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REPLIES OF THE COMMISSION TO CHAPTER 5 OF THE ANNUAL REPORT 2009

"RESEARCH, ENERGY AND TRANSPORT"

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INTRODUCTION

5.7. Research Framework Programmes involve technically and financially complex projects. The control environment is characterised by a large number of beneficiaries, each operating their own control systems.

Because the current legislative and contractual environment makes the management of project complex both for the beneficiaries and the Commission, simplification measures have been taken by the Commission for the implementation of FP7.

5.10. Most of the expenditure is managed directly by the Commission but FP7 also allows for the implementation of the budget in indirect centralised management mode; i.e. the Commission entrusts implementing tasks to Executive Agencies, Joint Undertakings set up by the EU and 'Article 185 Initiatives', which are structures created for the execution of research programmes undertaken jointly by several Member States.

5.16. The Commission agrees with the Court. Indeed the complexity of the rules is a major source of errors and ineligible cost claims. The Commission's Communication on simplifying the implementation of the research framework programmes¹ proposes actions to address this risk. As these proposals will only be implemented within the next framework programme, and as it needs to address the problems caused by complex eligibility requirements for grant beneficiaries, on 26 May 2010 the Commission adopted a Communication² to the other Institutions proposing a level for the tolerable risk of error in this area of between 2% and 5%. The proposed level of tolerable risk of error is established taking into account the cost-effectiveness of the controls and an acceptable level of residual error that is justified in the light of these costs.

REGULARITY OF TRANSACTIONS

5.19 Example 1

The Commission agrees with the findings of the Court and the recovery process is on-going.

5.20. At this stage of the programme cycle, and given the small number of FP7 interim payments included in the Court's sample, it is too early to draw conclusions on the frequency and the value of errors in FP7 by comparison with FP6.

EFFECTIVENESS OF SYSTEMS

5.31. The Commission shares the concern of the Court on the correctness of the FP6 audit certificates, which did not fully provide the additional assurance initially expected. However, the Commission maintains that this instrument made a substantial contribution to the prevention of errors, resulting in a significant decrease of the error rates in FP6 audits compared with FP5.

The Commission has taken remedial action in order to improve the quality of the audit certificates in FP7. FP7 audit certification is based on "agreed upon procedures", which require the certifying auditor to perform pre-defined procedures and report factual findings on

¹ COM(2010) 187 of 29.4.2010.

² COM(2010) 261 of 26.5.2010.

that basis. This approach should lead to a reduction in errors of interpretation of the eligibility rules by the auditors which occurred in FP6.

The Commission will continue assessing the reliability of audit certificates during its own financial audits.

See also reply to paragraph 5.49.

5.32-5.33. The ex-ante certification of beneficiaries' costing methodologies is only compulsory for those who wish to apply average personnel costing to their cost claims. It is optional for other beneficiaries.

In addition, beneficiaries are still required to provide a certificate for the final payment covering all periods if the cumulative requested contribution exceeds 375.000 euro. In practical terms, ex-ante certification does reduce the administrative burden for beneficiaries and contributes to substantial costs savings on audit fees.

See also reply to paragraph 5.36.

5.34-5.35. In its Communication on simplification, the Commission proposes to take into account any average personnel cost methodology applied as usual accounting practices of the beneficiaries, including a cost centre based approach, as long as they are based on actual personnel costs registered in the accounts and any double funding of costs under other cost categories is excluded.

The FP7 Rules for Participation authorise average personnel costs as an exception to the general rule of actual costs, providing this is the usual accounting practice of the beneficiary and that the average costs do not differ *significantly* from the actual costs. The criteria defined by the Commission aim to provide reasonable assurance that the application of a beneficiary's methodology will not lead to any significant deviation of the average costs reported vis-à-vis the actual costs. In the view of the Commission, these criteria represent the best possible balance between simplification and accountability concerns within the prevailing regulatory framework.

5.36. The intensity of audit certificate submissions under FP7 has been reduced to lower the administrative burden on participants. However, a Certificate on Financial Statements (CFS) is still required for beneficiaries who have received certification of their costing methodologies, since this only removes the obligation for a beneficiary to submit an intermediate CFS. A CFS must be submitted for the last reporting period if the cumulative requested contribution exceeds 375.000 euro. Following the intensive FP6 audit campaigns, many beneficiaries have undergone a learning effect and the Commission expects that beneficiaries are likely to apply improved project cost accounting practices as a result.

At the present juncture, it is not possible to conclude that the overall error rate will increase, as the risks identified may be offset by other measures.

5.40. The Commission welcomes the positive assessment of the progress made. It is fully aware of the required levels of co-ordination and is proceeding accordingly.

5.41. Additional efforts will be undertaken in order to improve the timely implementation of audit results.

The recovery process in the framework of the implementation of the audit strategy has also been subject to simplification measures³ in order to reduce the burden both for the Commission and the beneficiaries.

The performance of the recovery process has progressed significantly in 2009.

Most financial corrections are implemented by deducting the amount due from the next payment, which is the most cost-effective method of recovery. Since payments are usually made annually, this leads to a time lag in the recovery process.

The increased number of audits has multiplied the number of projects requiring corrections and adjustments.

5.42. From their creation in mid-February 2010, DGs MOVE and ENER apply liquidated damages in the same way as other research DGs.

RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS

5.44. The Commission welcomes the positive assessment of the Court for all the Annual Activity Reports covered by this chapter.

CONCLUSIONS AND RECOMMENDATIONS

5.45. The Commission underlines that the Court's finding regarding the error rate is in line with the past year and that the most likely error rate for the policy areas covered in this chapter lies between 2% and 5%.

This result is in line with the Commission's own findings. On 26 May, the Commission adopted a Communication⁴ proposing a tolerable risk of error level in this range (2%-5%). A DAS error rate around the middle of this range would, in the view of the Commission, be acceptable and justified. Beyond this level, additional action would be taken to reduce the error rate through increased controls addressing the major causes of error and taking into account the multi-annual nature of the expenditure. This rate should cover all Research Framework Programmes.

This level could be revised in the light of major changes in the control environment that would have an effect on the DAS error rate, in particular simplification actions taking effect in the next framework programme.

5.48. The Commission welcomes the positive trend noted by the Court. It underlines that the changes in audit certification requirements have been introduced to simplify and facilitate the participation of the beneficiaries

Furthermore, whilst recognizing the limited success of the ex-ante methodology certification, the full array of internal controls in place, including the FP7 audit strategy, will ensure the right conditions for sound financial management.

5.49. The Commission's primary objective is to efficiently achieve the research policy objective, whilst ensuring sound control of the related budget implementation.

(a) The Commission pursues a policy of actively feeding back findings of ex-post audits to the beneficiaries in order to ensure - where necessary - improvements in the work of the auditors delivering audit certificates. To this effect every beneficiary is requested in the course of the audit procedure to inform the certifying auditor on material audit findings. The Commission observes, however, that the main cause of the Court's observations is not so much the design

³ SEC(2009)1720 of 15.12.2009.

⁴ COM(2010) 261 of 26.5.2010.

or concept of the audit certificate but rather the relative complexity of the rules, duly referred to by the Court under paragraph 5.16. This inherent complexity impacts the work performed by the external auditors mandated by beneficiaries to deliver audit certificates. For FP7 it is expected that with the reliance on agreed upon procedures, the degree of errors due to such misinterpretation will significantly decrease.

(b) The certification on the methodology (CoM) is intended only for beneficiaries of multiple grants. The eligibility criteria for the CoM were reviewed in November 2008 and published in the FP7 Guide to Financial Issues.

The Commission recently took action in order to reinforce the attractiveness of the ex-ante certification of beneficiaries costing methodologies. The Commission expressed its views in this respect in its Communication on simplification of 24 April 2010 as well as in its proposal for triennial revision of the financial regulation and its implementing rules adopted on 28 May 2010. Genuine simplification could be yielded by allowing methodologies applied as usual accounting practice as long as they are based on actual personnel costs registered in the accounts.

(c) The Commission will further pursue its efforts to improve the timely implementation of audit results and continue to apply its guidelines on the application of liquidated damages. Furthermore the communication on the simplification of the recovery process adopted on 15 December 2009 provides measures to improve the performance of the recovery process.

5.50. The Commission fully agrees and refers to the orientations developed in its recent Communications on "*Simplifying the Implementation of the Research Framework Programmes*" and "*More or less controls? Striking the right balance between the administrative costs of control and the risk of error*".

5.51. The full impact of these simplification measures will be felt mainly in the next Framework Programme. Until such proposals are implemented, the Commission needs to address the problems caused by complex eligibility rules for grant beneficiaries. On 26 May 2010 the Commission adopted a Communication proposing a tolerable risk of error in this area of between 2% and 5%⁵. The tolerable risk level is established taking into account the cost-effectiveness of controls and an acceptable level of residual error that is justified in the light of these costs.

EU JOINT UNDERTAKINGS

5.56. The Commission monitors the implementation of the action plans devised by the Joint Undertakings to fully deploy their internal control systems.

5.57. The Commission shares the Court's opinion that the IAS of the Commission should exercise the same powers over the bodies set up by the EU having a legal personality and receiving contributions from the budget under Article 185 (3) of the general Financial Regulation as those which it exercises over Commission departments.

ANNEX 5.4. – 2. LATE PAYMENTS BY THE COMMISSION

The Commission welcomes the recognition by the Court of the progress made so far. The Commission is committed to pursuing these efforts to further improve its performance.

⁵ COM(2010)261.