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COMMUNICATION FROM THE COMMISSION

**PROGRESS REPORT AS AT 31 MARCH 2006 ON MODERNISING THE
EUROPEAN COMMISSION'S ACCOUNTING SYSTEM**

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1. INTRODUCTION

On 31 March 2006, the Commission's Accounting Officer forwarded to the European Court of Auditors the first provisional accounts of the European Communities to be prepared in accordance with internationally accepted accounting standards. Besides placing itself at the forefront of public bodies in this respect, the Commission has thus demonstrated to its Discharge Authorities its desire to be fully accountable for the taxpayers' funds which are entrusted to it.

These accounts are the fruit of three years' intensive work by all Commission services, and by the other institutions and agencies:

- Accounting rules were developed which were relevant to the Communities' activities and which complied with international standards, along with the appropriate accounting manuals;
- IT systems were developed to support the new accounting requirements;
- Each Commission service has adapted its administrative and financial procedures to record accounting events as and when they occur, and not only when cash is received or paid, or at year end only, and thus allow accrual-based accounts to be established;
- The balances necessary to open the first accrual-based accounts were determined.

This work was completed by January 2005, in time for the 2005 financial year to start on the right basis. Since January 2005:

- The opening balances have been checked and validated by the authorising services.
- The expenses to be accrued at the beginning and end of each year have been estimated by every service.
- All systems have been examined by the Commission's Accounting Officer to ensure that they are capable of recording and communicating the required accounting information.
- The Commission's accounts were prepared, and consolidated with those of 8 other institutions and 16 agencies.

The Commission has thus respected the deadlines set in the Financial Regulation for the preparation of financial statements which comply in all material respects with international standards, and has fulfilled its commitment to the European Parliament and the Council to report on its progress towards this goal¹, which they considered to be particularly ambitious.

The work is however not yet complete. Attaining complete respect of all accounting standards is a process which will take time to complete. The imprest accounts held in the Commission's external delegations need to be incorporated in the central accounting system, and the European Development Funds need to be moved to a modernised IT system. Delays in these

¹ The Commission has presented half-yearly progress reports up to and including 31 May 2005.

tasks arose from the difficulties in introducing new systems and the required training in geographically dispersed services, and do not have a material impact on the accounts.

The systems of two DGs need improving before they can be validated. Material errors have been found in the figures supplied by at least one DG, which has been asked to present corrected figures. Despite the efforts made by Commission services to check and recheck the opening balances and the accrued expenses, the Court of Auditors is likely to find further errors, which must where possible be corrected in the final accounts which are due by 31 July 2006. The risk of error is exacerbated by the inadequate number of qualified accounting staff in the Commission to absorb quickly such a large reform, by the delays incurred in some services, leading to hurried work, and by delays in developing certain accounting and reporting tools in the IT system and in updating documentation and training courses.

2. SUMMARY OF IMPLEMENTATION TO 31 MARCH 2006

The transition to a new accounting system in the European Commission has so far been successful. On 1 January 2005, the Commission moved the general accounting of the EU from cash-based to accrual-based accounts, a system which has already given the European Commission greater day-to-day control over its finances and provides it with better financial information. The accrual-based accounting system continued to be developed throughout 2005; development and improvement will continue in 2006 and 2007 to include progressively the European Development Fund, Delegations, the Agencies and a single datawarehouse.

A detailed action plan was established for the two years 2005 and 2006, and adapted and extended in the light of experience. The plans for 2006 and 2007 are presented graphically in annex. The work required to complete many IT developments was underestimated in the initial plan, which meant that certain tasks had to be rescheduled. The principal accounting projects still in progress are ABAC-EDF and ABAC-Delegations, which are now planned to be fully operational at the beginning of the 2007 (Delegations) and 2008 (EDF) financial years. The main issues arising during 2005 are presented in this report.

The Commission's Accounting Officer has presented to the Court of Auditors the provisional financial statements for 2005, the first to be prepared on a full accrual basis. The final statements are due to be approved by the Commission by 31 July 2006. All DGs and services have deployed considerable efforts to prepare the opening balances for this first year, to check them and make the necessary corrections, and to estimate the accrued expenditure at the beginning and end of the financial year on a coherent and consistent basis. Some checks on the data will continue until the final accounts are closed, some accounts must still be reconciled in the general accounts, and one Directorate-General has been requested to redo its estimates. Notwithstanding these efforts, given the magnitude of the task and the services' unfamiliarity with the new accounting procedures, and the limited number of qualified and trained staff, there is a risk that material errors and omissions will remain undetected in the final accounts.

Some accounting issues have been drawn to the attention of the Court of Auditors, in particular concerning the entities which were to be included in the EC's consolidated accounts, but which have not yet agreed to this inclusion, and the means of disclosure of the amounts to be called up from Member States to pay existing liabilities of the EC.

3. IMPLEMENTATION OF MODERNISED ACCOUNTING IN THE COMMISSION

3.1. Preparation of the financial statements and opening balances for the 2005 financial year.

The new reporting requirements for the 2005 *financial statements* were defined, and the accounting processes for closing the 2005 accounts and preparing the 2005 financial statements were prepared. The provisional annual accounts were delivered on 31 March 2006, the date set in the Financial Regulation.

In order to establish the *opening operational balances*, essentially all the information necessary for accrual accounting was uploaded into the central accounting system in January 2005; this included over 7 000 invoices or cost claims, 30 000 prefinancing entries, 92 000 assets and 3 100 guarantees. Each service was asked to verify the accuracy of these uploads by 1 May 2005, and in July 2005 each Director-General and Head of Service was requested to formally validate their opening operational balances. After verifications and controls, each DG validated the figures but requested some corrections to ensure the quality of the data. The last validation was received in January 2006.

The Court of Auditors was provided with details of the invoice and prefinancing uploads in February 2005, and the balance sheets by DG once they were sent for validation in July 2005. The Court of Auditors has also had access for consulting all the data booked in the accounting system since it was first introduced.

The major work in 2005 for the transition has been to finalise the opening *accrual balances* as at 1 January 2005, which proved to be an arduous task for DG Budget and all services alike. Guidelines on estimating the value of claims on EC funding not yet submitted by beneficiaries ('cut-off') were sent to the Directorates-General on 16 August 2005, after consultations with them as to the most appropriate basis for this estimation. By 31 January 2006, the last Directorate-General had prepared its individual methodology and cut-off bookings for the opening balance sheet, and by 17 March, the last DG had presented the information necessary for the year-end cut-off bookings. Reviews and coherence checks have been performed by DG Budget to ensure the quality of data. Some corrections will be required before the final accounts are approved on 31 July 2006, in particular concerning one DG which will be requested to rework its cut-off estimates.

Although all DGs did the work requested of them, there were considerable delays before the information was complete, as shown in Table 1. These delays reflect the difficulties of making the transition to accrual-based accounts within a short time-frame, and of providing IT tools and training to all services in good time.

Table 1

Information on financial accounts

	Date of request of data	Deadline for answers	DGs on time	Up to 1 month delay	More than 1 month	Last answers	Last request for additional bookings
			Initial contribution			Final version	
Checking on Opening balances	24/01/2005	31/03/2005*					
Validation of Opening balances	29/07/2005	15/09/2005	23	12	6	24/01/2006	10/03/2006**
Cut off on opening balance 01/01/05	16/8/2005	14/10/2005	6	15	19	23/2/2006	17/3/2006
Cut off 31/12/2005	4/10/2005	31/1/2006	18	21	1	13/3/2006	17/3/2006

* Deadline indicates the automatic correction period for uploaded invoices and prefinancing. No formal validation was required at this date.

** Even after the validation had been received a number of DGs submitted requests for further corrections to be made to the opening balance

As regards the consolidated accounts, the other institutions and the agencies provided the required information largely within the deadlines. The exceptions concern two institutions, which did not submit their cash-flow statements, and three entities which considered that they should not be included in the consolidated accounts, as the Financial Regulation permitted this exclusion (two agencies), or as they were not controlled by the European Community (the Joint Sickness Scheme). These issues should be resolved before the final accounts are approved.

The provisional accounts show that the EC's liabilities exceed its assets by some 62 billion €. This is because its revenue is called up only when payment of the liabilities is due. The principal liabilities are for staff pensions (32 billion €), and for claims on EAGGF, Guarantee section (47 billion €). In the absence of international standards for the presentation of the Member States' liabilities in this respect, the accounts will be finalised in the light of the Court of Auditors' remarks.

3.2. Loans and borrowings

Operations on loans and borrowing activities, which are outside the Commission's budget, were previously recorded in DG ECFIN's IT system, Globus. During 2005, this data was moved to the Commission's central system (SAP/CFM and FM). Certain financial instruments were uploaded to the new system in July, with the remaining instruments being moved in November 2005. Reporting functionalities are still being finalised. A central IT system upgrade will be required before it can produce accounts which are fully compliant with international standards. This upgrade is planned for the second quarter of 2006.

3.3. Training

In 2005, the main achievements in the area of training were:

- completion of the intensive ABAC training, which provided over 7 000 training places from October 2004 to June 2005;
- progressive updating of the courses on how to use ABAC, to take into account developments in the system, and to improve the quality of the courses. Satisfaction with ABAC courses rose from 79% in 2004 to 90% in 2005. In response to demand from DGs, a new integrated course was launched, covering all the basic aspects of managing transactions in both SI2 (gradually being phased out) and ABAC. Specific briefing sessions for authorising officers were provided in the first quarter of the year;
- Continued delivery of ABAC and SI2 courses after the completion of the intensive phase, as well as the courses on private and public-sector accounting, even though at times training material and documentation did not keep pace with system changes.

In 2006, the principal tasks will be:

- Continued delivery and update of courses, with a stronger message on the importance of choosing the correct accounts code, since this appears to be a problem in some DGs
- Delivery of training for staff to Delegations and Representations
- Preparation for delivery of training to staff of Agencies or other Institutions who may decide to adopt ABAC

3.4. Consolidation

A consolidation manual and reporting package has been prepared and sent to all Institutions/Agencies. A new IT consolidation tool (SAP ECCS) was developed and tested in November, using test reporting packages received from 15 participating Institutions/Agencies. The Institutions/Agencies have prepared their individual opening balance sheets and communicated them to the Accounting Officer of the Commission for coherence controls and consolidation. The provisional accounts of Institutions and Agencies have been successfully consolidated using the new tool.

3.5. Change of budgetary year

As from July 2005, all Directorates-General and services collaborated with DG Budget in reducing to a few days the period during which financial operations are interrupted while a new financial year is opened. This period was successfully reduced by more than three weeks compared to the usual timetable (Table 2). This achievement is not strictly part of the ABAC project, but due, on the one hand, to better coordination between 13 units of the five directorates of DG Budget and, on the other, to the use of the preliminary draft budget data as a basis for the first inter-services consultation on the internal Rules for 2006 as from September 2005. This provisional data was then updated once the budget had been adopted.

TABLE 2: COMPARISON BETWEEN THE OPENING OF THE 2006 AND 2005 YEARS

Event	2005/2006	2004/2005
Opening of the anticipated environment (*)	15.11	19.11
Inscription of voted appropriations enabling new commitment and related payments	21.12 (**)	10.1
Carry forward of outstanding (pre)commitments enabling their payment:		
- run 1	5.1 -- 9.1	31.1 -- 1.2
- run 2 (***)	20.1 -- 22.1	18.2
- run 2bis (***)	24.1	n/a
- run 3 (***)	3.2	28.2
Residual appropriations, main run	6.1 -- 9.1	3.2
Income run	16.1 -- 17.1	15.2
(*) The date 15/11 is laid down in RF 178.1 and 150.3 (**) Payments, with the exception of those allowed by RF 178.2, are not authorised before 1.1. (***) Additional runs concern DGs which had not carried out the required preparatory work in time for the earlier run		

4. CONTROL ENVIRONMENT AND VALIDATION OF LOCAL SYSTEMS

4.1. Communication and accounting quality.

The involvement of Directorates-General and the communication with them on accounting issues continued throughout 2005, in the form of meetings with the networks of accounting and financial correspondents. To make the accounts more reliable, the Accounting Officer's staff carried out checks during 2005 on the quality of the new accounting data. Any errors and inconsistencies found were communicated to the services concerned. Financial reporting by Directorate-General was developed, and several meetings with accounting correspondents were organized.

Work continues on improving the accounting control environment and clarifying roles and responsibilities, with a view to improving the quality of the accounting data.

4.2. Validation of local systems.

Concerning the *quality of data*, the modernised accounting system depends on the accurate and complete introduction of data by the many users of the central IT system (some 7000 are expected). The screens developed for users have progressively provided assistance aimed at minimising the risk of error, but the quality of the data introduced depends on the control environment put in place by each Authorising Officer by Delegation. DG Budget's validation

team of 8 persons has undertaken a programme of in-depth checks of systems laid down by the authorising officers to supply or justify accounting information, as required under article 61.1 (e) of the Financial Regulation, commencing with those assessed as presenting the higher risks.

The systems validation team in the Directorates-General completed all the work planned for 2005. The progress report published in July 2005 notes the overall satisfactory situation in 27 Directorates-General. The final report, adopted on 28 February 2006, describes progress made in all DGs, but there remain significant problems in the systems of two DGs (AIDCO and EAC), which led the Accounting Officer to suspend the validation of their systems until improvements were completed. Furthermore, the systems for recording the imprest accounts cannot be validated until the ABAC-Delegations IT project is completed (see §7 below).

5. IT DEVELOPMENTS FOR THE GENERAL BUDGET

The ABAC modules were progressively improved through releases in April, June and November 2005, and in March 2006. Invoices, payments and legal entity files can now be recorded through web-based applications. Work to improve security over access to the central accounting system (SAP) continued, and new restricted accesses for IT staff were implemented in February 2006. The ABAC system generally performed well, but some delays in the implementation of the IT development programme resulted in services being unable to make certain accounting corrections until March 2006.

The first phase of improvements to the **dunning procedure** was completed by mid-December. The second phase is due to be implemented by end September 2006.

Work progressed well on the **JRC's project** to use SAP-PS and CATS (timesheet) functionalities to support its needs for detailed budgeting and accounting for research projects. The project was implemented in readiness for the 2006 budgetary year.

A feasibility study completed in 2005 showed that the new version of the SAP FM module, **BCS (Budget Control System)** could be used to replace the version currently used for the central budget management, and that it was capable of incorporating the local budgetary lines required to provide departments with a more detailed system for managing their budgets. These local lines are currently managed in Si2. The introduction of BCS is now expected by end- 2006.

Progress on the development of a new financial **Single Data Warehouse**, necessary to complete the integration of IT files and of accounting records, was limited to the conceptual stage.

For **ABAC Contracts**, 2005 was focused on the provision of functions requested by the User Group and on completing deployment of the system in all the DGs. All contracts over 13 800 € and signed since January 2005 were required to be recorded in ABAC Contracts. At the end of March 2006, there were some 57 000 contracts with a total value of more than €7.7 billion registered in the application.

The main activities during 2005 for **ABAC Assets** were focused on the following areas:

- Completion of developments for accrual accounting and improved integration and coherence with the other ABAC applications, with a view to making data more coherent within ABAC;
- Completing the replacement of previous systems;
- Pilot phase of the development of applications for Delegations and Representations.

The Commission continued to improve **security** over access to the system, and to ensure the **synchronisation** of the accounting data held in the system (**Annex II**)

6. IMPLEMENTATION OF ABAC BY THE OTHER INSTITUTIONS AND AGENCIES

Several agencies and smaller institutions use a version of the Commission's Si2 system for their budgetary accounts. The Commission agreed to continue to make Si2 available during 2006, and to make all modules of ABAC available to those entities which wished to use them

A number of Agencies (2 executive and 9 traditional) and 2 committees (Economic and Social Committee, Committee of the Regions) have officially requested the use of ABAC. Five agencies will start using ABAC in 2006 on a pilot basis, the rest in 2007 and 2008.

For each Agency, a specific financial and accounting environment is implemented in ABAC. Individual accounting officers remain responsible for their accounts and for the execution of their payment runs.

7. ABAC DELEGATIONS

DG Budget, DG RELEX and DG DIGIT have determined the means of incorporating in ABAC the delegations' transactions which are at present executed via imprest accounts, and recorded on an independent system, RAI-web. Their fixed asset registers will have to be managed in ABAC-Assets. This project will require adaptations to the ABAC modules concerned and the development and completion of web-based applications. The roll-out to delegations is planned in 2006, though the link to SAP will not be in production until the year 2007 is opened. So far as possible, the roll-out to delegations will be aligned with that of ABAC-EDF (see §8 below).

8. EUROPEAN DEVELOPMENT FUND

In a separate exercise, the accounts of the European Development Funds ("EDF"), which differ from those of the General Budget, also need to be modernised.

Modernising the EDF includes preparing an updated chart of accounts and formulating new accounting rules in compliance with the requirements of accrual based accounting. The modernisation project will also include replacing OLAS, the existing IT system for the EDF. OLAS will be replaced by a combination of ABAC and the DG AIDCO local IT system, CRIS. Both ABAC and CRIS are already used for producing the General Budget accounts, and they are currently being adapted to the specificities of the EDF.

Substantial progress was made on the ABAC EDF project during 2005. A new chart of accounts and new accounting methods were drawn up and approved by the Accounting

Officer. In cooperation with DG AIDCO, a gap analysis was also carried to see what developments were still needed in ABAC and CRIS. These IT developments are underway and now aim to “go live” as of January 2008. Training the future users in the 46 ACP delegations remains a challenge.

It is important to underline that although the new IT support tools are currently being developed, the EDF annual accounts for 2005 were nevertheless drawn up in compliance with accrual based accounting principles. Furthermore, to ensure the comparability of the information in the annual accounts, the EDF Accounting Officer has restated the opening financial statements for the financial year 2005 on a full accrual accounting basis. The accounting information provided by the current IT accounting system (OLAS) was adapted where necessary, in order to present accrual-compliant data. The EDF Accounting Officer also made the necessary corrections to the cash based data, based on additional information supplied by the Authorising Officer.

9. FUTURE DEVELOPMENTS

The action plan has been updated for 2006 and extended to 2007 (see Annex). By end-2006, the full ABAC IT architecture should be in place. Further IT developments will relate mainly to improving user-friendliness and the financial reporting functions, and to achieving the longer-term aim of closer integration of local systems and providing further tools for user support and financial management. As regards the accounting framework, work will focus on defining the roles and responsibilities of the actors in the financial procedures, on improving the quality of accounting data and of management reports, and on monitoring compliance with validation criteria for local systems by all authorising officers by delegation.

10. CONCLUSION

The transition to a new accounting system in the European Commission met the statutory deadline and, on 1 January 2005, the Commission moved the general accounting of the EU from cash-based to accrual-based accounts, and is now in a position to comply in all material respects with internationally accepted accounting standards. The first definitive results of the system in place were tested and documented when the Commission's accounting officer prepared the provisional accounts on the due date of 31 March 2006. The Commission has thus achieved the objective of moving to accrual-based accounts within a very ambitious time frame. This objective could not have been achieved without the commitment and constructive collaboration of all Commission services.

However, although so far the transition has been managed successfully and comprehensive tests have been conducted, the verification work on local systems at the end of 2005 highlighted concerns on three systems where validation was not possible. The report on DGs' local systems also contains recommendations on improving controls over accounting information, better understanding of the choice of accounting codes, better training on accounting issues, and on the related cultural change. Moreover, Commission departments were under considerable pressure in 2005 to deliver new, complicated processes within ambitious deadlines. Work on improving the consistency checks within the accounting system will undoubtedly extend at least until the approval of the final consolidated accounts by 31 July 2006.

As regards the three local systems which could not be validated, two are planned to become compliant by end- 2006 (AIDCO and RELEX). There have been delays in developing a

replacement for the third system (EAC), so the DG concerned will have to ensure that the present system can be improved in time for the closure of the 2006 financial year.

The Commission is addressing the issue of its lack of qualified accounting staff by launching specialised external competitions to attract candidates with appropriate training and experience. It will also increase the number of training courses offered to existing staff.

The IT developments necessary to incorporate the European Development Funds, the Delegations' imprest accounts and the Agencies into ABAC should be completed by mid-2006, and thereafter the Commission will concentrate on completing the integration of the central IT systems, and on perfecting its security checks.

The project plans to provide each department's management with more reliable and complete information on the assets and liabilities for which it is responsible and on its financial relationships with each supplier (in the longer term), and, in the medium term, on the financial implementation of multiannual programmes and projects.

The lessons learnt from the problems and delays encountered during this first year of accrual-based accounting should enable the Commission to improve the quality of the financial information and compliance with deadlines for subsequent years' accounts.

Annex 1

Q1 06				Q2 06				Q3 06				Q4 06				Q1 07				Q2 07				Q3 07				Q4 07							
ABAC Agencies Pilot & Data Migration								ABAC Agencies Migration																											
								Mod Tests								Training & Int. tests																			
ABAC Delegations Developments								ABAC Delegations Migration								Deleg Post Impl support																			
								Tests		Corrections		Roll-out with out SAP link		Complete Roll-Out				Data upload in SAP																	
ABAC Assets for delegations development & PRESS												Migration & Roll-Out				Post Implementat.																			
								Trainin g				Trainin g																							
ABAC Assets vs SAP gap analysis								Assets to SAP migration?																											

Company Codes, CoA & Object Codes: HB Accounting, Security, Accounting Impact Analysis and Maintenance	
Accounting Follow up, DGs awareness & Training	
Acc. Manual new Web Site solution	
Provisional Closing	Final Closing
Accounting is the main impact	ABAC impacted
USM and DwH	ABAC-Assets impacted
Performance impacted	FED Functionnal

ANNEX II SYSTEM SECURITY AND SYNCHRONISATION

1. System Security.

Following the formalisation of the Security Policy for SINCOM2 in 2003 and taking account of the recommendations of various audits, an action plan was established the same year to reinforce security within the central accounting system.

The implementation of this action plan was continued in 2005, in particular regarding the revision of access in the accounting system, SAP, aiming to guarantee the segregation of functions, concerning in particular the management of the Treasury banking reconciliations, and to control the IT experts' accesses. Due to new emerging priorities (accesses to new modules of SAP and new users of other modules, including the more extensive use of SAP by other DGs), the revisions were not effective until February 2006.

In order to investigate and resolve dysfunctions in the system with the greatest effectiveness, a broad access (emergency profile) was kept in the system but will be activated only for a limited period necessary for the resolution of the problem. In these cases, the procedure of approval, monitoring and reporting of the interventions will ensure an effective control of the actions taken by the user of this "broad" access. A rigorous monitoring of system security was in place in 2005 and no major errors were found.

During 2005, an analysis was also launched for the complete recasting of security in ABAC Workflow, including the setting up of a workflow for subdelegations. A new, integrated ABAC disaster recovery plan was successfully tested in March 2006.

There remain two actions to be completed in 2006 concerning security:

- completion of the revision of the SAP accesses in DG Budget (e.g. by budgetary rapporteurs)
- the revision of the security module in ABAC Workflow, including the creation of an electronic workflow for subdelegations.

2. Quality of the system.

An important activity in 2005 concerned the identification of errors in the system and their correction. Checks on the datawarehouse, on a daily basis and at the end of the year, ensured the consistency of the budgetary data between Si2 and SAP at the level of each individual transaction. Changes in the system improved this consistency (for example in the treatment of the exchange rates). Three "system change requests" implemented in 2005 had a significant impact in the daily consistency of the system. Reconciliation reports for 2004 were presented to the Directorates-General to check the consistency of the budgetary data in the accounting annexes of the RAA with those encoded in Si2. In 2005, a major project was launched concerning the creation of a data model and its data dictionary for ABAC.