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European Commission

Internal Audit Service

Final Audit Report on DG RTD's Control Strategy for on-the-spot controls and fraud prevention and detection

29 September 2011

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1. EXECUTIVE SUMMARY AND CONCLUSIONS[1]

1.1. Background

Together with other Research Commission Services (RCS)[2], DG RTD implements EU research policy and supports the development of the European Research Area mainly through the Research Framework Programmes. Under the Seventh Framework Programme (FP7) for 2007-2013, which is currently being implemented, DG RTD's share is some EUR 25.2 billion in total. Although the programming period for the Sixth Framework Programme (FP6) for 2003-2006 has finished, DG RTD made payments amounting to EUR 753 million against cost claims during 2010 for on-going projects financed by FP6.

In recent years there have been a range of initiatives aimed at addressing the difficulties which have characterised the previous programming periods, in particular the development of common control and audit strategies amongst the RCS and in particular a common FP7 audit, or on-the-spot control, strategy designed to test the veracity of cost claims submitted by beneficiaries at different stages of the project cycle.

In addition, in line with the increased focus on fraud prevention and detection in the Commission, and following a recommendation made by the IAS[3], DG RTD has developed an Anti-Fraud Control Strategy. This strategy has resulted in an action plan which the DG is currently in the process of implementing. With such a key share of the overall research area spending budget, it is essential that DG RTD has a sound and credible control strategy and robust approach to dealing with the possibility of beneficiary fraud.

1.2. Audit Objectives[4]

The objective of the audit was to assess the internal controls underpinning DG RTD's on-the-spot controls processes and the adequacy and effective application of the fraud governance, risk management and internal control processes for fraud prevention and detection.

1.3. Audit Scope

The audit of the on-the-spot control processes focussed particularly on:
- the on-the-spot audit strategy and planning processes;
- the methodology, guidelines and procedures and coordination with the other research DGs and executive agencies;
- implementation/execution of the audit plan by the ex-post audit units either directly or by the external audit firms (EAFs);

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[1] The Executive Summary provides a synthesis of information on the audit including critical and very important findings, risks and recommendations as well as the audit opinion – its emphasis is on providing a quick understanding of the audit and its main results. The body of the report contains the detailed validated audit information and as such is the authoritative text.

[2] DGs RTD, INFSO, MOVE, ENER, ENTR, EAC and the European Research Council Executive Agency (ERCEA) and the Research Executive Agency (REA)

[3] Audit on DG RTD's Internal Control System for managing the 7th Framework Programme – Design; Recommendation 6: "Developing a fraud awareness strategy"

[4] For the audit methodology, see Annex 1.

- monitoring and reporting arrangements;
- monitoring the effectiveness of the system of audit certification;
- measures to ensure the quality of the work undertaken;
- the follow-up given to audit results including the monitoring and implementation of corrective actions.

The scope of the audit encompassed fraud prevention controls aimed at reducing the opportunity and motivation to commit fraud and detection measures to indicate the possibility of fraud. The audit covered the different internal control system components as defined by the COSO model: control environment, risk assessment, control activities, information and communication, monitoring.

The scope included the control systems to the extent they cover FP6, FP7 and other programmes managed by DG RTD (Research Fund for Coal and Steel). The control systems for the REA, ERCEA and the Joint Undertakings were not included.

It should be noted that as part of its 2010 AAR the DG made a reservation concerning the rate of the residual errors with regard to the accuracy of cost claims in the FP6.

The fieldwork was finalised on 21 June 2011. All observations and recommendations relate to the situation as of that date.

1.4. Strengths

Since the IAS' previous audit on ex-post control measures[5], DG RTD has strengthened considerably its ex-post audit function and made significant efforts to improve its processes and procedures. Over time, this has become a well established, mature activity and a key pillar of control responsible for delivering the bulk of the assurances in the AAR declaration. The IAS notes the significant increase in audit activity (both contracted out and undertaken in-house), aimed at reducing the error rate. The share of in-house audit staff has increased in particular. The audit methodology applied is mature and well documented in audit manuals, procedures and check-lists. Particular efforts have been made to report very clearly the results of the ex-post controls strategy in the AAR.

The IAS recognises the considerable ongoing efforts made by DG RTD, as "chef de file", with respect to the coordination of the audit activities and procedures of the research family, in particular through the development of the common FP6 and FP7 audit strategies, and by presiding over a number of coordination committees and groups.

The IAS also recognises that DG RTD has developed a comprehensive anti-fraud control strategy which addresses the main risks and has set up a corresponding action plan.

1.5. Audit Opinion and Major Audit Findings

In view of progress already made on these key areas and the state of maturity already reached, it is important to emphasise that the IAS's findings and recommendations should be seen as improvements needed to help to bring the DG to the next level of maturity in the controls process and to reinforce the key role DG RTD has to play in ensuring that the research budget is managed in a proportionate and effective manner.

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[5] IAS audit report "Ex-Post Controls – DG RTD" 21.12.2006

Based on the results of our audit as described in the objectives and scope of the audit engagement, we believe that the internal control system in place provides reasonable assurance[6] regarding the achievement of the business objectives set up for the on-the-spot controls and fraud prevention and detection processes, except for the following very important issues:

a) Common audit strategy and coordination issues

Ex-post audits, carried out either after interim and/or final payment on a project, are the main pillar of control in the research area and aim to identify and correct errors in beneficiary cost claims. The number of audits conducted has increased significantly over recent years, whereas ex-ante controls have been reduced under FP6 and even more under FP7, with the push for greater simplification. However, increased audit activity means an increased audit burden on beneficiaries and comes at a high cost to the DG in terms of resources, as borne out by DG RTD's view that it is no longer cost effective to increase the audit effort for FP6 to reduce the level of residual error to below 2%.

The interconnected nature of research means that there are common beneficiaries and therefore a strong need for effective coordination between the eight Commission Research Services. Despite the efforts made so far, coordination does not always work in practice. Certain problems can be corrected simply through better working arrangements. However, there is a more structural problem in so far as each service effectively has to act independently in order to satisfy its own accountability needs rather than coming together to serve the needs of the research area as a whole. The result is extensive and costly audit work, timing problems, delays in getting representative error rates and inconsistencies of approach. These problems have been flagged and recognised as a risk and the idea of a single, representative sample put forward as a solution. However, the IAS is aware that this may impact on the present accountability structure.

b) Fraud prevention and detection

Several RCS, including DG RTD, have developed their own anti-fraud strategies, building upon the initiatives already made in the research area. However, despite the fact that all RCS work under the same legal framework for the research framework programmes, have essentially very similar processes and control systems, many common beneficiaries and common preventive and detective measures, there is no common anti-fraud strategy for the research area as a whole. The recently adopted Commission Communication on the Commission's anti-fraud strategy recommends that, where applicable, implementation should be based on specific sectoral anti-fraud strategies.

DG RTD has prepared an action plan to implement its own anti-fraud strategy and has implemented certain elements, but a number of actions have been delayed and/or it is not clear how and when they will be implemented in practice. For example, the risk of double funding needs to be better addressed.

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[6] Even an effective internal control system, no matter how well designed and operated, has inherent limitations – including the possibility of the circumvention or overriding of controls – and therefore can provide only *reasonable assurance* to management regarding the achievement of the business objectives and not *absolute assurance*.

1.6. Risks and audit recommendations

In arriving at the above opinion, the following high risks that may affect the achievement of the business objectives for the process audited were identified:

a) Common audit strategy and coordination issues – Risk rating High

Although the Commission Research Services have worked hard to install credible control strategies through a common audit approach, there is a risk that the lack of effective coordination, due in part to the present accountability framework, coupled with the increasing cost of ex-post audits will lead to further inefficiencies and increase the burden on auditees without the proportionate increases in assurances.

DG RTD should, in conjunction with the other RCS and horizontal services, appraise the costs, benefits and accountability implications of consolidating the control strategy. To avoid the inefficiencies caused by auditing separate representative samples by each DG, the aim should be to have a single representative sample for the research area as a whole, aimed at determining the error rate for the policy area rather than for each service. To ensure that each RCS meets its own accountability and assurance needs, the central representative sample relating to each RCS could be augmented as necessary.

In addition, to address specific risks, each RCS should draw its own specific risk based sample. The planning of these audits should be centrally coordinated in order to avoid several audit visits to the same beneficiary.

More fundamentally, it could include the possibility of a single audit service or the appointment of a 'control architect' responsible for coordination, overseeing the overall structure, the work of the external audit firms and related framework contracts, the working methods, the allocation of responsibilities, etc.

b) Fraud prevention and detection – Risk rating High

Without the common steer of an overall sectoral fraud strategy, there is a risk that the RCS might fail to identify, prevent and detect significant and common fraud risks. This could have a major reputational impact, particularly given the experiences of DG INFSO and the advances already made in developing tools and methodology for the fight against fraud.

Certain specific anti-fraud measures have been taken by DG RTD, but the delays and lack of clarity surrounding the action plan means that this should still be considered as work in progress and if not addressed, could undermine the credibility of the achievements so far. Looking forward, and building upon the work already undertaken on its own specific strategy and the initiatives elsewhere, DG RTD should work with the other RCS to develop a common fraud strategy for the research area as a whole.

Its own action plan to implement its anti-fraud strategy should be updated to reflect more realistic target dates. Key actions should be defined more clearly, and overall monitoring of the action plan should be strengthened. Important areas still to be addressed include raising awareness, identifying 'red-flags', ensuring that anti-fraud checks are embedded in control systems, working with other DGs on specific risks such as plagiarism and double funding, ensuring that the necessary data is captured and further exploiting the use of advanced data search tools.

2. FULL REPORT

2.1. Introduction

2.1.1. Reason for the Engagement

As part of its 2010-2012 strategic audit plan, which is prepared in cooperation with the IACs, the IAS had foreseen separate audits on the control strategy and internal control systems put in place by DG RTD concerning, on the one hand, on-the-spot controls, and on the other hand, fraud prevention and detection. As part of its annual updating of the strategic plan, the two audits have been combined in one audit, in order to reduce the audit burden on DG RTD in 2011.

Control strategy - on-the-spot controls

The objective of the audit was to assess the internal controls underpinning the DGs' on-the-spot controls processes, focussing particularly on;

- the on-the-spot audit strategy and planning processes;
- the methodology, guidelines and procedures and coordination with the other research DGs and executive agencies;
- implementation/execution of the audit plan by the ex-post audit units directly and by the external audit firms (outsourced audits);
- monitoring and reporting arrangements;
- monitoring the effectiveness of the audit certification process
- measures to ensure the quality of the work undertaken;
- the follow-up given to audit results including the monitoring and implementation of corrective actions such as extrapolation of systemic errors, application of sanctions and implementation of adjustments.

Fraud prevention and detection

The objective of the audit engagement was to assess the adequacy and effective application of the governance, risk management and internal control processes for fraud prevention and detection in DG RTD.

The objective was based on the "proactive" approach to fraud prevention and detection also referred to as the "fraud audit" approach. In this approach, the search for fraud takes place when there is no fraud allegation or internal control weakness that would suggest that fraud is occurring.

The scope of the audit encompasses both preventive and detective controls:

- **Prevention** encompasses controls to reduce opportunity and decrease motive: fraud awareness programme, ethics policies, training.
- **Detection** encompasses controls which indicate possibility of fraud: exception reporting, advanced data search, ex-ante controls, ex-post control audit, ongoing risk assessment, whistle-blowing hotline.

Although the main focus of the audit was on fraud prevention and detection controls, it also covered fraud correction controls set up in order to ensure that identified instances of fraud or irregularities are effectively managed.

The scope of the audit engagement comprised the internal control system components of DG RTD as the COSO model defines them[7]:

- Control environment
- Risk assessment
- Control activities
- Information and Communication
- Monitoring

This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing.*

2.1.2. Description of Audited Activity/Process

Ex-post audit activity:

The RCS have adopted common audit strategies for FP6 and FP7. Several common coordination mechanisms have been set up to ensure a consistent approach between the RCS. These include inter alia the following working groups and committees: CAR - "Coordination group for external audits in the research family", ESC - "Extrapolation Steering Committee", JAC – "Joint Assessment Committee". Common guidelines and procedures, such as the Audit Process Handbook (APH), common checklists, templates, etc. and common IT tools have been developed. In DG RTD, Unit M1 is responsible, inter alia, for the overall planning and reporting on the audit activity, and performing on-the-spot ex-post audits. Unit M2 is responsible, inter alia, for supervising the audits performed by the External Audit Firms (EAFs), and for managing the certificates on methodology (CoM/CoMAv). Currently, about 75% of DG RTD's on-the-spot ex-post audits are outsourced to EAFs.

Corrective mechanisms:

Audit adjustments are implemented by the operational directorates, either through off-setting of the adjustment against the next payment, or through recovery. In addition, systemic errors identified are extrapolated to non-audited contracts of the audited beneficiary. The Extrapolation Steering Committee (ESC) confirms the systemic nature of the errors detected during the audits, thereby launching the extrapolation procedure. Beneficiaries cooperate in this extrapolation procedure on a voluntary basis. Unit M5 is the single point of contact for the submission of revised cost claims by the beneficiary. Contested extrapolation cases are centrally managed by Units M1 and M2 (depending on whether the underlying audit was performed "in-house" or "outsourced").

Audit certification

The system of audit certificates was introduced in FP6. Beneficiaries were required to submit an audit certificate prepared by an independent external auditor for cost claims responding to certain criteria. For FP6 the certifying auditor was requested to provide an audit opinion about the correctness of the financial data reported in the cost claim (Form C).

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[7] The scope of the audit engagement was defined based on a common audit programme on fraud prevention and detection developed by Auditnet, the network of Heads of IACs (the Internal Audit Capabilities) of the DGs of the European Commission, chaired by the Director General of the IAS.

Under FP7, the system was modified and audit certificates on financial statements (CFS) are based on "agreed upon procedures". The threshold for submitting an audit certificate was increased, so that it is estimated that 80% of the participations for which an audit certificate was needed in FP6 would no longer require an audit certificate (CFS) in FP7. In addition, ex-ante systems of certification were introduced[8]: two new types of ex-ante certificates on the methodology may be submitted: the Certificate on Average Personnel Costs (CoMAv) and the Certificate on the Methodology for Personnel and Indirect Costs (CoM). The acceptability of the methodology certificates is decided by an inter-service Joint Assessment Committee (JAC), after a desk review carried out by case-handlers in Unit M2 and the INFSO ex-post audit unit.

Fraud prevention and detection

DG RTD has developed an Anti-Fraud Control Strategy, describing its existing anti-fraud controls (those being presently developed) and outlining future developments. An action plan has been set up to further develop the anti-fraud strategy. While Unit M4 is responsible for monitoring the fraud prevention actions, Unit M1 is responsible for fraud detection controls and measures.

RCS exchange information and experiences with respect to fraud prevention and detection in the context of the FAIR committee.

DG RTD has developed the CHARON database to carry out advanced data searches for fraud detection purposes.

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[8] AAR on external audits 2010 p7

2.1.3. *Key Figures*

Table 1: Ex-post audits DG RTD (2010; Framework Programmes only)

	Number of audits closed	Number of participations audited	EC share of the costs accepted by the Financial Officer (€)	EC share of the accumulated adjustments in favour of the EC				
				Amount (€)	Annual error rate %	Cumulative error rate %	Representative error rate %	Residual error rate %
FP5	2	6	1.494.401	-564.028	-37,74%	-4,04%		
FP6	179	392	238.114.244	-13.179.828	-5,54%	-3,54%	-2,98%	-2,16%
FP7	180	251	47.736.506	-2.278.704	-4,77%	-4,83%	-4,79%	
Total	361	649	287.345.151	-16.022.559				

Table 2: Implementation of ex-post audit results (situation at 31/12/2010)

Audit adjustments (EUR)	*Results from external audits*	*Pending implementation*	*Implemented*		
FP5	6.549.721	135.394	6.414.327		
FP6	43.600.384	14.117.661	29.482.723		
FP7	2.264.450	2.107.262	157.189		
Extrapolation	*Contracts with systemic errors*	*Contracts without systemic errors*	*Implemented cases in favour of the Commission*	*Implemented cases in favour of the beneficiary*	*Cases to be implemented*
Number	6.160	1.657	577	86	3.840
Amount (EUR)			10.804.634	742.084	
Liquidated damages	*LD not applicable*	*Pre-information letter sent*	*LD claimed*	*Amount (EUR)*	
	390	115	79	619.603	

Table 3: FP7 Certificates on methodology (as of 13 May 2011; research family)

	Eligibility requests		Certificates				
Type of certificate	*Submitted*	*Accepted*	*Submitted*	*Accepted*	*Rejected*	*Withdrawn*	*Pending*
COM - Average personnel costs and indirect costs	114	70	23	7	9	2	5
COM - Real personnel costs and indirect costs			19	12	2	2	3
CoMAv - Certificate Average personnel costs	NA		85	46	9	23	17
Total			127	65	20	27	15

2.2. Audit Findings and Recommendation

Ex-post audit activity

TITLE: COMMON AUDIT STRATEGY, AND COORDINATION ISSUES **ACCEPT:** Y

REPORT FINDING NUMBER: 1 **PRIORITY:** VI

AUDIT FINDING:

Coordination

- FP7 is managed by 8 Research Commission Services (RCS), each performing their own ex-post audits, selecting their own representative sample and sometimes auditing common beneficiaries. It is essential that there is good communication between the RCS and coordination of audit plans. Although coordination mechanisms have been established these are not always effective in practice, due in part to the present accountability framework and are not always able to prevent planning "clashes". Given that many beneficiaries receive grants from different services, it is inevitable that some beneficiaries are being audited several times. As at 20 June 2011, for FP6 and FP7 together, 158 beneficiaries have been or are planned to be audited four times or more, of which 78 five times or more, and 20 seven times or more.
- Coordination ground-rules agreed in the CAR to address the risk of overlapping audits can actually delay the start of audits in practice. DG RTD, as the biggest RCS, and responsible for 40% of the audits of the research family[9], has been impacted the most by this. For DG RTD, only 30 representative audits were closed at the end of 2010 and at the 20th of June, only 91 audits had been launched and 45 audits closed.
- In order to get the representative error rate, the ground-rules for coordination are sometimes "overridden" on the basis that the beneficiary was in the MUS sample and has to be audited. The IAS noted that at the end of March 2011, at least 137 planning clashes were "overridden".

Consistency of approach – error rates

- Reliable representative error rates are a key part of a sound control strategy and should be obtained as soon as possible in the programming period to shape and direct subsequent corrective work and provide assurance for the AAR declaration. These are not yet available because of problems of coordination/constraints and/or the need to have a critical mass of cost claims to sample. Each RCS selects a MUS representative sample of 161 cost claims. However, there is little alignment between them in terms of timing and number of samples with the result that representative error rates are only available at different times for assurance purposes. The lack of a representative error rate was one of the reasons for some of the RCS of not making a reservation on FP7 in their 2010 AARs and there is a risk that representative error rates will not be available for the 2011 AARs.
- There are significant differences in the error rate calculation between the RCS. DGs RTD, MOVE and ENER calculate the residual error (RE) based on all non-audited contracts for an audited beneficiary, whereas DG INFSO calculates the RE based on all extrapolation cases for which a revised cost claim has been received. DG ENTR calculates the RE based

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[9] FP7 indicative targets: RTD 2100, INFSO, REA, ERC each 800, ENTR 382 and MOVE+ENER together 380, in total 5262 audits to be carried out by the RCS.

on all extrapolation cases that have effectively been implemented. DGs RTD and INFSO calculate the systematic error rate differently (see also Report Finding 3).

Cost effectiveness

- The increased focus on obtaining a positive DAS for the research area, by reducing the errors on the cost claims submitted by beneficiaries to below the prevailing materiality threshold of 2%, has placed more and more emphasis on ex-post audit to identify and correct errors in the cost claims. Indeed, the main action to deal with AAR reservations on the errors in FP6 has been to carry out even more audits to correct errors and "clean" the budget. DG RTD considers that it is no longer cost-effective to continually increase the audit effort in order to reduce further the error rates.
- However, the cost effectiveness of having multiple MUS samples across the RCS is coming under increased scrutiny. Increased audit activity corresponds to an increased cost of control and an increased burden on beneficiaries at a time when the focus is on trying to simplify and ensure policy objectives are achieved. A proposal to the discharge authorities for a tolerable rate of error for the research family higher than the current 2% materiality threshold to alleviate the control burden has not yet been agreed.

Scope for improving the effective coordination of the combined ex-post audit activity

There are two areas which could have a major impact on resolving the present coordination problems and the ensuing cost effectiveness issues.

- Firstly, the adoption of a single materiality level, covering the representative sample for all the research family, in line with the guidelines concerning reservations in the AAR. Each RCS is accountable for its own spending and sets/reports its own materiality level (through individual DG/AOSD representative error rates) and hence a high number of claims to be checked, irrespective of the size of its budget and complexity of the operations it finances and despite there being a common overall audit strategy for the research policy area. DG RTD reported these cross cutting coordination risks to the Commission's horizontal services in January 2010 and SG and DG BUDG raised in turn the possibility of a single audit structure for the research family, to be discussed in the Research Task Force. Pending the outcome of these discussions, they recommended that coordination be strengthened within the RCS. The Research Task Force addressed the issue of a single audit service in its report of July 2010, but concluded that the current structure should be kept until a decision is taken during the preparations for the next framework programme.
- Secondly, a less radical step would be to have a single sample system for providing assurance for all Research Commission Services. This was discussed in the Research Clearing Committee (RCC) as recently as 13 April 2011 and agreed as a priority because its absence presents a reputational risk for the Commission. It was then discussed in the CAR group May 2011, which concluded that the single sample system would have clear advantages and would be feasible, but would require further confirmation as to whether the system would be in line with the current accountability framework in the Commission. In this respect, one option would be to introduce a single declaration of assurance for all RCS together. The other option would be to maintain a system with separate declarations of assurance for each AOD. This was discussed in the RCC meeting as recently as 16 June 2011;
- Neither of these issues is new. Both have been raised previously as possible solutions to dealing with the coordination and cost effectiveness problems noted. The IAS is very aware that the RCS do not all agree and that DG RTD is probably more affected, but this audit has confirmed that these problems do exist and need to be resolved.

CURRENT RISK - RATING: HIGH:

Unless the current coordination problems, as experienced by DG RTD in particular, but also more generally by the research area, are addressed, there is a risk that further inefficiencies will persist, as will a burden on auditees, without a proportionate increase in assurance, particularly when coupled with the increasing cost of ex-post controls.

AUDIT RECOMMENDATION NO 1:

In view of the coordination problems noted and increasing cost burden, the IAS considers there is scope for rationalisation of the ex-post audit approach in the research area and recommends the following:

> DG RTD should, in conjunction with the other RCS and horizontal services, appraise the costs, benefits and accountability implications of consolidating the control strategy for the research policy area. To avoid the inefficiencies caused by auditing separate representative samples by each DG, the aim should be to have a single representative sample for the research area as a whole, giving each service assurance based on a common level of materiality. To ensure that each RCS meets its own accountability and assurance needs, the central representative sample relating to each RCS could be augmented as necessary.
>
> In addition, to address specific risks, each RCS should draw its own specific risk based sample. The planning of these audits should be centrally coordinated in order to avoid several audit visits to the same beneficiary.
>
> This appraisal should include the options of a single audit service and of a 'control architect' to oversee the existing structure, responsible for coordination, overseeing the work of the external audit firms and the framework contract, allocation of responsibilities etc.

TITLE: DG RTD AUDIT STRATEGY, AUDIT PLAN AND ITS EXECUTION **ACCEPT: Y**

REPORT FINDING NUMBER: 2 **PRIORITY:** I

AUDIT FINDING:

Lack of a documented DG specific strategy

The FP6 and FP7 audit strategies define broad principles for the ex-post audit activities and DG RTD has clearly worked on tailoring this is its own specific circumstances. The audit strategy is complemented, in practice, with a number of strategic decisions and policy options adopted, each of them individually adopted. However, it has yet to bring those decisions and policies together in one planning/strategy document which sets out:

- its approach to *all* its activities (FP7, FP6, CSF, Fusion, fraud);
- details on the number of MUS samples planned (which impacts the balance between representative and corrective audits and the related resource allocation);
- definition of how and to what extent advanced specific analyses will contribute to the selection of audits (aimed at the detection of fraud and irregularities);
- definition of the criteria to be used for the risk based selection of audits;
- definition of criteria for follow-up audits;
- KPIs for monitoring the performance of its audit activities and the quality of its deliverables such as timely delivery of audits, targets by strand (corrective vs representative), etc;
- planning prioritisation and related allocation of resources to the different types of audits and other activities of the audit units.

Gaps in the planning process

DG RTD uses a number of planning and reporting tools (e.g. AMS, "table de conduit", audit score board, mission planning table, etc.) and reports comprehensively on an annual basis in the AAR. However, the IAS notes that:

- Although the AAR provides a comprehensive report of the external audit activity undertaken in the year as a whole, there is no annual plan against which this can be compared.
- Available resources are calculated only based on the "rule of thumb" that roughly 350 audits (required to achieve the objectives of the audit strategy) can be carried out a year – in-house and by the EAFs– and that in-house, each auditor can carry out maximum 10 missions a year. A more detailed calculation was launched in 2008 but never finalised.
- The different range of tasks to be carried out by DG RTD external audit activity are not fully set out in a plan.
- There is no detailed reconciliation between the available resources and the resource requirement of the tasks planned, or an assessment of the discrepancies and subsequent prioritisation of tasks.
- The basis for the audits made during the FP6 and FP7 campaigns and the underlying risk criteria is clearly set out in the "Narrative Document", but this was only documented after the criteria for risk based sampling were decided and actually applied in practice.

- The indicative target for 2010 of the FP7 audit strategy was 210 audits. However, only 184 audits on FP7 were closed during 2010 by DG RTD, of which only 30 from the representative sample.
- Concerning FP6 audit strategy, the indicative targets were not updated to take account of the impact of wrong assumptions about the portion of systematic errors in the population. Additional audits were needed to reduce the residual error rate to below 2%.

Execution of the audit plan in practice

- The number of audits closed by DG RTD in recent years is significant and reflects the priority attached to this work (382 in 2008, 317 in 2009, 365 in 2010). However, despite this, it still takes a considerable time to close *individual* audits. For those started in the period 2008-2010, the average time to close was about 286 days (280 days for the outsourced audits, and 298 days for the in-house audits). On average, 23% of all audits take more than 1 year to close (21% for outsourced audits, 26% for in-house audits), and 44% take longer than 9 months to close (44% for both outsourced audits and in-house audits). At the end of 2010, 334 audits were still open, of which 300 relate to audits started in 2008-2010, representing 25% of all audits started in that period.
- An ECA[10]review of a sample of 30 audit files found that the average time between the date of the audit and the letter of conclusion exceeds 10 months. The IAS sample of 7 audit files (4 internal, 3 external) found the average time was 390 days.
- For the outsourced audits, the long delays can partly be explained by the increased number of involved actors and formal deadlines contractually agreed with the EAFs.
- It should also be noted that certain milestones are defined in the audit manual and/or in the framework contract with the EAFs. However, there are no such formalised milestones (pre-defined deadlines for the main steps of the process) for in-house audits to help monitor progress and prioritise resources. Coupled with the considerable time it sometimes takes to request additional information or confirm findings with auditees, this contributes to the long closure times.
- For the four in-house audits reviewed by the IAS, DG RTD explained that the long delay between the date of the mission and the draft report was because of priority being given to other tasks/audits. In two of those cases, the auditors needed to request additional information from the beneficiary, but this request was made a long time after the mission date.

CURRENT RISK - RATING: MEDIUM:

The lack of a formal annual planning/strategy document, coupled with the gaps in the audit planning process, needs to be seen in conjunction with the absence of a quality assurance and improvement programme noted in Audit Finding Number 4. For an already established audit service such as DG RTD's, such gaps pose a risk to its reputation and credibility, particularly given that ex-post audits are such a key part of the overall control strategy.

More specifically, without the key elements in place and in particular the absence of formal milestones, there is a risk to the continued effective management of the function and to the delivery of the planned assurances.

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[10] PF 4330

AUDIT RECOMMENDATION NO 2:

DG RTD should:

- formalise its DG specific audit strategy, within the framework of the common RCS audit strategies (FP6, FP7) and formalise an annual audit planning document and capacity plan (if necessary, strategy and planning aspects can be dealt with in the same document);
- set internal milestones, together with KPIs, for completing the different steps in the audit process (e.g. time between mission and requesting additional information to the beneficiary, between the mission and the draft report, between the draft report and the letter of conclusion, etc.) and ensure that these are effectively monitored in practice;
- reduce the time necessary to conduct and close audits.

TITLE: ERROR RATES	**ACCEPT:** Y
REPORT FINDING NUMBER: 3	**PRIORITY:** I

AUDIT FINDING:

- Currently the residual error rate is calculated based on the representative error rate, and the potential effect of the correction of all errors in audited amounts and of systematic errors on the non-audited amounts of audited beneficiaries. All errors detected in audited amounts are assumed to be corrected or will be corrected and that all non-audited amounts of audited beneficiaries are free from systematic errors, either because there are no systematic errors detected, or systematic errors will be recovered through the extrapolation process.
- However, extrapolation is a voluntary process on the part of the beneficiary and there is a high number of contested cases. Consequently, actual rates of implementation are quite low in number and value terms (see also Report Finding 5). Furthermore, the IAS found that Unit M5 has not yet recommended any follow-up audit on extrapolation cases. The IAS considers therefore that the effectiveness of the extrapolation process is not sufficiently demonstrated to justify the reliance in the calculation of the error rate on assumed future recoveries and there is risk of underestimating the reported residual error rate, which, given the continued sensitivity of the annual 2% materiality level for AAR reservations, could pose a reputational risk to the DG.
- It should be noted that calculation of residual error differs between the RCS. DGs RTD, MOVE and ENER calculate the residual error based on all non-audited contracts for an audited beneficiary, DG INFSO calculates it based on all extrapolation cases for which a revised cost claim has been received and DG ENTR calculates it based on all extrapolation cases that have effectively been implemented.
- The systematic error rate calculation used by DG RTD is different from the one used by DG INFSO (see also Report Finding 1). The IAS recalculated the DG RTD systematic error rate based on the DG INFSO method and the other way around, but found no significant deviation for the data as of 31/12/2010.
- Under the FP7 audit strategy, representative sampling and therefore also the error rate calculation should be based on cost statements. Audit adjustments should therefore be shown by cost statement and positive and negative adjustments netted at this level. However, DG RTD currently report at the level of "audited participations"[11] as its systems are not adapted to report at cost claim level. Audit adjustments and the annual and cumulative error rates for FP7 (and for previous FP) are calculated on this basis, except for the representative error rate for FP7, which is calculated separately based on an Excel listing of cost claims and related adjustments selected in the MUS sample.

CURRENT RISK - RATING: MEDIUM:

The reporting of error rates is particularly sensitive in view of the objective to obtain a positive DAS. Consequently, inconsistencies in approach between the RCS can pose a risk to the perceived reliability of these rates amongst key stakeholders/external users.

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[11] 'Audited Participation' means at the project level where all individual, related cost claims are consolidated.

AUDIT RECOMMENDATION NO 3:

DG RTD should coordinate with the other RCS and the central services to bring more consistency to the reporting of error rates for the research area as a whole. In addition, there should be an agreement on whether adjustments should be reported at the level of cost claims or audit participations and the reporting systems should be adapted accordingly.

TITLE: CONTINUOUS QUALITY IMPROVEMENT **ACCEPT:** Y

REPORT FINDING NUMBER: 4 **PRIORITY:** I

AUDIT FINDING:

DG RTD has put in place a number of procedures to ensure the quality of the audit activity, both concerning audits managed in-house and audits performed by the External Audit Firms (EAFS). These include proper file review processes, clear distinction between draft and final reports stages, supervisory arrangements, the development of audit manuals, checklists, standard templates, scoping of the work. For outsourced audits, DG RTD has also audit manuals, reporting and supervision arrangements.

However, the IAS notes that these measures have not yet been translated into a proper quality assurance and improvement programme, which, given that the audit function has been operational for several years, could bring it to the next level of maturity and strengthen existing procedures and credibility. Areas where the current approach could be improved include:

- Definition of the audit standards the DG intends to comply with.[12]
- The need for an audit charter or equivalent document which clearly addresses issues such as the purpose, authority, responsibility, position within the organisation and independence.
- Key performance indicators to monitor performance and quality.
- Conducting periodic internal reviews through self-assessments or peer reviews.
- Being externally and independently assessed to assess compliance with standards and identify improvements.
- Improvements to internal documentation.
- More systematic audit training and encouraging auditors to obtain an audit certification.
- Appropriate and effective arrangements for relying on the work of other auditors, which are in line with recognised auditing standards. The ECA has reached similar conclusion in its preliminary findings on its work on the research area ex-post audit functions, carried out in the framework of the DAS 2010[13], although it is noted that this finding was contested by RTD.

CURRENT RISK - RATING: MEDIUM:

The absence of a quality assurance and improvement programme needs to be seen in conjunction with the gaps in the planning process identified in Audit Finding No 2. DG RTD already has a well established audit function and to formally embrace such quality aspects should allow it to move to the next stage of maturity and demonstrate a very clear commitment to maintaining high standards. Failure to do so could pose a risk to its reputation and credibility, particularly given the importance of the function in the overall control strategy.

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[12] Although on some specific points, the APH refers to standards issued by the International Federation of Accountants (IFAC) or the American Institute of Certified Public Accountants (AICPA)

[13] PF 4330

AUDIT RECOMMENDATION NO 4:

DG RTD should develop a comprehensive quality assurance and improvement programme. Recognising the established nature of the DG's audit function, the components of this programme should be left to the DG to decide. However, the IAS recommends consideration be given to:

- Clearly defining the international audit standards it should comply with.
- The need for an audit charter or equivalent document which defines the purpose, authority, responsibility and position.
- Developing appropriate KPIs to monitor performance and quality.
- Periodic internal assessment through self-assessment and/or peer reviews
- Periodic external quality assessments to evaluate the quality of the audit activities and its compliance with the international audit standards.
- Additional procedures for increasing quality assurance for relying on the audit conclusions of the EAFS.
- Strengthening of the present supervision arrangements for in-house audits.
- Further development of the auditor training programme and encouraging auditors to obtain an audit certification.

Corrective mechanisms

TITLE: CORRECTIVE MECHANISMS **ACCEPT:** Y

REPORT FINDING NUMBER: 5 **PRIORITY:** I

AUDIT FINDING:

Delays in the issuance of guidelines

- Audit adjustments and extrapolation measures are already established procedures, but the finalised guidance on FP6 was only issued in September 2010 and for FP7 it has yet to be issued, although a draft is currently under discussion. In addition, although raised in a previous IAS audit[14], guidance on financial penalties and sanctions has yet to be issued. However, at the time of the audit, the draft guidelines were still being finalised.

Extrapolation process – a slow process with limited results

- Extrapolation is a long, complex and very resource intensive process. In practice significantly more extrapolation cases are launched than cases are closed. As at 31/12/2010, a total of 6159 DG RTD participations have been identified as potentially subject to extrapolation. For 5217 (85%) of those, DG RTD is the lead DG. Of the total 6159 participations, 663 (11%) had been closed as at end of 2010, of which 577 participations in favour of the Commission representing 10,8M€, and 86 participations in favour of the beneficiary representing 742 K€. For 1629 participations, extrapolation was considered not applicable. There are 1418 participations put on hold and managed centrally, mainly because the contractor does not agree with the proposal.
- As at 9 June 2011, extrapolation had been started up for a total of 6456 participations, out of which 874 (14%) had been closed, 26% cancelled and 60% are still open. The average time since the start of the open cases is some 605 days. A total of 2745 (71%) have been open for more than a year and 1860 (48%) more than 2 years.
- There are inherent reasons why the figures are so low. First, a large number of different parties are involved in the process. In addition, the process is essentially a voluntary one as beneficiaries cannot be forced to cooperate. However, despite this, there are weaknesses in the DG's management of the process as follows:
  - There is a lack of central monitoring. Only 13 reminders were actually registered in the database and the IAS noted problems with the current IT tools (e.g. ASUR) for the monitoring of the management of the extrapolation process by the AOSD. The system is not updated with the amounts effectively 'recovered' from the beneficiary (through off-setting against the next payment or recovery order). There is also a lack of guidance to users on the key fields to be completed (e.g. the date when the adjustment is considered to be implemented). In addition, the tool does not facilitate an effective tracking/follow up on progress of specific cases at the decentralised level, resulting in non-official, ad-hoc tables been developed outside the main tool.
  - Currently, there are no real materiality criteria for launching cases and no agreed extrapolation methodology for dealing with positive/negative adjustments. A prioritisation of cases is therefore difficult.
  - The monthly report on the implementation of audit recommendations lacks the key information, such as KPIs, necessary to be useful to management in monitoring

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[14] DG RTD's Internal Control System for managing the 7th Framework Programme – Design" dated 29-05-09

progress and was found to contain errors in the underlying data.

- In the extrapolation procedure, the beneficiary resubmits revised cost claims to the Commission. The correctness of these revised cost claims is verified through (1) plausibility and exhaustiveness checks and, if necessary (2) follow-up audits. The IAS found that Unit M5 has not yet recommended any follow-up audit on extrapolation cases.

CURRENT RISK - RATING: MEDIUM:

Given the delays and constraints involved in the extrapolation process, a failure to effectively manage, monitor and follow up cases could result in even more resources being consumed than is already the case. The process involves many actors and operates on a decentralised basis. A lack of clear guidelines may lead to incorrect procedures being applied, which may serve only to further delay what is already a long process. A lack of materiality criteria or prioritisation means that the number of cases is extremely high

AUDIT RECOMMENDATION NO 5:

DG RTD should ensure the relevant guidelines supporting corrective mechanisms are finalised as soon as possible and strengthen in particular the overall management of the extrapolation process through better guidance, monitoring, follow up and reporting. Materiality criteria and/or prioritisation of cases should be introduced.

Audit certificates

TITLE: AUDIT CERTIFICATES	**ACCEPT:** Y
REPORT FINDING NUMBER: 6	**PRIORITY:** I

AUDIT FINDING:

The system of audit certificates introduced in FP6 has been modified by an audit certificate system based on "agreed upon procedures" and the requirements for the number of cost claims for which a certificate had to be submitted to reduce the administrative burden. In addition, two new types of ex-ante certificates on the methodology which may be submitted prior to the costs being claimed have been introduced: the Certificate on Average Personnel Costs (CoMAv) and the Certificate on the Methodology for Personnel and Indirect Costs (CoM). The acceptability of the methodology certificates is decided by an inter-service Joint Assessment Committee (JAC), after a desk review carried out by Unit M2.

Low take-up of the certificates on methodology

- Take up rates for CoM and CoMAv have been very low. Only 46 CoMAv have been accepted so far compared with initial estimates of about 5000, the main reasons being the strict acceptability criteria and their late adoption. The 2011 Commission decision on additional simplification measures[15] introduced more flexible acceptability criteria and made CoMAv optional. The incentive for the beneficiaries is low and SMEs owner managers and physical persons have now to use flat rates and cannot use average personnel costs anymore. Hence, the take up probably will not increase significantly. At the time of the audit, only 19 CoM have been accepted compared to an estimate of about 700, with the restrictive eligibility criteria meaning that only a limited number of larger beneficiaries are eligible. Take up rates are unlikely to increase significantly either.
- The FP7 audit strategy includes very little on the link, if any, between the audit certification process and the control strategy more generally. DG RTD sees the CoM/CoMAv system as a pilot project rather than a pre-determined component of its assurance strategy. It acknowledges that, depending on the results, there can be an impact on the controls exercised in practice (although for the overall control strategy this impact is limited in view of the low take-up of the CoM/CoMAv). This can lead to a reduced audit scope (i.e. more focus on compliance with the approved methodology) where a CoM or CoMAv has been accepted. However, the audit certification process in general (including Cost Financial Statements) is not used to drive/influence the risk-based selection of audits with the risk of a potential disconnect between the ex-ante audit and ex-post part of the control strategy.

Monitoring effectiveness of the audit certificates system under FP7

- At present, DG RTD has no real assurance on whether the audit certification system is working as intended. In fact, in the framework of the DAS 2010, the ECA identified that 27 out of 33 cost claims examined (which were accompanied by an audit certificate) still contained errors and 14 were assessed as serious. Nine cost claims with errors and 3 with serious errors concern FP7[16].

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[15] COM (2011) 174 dated 24.01.2011

- The operational directorates (for CFS) and Unit M2 (for CoM/CoMAv) carry out desk reviews, but do not make checks on-the-spot of cost claims supported by such certificates to see whether the process actually works in practice. Where claims supported by audit certificates are hit through the ex-post audit sample, the auditor is required to report any differences between his opinion and the certified opinion. However, the results are not subject to any systematic review or analysis aimed at confirming to management the reliability of the system and the action to take, if any. Although certificates have been submitted since the beginning of 2009, to date, efforts to assess in a timely manner, the reliability of the audit certification system (CFS, CoM, CoMAv) under FP7 are still at an early stage, pending the build up of a critical mass to examine. In addition, despite the fact that the simplification decision was taken in January 2011, the guidance notes for managing the audit certificates process have not yet been updated in the audit manual.

CURRENT RISK - RATING: MEDIUM:

The audit certificates process was intended to be an important part of the overall control strategy from the research area. Unless the process is effectively monitored and assessed, there is a risk that DG RTD will not be in a position to adjust and refine that control strategy accordingly. Risks may not be properly addressed and assurances may be compromised and scarce control resources used inefficiently. However, the IAS acknowledges the need for there to be a critical mass to examine.

Failure to update and communicate key guidance on a timely basis to stakeholders increases the risk of procedural errors and the knock-on impact of delays to the process and increased costs.

AUDIT RECOMMENDATION NO 6:

- DG RTD should, in cooperation with the other RCS, assess and monitor the reliability and effectiveness of the different elements which make up the overall system of audit certificates (CFS, CoM, CoMAv). The results should be used to inform the control strategy and the preparation of the next framework programme

- In view of changes in the regulatory framework, the related guidance should be updated and made available to project promoters, beneficiaries, certifying auditors, etc.

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[16] PF-4350 (INFSO), PF-4351 (RTD)

Fraud prevention and detection

TITLE: FRAUD PREVENTION AND DETECTION	**ACCEPT:** Y
REPORT FINDING NUMBER: 7	**PRIORITY:** VI

AUDIT FINDING:

Common fraud prevention and detection strategy

The IAS notes that the RCS exchange information and experiences with respect to fraud prevention and detection in the context of the FAIR committee. The analysis[17] of detected fraud cases indicates that fraud schemes, red flags and preventive and detective measures are largely common to the RCS. However, despite the fact that all RCSs work under the same legal framework for the management of the research framework programmes, have essentially the same processes, control systems and guidance material for the selection, management and funding of similar projects, and have largely common beneficiaries, **there is no common fraud strategy for the research area as a whole**. Several RCS, including DG RTD have developed their own fraud strategy, taking into account DG INFSO's and/or DG RTD's fraud strategy as a reference. The recently adopted Commission Communication on the Commission's anti-fraud strategy recommends that, where applicable, implementation should be based on specific **sectoral anti-fraud strategies**.

DG RTD fraud strategy

Following a recommendation made by the IAS in a previous audit[18] and in line with the increased focus on fraud prevention and detection in the Commission, DG RTD issued its own anti-fraud control strategy in August 2010, together with an action plan with 17 concrete actions to further develop it.

Monitoring arrangements

The IAS notes that, while most actions were planned to be implemented by the first quarter or the first semester of 2011, several actions are either not yet implemented or the way they will be implemented is not yet clearly defined. For certain actions, it was not possible to obtain a concrete or up-to date reply on the state of play of the action.

Implementation of the fraud strategy in DG RTD

Based on its review of procedures and guidelines and interviews with staff in the key units, the IAS considers that DG RTD's management has identified the most significant weaknesses concerning the implementation of fraud prevention and detection measures and included these in the action plan. The focus of the IAS review therefore is on the action plan.

Fraud risk assessment (actions 2 and 4)

Using OLAF's[19] analysis of fraud cases and other sources as a guide, unit M4 made a list of potential fraud related risks. No directorate has identified any fraud related risk. Although the perceived likelihood of fraud risks is low, the fact that fraud related risks have not even been raised suggests a lack of awareness of the seriousness of the potential impact of fraud risks on DG RTD's operations as a whole, if not in the specific directorates.

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[17] "Compendium of anonymised cases – Research", OLAF

[18] "DG RTD's Internal Control System for managing the 7th Framework Programme – Design", dated 29-05-09

[19] "Compendium of anonymised cases – Research", OLAF

Awareness (actions 7, 8, 9, 10)

Whilst there is a general understanding of fraud prevention and detection and the link to controls and ethics, there appears to be very limited awareness of the DG's actual anti-fraud strategy. There is no specific guidance on fraud prevention and detection for DG RTD staff. References to the fraud strategy are included in the training for newcomers. Only the auditors of M1/M2 have attended a specific training on fraud prevention and detection organised by DG INFSO/OLAF.

Awareness raising actions (9 and 10) concerning the coaching of staff, organising training sessions and developing an awareness plan, which had a deadline of the first semester of 2011, have not yet been fully implemented. Training on fraud prevention and detection was included in the Learning and Development Strategy 2011, and the first training will take place in October 2011.

Fraud prevention and detection checks in ex-ante controls (action 13)

Procedures and controls carried out at all stages of the grant management process can contribute to anti fraud effort, but these have not been embedded in the processes and procedures or in relevant guidance material. Action 13 foresees guidelines on the application of additional ex-ante controls for fraud prevention and detection and to include these into existing guidance material on the relevant processes, including guidance on the use of pre-investigation tools and desk reviews during ex-ante controls. The deadline is the first semester 2011, but to date there is no concrete information available as to how this will be implemented in practice. The use of pre-investigation tools in ex-ante controls processes has not yet been defined/clarified.

Detection of plagiarism (action 17)

There are currently no systematic checks for plagiarism. Any such checks are at the initiative and expertise of the project officers. There are no IT tools or guidance material available to support the Project Officer (PO) or the ex-post audit units in this regard. Under Action 17 DG RTD plans to cooperate with DG INFSO in looking for a commercial IT tool to detect and prevent plagiarism and/or develop internally such a tool and include discretionary plagiarism checks in the guidelines. The deadline is the first quarter of 2012, but no suitable software has yet been identified or planned to be developed internally.

Access to audit results during ex-ante processes (action 5)

The IAS notes that selected data from ASUR on audit results and their implementation are included in CPM. However, more details on the audit results or the audit reports do not systematically feed into the common IT tools used by the staff in the UAF and in the operational units. The Audit Liaison Officer (ALO) in each 'Unité Administrative et Financière' (UAF) is informed of audit reports (draft and final) and has also access to reports of previous audits. He then transmits these reports to the Financial Officer/Legal Officer/Project Officer, but the latter are not able to consult directly audits made on their beneficiaries.

Action 5 plans to integrate AUDEX, the new central audit reporting system, into NEF, the tool used in the negotiation process. Although full implementation was expected by March 2011,

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[20] "DGT RTD internal Control System for managing the 7th Framework Programme – Design" dated 29/05/2009

the linking of AUDEX to CPM (not NEF as originally intended) is currently pending finalisation.

Fraud detection in the ex-post audit process (actions 1, 11, 12)

- Action 1 states that the new advanced data search tool CHARON would be used as a basis for the risk based selection of audits and as a preparation of batch audits. CHARON is used firstly to analyse information to identify projects, beneficiaries or individuals with a potential risk of irregularities or fraud, for possible audit. However, in practice the use of CHARON in this regard is still in the early stages. Secondly, CHARON is used to further analyse projects, beneficiaries or individuals for which suspicions have already been raised (e.g. in the framework of an OLAF investigation), either to decide on the need to launch an audit, or to prepare the audits. Here the use of CHARON is more advanced.
- From its sample of in-house managed audits and audits performed by the EAFs, the IAS found only very limited evidence of data gathering activities focused on fraud detection. The Audit Process Checklist has been updated to provide for the possibility to consult the advanced data search tool, but this update has not yet been approved for use. The guidance in the Audit Process Handbook on data gathering is only recommended and in practice only applied by the OLAF team. For other audits from the representative or corrective strands, it is left to the professional judgement of the auditor to decide whether to carry out additional data gathering activities specifically targeted at fraud detection, but the IAS understands these are not often considered necessary.
- The CHARON databases have been further developed and updated, with the new version, DAISY. The possibility of sharing CHARON with the other RCS has been discussed, but it is not yet clear to what extent INFSO will use CHARON and/or the link between PLUTO and CHARON.

Sanctions and penalties (action 14)

The lack of guidelines on the application of *financial penalties and sanctions* was already raised in a previous IAS audit[20] and the action plan following this audit planned for those guidelines to be issued by 31/12/2009. The guidelines were issued on 8 July 2011.

Double funding

The risk of double funding is not systematically addressed in the procedures and controls of the different phases of the grant management process (negotiation, project review, audit). Although the development of controls aimed to prevent and detect double funding, both prior to the signature of the grant agreement and ex-post, was included in the anti-fraud strategy, it was not included in the action plan. The risk of double funding was not identified in DG RTD's 2010 risk assessment exercise.

CURRENT RISK - RATING: HIGH:

Without the common steer of an overall sectoral fraud strategy, there is a risk that the RCS might fail to identify, prevent and detect significant and common fraud risks. This could have a major reputational impact, particularly given generally well-perceived anti-fraud efforts already made in key areas of the research domain.

The specific anti-fraud measures taken already by DG RTD are welcomed, but the delays and lack of clarity surrounding the action plan means that this should still be considered as work in progress and if not addressed, could undermine the credibility of the achievements so far.

AUDIT RECOMMENDATION NO 7:

- Looking forward, and building upon the work already undertaken on its own specific strategy and the initiatives elsewhere, DG RTD should work with the other RCS to develop a common fraud strategy for the research area as a whole.

- The action plan should be updated to reflect more realistic target dates. Key actions should be defined more clearly, and overall monitoring of the action plan should be strengthened. In particular, DG RTD should:

– ensure that those involved in the annual risk assessment are made sufficiently aware of fraud related risks. Such risks should be considered in the analysis made by the horizontal directorates;

– communicate the fraud strategy to all staff in the DG;

– review its ex-ante processes and procedures and ensure that specific, additional fraud checks are included, where relevant;

– work with DG INFSO in order to develop possible solutions for detecting plagiarism;

– examine the scope for making more use of data gathering activities, including using CHARON, as an input for the audit risk assessment;

– assess the double funding risks and ensure these are properly addressed in the control system in all stages of the grant management process;

– continue to explore, together with the other RCS, the possibility of common advanced data search tools, including the need to maintain separate Pluto and CHARON systems in the long run.

ANNEX 1: AUDIT METHODOLOGY

1. Audit Methodology

This audit engagement was conducted in conformance with the IAS Guidelines and Mutual Expectations Paper and the *International Standards for the Professional Practice of Internal Auditing.*

A letter announcing the audit on the Control strategy – On-the-spot controls was sent to DG RTD on 8 October 2010. A letter announcing the inclusion of Fraud prevention and detection in the scope of the audit was sent to DG RTD on 7 February 2011. The opening meeting to discuss mainly logistical and practical arrangements took place on 19 January 2011. Preliminary meetings to discuss the planning of the audit and the internal organisation of RTD, and to collect relevant information, were held with the designated DG RTD contact person and representatives of the units M1, M2, M4 and M5. In addition, the IAS attended meetings organised by the ECA in the framework of their ongoing audits on the ex-post audit function and the ex-ante certification of costing methodologies. The kick-off meeting with the Director-General of DG RTD took place on 10 March 2011.

The preliminary survey was conducted in order to gain an insight into the design and management of the processes and activities concerned and identify the specific objectives and scope of the audit. It involved the review of relevant information, a synthesis of previous audit work and meetings with DG RTD's staff.

Audit programmes and interview checklists for key relevant personnel were developed to evaluate the adequacy of the internal control system and risk management processes of the items mentioned in the scope. Interviews were carried out with staff in units M1, M2, M4, M5, R1 and a selection of operational and administrative and financial units. These interviews, together with supporting documents and relevant information obtained from the auditee formed the basis for the evaluation of the design of the internal control systems.

Following the evaluation of the adequacy of the internal control system, tests of transactions were performed in order to verify the application in practice of the strong internal controls. The testing has been performed on the basis of a judgemental sample of 7 audits (4 audits performed by Unit M1, 3 audits performed by External Audit Firms, and supervised by Unit M2) to understand the processes concerning ex-post audits and the resulting corrective actions (including extrapolation, recoveries and liquidated damages).

The IAS organised a formal validation meeting with the auditee on 28 June 2011. A "Findings Validation Table" (consisting of findings and indicating risks, draft recommendations and ratings) was issued by the IAS one week prior to the meeting.

2. Follow-Up

In accordance with the IAS's follow-up policy, an audit follow-up engagement is planned to be conducted within one year from the issuing of the final report.