation of the standards, principles and guidelines in auditing and accounting across the Member States.
- 3.2 A systematic approach by the ECA to quality assessment of the NAOs and IAS to allow it to assess the extent to which it can rely on the work of each NAO and the IAS.
- 3.3 The establishment of partnership/joint auditing in areas where there is common interest, a common reporting deadline and common standards.
- 3.4 An exploration of the possibility of commercial sub-contracting of the work of the ECA to NAOs. It would also be possible to envisage a situation where a NAO or the IAS might outsource some of its audit work to the ECA.
- 3.5 The establishment of a more active grouping of NAOs, IAS and ECA at a policy level to drive forward changes in procedures, practices and standards leading to the achievement of internationalisation of public audit and accounting standards. The group should establish connections with international standard setters, Universities and research institutions interested in audit and accounting development.
- 3.6 A review should be conducted to ensure that the links between the ECA and OLAF are such as to ensure compliance with the current thinking on forensic auditing.

4 Staffing arising from enlargement

In the preparation for enlargement, we recommend:

- 4.1 A review of the competencies and qualifications, including IT and Computer Audit qualifications, required for the professional staff.
- 4.2 Through use of away-days and similar opportunities for extended and participative discussion, the formulation of clear institution-wide roles and responsibilities for the top and middle levels of management
- 4.3 The introduction of a Change Management Programme to manage the organisational changes including the implementation of agreed changes.
- 4.4 A programme of management training and continuing professional development to be extended to all the top management, including the Members/Auditors General.

5 Professional standards on enlargement

We recommend:

- 5.1 That the work commenced on quality assurance be extended to include regular peer review of the audit policies, planning, execution and reporting of the ECA by an external independent body. This might, for example, be by the national audit offices of Australia or the United States of America or Canada; or one of the Big Four international audit firms.
- 5.2 That robust methodologies be put in place for both assurance audit and value for money audit in advance of the expansion of the EU. The issue of putting in place reliable accounting systems with sound internal controls is an urgent one for the Commission and it is one of the tasks of the ECA to ensure that the Commission is driven down the road of putting such systems in place as a matter of urgency. This is a major task for the ECA and one to which they should devote resources.
- 5.3 Clarification of the parameters of value for money audit. It is not the function of value for money audit to express an opinion on the parliamentary policies for expending resources on a particular programme. It is, on the other hand, its function firstly, to determine what were the criteria of success set for the programmes of expenditure and secondly, to express an opinion on whether the expenditure was efficient, economic and effective in the context of the criteria set.
- 5.4 In the light of the considerable work necessary to apply a model of risk assessment and internal control evaluation, a more classical model of assigning the value for money audit work to the internal auditor should be adopted. It is recommended that the IAS should take over the value for money auditing from the EAO. The EAO could then concentrate its resources on the assurance work. *
- 5.5 A review of the reports emanating from the ECA for clarity and the use of internationally recognised terminology indicating the level of qualification of opinion.
- 5.6 The publication of guidelines to direct whistleblowers who have decided to communicate information confidentially to the ECA.
- 5.7 An acceleration of the steps being taken to enhance the professional training and staff developmental review areas, particularly to ensure technical training for the new staff members who will probably come from the new Member States.

SECTION TWO

BACKGROUND

INTRODUCTION

In the context of Ireland's presidency of the EU commencing on January 1 2004, the Joint Committee on European Affairs has established an Advisory Group (the Group) to examine the role of the European Court of Auditors (ECA), particularly in the light of the admission to the Union of the ten new Member States, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia. The Group presents herewith its report to the Committee.

TERMS OF REFERENCE

The terms of reference for the Group are as follows:

"To consider the role of the European Court of Auditors, in particular, its capacity to fulfil its functions and to efficiently and effectively discharge its responsibilities, taking into account the needs of a Union of up to 25, or even more Member States and to report its findings to the Joint Committee on European Affairs".

MEMBERSHIP

The Membership of the Group is as follows:

Professor Patricia Barker, DCU (Chair)

Mr. Brian Coffey, AccBank

Ms. Mairead Divilly, Partner, Mazars, Chapman Flood

Ms. Mary Fulton, Partner, Deloitte & Touche

Mr. Moore McDowell, UCD

Mr. Brian Murphy, Irish Pharmaceutical Healthcare Association

SCOPE AND LIMITATIONS

There were no financial or HR resources available to the Group to conduct this examination. Its brief was to conduct a desktop review. However, the Group concluded that it would not be possible to reach any balanced conclusion in the absence of discussions with interested persons in Ireland and with Members of the ECA. Additionally, the Group felt that it would be imperative to visit the ECA to meet with some of the staff and officers. Therefore, meetings were arranged in Ireland, by members, at their own expense and a three-day visit was arranged to Luxembourg and funded by the private resources of the Group. The lack of resources and limited time available to the Group mean that the scope of the review has been restricted to an overview of the structure of the ECA and the fundamental working principles in the context of the enlarging membership and the concomitant different cultural, technical and professional traditions in auditing. The experience and perceptions of past Members, current Members, senior staff and other stakeholders has informed the recommendations of the Group. This report is presented to the Oireachtas Joint Committee on European Affairs. It is our understanding that the matters raised in this report will be referred to Conférence des Organes Spécialisés dans les Affaires

Communautaires (COSAC) by the Oireachtas Committee during the period of Ireland's Presidency of the European Union commencing on January 1, 2004.

CONSULTATION

The Group met on several occasions. Members of the Group met with a number of interested parties to ascertain views and to inform the Group's deliberations. We would like to put on record our thanks for the time given by these parties and for their openness and helpfulness. A full list of those to whom this thanks is due is included at Appendix One. The Group would also like to record its appreciation to Ms. Clare Balfe, DCU Business School, for her administrative assistance.

SECTION THREE

OVERVIEW OF ECA AT PRESENT

APPOINTMENT

The ECA is mandated by the Treaty establishing the European Community (last amended by the Treaty of Nice) (The Treaty) (Art. 246) to "carry out the audit". The ECA was established by the Treaty of Brussels in 1975. It became operational in 1977 and was promoted to 'Institution' in 1993 with the Maastricht Treaty. The name 'Court of Auditors' was taken from the continental European system of a court with judges overseeing the audits, having the power to make judicial rulings. The ECA consists of one national from each Member State (Art. 247). A Member of the Court of Auditors (a Member) is appointed by the Council, having consulted the European Parliament, based on proposals made by each Member State; for a period of six years (renewable). The qualifications required are that the Member should belong, or have belonged, to external audit bodies or be especially qualified for the office. It was originally envisaged that the Members should be nominated by Member States from their National Audit Office (NAO) – known in some member states as a 'court of auditors' and, in the case of Ireland, the office of the Comptroller and Auditor General.

The interpretation of 'especially qualified for the office' appears to be broad. It was suggested to us by one Member that 'especially qualified' means that every honourable citizen is qualified for consideration. Custom and practice has developed which makes it possible to predict the most likely profile of a Member. For example, the British Member is likely be appointed from HM Treasury; the Irish Member a politician experienced in budgetary matters; the Danish Member and, generally, the French Member from their respective NAOs, and so on. Details of the profile of the current Membership of the ECA is set out as Appendix Two.

Members are required to be independent (Art. 247.4) and may not take any instruction from their government or any other body. They may not engage in any other occupation (gainful or otherwise) during their term of office. (Art. 247.5)

Members are remunerated for the post on the same scale as a judge of the European Court of Justice, similar to that paid to a Commissioner. Benefits to which they are entitled include:

- The right to make grace and favour appointments of a Chef de Cabinet and a deputy Chef de Cabinet, two secretaries and a chauffeur (subject to approval by the Secretary General or College).
- A car
- The provisions of the Protocol on the Privileges and Immunities of the EC applicable to the Judges of the Court of Justice also apply to Members
- A travel allowance
- A three-year 'transition payment' after the final year of office to compensate for not becoming involved in organisations previously audited.

RANKING OF MEMBERS WITHIN THE ECA

The Rules of Procedure of the Court of Auditors (2002) stipulate that the Members themselves elect the President (regarded as *primus inter pares*) from among their number for a period of three years (renewable) (Art. 9). The ranking order, after the President, is based on date of appointment and, where Members have been appointed on the same day, based on age (Art. 7). Therefore, under the current structure, the ten new Member States will nominate Members who

will rank lower than the existing Members, and *inter sui*, if they are appointed on the same day, according to their relative ages.

WORK ALLOCATION

The ECA is divided into the President's Department and Audit Groups (Art. 12, Rules of Procedure). There are fourteen sectors, twelve audit and two horizontal (Audit Development and Reports – ADAR and Statement of Assurance – SOA). Each sector is headed by a Member and the sectors are currently grouped into four audit groups, headed by the most senior Member (doyen/doyenne). Members are allocated to a particular audit group based on negotiation with the President.

STAFFING OF THE ECA

The total staff complement is currently just over 600, of whom approximately 500 are on permanent contracts and 100 on temporary contracts. Just less than 50% of the staff Members are employed as auditors. The remainder are employed as translators and administrators. The number of staff holding professional audit qualifications was estimated by the ECA as between 15% and 34%. Although figures were not supplied, it was acknowledged by the Members that there is a serious gender imbalance with men predominating in the audit area (for example, no Heads of Division are women) and women predominating in the translation service. Although there is an attempt to ensure that staff are recruited in such a way as to provide a mix of nationalities from the Member States, the first two priorities in recruitment are technical competence and compliance with the fairly rigid recruitment and promotion rules of the EU.

Resources have recently been allocated to the training brief of the ADAR sector to enhance training and continuing professional development for staff. Modern human resource strategies of assisted development review have not, heretofore, been applied. However, a move in this direction is on the agenda of the Secretariat General.

FUNCTION OF THE ECA

Art. 248 mandates the ECA to 'carry out the audit'. It has the right to organise its own audits independently and to extend the audits into the field of 'sound financial management' (which is not the case for all the NAOs within the EU). Sound financial management audit is also known as value for money audit. There is also provision for the ECA to submit observations, particularly in the form of special reports, on specific questions and deliver opinions at the request of one of the other institutions of the community. (248.4). Additionally, the ECA is required to assist the European Parliament and the Council in exercising their powers of control over the implementation of the budget.

PRINCIPLES AND PROCEDURES APPLIED

Art. 248.1 of the Treaty sets the principles to be applied in the audit function of the ECA as an examination of all accounts of revenues and expenditure of the Community and of all bodies set up by the Community. The purpose of the audit is to provide an assurance as to:

- Reliability
- Regularity
- Legality

of the underlying transactions.

Art. 248.1 defines an audit as the examination of the accounts of all revenue and expenditure of the Community. Art. 248.2 specifies that the audit shall consist of an examination of whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound. In particular, there is a requirement to report on any cases of irregularity. There is an assumption that the audit of expenditure (but not income) will be based on commitments undertaken and payments made.

Art. 248.2 also requires the ECA to 'examine whether the financial management has been sound. In doing so, .. report in particular on any cases of irregularity'

The responsibility for the detection and investigation of fraud, however, is in the hands of the European Anti-Fraud Office (OLAF).

Although the above mandate appears to emphasise a compliance focus of audit, the ECA document on Court Audit Policies and Standards requires its staff (10/02) to conduct an audit in accordance with the International Organisation of Supreme Audit Institutions (INTOSAI) Auditing Standards and the International Federation of Accountants (IFAC) International Standards on Auditing insofar as applicable in the Community context. European Implementing guidelines for the INTOSAI Auditing Standards have been drawn up by an ad hoc group set up by the Contact Committee of Presidents of the EU (Supreme Audit Institutions (SAIs), chaired by the ECA. The introduction to the guidelines refers to the desire to provide a common methodological thread to run through the 'rich diversity of public audit traditions in the EU Member States'.

A detailed audit manual is in use. However, the section on sound financial management (or value for money auditing) is very thin.

At the time of writing, INTOSAI and IFAC's International Auditing and Assurance Standards Board (IAASB) are discussing the drafting of a Memorandum of Understanding on Guidelines for Financial Audit, which would incorporate public sector auditing into the body of the ISAs. The ECA is not a Member of INTOSAI and is not a member of the Public Sector Committee of IFAC. There are some Members with an interest in pursuing the participation of ECA in setting the international audit agenda.

As referred to above, there are different national traditions in public audit in the EU Member States. Therefore, although there is an audit manual which should standardise practice, auditors and the environments in which they audit have different traditions ranging from the risk and control assessment model; to a court model where Members are judges and have judicial powers; to what has been described as a 'search, find and punish' model.

REPORTING BY THE ECA

Having concluded its annual reviews and Special Reports, each group currently reports to the Court for discussion. The reports are then approved and a *procédure contradictoire* takes place with the auditees having the right to respond to points made in the Special Reports and the *Déclaration d'Assurance* (DAS). The Annual Report takes a considerable time to write, review, and process through the response procedure. The most current report available is that for the financial year ended December 2001, which was published on 28 November 2002.

STATEMENT OF ASSURANCE (DAS)

Although international auditing practice has guidelines for the tiering of audit and related services as:

- Audit

- Review
- Findings of agreed-upon procedures
- Compilation

It would appear that there is no such choice in the scope of work available to the ECA.

Additionally, international auditing practice provides readily recognisable forms of wording for 'true and fair' audit opinions, which include, for example:

- Disagreement – adverse opinion
- Uncertainty – disclaimer of opinion
- Disagreement – except for
- Uncertainty – subject to
- Uncertainty – subject to (scope limitation)
- Emphasis of matter
- Unqualified

The DAS refers to the audit carried out in accordance with the Court's own audit policies and standards and provides an opinion as to the reliability of the accounts and the legality and regularity of the underlying transactions. The reader is left unsure as to how any opinion (albeit qualified) that the accounts 'reflect faithfully the Communities' revenue and expenditure for the year and financial position at the year-end' could have been formed given the doubts expressed about the underlying accounting system and the accounting errors identified.

The most recently published DAS opinion refers to what would generally be regarded as serious qualifications of opinion as 'observations' and 'the remark':

"Except for the effects of the observations summarised in indents (a) to (d) below and the remark made in paragraph IV, the Court is of the opinion that the accounts of the financial year closed on 31 December 2001, as published in the Official Journal, faithfully reflect the Communities' revenue and expenditure for the year end and their financial position at the year end:

- (a) overstatement by 148.7 million euro of provisions paid to the Member States in respect of agricultural intervention stocks;*
- (b) entry without adequate justification under 'Sundry debtors' (sic.) of 980 million euro relating to cash transfers in third countries;*
- (c) provision of 564 million euro set up on doubtful bases in respect of the cost of dismantling the Joint Research Centre's nuclear installations;*
- (d) overstatement of commitments still outstanding by about 1,318 million euro*

Paragraph IV

The Court emphasises that most of its reservations and observations are matters that regularly recur. These weaknesses stem to a large extent from the Community accounting system which was not designed to provide an assurance that the various components of the Communities' assets have all been recorded. The Court considers that urgent in-depth action in the Commission's departments to cope with the risks arising from the short-comings in the accounting system is required.

PEER REVIEW AND QUALITY ASSURANCE

Best current international auditing practice incorporates a system of quality assurance of the work of the auditor. This includes systems for assessing the procedures and policies adopted by the audit teams and an ex-post review of the work done. It is usual to have a system of internal check and external peer review. The ECA has recently introduced a system of internal check, but to date, has implemented no system of peer review, although special reports are sent to outside

evaluators (mainly universities) for analysis and comments on the overall quality. A system of internal peer review was introduced some years ago, with Members conducting reviews of other group's work. However, it was not successful, as Members were reluctant to criticise each other and felt the system was "cumbersome and did not add value to the discussions that already took place in the Audit Groups and in the Court".

SECTION FOUR

ISSUES AND RECOMMENDATIONS

1. ENLARGEMENT OF MEMBERSHIP OF ECA BY TEN NEW MEMBERS

Implications of 25 Members of the ECA

Under the current Treaty provisions, ten new Member States will automatically give rise to ten new Members of the ECA, with five new members of staff for each Member and concomitant establishment requirements for additional offices, motor vehicles, equipment etc., i.e. a total of 54 new staff members associated with the new Membership. There will also be a requirement for 63 additional audit staff, 56 translation staff and 11 administrative staff arising from the enlargement – a total of 184 new full time employees. Current estimates for the annual direct payroll costs of the ten new Members and their entourage of five staff each, are in the order of €8m. The annual direct payroll costs of additional technical staff to cater for the additional audit work involved in the new Member States will be approximately €12m.

It is clear that enlargement will necessitate additional audit and translation staff. However, in all our discussions, we found little support for the expansion of the Membership of the court.

The arguments in favour of continuing with a system of one Member from each Member State could be summarised as:

- It will be better to allow the new Member States to participate in the current structure for a time. When they have had experience they can be party to any streamlining.
- In the current environment of tension between small Member States and large Member States, any change in the structure of the ECA could be seen as a dangerous precedent leading to demand for change in other Institutions.
- Given the different traditions of auditing around the Union, it is good to have representation of all traditions at the decision making level.
- The reports of the ECA are widely accepted throughout the Union because they are agreed by a body that has a voice from every Member State.
- Each Member State currently has its own 'eye' examining the expenditure of the Union.

Apart from the additional annual direct cost of €8m and unquantified indirect costs, the increase in Membership will have the following potential difficulties:

- Difficulty in finding work for ten very highly remunerated officers and their forty-four support staff
- A disimprovement in the already top-heavy structure
- Slowing down of decision making by virtue of having 25 people around the table
- Lengthy debate, with Members bringing their local experience to the discussion
- Decisions taken based on the desire to achieve consensus resulting in the lowest common denominator rather than the highest international standards
- Resources being spent on paying for additional Members that might otherwise be expended on recruiting world class audit staff
- Dilution of the reports in order to achieve consensus as to wording

The system of one member per Member State was established when there was a small number of Member States. The intention then was to establish a broad oversight board. Now the whole international environment of audit has become highly technical and requires a very specific range of qualification, skills and experience. It is clear why one would wish for representation from each Member State in the Parliament and possibly even the Court of Justice where democratic representation of different constituencies is critical. However, the ECA should have executives who are skilled and competent in the technical business of applying world class auditing procedures to the finances of the Union, regardless of their nationality. Competence is the key and not local representation.

One of the qualifications for Member is complete independence from the nominating government. However, it is not inconceivable that a Member would feel under pressure to influence a critical report concerning his/her own government, especially when his/her appointment and re-appointment is in the gift of that government. It is not enough for Members to be independent. They must also be seen to be independent.

If it is necessary to have in-house expertise in the accounting and auditing practices in Member States, this expertise can easily be obtained at the level of auditors. It is not necessary to have it at the level of Member.

This time of enlargement is a good opportunity to take a critical look at the Institutions. In the case of the ECA, it is timely to consider the objectives of the ECA and the most effective and efficient way to achieve those objectives.

Preparation for the prospect of 10 new Members

The ECA is currently engaged in a process of preparation for the new Members. Members formally commenced reflection and deliberation in 2000 and a proposal for structuring the Court was agreed towards the end of September 2003. Consultation was undertaken with a number of external bodies, but little formal consultation took place with the staff.

The proposal is for the current audit groups to absorb the new Members, giving rise to groups with approximately six Members. The work of the groups would be divided into tasks for which the Members would be responsible and the Members would manage the distribution of work within the group, acting as a form of chamber, under the leadership of one of their number, who would act as the managing Member or Dean. Staff within the groups could move flexibly to different tasks rather than with different Members. It is proposed that the chambers would approve certain reports themselves subject to taking them to the court in plenary for rubber-stamping only. This would be seen as a transitional arrangement with the ultimate intention of giving authorisation to each chamber to issue certain forms of report on its own authority. Major reports (so far, undefined) would, as at present, be debated and issued by the Members in plenary session. Under this proposal, therefore, two levels of report would emerge: those which are regarded as capable of being approved by a small number of Members and those requiring the full imprimatur of all the Members.

However, the Members recognise, as mentioned previously, that this is a pragmatic proposal to deal with the enlargement of Membership, and not an ideal solution.

Possible models

We assume that it is the objective of the Member States to have, in the ECA, a world class external audit function which would provide a high level of independent assurance to citizens as to the internal control systems in place to ensure that their taxation revenues are being applied in

accordance with their wishes in the most effective manner possible. It is clear to us that the current structure of appointing leadership to the ECA, based on national nomination of persons using fairly general qualification criteria, is not sustainable. We recognise that a treaty change would be required to reconfigure the ECA structure. We strongly recommend such a change.

The Group considered a number of options for structuring the ECA. The following were the main models discussed:

1. Do nothing and allow all Member States to nominate one Member each.

In this model, the Court would continue to consist of one national from each Member State, retaining the current collegiate system.

2. Retain one Member per State, with devolved decision-making

This is the model which is being currently discussed by the ECA. The Treaty of Nice stipulated (Art 248) that "the Court of Auditors may establish internal chambers in order to adopt certain categories of reports or opinions under the conditions laid down by its Rules of Procedures" Although the ECA's proposals to implement this provision are not yet published, it would be possible to envisage dividing the work of the ECA into four audit groups and two horizontal groups with perhaps 4/5/6 Members allocated to each. It is possible to envisage a situation whereby each group would elect a 'dean' or leader, with the group of leaders forming the ultimate decision making body.

3. Retain one Member per State, with two-tiers of decision making

This model, similar to that proposed by V. Giscard d'Estaing for the Commission, would involve streamlining an executive and dividing the 25 Members into voting and non-voting Members to ensure that each Member State has a voice (if not a vote).

4. Establish a post of Auditor General with a supervisory board.

A person would be appointed, under this model, based on his/her technical and managerial competence and experience. S/he would be internationally recognised and would command respect from the audit and finance community of all the Member States. The supervisory board would be a part time board of some twenty-five persons appointed by the Parliament but working with the Auditor General.

5. Establish a European Audit Office with five Members on a list system

Under this model, Members would be recommended to the Parliament from their Member States on the basis of a randomly ordered list of the Member States. The first five states on the list would provide Members for a term of office of five years. Each year one Member would retire and one would be appointed from the next Member State on the list.

6. Establish a European Audit Office with five Auditors General and a supervisory board

Five persons would be appointed based on technical and managerial competence and experience. As with the Auditor General in model 4, they would be internationally known commanding respect and acceptance. They would appoint one of their number as Managing Auditor. They would serve for a period of six years, renewable for a further three years. The supervisory board would be as model 4.

The Group considered these models in detail. In relation to the structure of the Institution, although **Model One** is familiar, we regarded it as too cumbersome. We would recommend strongly against this model. However, if nothing is done and this arrangement proceeds, the very least that should be done is to make provision in the Accession Treaty for 50% of the new Members to be appointed for a period until March 2006 with the remaining 50% having an initial period of appointment until November 2007. This would allow for integration with the existing terms of office and would ensure that not all new Members complete their term of office at the same time.

Model Two above provides a pragmatic solution to the political situation as it currently exists (i.e. the current Treaty of Nice requirement to have one Member for each Member State). But it fails to grapple with the fundamental problem of having an unbalanced, clumsy, unnecessarily expensive and un-businesslike top-level management structure. There would still be too many skippers and not enough sail trimmers. Additionally, it is not clear which reports could be approved by the chambers and which by the college. There is a possibility of legal challenge to a decision if it were incorrectly defined for approval.

Model Three is unlikely to be acceptable to the Member States required to wear the mantle of non-voting Membership. It was indicated to us that it is likely that, should any of the larger Member States be required to fill the non-voting seats, were this model to be adopted, they would withdraw from the ECA altogether. In any event, this model still leaves all the problems of a top-heavy management.

Model Four above is most familiar to us in Ireland. It would also be most familiar to our neighbours in the United Kingdom and would probably be acceptable to some of the other Member States. However, it is our opinion that it is too drastic a move towards the ultimate goal of a world-class technical audit institution to take at this juncture. It is our opinion that it would be too difficult, politically, to move from one-Member-one-state system to a single Auditor General system in one step. Additionally, it would be hard to find such a high level person with all the required competencies captured in one man or woman.

We believe that there would be problems of ensuring an appropriate mix of persons under **Model Five**, since the appointments would be made independently of each other and could be influenced by political rather than technical criteria. Additionally, there would be gaps of up to 25 years before the member states take their initial places and thereafter, a further gap of 25 years (assuming no further enlargement) with no representation.

RECOMMENDATIONS

- 1.1 We recommend a change to the appointment mechanism of the executive of the European Court of Auditors along the lines suggested in **Model Six**. The five Auditors General should be selected by international competition based on identified competencies (see below), using the most current methods of professional leadership selection. The Auditors General should be sought and selected by an independent group of professional 'head-hunters'. They should appoint, from amongst their number, a senior Auditor General who would act as manager of the team of five. We suggest five Auditors General, although it is possible to conceive of a management team of three or seven. The appointment of the leadership of the ECA would, thereby, be based on objective technical criteria rather than on geographic representation.
- 1.2 We suggest that there should be twenty five (or one seat for each Member State) members of the supervisory board, appointed by virtue of their experience and expertise in areas such

as international public accounting standards, international public auditing standards, public finance, government service, law, economics, political science, corporate governance and general management. The key to selection should be competence. Members of the supervisory board would be appointed by their national parliaments. It is envisaged that they would meet quarterly. These positions would be non-executive and members would receive a small stipend and their expenses. They would act in a supervisory role, would establish a professional selection team to search for and select the five Auditors General, would receive the annual reports of the European Audit Office and would be ultimately responsible for allocating resources. They would require a small secretariat to service their business.

- 1.3 Since the auditors report to the Parliament, the professional selection team would make a recommendation to the supervisory board, which would, in turn, recommend to the Parliament the initial team of five, which would, as at present, be adopted as a group, by the Parliament. Further vacancies would be filled in the same way, cognisant of maintaining the mix of competencies.
- 1.4 We recommend that the name of the Institution should reflect the reality that the ECA is not a court in the way that many Member States' courts of auditors are, with judges holding judicial powers. We would suggest the name 'European Audit Office'.
- 1.5 The recommendations 1 – 4 above would require Treaty change via Intergovernmental Conference. As a recommendation that should be implemented with immediate effect, we suggest that, in order to maintain the communication lines with Member States, we recommend that the EAO should host meetings with representatives of their own parliaments' European Affairs Committees each year, to demonstrate the work of the ECA, highlighting developments, present the annual report and to answer any questions. This recommendation could be implemented with immediate effect.

2. COMPETENCIES OF AUDITORS GENERAL

Present situation

The Treaty requires that "Members of the Court of Auditors shall be chosen from among persons who belong or have belonged in their respective countries to external audit bodies or who are especially qualified for this office".

At present, Members are nominated by the government in their own Member State. This militates against assessing the competencies of the leadership team of the ECA as a package. There is, for example, only one professionally qualified accountant. In general, the experience since 1977 has been of a "mixed bag", with some highly energetic and very productive and effective Members and some who are perceived as less effective.

Some outside commentators have expressed the view that only men and women with professional audit qualifications should be appointed to the ECA. However, the experience of those working in the ECA would not confirm such a clear selection criterion. Some of the 'political appointees' have proved to be visionary, extremely hard working and excellent leaders of change. On the other hand, some of the professionally qualified accountants have proved quiet and not necessarily at the cutting edge of professional developments. Indeed, it was suggested to us that it would be better to have no auditors than all auditors. It was clear to us that qualification and experience in audit by itself is not enough to provide the range of skills needed to manage a modern audit facility. There is a package of competencies, skills, qualifications and experience that can be identified to provide optimal management. One of the

advantages of having five Auditors General is that these competencies need not all be located in one individual, but should be present in the five as a team.

Although there is, at present, a structure for Continuing Professional Development for the staff of the ECA, there has been no history of a programme of CPD for the Members. There is a small budget for training Members, but it has generally been the case that Members are not interested in the formal development of their own audit or business competencies. Additionally, they have been reluctant to join training courses with other members of staff. We believe that it is imperative that all the staff of a modern audit office, right up to the top, should subject themselves to regular formal updating of their skills in this rapidly changing environment.

RECOMMENDATIONS

2.1 We recommend the appointment of an executive team with a mix of high level professional, technical and management competencies. We recommend that each Auditor General should have the competencies marked thus: ◇. The other competencies recommended below should be present among the five appointees, but not necessarily in each one.

2.1 Competencies which should be present across the five Auditors General of the EAO should be stipulated and should include:

- Professional auditing qualification and experience at world-class level, ideally with undergraduate qualification in a non-business field, such as engineering, philosophy, medicine etc.
- IT and Computer Audit qualification and experience (incorporating knowledge of the audit of computerised accounting information systems and the use of computer based audit tools)
- Statistics qualification and experience
- Risk analysis and risk management experience
- Legal training and experience
- Excellent communication skills (including cultural sensitivity, willingness to participate, ability to listen and a knowledge of corporate communication) ◇
- Fluency in at least English and French ◇
- Understanding of the political sensitivity of certain situations ◇
- Understanding of economics
- Understanding of public finances ◇
- Knowledge of the workings of the European institutions
- Excellent management skills (including change management, financial management, organisational skills and human resource management)
- Strategic and analytical thinking
- Problem solving
- Common sense ◇
- Independence ◇
- A good sense of ethical values ◇
- Willingness to participate in personal CPD and developmental review ◇
- Integrity and the capacity to command the respect of the staff and of the international audit and public finance communities ◇
- Ability to motivate
- Self-efficacy ◇

2.2 A comprehensive programme of CPD for the Auditors General (including management and personal development) should be implemented.

Neither of these recommendations requires Treaty change and could be implemented regardless of the management structure.

3. NATIONAL AUDIT OFFICES AND INTERNAL AUDIT SERVICE

Present situation

The role of the NAOs has some overlap with the role of the ECA. The relationship between the NAO and the ECA has some of the characteristics of the relationship between external auditor and internal auditor. However, it is a complex relationship. Some of the reasons for the complexity are:

- Only approximately 5 - 10% of the Member States' finance comes from the EU and, therefore, the audit of the EU funds is not as significant to NAOs as it is to the ECA.
- Public accounting systems vary across the EU. For example, accruals based accounting is not universally used and, in some member states, ex ante control of spending is the practice.
- The audit cultures in the NAOs across the EU are significantly different. In some, the culture is moving towards a corporate governance model with identification of the key business risks and of the controls put in place to mitigate the risks. In others, the culture is still one of random or detailed checking of transactions. In some, there is experience of value for money audit and in others it is strictly compliance auditing. Some Member States' NAOs have some of the characteristics of policemen, seeking out, exposing and punishing error and fraud. Others have created an environment of partnership with the auditees to improve systems based on the risk assessment in a proactive way.
- The auditing standards and guidelines used are not universally at the highest international standards.
- In some NAOs, the audit report is published within six months of the financial year-end. In others the audit reports can be up to seven years after the year-end.
- There is considerable sensitivity between the ECA and the NAOs as to respective authority. The ECA is required to improve cooperation, but the NAO is not; and has rights to be present during the audit of the ECA in their Member State. It is felt at the ECA that some NAOs view them as 'big brother' and cooperation is sometimes difficult.
- Some Member States have Courts of Auditors with judicial powers and judges making judgements. Others have professional public sector auditors reporting to parliament.
- There is a perception of unwillingness among some NAOs to engage in debate with other EU NAOs to develop common standards of auditing.

In summary, the relationship between the ECA and the NAOs can be difficult. There is a commitment to enhance the relationship, however. The Treaty of Nice introduced a declaration inviting the ECA and the NAOs to improve the framework and conditions for cooperation between them, while maintaining the autonomy of each. There exists a Contact Committee of Presidents of Supreme Audit Institutions. This Contact Committee carries out initiatives in the field of audit standards, methodology and joint audits.

Another player in the shared field of auditing the European Union finances, is the fairly recently established Internal Audit Service of the Commission (IAS). The ECA has established a working relationship with the Audit Progress Committee of the Commission. The internal/external auditor relationship is clearer between the ECA and the IAS than in the case of the relationship with the NAOs. The working relationship established has incorporated work on information sharing, joint training etc. There is considerable potential for collaboration and the application of the best

international principles and practices of external auditor reliance on the work of the internal auditor.

It is not desirable that the work of managing the economies of the Member States be impeded by an unnecessary burden of duplicated auditing. As an example, in Ireland, the Department of Agriculture and Food had approximately 2,800 audit days in 2002, made up as follows:

Audit Body	Number of days
NAO - Comptroller and Auditor General	332
Deloitte & Touche (Certifying Body)	373
European Court of Auditors	76
IAS – EU Commission	33
Internal Audit Unit	1,986
Total	2,800

This does not take into account the work of the Department’s own Audit Committee, and the De Santo Veterinary Inspection. OLAF did not audit the Department in 2002. In some cases, the various auditors were conducting audit work on the same expenditure programmes.

We recognise that it would not be desirable to force the NAOs to audit the funds of the Community. However it is desirable to work towards a very high standard of auditing and accounting right across the EU, for both EU and local Member State expenditure. There is the potential for an elevation and convergence of standards of public accounting and audit. This should be underpinned by a genuine commitment, as members of the same community, to contribute to a movement to have all boats rise together. It is highly desirable that, in this technical area, there should be an abandonment of diverse, local and outdated practices and a movement towards high quality, uniform, international standards of audit and accounting. Therefore we recommend a managed movement towards better collaboration between the ECA, the NAOs and the IAS. This would involve:

RECOMMENDATIONS

- 3.1 A commitment to internationalisation of the standards, principles and guidelines of the Member States. This would probably need parliamentary agreement in principle, and implementation that could be facilitated by active participation of the ECA, IASB in INTOSAI and IAASB. There is already a movement for internationalisation of auditing and accounting, which would facilitate this objective.
- 3.2 A systematic approach by the ECA to quality assessment of the NAOs and IAS to allow it to assess the extent to which it can rely on the work of each NAO and the IAS. There is some assessment done at present of the work of the NAOs for this purpose, but it is done on a task-by-task basis and not on an institutional basis.
- 3.3 The establishment of partnership/joint auditing in areas where there is common interest, a common reporting deadline and common standards. This would not preclude reporting to different users on the same expenditure, by the partners.
- 3.4 An exploration of the possibility of commercial sub-contracting of the work of the ECA to NAOs in circumstances where the NAO is prepared to submit itself to an examination of its procedures and practices and to adhere to the policies and procedures of the ECA. It would also be possible to envisage a situation where a NAO or the IAS might outsource some of its audit work to the ECA. This assumes the application of internationally accepted

high quality audit standards by the ECA. This would not be an invasion of the 'patch' of the sub-contractor, but simply an efficient and effective way of utilising expertise across the EU.

- 3.5 The establishment of a more active grouping of NAOs, IAS and ECA at a policy level to drive forward changes in procedures, practices and standards leading to the achievement of internationalisation of public audit and accounting standards. This grouping should not just be an occasional talking shop, but a high level strategic and policy group. The group should establish connections with international standard setters and Universities and research institutions interested in audit and accounting development.
- 3.6 A review should be conducted to ensure that the links between the ECA and OLAF are such as to ensure compliance with the current thinking on forensic auditing.

None of the above recommendations requires Treaty change.

4. STAFFING ARISING FROM THE ENLARGEMENT

Present situation

Additional staff will clearly be required to cope with the increased workload arising from the enlargement. As mentioned previously, there is no need to increase the complement of staffing at the level of Member (indeed, it is recommended to reduce it). It has become more difficult to recruit and hold high calibre auditing staff. This arises for a number of reasons:

- More attractive and flexible salary packages available in the private sector.
- The location of the IAS in Brussels is perceived as more attractive, especially to young, single auditors, and some staff are moving there.
- Very rigid requirements for recruitment and reward imposed by the EU Staff Regulations.
- It was suggested to us that excluding staff without a degree but with a professional qualification was inappropriate. (We felt, however, that most professional auditors are graduate entrants, so this may not, in future, be such a problem). However, it is possible for somebody to apply for the post of auditor with, for example a degree in political science and, due to the inordinate delay before the call to interview, to be able to 'mug up' enough on the technical material to pass the assessment procedures.
- Lack of modern staff development HR strategies (although this issue is currently being addressed by the Secretary General).
- Very heavy work loads with little time to address over-view policy issues.
- Difficulty in establishing *esprit de corps* due to widespread locations and lack of communication across the groups (this issue is also being addressed by the Secretary General, who has plans for establishment modifications.)
- Lack of clarity about the respective roles and responsibilities and inter-relationships between the Members, Heads of Cabinet, Heads of Division and Attachés.

- Absence of a modern change management programme. The Members have been engaged in a consultation process for almost three years concerning strategic planning for the changes that will be necessary to deal with enlargement and the changing audit environment. When asked how the staff had been involved in this process, responses ranged across a spectrum of benevolent dictatorship with very strong adherence to principles of top-down management; to a lack of understanding of current practices and thinking about change management; to a view that staff would be protected from the change and would, therefore not be interested, to an admission that management practices in this area were out-dated; to a position that staff would be informed once the structures had been agreed and then they would be consulted on the implementation.

There was some initial fear that taking staff from the new entrant states and trying to audit in those states might present a considerable challenge to the ECA. However, following extensive pre-entry assessment and collaboration with the NAOs in the new member states, that fear has been somewhat alleviated. Although many of them were operating formerly under socialist financial systems, all have expressed a willingness to advance and develop their financial and control systems to bring them to EU standards. Indeed, the opinion was expressed to us that the NAOs in some of the older established member states will present more difficulty than the newly accepted members, many of whom are currently working closely with the ECA to enhance their own standards to bring them to a high international quality.

RECOMMENDATIONS

In the preparation for enlargement, we recommend:

- 4.1 A review of the competencies and qualifications, including IT and Computer Audit qualifications, required for the professional staff of the EAO
- 4.2 Through use of away-days and similar opportunities for extended and participative discussion, the formulation of clear institution-wide roles and responsibilities for the top level of management
- 4.3 The introduction of a Change Management Programme to devise and manage the changes necessary across the entire organisation and to drive the implementation of agreed changes. Priority must be given to ensuring that the staff are genuine participators in the change and continue to be highly motivated
- 4.4 A programme of management training and continuing professional development to be extended to all the top management, including the Members/Auditors General (referred to previously)

None of the above recommendations requires Treaty change.

5. PROFESSIONAL AUDITING STANDARDS ON ENLARGEMENT

Present situation

Our group did not conduct any review of the auditing standards applied by the ECA and we are not, therefore, competent to pass any judgement on the quality of the work done by the court. However, it is clear that the audit work of the ECA is complex and is not exactly the same as the work done by a private auditor or a NAO. There are complexities of geography, language, audit and accounting culture and the audit trail itself. The CAP reform, moving towards direct

payments with different systems in place in different Member States will, for example, add to the already existing complexity.

The ECA has, as its *modus operandi*, risk assessment and internal control audit in a multi-cultural environment. Its own staff, although trained to the current audit guidelines come, themselves, from very varied backgrounds. In the area of Assurance, it is clear from the audit report (Official Journal, 2002), that the Commission's accounting systems are not of a sufficiently high standard that an audit based on assessment of risk and of controls could be conducted. This audit must, by virtue of the lack of controls and the poor systems, involve a considerable amount of substantive audit.

In the area of value for money (or 'sound management') audit, even a cursory glance at the Audit Manual highlights the paucity of clear guidelines for this work. Additionally there seems to be some resistance to an ECA methodology. Some commentators in the ECA expressed the view that there is a difficulty in 'value for money' audit as it necessitates some level of subjective commentary on political decisions. It is important that there is a clear understanding of the parameters of value for money audit. It is not the function of value for money audit to express an opinion on the parliamentary policies for expending resources on a particular programme. It is, on the other hand, its function firstly, to determine what were the criteria of success set for the programmes of expenditure by the parliamentary policy makers and secondly, to express an opinion on whether the expenditure was efficient, economic and effective in the context of the criteria set. Value for money audit should not include any commentary on the political decision or on the validity of the criteria themselves.

Each audit and sub-task should have clear and specific objectives, which can be used as a basis for the examination and as a framework for assessing the audit when it is completed. This was reported to us as not currently the case with the ECA. There appears to be a tendency, possibly exacerbated by some NAOs, for audit staff to visit audit sites, 'hoover up' documents and arrive back at base with so much documentation that it is impossible to review it all. Resultant reports tend not to focus on a set of pre-stated objectives of the audit, the tests effected to achieve the objectives and the opinion based on the outcome of those tests. The reports can often be guided by the unspoken rule 'if it was done, it must be written about', which leads to lengthy reports from which it is difficult to extract the key opinion.

The quality of work done by the ECA is not subject to independent peer review, although considerable effort has been applied to installing an internal system of quality review, which appears of a high standard.

RECOMMENDATIONS

We recommend:

- 5.1 that the work commenced on quality assurance be extended to include regular peer review of the audit policies, planning, execution and reporting of the ECA by an external independent body. This might, for example, be the national audit offices of Australia or the United States of America or Canada; or one of the Big Four international audit firms.
- 5.2 that robust methodologies be put in place for both assurance audit and value for money audit in advance of the expansion of the Member States. In the area of assurance audit, systems should stipulate clear criteria and specific objectives with specified tasks to provide a logical and coherent basis for planning, execution, opinion formation and review. The issue of putting in place reliable accounting systems with sound internal controls is an urgent one for the Commission and it is the task of the ECA to ensure that the Commission

is driven down the road of putting such systems in place as a matter of urgency. This is a major task for the ECA and one to which they should be devoting resources.

- 5.3 that the parameters of value for money audit are clarified as a determination of the objectives and criteria of success set for the programmes of expenditure by the parliamentary decision makers and an expression of opinion on whether the expenditure was efficient, economic and effective in the context of the criteria set.
- 5.4 that, in the light of the considerable work that is necessary to move from substantive auditing to risk assessment and internal control evaluation, a more classical model of assigning the value for money audit work to the internal auditor be adopted. It is recommended that the IAS should take over the value for money auditing from the ECA. The ECA could then concentrate its resources on the assurance work.
- 5.5 that the steps being taken to enhance the professional training and staff developmental review areas are accelerated to ensure technical training for the new staff members who will probably come from the new Member States.
- 5.6 that a review be undertaken of the reports emanating from the ECA to ensure clarity and the use of internationally recognised terminology to indicate level of qualification of opinion.
- 5.7 that guidelines be published to direct whistleblowers who have decided to communicate information confidentially to the ECA.

Recommendation 5.4 above is the only recommendation requiring Treaty change.

SECTION FIVE

CONCLUSION

In conclusion, we would like to reiterate our appreciation to the people who gave so generously of their time to inform our debate. We wish the ECA every success at this very exciting time in its development. We urge the decision takers to be courageous and to grasp the nettles required to amend the structure of the Court to facilitate change which will make it better prepared to manage the increasing demands placed on it by virtue of the enlargement of the Union and the increasing technical complexity of the international auditing and accounting environments. We would emphasise, however, that implementation of many of our recommendations can be commenced with immediate effect and do not require Treaty change.

SECTION SIX

ABBREVIATIONS

COSAC	Conférence des Organes Spécialisés dans les Affaires Communautaires (Conference of Community European Affairs Committees)
EAO	European Audit Office
ECA	European Court of Auditors
IAASB	International Auditing and Assurance Standards Board (Board of IFAC)
IAS	Internal Audit Service
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
INTOSAI	International Organisation of Supreme Audit Institutions
ISA	International Accounting Standards
NAO	National Audit Office
OLAF	European Anti-Fraud Office
SAI	Supreme Audit Institution

SOURCES

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The European Court of Auditors 1977 – 1997, Proceedings of a conference to mark the 20th Anniversary, Curia Rationum

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Code of good Administrative Conduct for Staff of the ECA,ECA, 19.06,2000

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Court Audit Policies and Standards, European Court of Auditors, May 2000

European Implementing guidelines for the INTOSAI Auditing Standards, Contact committee of Presidents of the SAIs of the European Union, ad hoc group, 1998

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APPENDIX ONE

Parties consulted by the Group

Desmond, Barry, former Member of the European Court of Auditors

O'Halpin, Eunan, Professor of Politics, Trinity College

Brennan, Niamh, Professor of Accounting, UCD

Purcell, John, Comptroller and Auditor General

Laffan, Brigid, Professor of Political Science UCD

Ryan, Richie, former Member of the European Court of Auditors

Valles, Juan Manuel, President ECA

Hervé, Michel, Secretary General ECA

Salmi, Aunus, Member, ECA

Speed, John, Head of Division, ECA

Fennessy, Edward, Head of Division, ECA

Madden, Gerry, Cabinet Attaché, ECA

Geoghegan-Quin, Máire, Member, ECA

Maynard, Colin, Director

Clemente Giorgio, Member, ECA

Bostock, David, Member, ECA

Weber, Hubert, Member, ECA

Caldeira Vitor, Member, ECA

Bernicot, Jean-François, Member, ECA

Engwirda Maarten, Member, ECA

Healy, Richard, Department of Agriculture

Marian Byrne, Department of Agriculture

APPENDIX TWO

Members of the European Court of Auditors at October 2003

Name	Country	Gender	Background
Vallés, J	Spain	M	Law degree, Corporate manager, MP
Bernicot, J	France	M	Degrees in Engineering, civil servant, French Court Auditors
Von Wedel H	German	F	Degrees in Law, Civil Servant, MP, German Court Auditors
Bostock, D	UK	M	Degrees in Economics of Public Policy, History, HM Treasury
Clémente, G	Italy	M	Law degree, magistrate in Italian Court Auditors
Colling, F	Lux	M	Degrees in Electronic Engineering, Computer Control Systems Designer, MP
Tobisson, L	Sweden	M	Degrees in Political Science, MP
Weber, H	Austria	M	Law degree, civil servant, Austrian Court Auditors
Engwirda, M	NL	M	Degrees in law and International Relations, Government Adviser, MP
Reynders, R	Belgium	M	Degree in Economics, central bank researcher, Board Member, IMF advisor
Salmi, A	Finland	M	Business Degree, Accountant, businessman, partner firm of accountants
Levysohn, M	Denmark	M	Degree in Law, Danish National Audit Office
Sarmas, I	Greece	M	Degree in Law, Greek Court Auditors
Geoghegan-Quinn, M	Ireland	F	Teacher, MP, Government Minister
Silva Caldeira, V	Portugal	M	Degrees in Law and European Studies, Lecturer, Civil Servant

MP = Served as Member of Parliament in his/her own Member State