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Directorate A - Inter institutional and legal matters – Framework programme

A.4 External audits

A.5 Implementation of audit certification policy and outsourced audits

ANNUAL ACTIVITY REPORT ON EXTERNAL AUDITS 2009

ANNUAL ACTIVITY REPORT ON EXTERNAL AUDITS – 2009
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EXECUTIVE SUMMARY

During 2009, the third year of the multi-annual FP6 Audit Strategy, the external audit Units have continued to ensure its effective implementation while taking stock at the same time of its results and findings for the preparation of the Audit Strategy for FP7, which was agreed in September by all Commission services concerned. The FP7 audit campaign was consequently launched, and it is expected to last until 2016.

The FP7 Audit Strategy (AS) is a natural progression from the strategy developed for FP6. Its objectives are similar and it follows on the statement made in the FP6 Mid-term review that it was delivering its expected outcomes. Certain assumptions of the FP6 Strategy have de facto been corroborated by results and those assumptions could therefore safely be applied for FP7, such as the fact that most errors found relate to personnel costs and overheads, or that extrapolation has an important potential 'cleaning' effect of systematic, material errors in the budget.

Having said that, there are also important changes in the FP7 AS. Some are the result of technical refinements borne out of previous experience and of information about the auditable population not available previously, such as the possibility of using actual costs submitted by beneficiaries as the basis for sampling instead of theoretical funding estimations made when contracts are signed. Other changes relate to the inherent differences between FP6 and FP7 in areas such as requirements for audit certificates (compulsory in FP6 but only required when the requested funding is over 375,000 € in FP7), or the number of Commission services involved (6 Research DGs and 2 Executive Agencies instead of just 4 Research DGs).

Nevertheless, the most important changes from the point of view of the effectiveness of the FP7 AS result from assumptions in the FP6 AS which have been proven erroneous by results, in particular the assumption that most material errors in FP6 would be of a systematic nature. In fact, systematic errors so far account for only about [REDACTED] of errors in favour of the Commission. This important finding, combined with the subsequently reduced 'cleaning' effect of extrapolation, has to lead in turn to a revision of the expectation that effective auditing, extrapolation and recovery will lead to a residual error rate of less than 2%. The fact that this assumption is to be nuanced was already highlighted in the ABM Progress report(s) of 2009.

Another significant finding is that the FP6 representative error rate has stabilised around [REDACTED] during the last year. This result compares with an overall [REDACTED] error rate for FP5, and it is based on an auditing volume already five times bigger than for FP5, an enormous proportional FP-on-FP increase in auditing efforts. [REDACTED]

During the last year we also achieved one of the main objectives of the FP6 Audit Strategy, namely to 'clean' from systematic material errors at least [REDACTED] of the budget. In addition, [REDACTED] FP6 audits have been closed so far by the end of 2009. This is well above the original minimum multi-annual target [REDACTED], attained more than one year ahead of schedule.

Other highlights of the year include: the adoption by the Commission in June 2009 of a decision on interim implementation rules concerning acceptability criteria for the average personnel cost methodology; the signature of six new framework contracts for the provision of audit services by external audit firms and the successful migration to a new IT audit management system (AMS), replacing a local tool.

Even though 2009 has been another busy and successful year for the external audit Units, and this report provides much proof of that, it is still worth mentioning areas where additional efforts will be needed during the year ahead.

There were examples during 2009 of the limitations inherent to the current governance structure in the research family, with multiple AODs, multiple external audit Units and a substantial overlap of common beneficiaries, when it comes to effective implementation of the audit strategies.

[REDACTED]

Despite the development of several IT tools for planning co-ordination purposes during the year, these limitations will have a bigger impact in FP7 considering the increase in the number of Commission services involved and constraints created by certain technical refinements.

These issues were transmitted as cross-cutting risks to central services of the Commission, in view of their potential consequences.

Implementing extrapolation has remained difficult during 2009 [REDACTED]
[REDACTED] Two important actions have been taken in this respect: a more centralised system for reception and processing of revised cost statements in our DG, and simplification measures for beneficiaries, but their effect has still to be felt. In addition, follow-up reviews and audits on extrapolation cases were launched in order to formally close older extrapolation cases. At the end of 2009, DG RTD has [REDACTED] extrapolation cases on file; for all RDGs there are [REDACTED] cases. In total, [REDACTED] [REDACTED] participations are affected by extrapolation. The increase in workload generated by extrapolation for both the Commission services and beneficiaries, together with the request in the EP's discharge resolution for the 2008 financial year to reduce the need for beneficiaries to re-calculate cost statements already submitted, were at the basis of the Commission Communication of December 15th, 2009 seeking ways to facilitate the implementation of extrapolation through, for example, flat-rate corrections. The external audit Units contributed to the elaboration of this Communication.

The commitment to the development of a fraud detection strategy for DG RTD has led to an increase in activity in RTD A.4, in particular in its dealings with OLAF. These very resource-intensive files are bound to grow in importance in the years to come and may have resource implications.

[REDACTED] as well as its involvement in the pilot-project for scientific/technical audits.

In 2010, efforts will be equally concentrated on FP6 and FP7 audits with a view, on the one hand, to bring the implementation of the FP6 AS to completeness and, on the other, to provide a first representative indication of the amount of error present in FP7 at this point, as well as correcting any errors encountered as early as possible so that they do not reoccur during the lifetime of the framework programme.

1. BACKGROUND

1.1. Introduction

The purpose of this document is to report on the ex-post audit activities in DG RTD during 2009, using the numerical results of the verifications carried out and providing feedback on any qualitative issues that may have come to light. As such, it also contributes to the opinion of the Director General in DG RTD's Annual Activity Report on whether reasonable assurance exists that the legality and regularity of the underlying transactions have been respected.

1.2. Legal background

For FP6, which is still the major source of work for ex-post audit activities, the legal basis for the external audit activity is Annex III point 2, paragraph 7 of the Decision n° 1513/2002/EC of the European Parliament and of the Council, and Article 18 of Regulation (EC) n° 2321/2002 of the European Parliament and of the Council. For FP7, reference must be made to Article 5 of the Decision n° 1982/2006/EC of the European Parliament and of the Council, and Article 19 of Regulation (EC) n° 1906/2006 of the European Parliament and of the Council.

The model contract for the 6th Framework Programme (Annex II, Article 29) states that: *'the Commission may, at any time during the contract, and up to five years after the end of the project, arrange for audits to be carried out, either by outside scientific or technological reviewers or auditors, or by the Commission departments themselves including OLAF'*.

Similar provisions are foreseen in the model grant agreement for the 7th Framework Programme (Annex II, Article 22).

1.3. The mission of the External Audit Units

Through the execution of financial audits to the highest professional standards, the external audit Units provide a level of reasonable assurance to senior management and, ultimately, to the Discharge Authority (European Parliament and Council), on whether DG RTD contractors are in compliance with the terms of the RTD contract(s). As such, the ex-post audit results provide a representative error note and initiate the recovery procedure managed by the operational services. By doing so, the external audit function contributes to the protection of the European Union's financial interests.

The responsibilities related to external auditing are attributed to two Units: RTD A.4 is responsible for strategy and planning coordination, in-house on-the-spot audits and back-office work¹; RTD A.5 is responsible for outsourced on-the-spot audits and the implementation of the audit certification policy. The mission statements of both Units are in Annex I.

¹ Back-office work refers to a number of tasks in support of the auditing function including information systems and data maintenance, batch preparation, extrapolation, management reporting and a variety of administrative tasks.

1.4. Relation with the control framework activities of DG Research

Ex-post audit activities need to be seen as part of the overall integrated control framework put in place by the Directorate General. Internal control activities include all ex-ante and ex-post evaluations, controls, financial and scientific verifications and monitoring tools.

In the area of grant management for research expenditure, the focus remains very much on ex-post controls after payment, avoiding ex-ante controls for contractors as much as possible before payment. This is a conscious decision with the aim to reduce administrative burden ex-ante as much as possible, facilitating in general the time-to-grant process.

Accounting transactions included in the cost statements are processed through the internal control systems of beneficiaries, checked in FP6 by their certifying auditors, who then issue an audit certificate. These transactions are also monitored by the Commission's Project Officers (scientific and financial) even before the arrival of the cost statements, and thereafter checked by means of desk reviews before payments are made. The use of certifying auditors is very different under the 7th Framework Programme (FP7). Simulation exercises have shown that 82% of the transactions for which an audit certificate was needed under FP6 would not require an audit certificate in FP7. As a conclusion, the internal control system under FP7 will rely even more on the ex-post audit activity.

The control chain described above, which operates before any ex-post financial audit is carried out, has to be considered in the overall evaluation of risk and of the external audit results. Close cooperation exists between auditors and Operational Units in the preparation phase of an audit, as well as in the implementation phase of the audit findings, in the form of contacts through the Audit Liaison Officer in order to obtain an agreement concerning audit findings and their implementation.

In 2009, DG RTD continued following up the conclusions of the ad-hoc working group charged with defining the scope, feasibility and possible synergies with scientific and technological audits (as opposed to project reviews and ex-post impact assessments). RTD A.4 carried out the first pilot-projects of technological and scientific audits.

1.5. The audit campaigns

Given the reliance on ex-post audit activity, a general approach was defined for FP5 and proper audit strategies have been established for FP6 and FP7.

1.5.1. The FP5 audit campaign

For the 5th Framework Programme (FP5), DG RTD's audit policy was mainly based on random sampling, and partially on risk assessments. The underlying assumption was that, provided that the sample was large enough, conclusions could be drawn for the whole population. DG RTD decided that a sample of around 10% of contractors would be audited over the lifetime of the Framework Programme, in order to give a representative picture of the population.

It was later recognised that, with the resources available at the time, the 10% target was unrealistic. At present, there remain only ■ ongoing FP5 audits, which should be the last (with the possible exception of the odd audit on request). By the end of the FP5 audit campaign, an

audit coverage of [REDACTED] of the beneficiaries is expected (compared with the originally foreseen 10%). Cumulative FP5 results can be found in section 3.

1.5.2. The FP6 audit campaign

In the three years of implementation of the FP6 Audit Strategy, which covers four years in total (2007-2010) and was established after the critical Discharge procedure in 2006, the focus has been on increasing the number of audits, improving the consistency of approach and the coherence of conclusions, more homogeneous audit policies (including reporting and documenting), calculating reliable and representative error rates, and introducing the extrapolation procedure.

The Mid-term review of the FP6 Audit Strategy, finalised in the beginning of 2009, concluded that all the RDGs believed that the corporate FP6 Audit Strategy is delivering its expected auditing output satisfactorily. However, a number of issues had to be either addressed or taken as a given:

1. Despite constant coordination efforts, the 'corporate' character of the Audit Strategy reaches its limits in the independence of the four AODs.
2. The reinforcement of the process of extrapolation has turned out to be very time-consuming and labour-intensive (see section 2.3.3)
3. The increased number of audits and the effectiveness of the audit approaches are generating a higher number of contested cases, some of which are leading to legal cases. These will require more attention of the Commission services in order to defend its financial interests.

2009 has been the third year of implementation of the multi-annual FP6 Audit Strategy. The strategy is now well advanced, as exemplified by the fact that the DG RTD overall minimum target of [REDACTED] audits over its four-year lifespan has already been comfortably surpassed (see section 3.1 Table 3.6).

[REDACTED]

[REDACTED]

[REDACTED]

From an ex-post control point of view, additional efforts could consist of:

[REDACTED]

[REDACTED]

Given the ongoing debate on the 'tolerable rate of error' and doubts on the cost-effectiveness of additional controls, no clear decision has been taken. Indeed, the presence of a material level of non-systematic errors on contracts with audited beneficiaries, which cannot be corrected by means of extrapolation, is relevant for the ongoing work for the determination of the 'tolerable error rate' in the research area. This technical work is due to be concluded in the course of 2010 so as to adopt a Commission communication to the Budgetary Authority and the European Court of Auditors (ECA) during the first half of the year.

[REDACTED]

Although these and other insights result from a body of over [REDACTED] closed audits, there are still [REDACTED] ongoing FP6 audits at this point. It is therefore too early to draw final conclusions for FP6, but the experience so far of implementing the FP6 Audit Strategy has been invaluable in designing the strategy for FP7.

1.5.3. The FP7 audit campaign

2009 has seen the start of the FP7 audit campaign. Several months of cross-RDG discussions resulted in a common Strategy document for all RDGs and Executive Agencies being adopted at the end of September 2009 but, even though [REDACTED] FP7 audits have already been launched, the number of them closed so far is too small and not representative enough to say anything substantial at this stage.

The start of the campaign was also delayed by the natural time lag between the start of a framework programme and the point in time at which it begins to become 'auditable'. During 2008 and 2009, RTD A.4 run four checks at different points in time to assess the 'maturity' of the FP7 auditable population, and after the last one of these, carried out in May 2009, it was considered that a first set of FP7 audits would be cost-effective and material

Compared with the FP6 Strategy, the most important differences of the FP7 Audit Strategy are that, with the creation of the executive agencies, the FP7 Strategy now concerns six Commission services instead of four, and that ex-ante certification controls will have to be taken into account when carrying out ex-post audits.

On a more technical level, as well as already taking advantage of the refinements introduced to the formulae for the calculation of error rates in FP6, the FP7 Strategy introduces qualitative improvements in several areas. It removes the stratification of the population used in FP6 and aims to provide a more accurate representative error rate by [REDACTED]

[REDACTED]

Improvements have also been introduced to the way in which representative samples are selected and audited. The selection parameters have been brought more in line with those used by the ECA, and the sample units are individual cost statements. The possibility of taking multiple samples over the expected implementation of the Strategy (2009-2016) is foreseen,

[REDACTED]

Increased efforts in cross-RDG co-ordination will be needed for an appropriate implementation of the FP7 Strategy

[REDACTED]

2. ACTIVITIES

2.1. Types and nature of the audits carried out

The external audit Units select the ex-post audits in accordance with the methods described in the Audit Strategies.

For FP6, this means according to three strategic strands:

- **TOP:** this is a selection of the beneficiaries which receive the most money from the Commission. The DG RTD list of top beneficiaries consists of [REDACTED] contractors which receive [REDACTED] of the FP6 budget managed by DG RTD. All beneficiaries in this sample have been audited at least once (on at least three participations) and, where necessary, further audits are carried out in order to confirm the presence or not of systematic material errors for each beneficiary.
- **MUS:** using the monetary unit sampling technique to ensure statistical representativity, a selection of [REDACTED]² beneficiaries was made from the non-TOP DG RTD population. One audit is carried out for each of them.
- **RISK:** a number of different criteria have been used to select the beneficiaries in this strand. The audits of this strand are intended to have a corrective effect on the amount of errors present in the DG RTD population. The results of these audits are not taken into account for the calculation of the representative error rate.

For FP7, the strategic strands are:

- **REPRESENTATIVE:** using statistically representative sampling methods, a number of audits will be undertaken for the purpose of accurately identifying the amount of error present in the population (i.e. representative error rate).
- **CORRECTIVE:** audits will be selected using a variety of criteria trying to maximise their potential corrective effect.

In addition, there are additional auditing commitments in the following areas:

[REDACTED] **FUSION:** the current arrangement with RTD J is to audit all FUSION associations on a cyclical basis. [REDACTED]

[REDACTED]

- COAL AND STEEL (C&S): in 2009 a small number of audits were again launched on beneficiaries who receive funds from the Research Fund for Coal and Steel (RFCS), which is managed by RTD K. Following an agreement to make the selection of beneficiaries more representative in the future, a wider sample will be taken in 2010. RFCS contracts do not follow the provisions of the Framework Programmes, and therefore these audits are considered as not FP-related.

AUDITS ON REQUEST: audits in this category are performed at the request of the operational services, and they are normally quite specific in their scope.

audit requests were put forward to RTD A.4. In cases, the audit request was accepted and the related audit mission integrated into the usual audit planning of RTD A.4. Priority is given to these audits and, hence, more than half of the accepted audits have been carried out and ended in 2009.

In cases, the need to carry out a financial or scientific audit was not recognized or, in one case, the audit request was withdrawn. In further cases, the audit request was considered either incomplete or premature, so that these audit requests are considered 'on hold' and can be renewed at any time.

The figures are in line with previous years. It is to be noted that for the first time, *Scientific Audits* have been carried with participation of Unit A.4 in 2009 (these are included in the accepted audit requests).

- Joint audits with the ECA (see section 2.4).
- TECHNICAL AUDITS: a new DG RTD-wide procedure for the undertaking of audits of a scientific nature, with or without the involvement of the financial audit Units, has been developed by RTD A.6. The first pilot-projects have been launched during 2009.
- Some beneficiaries can be in non-EU countries ('third country audits'), although there is no specific commitment to do a certain number of these and they are done when they are part of wider selections.

Audits can be either done by the European Commission auditors (in-house) or outsourced to an external audit firm (batch), under a framework contract. The aim is to have 25% of the audits carried out in-house. For FP7, there has been a change of main supplier for the external audits.

2.2. Cross-RDG coordination

The adoption of common corporate Audit Strategies means closer coordination between the RDGs in a significant number of areas.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Since 2008, all RDGs are using the common 'Audit Process Handbook' for FP6 audits. This handbook contains all the procedural steps and the templates relating to the performance of an external audit with own resources. The objective is to ensure a common approach for all audit tasks and the application of generally accepted auditing standards.

[REDACTED]

2.3. Extrapolation

Extrapolation is a key component of the common audit strategies because , its essential role in 'cleaning' the budget from systematic material errors must have its maximum effect in order to see a significant reduction from the representative error rate to the residual error rate.

2.3.1. Extrapolation policy and coordination

In the very beginning, the implementation of extrapolation was carried out separately by each RDG. This resulted in different practices in the four RDGs towards common contractors.

2.3.2. Extrapolation management

| | 2019 | 2020 | 2021 | 2022 | 2023 |
|--------------------------------------|------|------|------|------|------|
| 1. Revenue | 100 | 100 | 100 | 100 | 100 |
| 2. Operating Expenses | 20 | 20 | 20 | 20 | 20 |
| 3. Operating Income | 80 | 80 | 80 | 80 | 80 |
| 4. Interest Expense | 10 | 10 | 10 | 10 | 10 |
| 5. Income Before Tax | 70 | 70 | 70 | 70 | 70 |
| 6. Tax Expense | 14 | 14 | 14 | 14 | 14 |
| 7. Net Income | 56 | 56 | 56 | 56 | 56 |
| 8. Other Comprehensive Income | 0 | 0 | 0 | 0 | 0 |
| 9. Comprehensive Income | 56 | 56 | 56 | 56 | 56 |

Table 2.2 - Current status of the DG RTD extrapolation cases 2009 (as of 31/12/09)

This overview shows that extrapolation frequency has remained stable over 2008 and 2009.

2.3.3. *Extrapolation implementation*

As each individual extrapolation case can potentially affect many projects across a number of RTD Directorates, ongoing extrapolation cases require a significant amount of effort, attention and supervision by the operational services responsible for the follow-up actions, as well as by the external audit Units. The experience acquired so far has underlined the challenges in this area, especially with regard to following up the reception of revised cost statements.

To address this issue, a new Unit (RTD R.7 'Management of debts and guarantee funds') was created to act as a central reception point and deals with all extrapolation cases launched as of 13/03/2009. In addition, to improve the coordination of the implementation process, this new service is in charge of monitoring those beneficiaries that do not react promptly to Commission requests through reminder letters, or those who request an extension of deadlines.

For all DG RTD-led extrapolation cases, (i.e. initiated by DG RTD), so far [REDACTED] participations have been identified as potentially affected by the application of extrapolation. Among these, [REDACTED] have been implemented (i.e. amount due adjusted), [REDACTED] are currently under implementation, [REDACTED] relate to the extrapolation cases currently 'on hold' (i.e. the centrally managed cases) and [REDACTED] have been cancelled (since according to the contractor no extrapolation is required).

In addition, [REDACTED] cases initiated by other RDGs have an impact on DG RTD because the beneficiaries participate in [REDACTED] RTD projects, of which [REDACTED] have been implemented, [REDACTED] are currently under implementation and [REDACTED] relate to cases for which the audit results are under discussion ('on hold' cases).

Table 2.3 – DG RTD contracts affected by extrapolation

Moreover for ■ RTD-led cases, ■ participations managed by other RDGs are equally to be revised in the extrapolation process.

A clear step forward to better coordinating the extrapolation process across the four RDGs has been made through the introduction of the first release of SAR-EAR (cross-RDG extrapolation IT tool launched in September 2009) (see section 2.9).

2.3.4. Extrapolation follow-up activities

During 2008, and on the initiative of RTD A.4, 6 extrapolation follow-up meetings were organised in order to ensure better coordination within DG RTD. Given the decentralised structure in DG RTD financial management, this has been an essential initiative. During another 2 meetings in 2009, representatives of operational RTD Directorates responsible for the implementation of extrapolation have discussed the status of ongoing cases and any further actions to be taken, based on the latest information collected by all stakeholders. The meetings also allow for useful discussions of practical issues (i.e. registering and analysing revised cost statements, development of software tools to monitor follow-up, issues relating to the recovery procedure, possibility of global recovery orders, legal issues, etc.). The last meeting chaired by RTD A.4 took place in July 2009. From September 2009 onwards, these coordination tasks have been handed over to RTD R.7 which initiated a number of working groups involving UAFs .

Monitoring the actual implementation of the extrapolation is carried out by RTD R via the ASUR-EXTRA tool where the services encode the actual implementation information for each participation involved. The audit Units base themselves on this information to further decide on any appropriate follow-up action to be undertaken.

RTD R.7 did not take over the management of the extrapolation cases of before 13 March 2009, so a follow-up campaign was initiated in September 2009 on all RTD extrapolation cases launched before 13/03/2009 in order to ensure that extrapolation adjustments have been properly applied by beneficiaries. Each case has been analysed through either a detailed or a global desk review with a focus on the contractor's cooperation level, number of corrected cost statements received, amount of the adjustments etc.

Currently, ■ cases have been selected for further analysis, excluding the 'on hold' cases. Of these, ■ follow-up audits on the spot have been decided and scheduled. For ■ audits, no follow-up was required at this stage but rather an action at Operational Units' and/or RDG-level before allowing the external audits to take an appropriate cost-effective decision. For this part of the process the audit Units rely on the other services. For the remainder, the analysis is ongoing.

In the course of 2010, this closing follow-up per individual extrapolation case will continue.

2.3.5. *Further considerations*

Overall, as already highlighted in previous year's reports, it can be concluded that the extrapolation process and its follow-up remain complex and time-consuming, still requiring substantial resources. [REDACTED]

[REDACTED]

[REDACTED]

In this respect and in the framework of an overall simplification process for the contractors, the possibility of flat rate calculations to establish the outstanding debt has been introduced³ as of 15/12/2009. Furthermore, eligibility criteria of certain expenditure (direct taxes and social charges), having led to numerous discussions, have been more explicitly defined. This should make it simpler to decide on the eligibility (or not) of these types of expenditure. In collaboration with RTD R, the actual implementation of these simplification measures for the extrapolation process is currently under way. It is expected that these simplification measures will lead to a more cost efficient use of human resources both for Commission services and for beneficiaries, while safeguarding the principle of sound financial management.

The overall financial result of actual recoveries/adjustments related to extrapolation is potentially very important. However, given the fact that most of the extrapolation cases are still ongoing, the financial impact to date of extrapolation remains modest. It is important to note that the time needed to actually implement the financial adjustments and to initiate the related recoveries can be up to two years or more in difficult cases as the end of subsequent cost reporting periods is awaited. This is likely to be even longer in FP7 as the cost reporting periods are longer.

Table 2.4 - Overall adjusted amounts due to extrapolation

| | Euros |
|---|------------|
| (-) Adjustments in favour of the Commission | [REDACTED] |

³ Commission Communication SEC(2009)1720, 15 December 2009.

| | |
|---|--|
| (+) Adjustments in favour of the beneficiaries | |
|---|--|

It will be necessary to improve further the working procedures, and – as already mentioned before - commit appropriate resources to the follow-up of extrapolation cases, as well as improve the IT systems used to register, manage and monitor extrapolation cases.

2.4. Collaboration with the ECA

During 2009, our collaboration with ECA continued on the strengthened basis developed during the previous years. Better planning co-ordination has allowed a much earlier awareness of audits carried out by both sides on beneficiaries audited previously by either

For a number of reasons, including scheduling and resource constraints, not many joint audits with ECA were carried out in 2009. On the other hand, RTD A.4 carried out some audits which were directly triggered by previous audits by ECA, mostly in cases where extrapolation was proposed by the ECA for which DG RTD sought to confirm and reinforce its assessment on the basis of a bigger sample. This approach will be continued in the future as a way of increasing the corrective effect of the auditing efforts.

More generally, referring to the observations in the ECA's Report on 2008, the ECA confirmed that the FP6 Audit Strategy is a sound one because it addresses the risks of cost overstatement, but underlined that significant challenges remain such as recoveries and simplification.

The new FP7 Audit Strategy was presented to ECA representatives at the end of October 2009.

2.5. Reporting activities

The external audit Units are asked to report throughout the year in quite a different number of formats and to a variety of audiences

These improvements could not have been achieved without changes to various IT systems and tools which are used for data collection, together with laborious one-off exercises collecting

historical data retrospectively. Recent improvements in the quality of FP6 data at DG level contribute to the fact that FP6 audit findings can be measured more and more accurately.

2.6. OLAF cases

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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2.7.3. The quality review process

The quality review process for the audit reports done by the European Commission auditors was strengthened in 2009.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]





2.8. Collaboration with the DG RTD administration and finance (UAF) network

Throughout 2009, the external audit Units have strengthened close working relationships with the administration and finance Units during planning and preparing new audit campaigns, during the audits (in order to obtain feedback on draft audit conclusions), and after the audits (for the implementation of the final audit conclusions).

Moreover, ad-hoc bilateral meetings have been held whenever appropriate to discuss specific files. The external audit Units also participate in the monthly UAF meetings to present and clarify matters linked to audit and financial issues.

2.9. Sharing Audit Results (SAR) and other IT developments

Where IT developments are concerned, throughout 2009 the external audit Units were focused, on the one hand on a more optimal sharing of audit results (SAR) with the rest of the RDG family and, on the other, on the migration and centralization of local applications. The highlights were:

- **Audit Management System (AMS) in DG RTD** – AMS was put in production in August 2009 (Phase 1) and it has replaced Aubase (the former audit management system that was developed locally by the external audits unit).
 - **Extrapolation of Audit Results (SAR EAR)** – SAR EAR was put in production in September 2009 in order to coordinate extrapolation cases among different RDGs.
 - **Planning of Audit Activities (SAR PAA)** – SAR PAA was put in production in December 2009, and full deployment will be completed by February 2010.
 - **Extrapolation (EXITs)** - To address the acute need for the administration and management of the work created by extrapolation, a new application called EXITs was developed by Unit A.4. It is currently using AMS data tables. The plan is to include its functionality in AMS Phase 2.
- 

2.10. FP7 Methodology Certification

2.10.1. General background

The Certification policy for the FP7 Grant Agreements was designed with the aim to correct the most common errors identified in the past, and in particular those related to personnel costs and indirect costs. In this context, FP7 introduced, in addition to the Certificates on the Financial Statements (known under FP6 as 'audit certificates'), two new types of ex-ante

certificates on the methodology which may be submitted prior to the costs being claimed: the *Certificate on Average Personnel Costs (CoMAv)* and the *Certificate on the Methodology for Personnel and Indirect costs (COM)*.



In June 2009, the Commission adopted a decision on interim implementation rules concerning acceptability criteria for the average personnel cost methodology⁷.



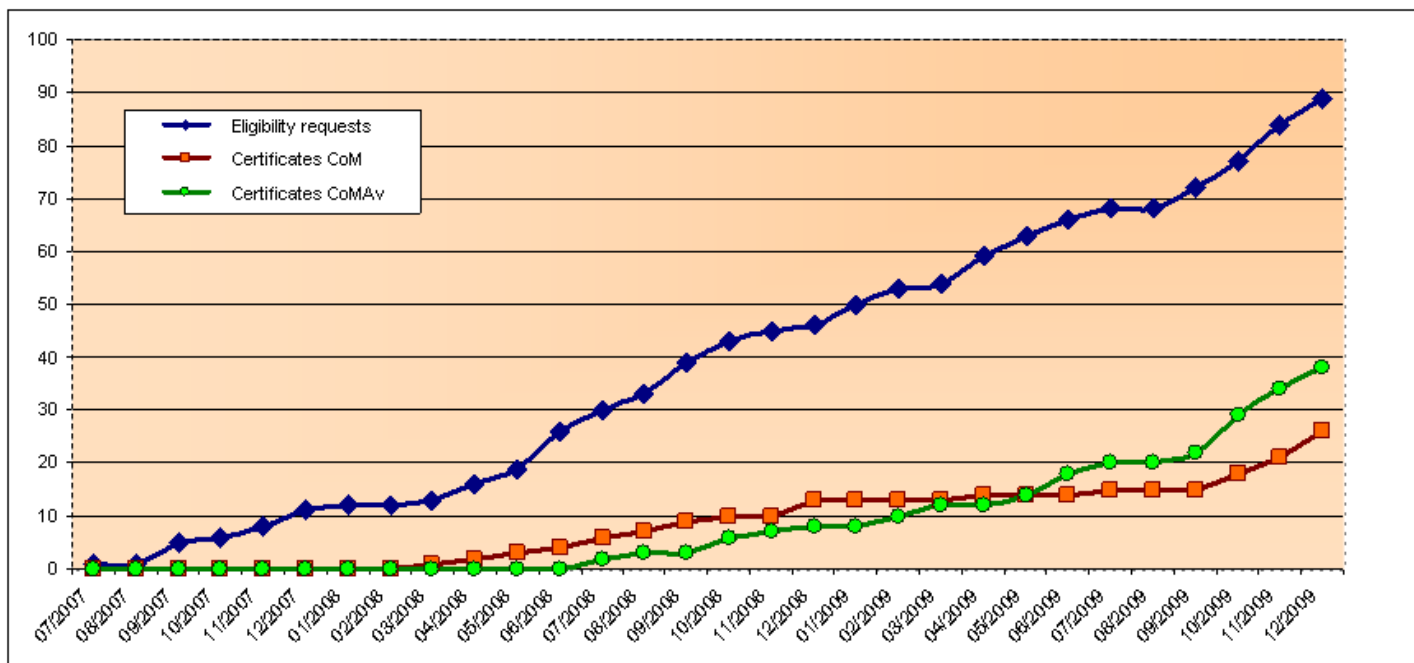
2.10.2. State of play of Certification files as of 31 December 2009

At the end of December 2009, the state of play of submitted requests for eligibility and certificates is as follows:

| | Eligibility Requests | | Certificates | | | | |
|--|----------------------|----------|--------------|----------|----------|-----------|---------|
| Type of Certificate | Submitted | Accepted | Submitted | Accepted | Rejected | Withdrawn | Pending |
| CoM Average Personnel Costs and Indirect Costs | ■ | ■ | ■ | ■ | ■ | ■ | ■ |
| CoM Real Personnel Cost and Indirect Costs | | | ■ | ■ | ■ | ■ | ■ |
| Certificate Average Personnel Costs (CoMAv) | ■ | | ■ | ■ | ■ | ■ | ■ |
| ■ | | | ■ | ■ | ■ | ■ | ■ |

The figures indicate that the certification activity started slowly yet an increasing trend is noted. The graph below indicates the evolution over time of the methodology certification activity between July 2007 and December 2009. There is an uninterrupted increase, both in eligibility requests and submissions. Where initially they were mainly CoM, the CoMAv has surpassed the CoM. This indicates that beneficiaries are finding out that this is a mandatory requirement to claim average personnel costs. In the last months of 2009 an increased submission activity can be noted which may predict a likely uptake of submissions for 2010.

⁷ Commission Decision C(2009)4705



When judging the limited number of methodology certificates approved so far it should be borne in mind that FP7 introduced the requirement for 'full cost' accounting for all beneficiaries. This means that all beneficiaries previously participating under the 'additional cost' regime – mostly universities and public research organizations without analytical accounting, or even cash-based accounting – now must account for the full-costs of their research. Feedback obtained from many stakeholders indicates that most are in a preparatory or, at best, transition phase due to which their cost accounting methodology is not in 'steady state' and accordingly no methodology is yet presented for certification. RTD A.5 services are however in contact with a number of European universities (currently from UK, DE, NL, FR, IT and BE) who are getting prepared and are strongly motivated to seek approval of their methodology.



The upcoming Communication to the Council and the European Parliament on simplification will explore options for further simplification in research funding. This communication should launch a broad inter-institutional discussion and will permit the Commission to consider new concepts for research funding, including a broader approach towards actual costs and recognition of usual accounting practices. Also, in this context, the parallel work on the concept of tolerable risk of error to ensure the right balance between control costs and error rates, sound financial management and simplification could be referred to.

2.10.3. *Supporting IT tools*

The development of the central IT tool in OMM to support the management of the FP7 certification activities was started in the third quarter of 2007 under the responsibility of RTD R.4. Due to resource constraints, this project was no longer considered by RTD R.4 as an IT priority and was finally abandoned due to the implementation of PDM/URF in replacement of OMM.

From June 2008 onwards a new web-based project was launched, promoted by ITPO. This project aims to provide a central web-based IT tool, solely dedicated to supporting the FP7 methodology certification. In 2009 Unit R.4 initiated a contract with an external service provider for the development of the web-based system. Design and analysis phases were carried out in the last quarter of 2009 [REDACTED]

2.10.4. *Inter-service collaboration*

An inter-service Working Group on FP7 Certificates on the Financial Statements (WGCFS) has been established involving representatives from the research DGs and REA and ERC Executive Agencies. The aim of the Working Group was to develop guidance and support for the Operational Units and, in particular, for the Financial Officers who handle the FP7 Certificates on the Financial Statements (CFS). Its purpose was to ensure a coherent, harmonised and consistent approach on CFS-related matters throughout the Research and Executive Agencies. [REDACTED]

2.10.5. *Communication activities*

These matters of ex-ante certification have also required intensive communication:

- Handling questions submitted through the Research Enquiry Service on *Europe Direct*. Approximately 100 questions concerning average personnel costs were answered in 2009.
- An internal awareness-raising campaign on FP7 Certification issues leading to meetings with Operational and UAF Units.
- Participation in seminars, conferences, bilateral meetings and pilot reviews (around 50 events in total).
- Posting of certification-related documents on www.cordis.europa.eu (FAQ document, specific certification-dedicated pages, 'Guidance notes for Beneficiaries and Auditors').
- Regular meetings with NCPs for legal and financial issues.

2.11. Coordination of outsourced audits

Six new framework contracts for the provision of audit services were signed during the year dealing with audit services on FP6 and FP7 grants respectively. The new framework contracts covering FP6 audits were signed in February 2009 and the ones for FP7 audits in June 2009. These framework contracts cover the outsourcing of audits on FP6 and FP7 grants for the period 2009-2012 with a potential market value amounting to [REDACTED] respectively.

Each of these framework contracts is signed with three different audit firms to be used under a 'cascade' principle, i.e. when the first on the list cannot execute the audit, the second, possibly the third company on the list is taken.

The new framework contracts brought new firms to the scene and extensive efforts were made by RTD A.5 to prepare these firms for the EC's audit requirements and expectations.

[REDACTED]

The external audit firms operate according to established professional audit practice and standards and provide a necessary complement to DG RTD's in-house audit expertise and capacity.

RTD A.5 closely monitors the performance of the audit firms ensuring that, as far as possible, all audits are completed and closed within the contracted time frame. In addition to the daily follow-up of individual audit assignments, this monitoring involves the following processes:

- [REDACTED]
- Occasional accompanying of external audit firms on on-the-spot audits.
 - Providing guidance and clarification on specific problems.

- [REDACTED]
- Normal contract management issues, such as setting up contracts, amendments, payments, penalties etc.

RTD A.5 manages the public procurement procedures for the new framework contracts for audit services on FP6 and FP7 research grants on behalf of all RDGs and related agencies.

2.12. Other activities (Art.169 Initiatives/JTIs/Agencies)

[REDACTED]

[REDACTED]

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[REDACTED]

2.12.3. Executive Agencies – REA and ERCEA

The external audit Units were also involved in the process of setting up of the two 'DG RTD' Executive Agencies, in particular where the Audit Strategy is concerned.

The relationship between the Agencies and DG RTD has been laid down in Memoranda of Understanding.

[REDACTED]

2.12.4. Joint Technology Initiative (JTIs)

RTD A.4 has also been involved in the process of defining parts of the internal control system of the JTIs, in particular concerning ex-post audit issues. Working groups exist under the chairmanship of RTD R. RTD A.4 participated mostly in the definition of the ex-post auditing features, the reporting requirements and the procedures to assess 'in-kind' contributions.

2.13. Scientific/technical audits

The focus in financial audits on compliance with the legal and regulatory framework has led

[REDACTED] to undertake, where applicable, on-site technological and scientific audits as foreseen by Art. 11.23, Annex II of the FP7 Grant Agreement and Art. 1129, Annex II of the FP6 Contract. The aim is to look at the projects from an independent scientific view and independently from the project reviews that take place during the lifetime of a project.

[REDACTED]

Despite the difficulty of this type of scientific audits, they may gain importance in the course of the following years.

3. RESULTS AND ANALYSIS

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ANNEX I: MISSION STATEMENTS

MISSION STATEMENT RTD A.4: EXTERNAL AUDITS

The Unit contributes to the assessment of the legality and regularity of the DG RTD payment transactions by means of ex post financial audits, thereby providing a basis of reasonable assurance to senior management and other stakeholders (including the budget discharge authorities) that RTD contract participants are in compliance with the financial terms of the RTD contract. The corrective actions and follow-up measures which result from the ex post audit activity contribute to the protection and safeguarding of the European Union's financial interests in the research area.

[REDACTED]

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MISSION STATEMENT RTD A.5 'Implementation of Audit certification policy and outsourced audits'

RTD A.5 contributes to the assessment of the legality and regularity of the DG RTD payment transactions by means of ex post financial audits, thereby providing a basis of reasonable assurance to senior management and other stakeholders (including the budget discharge authorities) that RTD contract participants are in compliance with the financial terms of the RTD contract. The corrective actions and follow-up measures which result from the ex post audit activity contribute to the protection and safeguarding of the European Union's financial interests in the research area.

Through the certification function for FP7, the unit aims to contribute in an ex ante manner to the legality and regularity of future DG RTD payment transactions by ensuring that the cost methodology systems of FP7 beneficiaries are in compliance with the rules, thereby resolving main errors observed in the past from the outset.

[REDACTED]

[REDACTED]

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