



Council of the  
European Union

038205/EU XXVI. GP  
Eingelangt am 12/10/18

Brussels, 12 October 2018  
(OR. en)

13081/18

ECOFIN 910  
UEM 302  
FIN 787

#### COVER NOTE

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From:	Mr Klaus-Heiner Lehne, President of the European Court of Auditors
date of receipt:	8 October 2018
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	Opinion No 2/2018 (pursuant to Article 287(4), TFEU) "The audit and accountability considerations concerning the proposal of 6 December 2017 for the establishment of a European Monetary Fund within the Union legal framework"
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Delegations will find attached Opinion No 2/2018 of the European Court of Auditors.

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Encl.: Opinion No 2/2018 of the European Court of Auditors



EUROPEAN  
COURT  
OF AUDITORS

## Opinion No 2/2018

(pursuant to Article 287(4), TFEU)

“The audit and accountability considerations concerning the proposal of 6 December 2017 for the establishment of a European Monetary Fund within the Union legal framework”

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## **GLOSSARY AND ABBREVIATIONS**

**The international financial institutions (IFIs)** are a group of financial institutions that include the World Bank, the regional development banks, and the International Monetary Fund. They are responsible for deploying public capital in their citizens' best interests and are the largest source of development finance in the world.

**Internationally accepted audit standards** are specified by different public and professional standard-setting bodies, such as the International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB) or the International Standards of Supreme Audit Institutions (ISSAIs) issued by the International Organisation of Supreme Audit Institutions (INTOSAI).

**The International Organization of Supreme Audit Institutions (INTOSAI)** is the global professional organisation for the external government audit community. INTOSAI provides an institutionalised framework for supreme audit institutions to promote development and transfer of knowledge, improve government auditing worldwide and enhance professional capacities, standing and influence of members in their respective countries.

**A supreme audit institution (SAI)** is a national authority responsible for auditing government revenue and spending. The OECD defines a SAI as being responsible for overseeing and holding government to account for its use of public resources, together with the legislature and other oversight bodies. SAIs have different models and institutional arrangements regarding the legislature, executive and judiciary. Where there is more than one body fulfilling the public sector external audit role, the SAI is usually distinguished as possessing the strongest constitutional guarantees of independence

**THE COURT OF AUDITORS OF THE EUROPEAN UNION,**

Having regard to the Treaty on the Functioning of the European Union (the TFEU), and in particular Article 287(4) thereof; together with the Treaty establishing the European Atomic Energy Community (TEAEC), and in particular Article 106(a) thereof;

Having regard to the Treaty Establishing the **European Stability Mechanism**;

Having regard to the Proposal for a Council Regulation on the establishment of the European Monetary Fund (the Commission proposal)<sup>1</sup>;

Having regard to the request by the Chair of the European Parliament's Committee on Budgetary Control of 19 June 2018 for an opinion on the Commission proposal, received by the European Court of Auditors ('ECA') on 23 June 2018 (see *Annex I*);

Whereas;

- (a) the political discussions on the future of the **European Stability Mechanism** (ESM) are still ongoing, and without prejudice to any decisions to be made on whether to retain the ESM on an intergovernmental basis for the foreseeable future or whether to establish a European Monetary Fund (EMF) as an EU body, the audit and accountability frameworks for both scenarios are an important consideration right at the start of any reform process;
- (b) the TFEU does not contemplate the use of the EU institutions to support entities established outside the EU legal framework, such as the ESM. However the use of EU institutions to support non-EU bodies in certain circumstances became established in EU law when the European Court of Justice ruled that "the Member States are entitled, in areas which do not fall under the exclusive competence of the Union, to entrust tasks to the institutions, outside the framework of the Union [...] provided that those tasks do

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<sup>1</sup> Proposal for a Council Regulation on the establishment of the European Monetary Fund, **COM(2017) 827 final**.

not alter the essential character of the powers conferred on those institutions by the EU and TFEU Treaties”<sup>2</sup>.

- (c) under Article 287 TFEU, the ECA is the auditor of all EU bodies, offices or agencies unless precluded by the relevant constituent instrument establishing them;
- (d) the Commission proposal provides for the establishment of the EMF as an EU body<sup>3</sup>, and makes the EMF accountable towards the European Parliament and the Council<sup>4</sup> and subject to judicial control by the Court of Justice. Recital (64) of the proposal does not preclude the ECA from exercising its audit powers. Although the Commission proposal recognises the ECA’s audit powers pursuant to Article 287 (1) of the TFEU, it maintains the current set-up of a Board of Auditors (BoA) ;
- (e) the Commission, as regards the deepening of the Economic and Monetary Union, favours solutions “within the Treaties, so as to avoid any fragmentation of the legal framework, which would weaken the Union and question the paramount importance of EU law for the dynamics of integration”<sup>5</sup>. It adds that “intergovernmental solutions should therefore only be considered on an exceptional and transitional basis” and “must be carefully designed so as to respect EU law and governance, and not raise new accountability problems”<sup>6</sup>. Consistent with this line of thinking, the ECA, in its Landscape Report on accountability and audit gaps<sup>7</sup> and its recent briefing paper on the

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<sup>2</sup> Case C-370/12 *Thomas Pringle v Government of Ireland and Others*, The Court of Justice of the EU, 27 November 2012, paragraph 158.

<sup>3</sup> The Commission proposal, Recital 17.

<sup>4</sup> The Commission proposal, Article 5.

<sup>5</sup> A blueprint for a deep and genuine economic and monetary union: Launching a European Debate (Communication), COM(2012) 777 final, p. 13.

<sup>6</sup> *ibid.*

<sup>7</sup> European Court of Auditors, Landscape Review “Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements”, paragraph 84.

multiannual financial framework<sup>8</sup>, stressed that the EU and its Member States should, as far as possible, avoid creating a combination of different audit arrangements;

- (f) both the ESM and proposed EMF are not financed directly by the EU budget. Insofar as they remain directly capitalised by Member States, they are not covered by the accountability, audit and financial reporting provisions of the Financial Regulation<sup>9</sup> and would require such considerations to be in-built into the constituent instrument of the body itself;
- (g) audit mandates should include all dimensions of public audit: financial, compliance and performance audit. They should also provide all necessary safeguards to ensure that such audit rights can be exercised on all contracting parties involved in the use of public finances, to enable the auditors to exercise their functions effectively;
- (h) all external auditors appointed to perform audits of public funds should conform to internationally accepted audit standards;

HAS ADOPTED THE FOLLOWING OPINION:

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<sup>8</sup> European Court of Auditors, Briefing Paper “The Commission's proposal for the 2021-2027 Multiannual Financial Framework”, paragraph 34.

<sup>9</sup> Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012 (OJ L 193, 30.7.2018, p. 1).

## INTRODUCTION

1. The ESM was established in 2012. Its mission is to provide financial assistance to euro-area countries experiencing or threatened by severe financing problems. This assistance is granted only if it is proven necessary to safeguard the financial stability of the euro area as a whole and of ESM Members<sup>10</sup>. The ESM was set up as an intergovernmental organisation by means of a treaty between euro-area Member States.

2. The revenue and expenditure of the ESM are outside the EU budget, and its capital contributions come from its member countries. Decision-making powers are vested in the Board of Directors and the Board of Governors. The Board of Directors consists of senior officials from finance ministries, and the Board of Governors of the finance ministers of the euro-area member states. The Commission and the European Central Bank have observer status on both the Board of Governors and the Board of Directors, but no voting rights. The ESM is based in Luxembourg and employed 174 staff as at the end of 2017. It has disbursed 273 billion euros in lending to five member countries and has an unused lending capacity of 380 billion euros<sup>11</sup>.

3. Since 2013, the Parliament has called for the integration of the ESM into the EU legal framework<sup>12</sup>. The Five Presidents' Report of June 2015 stated that "its governance should therefore be fully integrated within the EU Treaties"<sup>13</sup>.

4. In December 2017, the Commission published a Communication entitled "Further steps towards completing Europe's economic and monetary union: a roadmap"<sup>14</sup>. As part of this

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<sup>10</sup>Treaty establishing the European Stability Mechanism (2012), Article 3.

<sup>11</sup>European Stability Mechanism, Annual Report 2017 (2018), p. 15.

<sup>12</sup>European Parliament Resolution of 12 June 2013 on *strengthening European democracy in the future EMU*, para 11.

<sup>13</sup>Jean-Claude Juncker in close co-operation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, Martin Schulz, *The Five Presidents' Report: Completing Europe's Economic and Monetary Union* (Commission, 2015) p. 18.

<sup>14</sup>Commission Communication "Further Steps Towards Completing Europe's Economic and Monetary Union: A Roadmap", COM(2017) 821 final.



package, the Commission presented a proposal for a Council regulation to replace the ESM with an EMF<sup>15</sup> (the ‘Commission proposal’), which would become part of the EU legal framework.

5. On 19 June 2018, the Chair of the European Parliament’s Committee on Budgetary Control (CONT) asked the ECA to provide the European Parliament with “an opinion on the best way to shape the control mechanism of the future EMF”, specifically in the context of “any future accountability gap and to ensure adequate audit arrangements” (see *Annex I*).

6. Further impetus comes from the INTOSAI Guidance for Good Governance, which state that “where the scope or structure of the international institution changes fundamentally, the external audit arrangements should be considered carefully and updated if necessary”<sup>16</sup>.

7. The ECA’s 2014 Landscape Review on accountability and audit arrangements outlined certain criteria which can be used in assessing public accountability and audit<sup>17</sup>. These include clarity of information required for accountability purposes, and a role for parliamentary oversight, supported by an external audit opinion.

### **GENERAL REMARKS**

8. In line with the ECA’s view as set out in the briefing paper<sup>18</sup> on the Commission’s proposal for the 2021-2027 Multiannual Financial Framework, published in July 2018, we welcome the aim of the Commission proposal to bring the ESM within the EU legal framework. EU policy should be carried out within a robust accountability framework with a role for parliamentary oversight on the basis of external audit opinion. Such frameworks should be broadly consistent across EU policy areas and should avoid gaps or overlaps. The

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<sup>15</sup>The Commission proposal.

<sup>16</sup>INTOSAI, Guidance for Good Governance “GOV 9300 Principles for External Audit Arrangements for International Institutions” (2016), principle 1.3.

<sup>17</sup>European Court of Auditors, Landscape Review “Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements”, Table 1, p. 13.

<sup>18</sup>European Court of Auditors, Briefing Paper “The Commission’s proposal for the 2021-2027 Multiannual Financial Framework”, Paragraph 34, final bullet.

Commission proposal is a step in the right direction in this regard, although some ambiguity exists on the roles and mandates of different auditors involved and certain shortcomings in the accountability and audit chain need to be addressed.

9. This opinion sets out the ECA's considerations regarding the accountability and related audit arrangements of the proposed EMF as an EU body. First, we review the ESM's current arrangements as the Commission proposal seeks to retain much of the current audit and accountability framework of the ESM. We then review the EMF's audit and accountability arrangements as envisaged in the Commission proposal and make recommendations on changes needed to address the challenges identified. The responses of the ESM and the ESM's Board of Auditors are included, respectively, in *Annex II* and *Annex III*.

10. Since the Commission published its proposal, EU leaders have provided political direction for reform of the ESM to proceed in two steps<sup>19</sup>. In the first step, by the end of this year, the key features of a reinforced ESM, including possible further steps to reinforce its role and governance will be prepared, to address aspects of the proposals set out in the December 2017 Commission proposal, while retaining the ESM's intergovernmental nature. In the second step, over the longer term, the ESM member countries and the EU may consider integrating the ESM into the EU legal framework.

## **PART I - THE EUROPEAN STABILITY MECHANISM - KEY CHALLENGES FOR THE AUDIT AND ACCOUNTABILITY FRAMEWORK**

11. This section examines the ESM's current audit and accountability arrangements. The ESM is an international financial institution (IFI). As such, audit arrangements from other IFIs, as well as relevant best-practice guidelines from the International Organisation of Supreme Audit Institutions (INTOSAI), are relevant.

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<sup>19</sup> *Statement of the Euro Summit Meeting* (29 June 2018) EURO 502/18. Letter from Eurogroup President Mário Centeno to European Council President Donald Tusk (25 June 2018).

### **The ECA does not have audit rights vis-à-vis the ESM, but could assume them on request**

12. The ESM currently has a five-person Board of Auditors (BoA)<sup>20</sup>. It comprises two members appointed upon nomination by SAIs, two upon proposal by the Chairman of the Board of Governors and one member appointed upon nomination by the ECA (who may retain his or her BoA position even after his or her mandate as an ECA member ends). All ESM BoA members are obliged to avoid conflicts of interest, act independently, and neither seek nor take instructions from other bodies.

13. The mandate of the BoA is to “draw up independent audits... [and] inspect the ESM accounts and verify that the operational accounts and balance sheets are in order” and to “audit regularity, compliance, performance and risk management of the ESM in accordance with international auditing standards”<sup>21</sup>. The BoA currently draws support from the active audit staff of various SAIs and from the ECA, who are accustomed to applying in their work the relevant international audit standards.

14. The management of the ESM is essentially accountable to its Boards of Governors. The ESM currently has no formal accountability to either the European Parliament or national parliaments, although its managing director appears before the European Parliament when invited, as well as national parliaments. The BoA generally does not participate in these hearings, although nothing would preclude its appearance, or indeed at a national parliament.

15. The ECA currently has no audit rights vis-à-vis the ESM. Even if the ESM retains its intergovernmental character, there are areas where the ECA would be able to play a role in its audit and accountability framework. Case law demonstrates that Member States can

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<sup>20</sup> The framework for the ESM BoA is set out in Article 30 of the Treaty establishing the ESM (the Treaty) and Article 24 of the ESM By-Laws. The members of the Board of Auditors are appointed by the Board of Governors, on the basis of Article 30(1) of the Treaty and Article 24(1) of the ESM By-Laws.

<sup>21</sup> Treaty establishing the ESM (Article 30(3)-(4)) and the ESM By-Laws (Article 24(4)).

confer tasks upon the ECA outside the framework of the EU legal order, subject to the following conditions:

- (i) the areas in which the Member States confer powers to the ECA do not fall under the EU's exclusive competence<sup>22</sup>,
- (ii) those tasks are compatible with the TFEU and
- (iii) they do not alter the essential character of the powers conferred on the ECA by the EU and the TFEU<sup>23</sup>,
- (iv) that, in the view of the ECA, they are appropriate, desirable and worth pursuing.

16. In order to align the ESM's accountability arrangements with those of other EU bodies, and also help to prepare for the ESM's eventual incorporation into the EU framework, the ESM, in agreement with the ECA, could confer a mandate on the ECA for certain aspects of the external audit of the ESM, such as performance or compliance audit work.

#### **Board of Auditors members' terms of office are short**

17. The BoA's membership is entirely external and is not drawn from the institution's own board of directors. This is similar to the arrangements of the other international financial institutions, such as the European Investment Bank and International Monetary Fund. By comparison, both the Asian Development Bank and the European Bank for Reconstruction and Development each have an audit committee with membership drawn from their own boards of directors.

18. BoA members serve a three-year, non-renewable term of office. Their terms are staggered so they are replaced at different points. A three-year term is relatively short

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<sup>22</sup> As regards the ESM, the Court of Justice of the EU stated that its activities fall under economic policy, in which the Union does not have exclusive competence (see Pringle, paragraph 160).

<sup>23</sup> For instance, such an alteration would occur if the tasks conferred by the Member States impaired the ECA's independence or if the ECA were given a role completely different from its role under EU law.

compared to peer institutions, for example EIB Audit Committee members have six-year, non-renewable terms. The terms of the ESM BoA members are at the lower end of what is recommended by the relevant INTOSAI Guidance for Good Governance, which states that “ideally, appointments should be for a minimum of three to four years, with a maximum of six years”<sup>24</sup>. This means that BoA members’ terms may only overlap for short periods and this makes it challenging to ensure business continuity and undertake work that may be multi-annual in nature. For example, due to the current set-up, all of the current members began their terms over a 14-month period beginning in October 2015, meaning that the preceding board was completely replaced over this period. Any extension of the standard term of office for the BoA members would require an amendment of Article 24 (1) of the ESM By-Laws and hence the approval of the Board of Governors.

#### **Recommendation 1**

In order to ensure business continuity of the BoA, the ESM Board of Governors should consider amending Article 24 (1) of the ESM By-Laws to allow for a longer term of office for BoA members or, alternatively, to allow members to serve a second term.

#### **Reporting by the BoA on its audit findings is very limited**

19. The BoA approaches its obligation to “inspect the ESM accounts and verify that the operational accounts and balance sheet are in order”<sup>25</sup> in two ways: by means of its annual report, and by means of a short statement from its Chairperson accompanying the ESM financial statements. The BoA’s annual report of is addressed to the members of the Board of Governors, who are in turn accountable to their national parliaments as representatives of their governments. The BoA’s annual report is also forwarded to national parliaments by the respective Governors and is also circulated to the European Parliament for information.

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<sup>24</sup> INTOSAI, Guidance for Good Governance “GOV 9300 Principles for External Audit Arrangements for International Institutions” (2016), principle 2.4.

<sup>25</sup> ESM Treaty, Article 30(3)-(4).

20. The annual report describes the BoA's activities and mentions the topics of the audit work that it has carried out. However, the annual report does not specify the audit findings or recommendations and thus they are not placed in the public domain<sup>2627</sup>. The BoA's practice does not meet the principle as specified in the relevant INTOSAI Guidance for Good Governance, which states that external audit reports should be made public with clear criteria for exceptions<sup>28</sup>.

21. The BoA's other public output is a short statement that is published with the ESM annual report, together with the financial statements and the report by the private audit firm. The BoA has informed us that it prepares this statement after it has seen and reviewed the report of the private audit firm. This statement references the mandate and activities of the BoA and concludes with the following text: *"The BoA notes that, to the best of its judgment, no material matters have come to its attention that would prevent it from recommending that the Board of Governors approve the ESM financial statements for the year ended 31 December 2017."*<sup>29</sup>

22. The language used in the above statement by the BoA is not categorical, and it is unclear whether the BoA is actually recommending the approval of the financial statements<sup>30</sup>. In any case, even if it is recommending their approval, it is not a statement on

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<sup>26</sup> The BoA has informed us that it provides the findings and recommendations of its audits to ESM management and to the risk committee of the Board of Directors. However, the most recent annual report does not provide detail on this process.

<sup>27</sup> The BoA has informed us that it holds regular discussions with the ESM senior management on the integrity and adequacy of the financial statements and the related controls, and when deemed appropriate it requests changes to the draft financial statements and improvement to disclosures and explanatory notes.

<sup>28</sup> INTOSAI, Guidance for Good Governance "GOV 9300 Principles for External Audit Arrangements for International Institutions" (2016), principle 6.4: "In order to enhance transparency and accountability all external audit reports presented to the governing body should be publicly available. Exceptions should be based on clear and relevant criteria concerning classified and confidential information."

<sup>29</sup> ESM Annual Report 2017 (2018), p. 115.

<sup>30</sup> ESM Annual Report 2017 (2018), p. 111. The report by the private audit firm on the ESM is unambiguous in this regard, with the following statement in 2017: "In our opinion, the

whether the operational accounts and balance sheets are in order, which is what the ESM treaty requires (see paragraph 13).

23. The reporting by the ESM BoA is not in line with the relevant principle which states that the external auditor should express an opinion “as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework”<sup>31</sup>.

24. By way of comparison, the ECA’s specific annual reports generally include a clear verdict on the accounts of the audited body, with wording such as “In our opinion, payments underlying the accounts for the year in question are legal and regular in all material respects”.

25. Similarly, the annual report of the audit committee of the European Investment Bank (EIB) contains details on the findings of its audits, and there is a statement on the legality and regularity of the accounts. The Statute of the EIB is unambiguous in this regard, however, obliging its audit committee to “confirm that the financial statements ... give a true and fair view of the financial position of the Bank.”<sup>32</sup>

#### **Recommendation 2**

In order to enhance transparency and to provide greater clarity for external stakeholders about the legality and regularity of its accounts:

- (a) The BoA’s report should include detail on the substance of its audit reports and findings, with clear criteria for exclusion of confidential and other sensitive information.

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accompanying financial statements give a true and fair view of the financial position of the Entity”.

<sup>31</sup> INTOSAI, "ISSAI 200 Fundamental Principles of Financial Auditing" (2013), paragraph 16.

<sup>32</sup> Consolidated version of the Treaty on the Functioning of the European Union, Protocol (No 5) on the statute of the European Investment Bank, Article 12(3), (OJ C 202, 7.6.2016, p.251).

- (b) The BoA should make a clear statement as to whether the ESM's operational accounts and balance sheet are in order.
- (c) The BoA should provide an assessment of whether the ESM's financial statements provide a true and fair view of its financial position.

### **Limited audit and evaluation of ESM performance**

26. Officially, the BoA has a specific performance audit mandate<sup>33</sup>. To date, however, the bulk of the audits described in the BoA's reports have been of a financial and compliance nature, although more performance audit work has been described in recent years.

27. In addition, the ESM does not have a standing evaluation function for its policies and programmes, either internal or external. Nevertheless, in 2016 it commissioned an evaluation report of ESM financial assistance, which was published in 2017. This covered policy relating to lending to five programme countries: Ireland, Portugal, Spain, Cyprus and Greece<sup>34</sup>.

28. By way of comparison, since 2001 the International Monetary Fund has had an Independent Evaluation Office, which conducts objective and independent evaluations on issues of relevance to the mandate of the International Monetary Fund. The Asian Development Bank and European Bank for Reconstruction and Development also have internal evaluation departments, albeit outside their regular reporting arrangements.

29. If granted a mandate, the ECA would be in a position to carry out performance audits of the ESM. This would be in addition or in parallel to any evaluation function at the ESM, which could have different objectives and approaches. The ECA is legally permitted to carry

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<sup>33</sup> ESM By-Laws (Article 24(4)) states that the BoA "shall audit regularity, compliance, performance and risk management of the ESM in accordance with international auditing standards". INTOSAI "ISSAI 3000 Standard for Performance Auditing" (paragraph 17): "Performance audit is defined as an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organizations are operating in accordance with the principles of economy, efficiency and/or effectiveness and whether there is room for improvement."

<sup>34</sup> ESM, "EFSF/ESM Financial Assistance Evaluation Report" (2017)



out performance audits of the ESM in the interests of improving the overall accountability of the European economic governance framework. It would be consistent with the ECA's current work programme, which involves evaluating the performance of EU bodies with complementary activities to those of the ESM.

### **Recommendation 3**

In order to enhance the audit and evaluation of ESM performance:

- (a) The ESM should develop an internal evaluation function to evaluate the tasks conferred on it and report externally on their effectiveness, in line with practice in peer institutions.
- (b) The ESM could grant a mandate to the ECA which would address the external performance audit gap identified.

## **PART II - THE PROPOSED EUROPEAN MONETARY FUND – KEY CHALLENGES FOR THE AUDIT AND ACCOUNTABILITY FRAMEWORK**

30. The next section specifically examines the Commission proposal in the context of the request from the Parliament's Committee on Budgetary Control, as described in paragraph 5.

### **Proposed changes to the ESM's audit framework**

31. The Commission proposal would see the EMF retain the main features of the ESM's external audit framework (as set out in *Part 1*). It provides some clarification of the BoA's role, in part by incorporating elements of the current ESM by-laws<sup>35</sup>.

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<sup>35</sup> The Commission proposal, Annex, Article 35(1) and (3). In particular, the selection procedures for the members are clarified, the process for election of a chairperson is set out, as is the need for BoA members to avoid conflicts of interest. The scope of the BoA's tasks is also better defined, now encompassing 'the audit the regularity, compliance, performance and risk management of the EMF in accordance with international audit standards.'

### **The position of the ECA as EMF's external auditor is not explicit**

32. The ESM currently plays a role in the provision of stability support for member countries, but not for negotiating the policy conditions for the receipt of a financial assistance programme. The Commission proposal would give the EMF a greater role in the design of programme conditionality, in co-operation with the Commission and in liaison with the European Central Bank<sup>36</sup>.

33. The ECA has full audit rights over the Commission's involvement in such policy design and implementation, but the proposal does not set out how the ECA would exercise its rights over the EMF in this context. Clear specification of rights would, in this case, avoid the potential for confusion about the ECA's role.

34. The Commission proposal would see the EMF integrated into the EU framework via Article 352 of the TFEU. The EMF would be established, pursuant to Union law, as a Union body with legal personality<sup>37</sup>. In these circumstances, the ECA would have full audit rights over the EMF under Article 287 of the TFEU, which empowers the ECA to be the external auditor of all EU institutions, bodies and agencies unless precluded by their respective constituent instrument. The Commission proposal contains no such preclusion and, in recital (64), indeed acknowledges the ECA's audit powers to be exercised pursuant to Article 287 of the TFEU. This reference means automatically that the ECA would be in charge of carrying out financial, compliance and performance audits of the EMF.

35. However, the Commission proposal has a serious shortcoming in this respect as it does not specify the ECA's operational role. The Commission proposal suggests that private auditors selected from internationally reputable audit firms would carry out financial audits of the EMF, and the BoA would audit the Fund's regularity, compliance, performance and risk management. Such arrangements could be read as implicitly assigning the external audit mandate to bodies other than the ECA. Dual or multiple external audit mandates are

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<sup>36</sup>The Commission proposal, Annex, Article 13(3).

<sup>37</sup>The Commission proposal, Recital (17).

generally avoided, for the obvious reason that conflicting audit opinions could arise, and there could be either duplications or overlaps in the work of different external audit bodies.

36. Furthermore, such different audit arrangements could lead to ambiguity and could even potentially be considered an implicit preclusion of the ECA's audit powers, even though recital (64) sets out the intention for the ECA to have full audit rights over the EMF. The management of the ESM has proposed that the ESM should be brought within the EU legal framework along the lines of the EIB via changes to the EU Treaty framework. Currently, relative to the EIB, the ECA has audit rights only over specific programmes financed by the EU budget and executed by the EIB. Other audit arrangements for the EIB are specified in Protocol No. (5) annexed to the TFEU. If a similar approach to the EIB were to be followed for the ESM, the ECA would be precluded from conducting effective audits of the ESM.

37. An arrangement where the ECA is given a clearly defined external audit mandate would be the simplest in procedural terms and the most consistent with the current audit and accountability arrangements for EU financial and economic governance. However, there is scope to make use of the work of other auditors in formulating public audit opinions. Indeed, the ECA already issues about 50 specific annual reports on the activities of EU agencies and bodies. In most of these cases, as provided for in the regulation, the ECA's role includes reviewing and re-performing the work of external auditors. In the specific case of the EMF, given the particular audit assurance required for its capacity to raise funding in markets, we consider this kind of assurance to be necessary and complementary to the assurance provided by public auditors which primarily serves public accountability purposes.

38. When the ESM is integrated into the EU framework, the ECA will assert and exercise its full audit rights as per Article 287 TFEU. If ESM member countries wish to retain external involvement in the EMF audit structure, it could retain a committee with external membership to provide guidance for and/or oversight of the EMF's internal audit process. However, the ECA could not consider nominating a member in this set-up as it would conflict with the ECA's role as the holder of the external audit mandate.

**Recommendation 4**

In order to avoid the potential for confusion about the ECA's role and in order to avoid expensive duplication of work:

- (a) The ECA's role as independent external auditor of the EMF should be explicitly stated in the main text of any legislative basis for an EMF, making clear that the role of private audit firms and any other audit input would be complementary to that of the ECA.
- (b) Any legislative basis for an EMF should require provisions built in to the contracts with private auditors to ensure that the ECA has full access to their working papers and is able to carry out reviews and rely on their work.

**Parliamentary oversight not designed to be based on an audit opinion**

39. The Commission proposal would give the Council and Parliament a greater role in the EMF than they currently have in the ESM. Article 5 of the Commission proposal would see the EMF submitting to the Parliament and Council a report on the execution of its tasks, as well as its annual accounts and financial statements. The Parliament could then hold a general debate based on these, and the managing director would also be obliged to report to Parliament on the execution of the EMF's tasks, and to facilitate confidential oral discussions behind closed doors with relevant Committee Chairs and Vice-Chairs.

40. This would be an improvement on the current arrangement, where the managing director of the ESM appears on a voluntary basis before the Parliament. To date, there has been no formal consideration of an external audit opinion during these exchanges of views with the ESM.

41. The proposed parliamentary oversight arrangements for the EMF do not envisage any role for the Parliament in considering audit reports. Given that the EMF would be outside the EU budget (see paragraph 2), it would fall outside the scope and discharge provisions of the Financial Regulation. However, several other self-financed entities that exist already (EU Intellectual Property Office, the Community Plant Variety Office and the Single Resolution Board) have discharge provisions within their respective constituent instruments.

42. Our view, as expressed already in our Landscape Review on accountability and audit gaps<sup>38</sup>, is that although such revenue does not come from the EU budget, it arises from the exercise of public authority at EU level and its use has the same nature as that of other EU funds. There is therefore no compelling reason to treat EMF revenue differently to that of entities financed from the EU budget, and the absence of robust provisions for parliamentary oversight and discharge of the EMF's financial, compliance and performance responsibilities is a key gap in its proposed accountability arrangements.

43. The Commission proposal does not provide for an examination of the ECA audit reports by the Parliament during the EMF's discharge procedure. Such an examination would be in line with the practice set out in Article 319 of the TFEU. The discharge procedure would take account of ECA's statement of assurance about the reliability of the EMF's annual accounts and the legality and regularity of the underlying transactions. The discharge procedure would also consider any ECA performance audit findings on the EMF.

**Recommendation 5**

When the ESM is integrated into the EU legal framework by setting-up an EMF, and in order to reinforce the relevance of audit to the accountability and democratic oversight, the ECA should be given a clear and formal role in the discharge procedure of the EMF.

This opinion was adopted by Chamber IV, headed by Mr Neven MATES, Member of the Court of Auditors, in Luxembourg at its meeting of 18 September 2018.

*For the Court of Auditors*



Klaus-Heiner LEHNE

*President*

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<sup>38</sup> ECA Landscape Review "Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements", paragraph 84.

***Annex I – Request for opinion by European Parliament’s Committee on Budgetary Control***

Committee on Budgetary Control  
The Chair

Mr Klaus-Heiner LEHNE  
European Court of Auditors  
12, rue Alcide De Gasperi  
Luxembourg  
L- 1615

D 310044      19.06.2018

Dear Mr President Lehne,

As you are aware, the European Commission presented in December 2017 a proposal for a Council regulation on the establishment of the European Monetary Fund (under the article 352 of TFEU), as one of the initiatives announced in the Commission’s Communication “Further steps towards completing the economic and monetary union”.

This proposal provides that the EMF would succeed to and replace the **European Stability Mechanism**, as a unique legal entity under Union law. When the creation of a new EU body within the Union framework is at stake, the challenges of EU democratic accountability, auditing and efficiency of activities are of paramount importance.

With a view to preventing any future accountability gap and to ensure adequate audit arrangements, I would very much appreciate, on behalf of the Committee on Budgetary Control, if the Court could kindly provide the Parliament with an opinion on the best way to shape the control mechanism of the future EMF as soon as possible and in the most appropriate format.

I’m looking forward to hearing from you and thank you again for your excellent cooperation.

Yours sincerely,

Dr Inge Gräsle

**Annex II – Reply of the ESM**

Mr Alex Brenninkmeijer  
European Court of Auditors  
12, rue Alcide de Gasperi  
L-1615 Luxembourg

Luxembourg, 24 September 2018

Dear Mr Brenninkmeijer,

Thank you very much for sharing with ESM the Opinion of the European Court of Auditors (ECA) on the audit and accountability considerations concerning the Commissions' proposal of 6 December 2017 for the establishment of a European Monetary Fund (EMF).

We take note that the Opinion is issued by ECA in response to a request from the Chair of the Committee on Budgetary Control of the European Parliament dated 19 June 2018. We concur with the position of the Committee on Budgetary Control that accountability, auditing and efficiency of activities of public institutions are of paramount importance.

In this regard, I would also like to recall the letter from Mário Centeno, President of Eurogroup and Chairperson of the ESM Board of Governors to President Donald Tusk from 25 June 2018. In the letter, he states that "In the longer term, Leaders could decide to incorporate the ESM into the EU framework, preserving the key features of its governance".

An emerging majority of ESM shareholders favour ESM being integrated into the EU framework, as long as this is done under primary law and in a similar way to the European Investment Bank (EIB). The EIB is an EU body with its own capital. It enjoys financial autonomy and is endowed with its own decision-making bodies. As noted by Mário Centeno, this solution can be implemented only in the longer term. It is essential that the audit arrangements of ESM in the future do not result in duplication of audit effort and continue to meet the expectations of investors on the capital markets.

At the same time, we take note that your Opinion contains also a number of recommendations on the ESM's current audit and accountability arrangements. In this respect, many of your recommendations relate to the work of the Board of Auditors. As ESM management, we fully respect the independence of the Board of Auditors and cannot express any opinion on the methodology of their work or on the scope of their reports. We understand that the Board of Auditors will provide its own observations on the Opinion.

We would like to reiterate that the ESM Members find the current audit arrangements of ESM to be in line with best practice for international financial institutions. Specifically:

- The audit arrangements of the ESM were established by the ESM Members in consultation with their national supreme audit institutions as well as ECA. As a result, the Board of Auditors was set-up as an independent oversight body of the ESM, appointed by and directly accountable to the ESM Board of Governors. The Board of Auditors has a comprehensive audit mandate including all dimensions of public audit: financial, compliance and performance audit, as set forth in Article 30 (3) of the ESM Treaty and Article 24 (4) of the ESM By-Laws. In this regard, a recent report of Transparency International on ESM praises the “world-class audit arrangements” of the ESM.
- ECA already has an important role in the ESM audit arrangements as one of the members of the Board of Auditors is appointed upon nomination by ECA. Moreover, ECA staff often act as subject matter experts, appointed by the Board of Auditors to support the performance of its independent audits of the ESM in line with Article 24 (5) of the ESM By-Laws. ECA, along with the European Parliament, is among the official recipients of the ESM Annual Report and the Annual Report of the Board of Auditors which reinforces the transparency and accountability of ESM’s activities.
- The accounts of the ESM are audited in accordance with generally accepted auditing standards by independent external auditors on an annual basis. The independent external auditors are “*approved and subject to public oversight in accordance with Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006*”, as specifically required under the ESM By-Laws (Article 22). The Board of Auditors’ oversight of the external auditors’ work and its report in respect of the ESM Financial Statements provide additional assurance to the ESM Members regarding the operational accounts and balance sheet of the ESM.
- Lastly, we take note of your recommendation that the ESM should develop an internal evaluation function. In September 2016, the Board of Governors appointed a high-profile Independent Evaluator to assess the relevance, effectiveness and efficiency of EFSF and ESM financial assistance. The ensuing Evaluation Report was presented to the Board of Governors and is available to the general public on the ESM website. Given the small size of the ESM and the limited number of its financial assistance programmes to date, the set-up of a permanent ESM evaluation function would not be efficient for the time being. This could be considered in the future if ESM develops further. In the meantime, we will continue to learn from the evaluation practices at peer institutions. The evaluation team has closely collaborated with experts from the Independent Evaluation Office (IEO) of the IMF and EIB in developing the methodology for the first evaluation noted above.

On a more general note, in addition to ESM’s robust audit arrangements, the ESM Members have established also strong governance and accountability mechanisms. ESM decisions are subject to approval by the ESM governing bodies. In this context, decisions are also subject to involvement of national parliaments. In fact, ESM is subject to parliamentary oversight at national level to a degree that is unparalleled at peer institutions (e.g. IMF lending decisions are not subject to review by the national parliaments of the IMF Members). The ESM Governors appear before their respective parliaments to explain or seek a mandate for decisions related to ESM activities. Upon invitation, the ESM Managing Director and senior staff visit national parliaments to present ESM activities and, when necessary, provide explanations.



ESM pro-actively cooperates also with the European Parliament. Since 2013, on a voluntary basis, the ESM Managing Director has regularly attended hearings before the Economic and Monetary Affairs Committee. Numerous additional contacts with the European Parliament at the level of the Conference of Presidents or with individual parliamentary groups and members also take place. As a next step, we will explore whether the ESM could enter into a memorandum of understanding with the European Parliament which could serve as a basis for more regular reporting.

In closing, I would like to thank you again for sharing the upcoming Opinion and trust that this letter provides an important perspective to the discussion. ESM remains available to engage in a further dialogue with you on the future audit and accountability arrangements of the ESM once there is more clarity on how the ESM would be brought into the EU framework.

Yours sincerely,

Kalin Anev Janse

Secretary General

Member of the Management Board

### ***Annex III – Reply of the ESM’s Board of Auditors***

Luxembourg, 24 September 2018

Mr Alex Brenninkmeijer  
European Court of Auditors  
12, rue Alcide de Gasperi  
L-1615 Luxembourg

Dear Alex,

Thank you very much for providing the Board of Auditors with the Opinion of the European Court of Auditors on *“The audit and accountability considerations concerning the proposal of 6 December 2017 for the establishment of a European Monetary Fund within the Union legal framework”* (‘Opinion’).

The Board of Auditors notes that the European Court of Auditors (‘ECA’) does not hold a mandate for the evaluation of the work of the Board of Auditors, and that your Opinion is therefore not based on a full evaluation exercise. However, the Board of Auditors is appreciative of the opportunity to hear the considered views of a respected institution on elements of the Board of Auditors’ work as provided to us in the Opinion.

It might, perhaps, have been better if your Opinion had clarified, in using INTOSAI principles, that the Board of Auditors is not a Supreme Audit Institution (‘SAI’), nor is it in the same situation as other external audit bodies whose mandate extends beyond a single institution. The Board of Auditors must therefore, to some extent, judge the application of standards and principles against its particular role. We are not of the view that there is any ambiguity, for example, in our statement on the financial audit. After extensive review of the audit work of the appointed external audit firm, including extensive analysis of the working documentation of those auditors, using a template directly borrowed from your own institution, we make *the statement that “no material matters have come to [our] attention that would prevent [us] from recommending that the Board of Governors approve the ESM financial statements”*. This is not at all ambiguous, and avoids a duplication of the work and statements of the external auditor.

In overall terms, the Board of Auditors:

- commissions, considers and finalises its own special audit reports which can cover regularity, compliance, performance, risk management of the ESM, using the services of qualified staff from SAIs, including the ECA,
- reviews in great detail the work of the external auditor in relation to the accounts, as indicated above,

- comments in advance and requests adjustments it deems appropriate in the published annual accounts,
- engages on an extensive and ongoing basis with the internal audit function and its work,
- meets management of the ESM and receives reports and updates throughout the year,
- and, of course, reviews its own modus operandi from time to time, with a view to continuous improvement.

In this last context we will, of course, be considering your suggestions and the extent to which they can usefully be incorporated into our work.

Being dedicated to a single “client”, the Board of Auditors can perhaps develop a specialised understanding and tailored approach to its work on the ESM. The question of whether other audit and accountability arrangements might be appropriate in the future, in tandem with different institutional arrangements, is for the parties to the ESM Treaty to assess. We would note, however, that any new arrangements should avoid unnecessary duplication of functions and be acceptable in the financial markets which provide ESM’s funding, while ensuring appropriate accountability and oversight.

Yours sincerely,

Kevin Cardiff

Chairperson of the Board of Auditors