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## COVER NOTE

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From:	Mr Klaus-Heiner LEHNE, President of the European Court of Auditors
date of receipt:	4 November 2016
To:	Mr Peter KAZIMIR, President of the Council of the European Union
Subject:	Report on the annual accounts of the European Institute of Innovation and Technology for the financial year 2015 together with the Institute's reply

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Delegations will find attached the European Court of Auditors' report on the annual accounts of the European Institute of Innovation and Technology for the financial year 2015.

This report is accompanied by the Institute's reply and will shortly be published in the *Official Journal of the European Union*.

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Encl.: Report on the annual accounts of the European Institute of Innovation and Technology for the financial year 2015 together with the Institute's reply.<sup>1</sup>

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<sup>1</sup> In English only. The other languages of this report are available on the European Court of Auditors' website: <http://eca.europa.eu/>.



EUROPEAN  
COURT  
OF AUDITORS

Report on the annual accounts  
of the European Institute of Innovation and Technology  
for the financial year 2015  
together with the Institute's reply

## **INTRODUCTION**

1. The European Institute of Innovation and Technology (hereinafter “the Institute”, aka “EIT”), which is located in Budapest, was created by Regulation (EC) No 294/2008 of the European Parliament and of the Council<sup>2</sup>. The Institute’s objective is to contribute to sustainable European economic growth and competitiveness by reinforcing the innovation capacity of the Member States and the European Union. The Institute awards grants to an increasing number of “Knowledge and Innovation Communities” (KICs), linking the higher education, research and business sectors with one another and aiming thereby to boost innovation and entrepreneurship. KICs coordinate the activities of hundreds of partners. The grants provided by EIT reimburse partners’ costs and costs stemming from the KICs’ coordination activities.
2. **Table 1** presents key figures for the Institute<sup>3</sup>.

**TABLE 1: KEY FIGURES FOR THE INSTITUTE**

	<b>2014</b>	<b>2015</b>
Budget (million euro) <sup>4</sup>	174,9	231,7
Total staff as at 31 December <sup>5</sup>	48	50

*Source:* data provided by the Institute

## **INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE**

3. The audit approach taken by the Court comprises analytical audit procedures, direct testing of transactions and an assessment of key controls of the Institute’s supervisory and

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<sup>2</sup> OJ L 97, 9.4.2008, p. 1.

<sup>3</sup> More information on the Institute's competences and activities is available on its website: [www.eit.europa.eu](http://www.eit.europa.eu).

<sup>4</sup> Budget figures are based on payment appropriations.

<sup>5</sup> Staff includes officials, temporary and contract staff and seconded national experts.

control systems. This is supplemented by evidence provided by the work of other auditors and an analysis of management representations.

#### **STATEMENT OF ASSURANCE**

4. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU), the Court has audited:

- (a) the annual accounts of the Institute, which comprise the financial statements<sup>6</sup> and the reports on the implementation of the budget<sup>7</sup> for the financial year ended 31 December 2015, and
- (b) the legality and regularity of the transactions underlying those accounts.

#### ***The management's responsibility***

5. The management is responsible for the preparation and fair presentation of the annual accounts of the Institute and the legality and regularity of the underlying transactions<sup>8</sup>:

- (a) The management's responsibilities in respect of the Institute's annual accounts include designing, implementing and maintaining an internal control system relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies on the basis of the accounting rules adopted by the Commission's accounting officer<sup>9</sup>; making accounting estimates that are reasonable in the circumstances. The Director approves the annual accounts of the Institute after its accounting officer has prepared them on the basis of all available information and established a note to accompany the accounts in which he declares, *inter alia*,

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<sup>6</sup> These include the balance sheet and the statement of financial performance, the cash flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

<sup>7</sup> These comprise the budgetary outturn account and the annex to the budgetary outturn account.

<sup>8</sup> Articles 39 and 50 of Commission Delegated Regulation (EU) No 1271/2013 (OJ L 328, 7.12.2013, p. 42).

<sup>9</sup> The accounting rules adopted by the Commission's accounting officer are derived from the International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, where relevant, the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

that he has reasonable assurance that they present a true and fair view of the financial position of the Institute in all material respects.

- (b) The management's responsibilities in respect of the legality and regularity of the underlying transactions and compliance with the principle of sound financial management consist of designing, implementing and maintaining an effective and efficient internal control system comprising adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used.

### ***The auditor's responsibility***

6. The Court's responsibility is, on the basis of its audit, to provide the European Parliament and the Council<sup>10</sup> with a statement of assurance as to the reliability of the annual accounts and the legality and regularity of the underlying transactions. The Court conducts its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require the Court to plan and perform the audit to obtain reasonable assurance as to whether the annual accounts of the Institute are free from material misstatement and the transactions underlying them are legal and regular.

7. The audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and regularity of the underlying transactions. The procedures selected depend on the auditor's judgement, which is based on an assessment of the risks of material misstatement of the accounts and material non-compliance by the underlying transactions with the requirements in the legal framework of the European Union, whether due to fraud or error. In assessing these risks, the auditor considers any internal controls relevant to the preparation and fair presentation of the accounts, as well as the supervisory and control systems that are implemented to ensure the legality and regularity of underlying transactions, and designs audit procedures that are appropriate in the circumstances. The audit also entails evaluating the appropriateness of accounting policies, the reasonableness of accounting estimates and the overall presentation of the accounts. In preparing this report and Statement of Assurance, the Court

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<sup>10</sup> Article 107 of Regulation (EU) No 1271/2013.

considered the audit work of the independent external auditor performed on the Institute's accounts as stipulated in Article 208(4) of the EU Financial Regulation<sup>11</sup>.

8. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its statement of assurance.

#### **Opinion on the reliability of the accounts**

9. In the Court's opinion, the annual accounts of the Institute present fairly, in all material respects, its financial position as at 31 December 2015 and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of its Financial Regulation and the accounting rules adopted by the Commission's accounting officer.

#### **Basis for qualified opinion on the legality and regularity of the transactions underlying the accounts**

##### *Irregular flat rate for calculating indirect eligible costs related to grants*

10. The EU contribution to the Institute's budget in the period running from 1 January 2014 to 31 December 2020 is provided under the Horizon 2020 financial envelope which implies that the Institute has to apply Horizon 2020 (H2020) rules. H2020 is the successor programme of the Seventh Framework Programme for research, technological development and demonstration activities (FP7), adopted by Decision No 1982/2006/EC of the European Parliament and of the Council<sup>12</sup>, that ran from 2007-2013. The EIT did not participate in this programme.

11. The Institute aligned its Financial Regulation with effect from 1 January 2014 to H2020 rules and as of that date only a uniform flat rate of 25 % is applicable for the calculation of indirect eligible costs related to grants<sup>13</sup>. Following the assessment of the 2014 business plans the EIT had informed the KICs in October 2013 by official letter that this might happen. Contrary to this provision, the 2014 grant agreements signed in February 2014 with the KICs continue to provide for a flat rate of 40 % for non-profit public bodies, higher education establishments, research organisations and SMEs.

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<sup>11</sup> Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

<sup>12</sup> OJ L 412, 30.12.2006, p. 1.

<sup>13</sup> Article 90(1) of the EIT Financial Regulation

12. The 40 % flat rate was provided for in Article 75(8) of the EIT financial rules (preceding its Financial Regulation) which were repealed with effect from 1 January 2014. Whilst the EIT Financial Regulation provides a transitional period for two articles of said financial rules, it does not include such a period for Article 75(8) allowing the use of a 40 % flat rate. Such a transition period is not provided for in the H2020 rules either. Article 57 of the H2020 rules which deals with the transition from FP7 to Horizon 2020 provides in paragraph 2 that “this Regulation [Horizon 2020 rules] shall not affect the continuation or modification ... of the actions concerned ... until the award of financial assistance by the Commission or funding bodies under Decision No 1982/2006/EC [FP7] or any other legislation applying to that assistance on 31 December 2013, which shall continue to apply to the actions concerned until their closure”. However the EIT was not part of FP7 and consequently did not award assistance under it. Therefore the EIT financial rules do not fall under the legislation applying to that assistance [FP7]. The transitional provisions under article 57 (2) of the H2020 rules are therefore not applicable to the 2014 grant agreements and the related payments.

13. In the absence of a valid legal basis, the flat rate of 40 % for the reimbursement of indirect eligible cost is irregular. The total amount overpaid in applying this flat rate is 5,5 million euro, corresponding to 3 % of the 2015 grant transactions<sup>14</sup>.

#### *Outcome of the 2014 grant transactions ex post verification*

14. The errors found as a result of ex-post verification of a sample of 2015 grant transactions, after correcting for the overpayment described in paragraph 13 lead to a residual error rate of 2 % for the 2014 grant transactions (1,46 % without such correction).

#### *Combined error rate*

15. The combined error rate of the matters described in paragraphs 10 to 14 is 5 % of the 2015 grant transactions or 4,9 % of the total 2015 expenditure.

#### **Qualified opinion on the legality and regularity of the transactions underlying the accounts**

16. In the Court’s opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraphs 10 to 15, the transactions underlying the annual accounts for the year ended 31 December 2015 are legal and regular in all material respects.

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<sup>14</sup> The 2015 grant transactions include the final payments and clearings of pre-financings made in 2015 for grants amounting to 183,3 million euro.

17. The comments which follow do not call the Court's opinions into question.

### **COMMENTS ON THE LEGALITY AND REGULARITY OF TRANSACTIONS**

18. In 2015, the Institute informed the KICs that its financial contribution over the first five years (2010-2014), did not exceed the 25 % ceiling of their respective global expenditure. However the poor definition of KIC Complementary Activities ("KCA") impaired any clear assessment as to whether costs associated to KCA should be accepted or not in the maximum EIT contribution. The Court in its Special Report 4/2016 concluded that this funding condition (which continues to be applied in the new period 2014-2020) is of little or no added value, and removing it would alleviate much of the operational and financial reporting burden of the KIC partners<sup>15</sup>.

### **COMMENTS ON INTERNAL CONTROLS**

19. The Certificate of Financial Statement ("CFS") requested from KIC partners claiming reimbursement of more than 325 000 euro shall contribute to the Institute's ex-ante verification of cost statements<sup>16</sup>. However, the quality of these certificates varies significantly, limiting the assurance that can be obtained from them and requiring the Institute to carry out additional checks.

### **COMMENTS ON BUDGETARY MANAGEMENT**

20. The EIT founding regulation provides that "the EIT shall mobilise funds from public and private sources and use its resources in accordance with this Regulation. It shall in particular seek to raise a significant and increasing proportion of its budget from private sources and from income generated by its own activities."<sup>17</sup>. In spite of the said provision that clearly

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<sup>15</sup> Special Report 4/2016: The European Institute of Innovation and Technology must modify its delivery mechanisms and elements of its design to achieve the expected impact

<sup>16</sup> Article 34 of Regulation (EU) No 1290/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 81).

<sup>17</sup> Article 5 (1)(d) of Regulation (EC) No 294/2008.



refers to the EIT budget, the contribution from the Horizon 2020 financial envelope accounted for 99 % of its 2015 budget.

21. Even though the Institute is allowed to re-enter unused appropriations (appropriations not committed during the year or de-committed by the year end) in the budgets of the following three years<sup>18</sup>, it had not adapted its process in time to re-enter 26,6 million euro available from the 2014 grant agreements in the 2015-2017 budgets. These appropriations result from the lower than expected use of funds by KICs.

22. The level of carry-overs for committed appropriations was high for Title II at 0,4 million euro, i.e. 44 % (2014: 0,5 million euro, i.e.36 %). These carry-overs mainly relate to contracts for IT services going beyond year-end and for meetings for which invoices had not yet been received.

### **OTHER COMMENTS**

23. The original target set by the Commission for the Institute to obtain financial autonomy was 2010. However it obtained only partial financial autonomy in June 2011 under the condition of continued ex ante approval of grant related transactions and of procurements above 60 000 euro by its (parent) Directorate General Education and Culture.

24. The 2014 grant agreements with the three KICs were signed after the start of the grant funded actions on 1 January 2014. Initially signed in February 2014, amendments involving 38 million euro of additional funds were signed only by the end of March 2014.

25. The Institute funds the EIT Digital Master's programme in which 16 European universities participate. The model for reimbursing the universities' costs combines a lump sum maximum 8 000 euro per student (following the Erasmus Mundus programme provisions) plus actual costs including flat rate based indirect costs. On average a total of 15 000 euro per student was paid to the universities in 2015 on this basis (including the lump sum). However, the model has never been formally defined and does not allow a distinction between activities covered by the lump sum and those covered by the actual costs. The

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<sup>18</sup> Article 14 (1) of the EIT Financial Regulation.

Institute should move towards a clear and formally defined model based on a single method for declaring costs such as a substantiated single lump-sum.

26. Based on the decision of the KIC Supervisory Board one KIC legal entity paid gross bonuses of 646 000 euro to 55 of its staff (individual bonuses as much as 100 000 euro) which the Institute reimbursed at 100 %. Paying such bonuses using only public funds is an unusual practice and they should be taken into account in the ceiling for the EIT funding of individual salaries which will be applied with effect from the 2016 grant agreement. This principle of sound financial management was also breached when a KIC partner procured public relations services with daily rates ranging from 800 euro to 3 250 euro per person, which were also fully reimbursed by the Institute.

27. The Institute used a Commission framework contract ("FWC") for the organisation of innovation conferences taking place in 2015 and 2016. Under this FWC services were subcontracted for which prices were not set in the FWC. The prices agreed for these services range from 800 euro per day for a junior consultant to 2 250 euro per day for a senior consultant (almost four times the price agreed in the FWC for a senior manager). The cost of services procured at such prices amount to more than 100 000 euro per conference.

#### **FOLLOW-UP OF PREVIOUS YEARS' COMMENTS**

28. An overview of the corrective actions taken in response to the Court's comments from previous years is provided in **Annex I**.

This Report was adopted by Chamber IV, headed by Mr Baudilio TOMÉ MUGURUZA, Member of the Court of Auditors, in Luxembourg at its meeting of 13 September 2016.

*For the Court of Auditors*

(s) Vítor Manuel da SILVA CALDEIRA

*President*

Follow-up of previous years' comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2012</b>	<p>In addition to the matter described in paragraphs 9 to 13, budgets for grant agreements signed in 2010 and 2011, which resulted in payments in 2012, were not sufficiently specific. There was no link between the approved funds and the activities to be implemented. [Grant agreements...] and did not include rules for the procurement of goods and services by the KICs and their partners.</p>	<b>Completed</b>
	<p>Grant agreements did not set individual thresholds for specific cost categories (i.e. staff costs, sub-contracting, legal services, etc).</p>	<b>Outstanding<sup>1</sup></b>
<b>2012</b>	<p>EIT also carried out technical verifications for all funded projects as part of its ex ante verifications. However, there was a lack of quantifiable targets that hampered an effective assessment of project activities and results. Business plans did not define in detail the activities to be implemented; nor did they set clear milestones, deliverables per activity or quality criteria.</p>	<b>Completed</b>

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<sup>1</sup> The EIT has introduced ceilings for the maximum EIT contribution to the overall management and overhead costs of KICs as well as for the costs of individual KIC management staff members starting from 2016. However it has not planned any further specific corrective actions in response to this matter as outlined in its reply to the Court's Specific Annual Report for the financial year 2012.

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2012</b>	Out of the committed appropriations carried over from 2011 amounting to some 22 million euro, some 10 million euro (45 %) were cancelled in 2012. The high level of cancellations is mainly due to lower than estimated costs claimed by beneficiaries under 2011 grant agreements (9,2 million euro or 92 % of cancelled carry-overs).	<b>N/A</b>
<b>2013</b>	The Framework Partnership Agreements (FPA) with the three KICs stipulate that the EIT financial contribution may cover up to 25 % of the KIC's global expenditure over the first four years, from 1 January 2010 to December 2013. According to the figures reported by the KICs, this ceiling was respected by all three KICs. However, as these figures will not be audited before 2015, there is no appropriate audit evidence that the EIT funding did not exceed this 25 % ceiling.	<b>Completed</b>
<b>2014</b>	The EIT has gradually improved its financial verification of the KICs' cost claims. However, the operational verification of deliverables is lagging behind. The KICs' annual business plans still include an inadequate definition of deliverables and there is no clear link between planned deliverables and eligible cost per partner and cost category. Also, the Court has found cases where the full amount of the EIT grant was paid out even if some of the objectives set in the business plan have not been achieved.	<b>Completed</b>

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2014</b>	The Institute overestimated its budgetary needs for 2014 by 13,1 million euro, i.e. 5,6 % (2013: 3,4 million euro, i.e. 2,5 %) and only 220 million of the 233,1 million euro available were committed. The low implementation rate is mainly related to non-used appropriations for grants (11,4 million euro) to fund KIC activities. The KIC's business plans, on the basis of which grant agreements were signed, did not require the use of total 2014 appropriations available to the Institute. The appropriations not used will be re-entered in the Institute's budgets for the years 2015-2017 as stipulated in the Institute's Financial Regulation.	<b>Ongoing</b> <sup>2</sup>
<b>2014</b>	While the KICs are to develop strategies for financial sustainability, to date, and in the fifth year of their existence, they remain fully dependent on financing by the Institute and KIC partners.	<b>Ongoing</b> <sup>3</sup>
<b>2014</b>	Since its creation in 2009, the Institute has suffered from high staff turnover and instability at management level. In June 2014, the Governing Board decided to second the Institute's Director on a long-term research mission to the European University Institute in Florence for the remaining eleven months of his mandate. The interim Director took over duties in August 2014 (just after his recruitment and appointment as Chief Operating Officer (COO)) and is now the fourth person occupying the Director's post within a period of six years. The vacancy notice to recruit a new Director was published in July 2015.	<b>Ongoing</b> <sup>4</sup>

<sup>2</sup> Budgetary needs for 2015 were overestimated by 25 million euro, i.e. 9,4 %; only 241,6 million euro appropriations available were committed. The reason for the low implementation rate remained the same. The appropriations not used can be re-entered in the budgets for 2016 - 2018.

<sup>3</sup> Revenue declared by KIC partners under 2014 GA amounted to 0,3 million euro.

<sup>4</sup> Staff turnover rate in 2015 was 17 % (posts staffed at the beginning of the 2015). The procedure for the appointment of a new Director is still ongoing.

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2014</b>	Two of the three Head of Unit posts have been vacant since 2013. One is occupied ad interim since 2013 which is in contradiction with the Staff Regulations that stipulate a maximum period of one year. The other is currently occupied by the COO who also serves as the interim Director and who thus fulfils three roles at the same time.	<b>Ongoing</b> <sup>5</sup>
<b>2014</b>	Although the situation has improved in comparison with 2013, 20 % of the posts in the EIT establishment plan were still vacant at the end of 2014 (compared with one third at the end of 2013).	<b>Ongoing</b> <sup>6</sup>
<b>2014</b>	<p>Emphasis of matter</p> <p>Without calling into question the unqualified opinion expressed in paragraph 9, the Court draws attention to the fact that the EIT financial contribution may not exceed 25 % of the KIC's global expenditure over the first five years, from 1 January 2010 to 31 December 2014. According to the figures reported by the KICs, this ceiling was respected. The EIT obtained audit certificates by 31 March 2015 on the costs of KIC complementary activities (KCA) incurred during 2010-2014. In addition to obtaining the audit certificates, in 2015 the EIT conducted a review of the portfolio of KIC complementary activities to ensure that only those activities are accepted that meet all legal and operational requirements set for KCAs including to have a link with KIC added value activities funded by the EIT.</p>	<b>Completed</b>

<sup>5</sup> One vacant head of unit post has been staffed; the other head of unit post is still vacant and filled on ad interim basis since 2013.

<sup>6</sup> 16% of the posts in the Institute's establishment plan were vacant at the end of 2015.

## THE INSTITUTE'S REPLY

10-13. The EIT disagrees with the conclusion of the Court of Auditors, as no “overpayment” or irregular payment was made for the reimbursement of indirect costs of Knowledge and Innovation Communities (KICs) under the 2014 grant agreements.

The EIT is part of the Horizon 2020 framework programme and has to apply the rules of the Horizon 2020 Rules for Participation and Dissemination starting from 1 January 2014. Article 57(2) of the Horizon 2020 Rules for Participation and Dissemination provides explicitly for the following transitional measure: „this Regulation shall not affect the continuation or modification including the total or partial termination, of the actions concerned, until their closure, or until the award of financial assistance by the Commission or funding bodies under Decision No 1982/2006/EC or any other legislation applying to that assistance on 31 December 2013, which shall continue to apply to the actions concerned until their closure”. The EIT qualifies as “funding body” and the EIT Regulation qualifies as “any other legislation” in application of this particular provision. The legislation applicable to the EIT financial assistance on 31 December 2013, the EIT Financial Rules, explicitly allowed the use of a 40 % flat rate for reporting indirect costs by higher education institutions, research organisations, non-profit public bodies and SMEs. Therefore, the use of the flat rate of 40 % by these bodies was legal and regular under the 2014 grant agreements. Consequently, the EIT does not accept the conclusion of the Court of Auditors, as no overpayment was made. While the EIT indeed notified the KICs in October 2013 of potential changes in the rules for reporting indirect costs under Horizon 2020, this notification happened before the Horizon 2020 Rules for Participation and Dissemination, including the above mentioned transitional measures in Article 57, were adopted by the European Parliament and the Council on 11 December 2013. Based on the transitional measures adopted, the EIT did not need to disallow the use of a 40 % flat rate for reporting indirect costs by higher education institutions, research organisations, non-profit public bodies and SMEs.

In order to provide the relevant context, it is important to recall the process how the 2014 grant agreements were established. The 2014 EIT-KIC grant agreements were based on the

2014 Business Plans of KICs that were prepared by the Knowledge and Innovation Communities during 2013. The annual call for the 2014 Business Plans was launched by the EIT by sending the Business Plan guidance to the KICs in April 2013. In line with the guidance provided by EIT, KICs developed in consultation with their partnership and submitted their 2014 Business Plans to the EIT by 30 September 2013. Following the evaluation of the 2014 Business Plans by the EIT, supported with external experts, the EIT Governing Board decided on the 2014 funding allocation to KICs on 5 December 2013. Based on this decision of the Governing Board, KICs amended their Business Plans in January 2014 in order to align them with the funds allocated. The grants were awarded by the EIT Director and the grant agreements were signed in February 2014. In line with the principle of legal certainty, funding rules shall not be changed after a call for proposal has been launched.

Therefore, and in line with the transitional arrangements provided by the Horizon 2020 Rules for Participation and Dissemination, the entry into force of the new Regulation on the Horizon 2020 Rules for Participation and Dissemination should not have affected the continuation of the actions concerned (i.e. the 2014 Business Plans of the KICs, which were established and assessed by the EIT in 2013) until the award of financial assistance by the EIT. This award should have been carried out under the legislation applicable on 31 December 2013.

The EIT was indeed not part of the Seventh Framework Programme for research, technological development and demonstration activities (FP7). However, the EIT is part of Horizon 2020 and the majority of KIC Partners are beneficiaries under both FP7 and other Horizon 2020 programmes, too. Therefore, it is coherent to apply the same 40 % flat rate to the transition from the pre-H2020 EIT financial assistance to Horizon 2020 as from FP7 to Horizon 2020.

Besides, it is important to recall that calls for proposals under FP7 were launched by DG Research and Innovation until as late as December 2013 and grant agreements resulting from those calls were signed until as late as October 2014. Many of those grant agreements are still running in 2016 and follow the rules of the FP7 legal framework based on the same transitional provisions of the Horizon 2020 Rules for Participation and Dissemination. The



EIT did not provide preferential treatment to its beneficiaries (KIC Partners) affected by the 40 % flat rate in the 2014 grant agreements.

14. As reported in the EIT Consolidated Annual Activity Report for 2015, the residual error rate of 2015 grant transactions, made under the 2014 grant agreements, after ex-ante and ex-post controls is 1,46 %.

15. For the reasons described in the replies to paragraphs 10 to 14, the error rate of 2015 grant transactions, as calculated by the EIT, is 1,46 %.

18. The EIT had obtained audit certificates from independent auditors on the costs of KIC complementary activities by 31 March 2015 in order to ensure that the EIT financial contribution did not exceed the 25 % ceiling over the years 2010-2014. On the basis of the audited figures, the funding percentages for the period 2010-2014 are as follows: Climate KIC – 16 %, KIC InnoEnergy – 19 % and EIT Digital – 21 %.

As the percentages are well below the 25 % ceiling set out in the EIT-KIC Framework Partnership Agreements, the EIT has obtained assurance on compliance with the applicable legal basis.

Nevertheless, the Commission and the EIT accepted the recommendation of the Court's Special Report 4/2016 to propose an amendment to the EIT legal basis removing the 25 % funding condition in order to alleviate the operational and financial reporting burden on the KIC Partners. Until such an amendment is adopted, the EIT will implement the currently applicable legal basis.

19. The EIT applies the audit certificate methodology devised by DG Research and Innovation for the Horizon 2020 framework programme starting from the 2014 grant agreements. The revised methodology includes more detailed instructions and agreed upon procedures as well as 63 standard factual findings covering all cost categories.

Furthermore, the EIT has developed a comprehensive grant assurance strategy that is built on both ex-ante and ex-post verification, including the CFS, in order to ensure the legality and regularity of transactions.

20. The EIT interprets the applicable legal basis differently. Recital (16) of the EIT Founding Regulation provides an explanation of Article 5(d) of said Regulation as follows: “Therefore, it is expected that industry, the finance and service sectors will contribute significantly to the budget of the EIT and, in particular, to the budget of the KICs. The KICs should aim at maximising the share of contributions from the private sector.”

In this light, the EIT is of the opinion that the EIT shall primarily mobilise funds from public and private sources via its Knowledge and Innovation Communities. Therefore, the EIT interpretes the quoted article as including the budget of KICs when the EIT budget is referred to. In this light, the EIT has been successful in mobilising funding from other public and private sources via its Knowledge and Innovation Communities. The share of funding from sources other than the EIT to the budget of the three first wave KICs concerns for the most part the complementary activities declared by the KICs and was 84 % (Climate-KIC), 81 % (KIC InnoEnergy) and 79 % (EIT Digital), respectively, in the period 2010-2014.

21. The amount of 26,6 million euro unspent by KICs from the 2014 grant agreements became known to the EIT when KICs claimed the actual amount of 187,2 million euro in March 2015. At that time, it was not possible anymore to cancel the unused appropriations entered for year 2014, which only then could have been re-entered during the next three years.

As a direct consequence of the lessons learnt in the framework of the 2014 grant agreements, the EIT carried out a budget review and the KICs were requested to revise their 2015 Business Plans and Budgets in October 2015 and they submitted amended Business Plans and Budgets in November 2015. As a result of the reduction in KIC Budgets, the EIT could decommit unspent amounts, which have then been cancelled and re-entered in the estimate of revenue and expenditure for 2016. This shows that, in close collaboration with the KICs, the EIT management of the budget has significantly improved.

In this context, the recommendations of the Court of Auditors in Special Report 4/2016 are relevant. EIT-KIC grant agreements signed before the start of the activities and covering a longer period than the calendar year should improve the absorption of available funds by the KICs.

22. The total amount reported by the Court consists of planned carry-overs that was necessary due to the nature of activities such as services going beyond year-end and meetings held in December 2015 for which invoices were only received in January 2016. These planned carry-overs do not indicate weaknesses in the budgetary management of the EIT but are a standard budget management tool.

23. The EIT requested the Commission to re-launch the process leading to full financial autonomy. The Commission set out the roadmap and timetable of the process in May 2016. According to the indicative timetable, the Commission will complete its financial autonomy assessment report in December 2016 – January 2017.

24. Due to the annual nature of the EIT's budget, and the fact that the EU budget is generally not adopted before mid-December, grant agreements for a given year cannot be signed before 1 January of that particular year. The EIT committed itself to decrease the gap between the starting date of the action as defined in the KICs' Business Plans and the date of signature of the grant agreements. As a result of this effort, the 2014 grant agreements were signed with the three KICs in February 2014.

As regards the amendments of grant agreements signed in March 2014, it is important to note that significant uncertainties surrounded the EIT's 2014 annual budget due to the ongoing negotiations related to the 2014-2020 Multiannual Financial Framework and Horizon 2020. Therefore, the EIT Governing Board took a prudent approach and decided in September 2013 to allocate only 180 million euro, as a first tranche, for the 2014 grant agreements. After the 2014 annual budget had been confirmed, the EIT awarded further grants totalling 38,5 million euro, as a second tranche, to the three KICs in March 2014.

25. The education activities covered by lump sums and actual costs can be distinguished in the EIT Digital Masters Programme. The lump sum tuition fees cover the costs of the universities related to the participation of students in technical courses. On the other hand, the activities reported based on actual costs relate to the EIT Digital specific learning outcomes and provide added value for students compared to the standard Masters Programmes offered by the participating universities.

The EIT accepts that it should move towards a single lump sum model for financing KICs' Masters programmes in order to simplify the cost reporting, once sufficient statistical data is available to establish such a single lump sum in line with the provisions of Article 124(2) of the EU Financial Regulation.

26. The EIT is of the opinion that bonuses, as variable components of the basic remuneration of KIC management staff, comply with all relevant rules and regulations, in particular section 1.1.3 of Horizon 2020 Annotated Model Grant Agreement which defines the eligibility conditions for variable components paid by beneficiaries. More precisely, the variable complements were authorised by the employment contracts, they were determined on the basis of objective conditions, which were documented by the KIC Legal Entity and verified by EIT. The net amount actually paid to employees depends on the applicable withholding tax rate and the employees' individual tax situation. On the basis of a tax rate of ca. 40 %-50 % of the gross amount reported by the Court of Auditors, the net amount was on average around 6 000-7 000 euro per person.

While the practice of reimbursing bonuses, as variable and performance-based components of remuneration, may be unusual, the objectives pursued by KICs as business-driven organisations, such as aiming for financial sustainability, are also unusual and cannot be found in other programmes. The use of variable elements as part of the basic remuneration can provide a strong incentive for good performance and ensure that value for money is achieved. In fact, performance-based remuneration of KIC management staff is considered most appropriate in a business-driven model. Furthermore, it is important to note that the EIT contribution to salaries paid to KIC management staff, including bonuses will be kept below the ceiling established by the EIT in 2016 grant agreements.

Finally, the EIT is of the opinion that Recommendation No 3 of the Court of Auditors' Special Report 4/2016 is relevant in this context. According to the Court of Auditors, "the EIT should seek greater autonomy and make use of the flexibility in Horizon 2020's legal basis. In particular, it should adopt specific rules tailored to the needs of the KIC partners." This is exactly what the EIT has done when accepting the performance-based remuneration system introduced by the KIC Legal Entity in question.

As regards the public relations services procured by another KIC Partner, a renowned public university, it is important to note that the subcontractor providing the public relations services had been selected in a competitive tendering process carried out in full compliance with the procurement rules of the KIC Partner. Therefore, the EIT is of the opinion that best value for money has been ensured and the principles of sound financial management have been complied with. The audit conclusion on sound financial management is unclear, as no comparable benchmark prices have been provided by the Court for the services procured by the KIC Partner.

27. The subcontractor was identified and contracted by the Framework Contractor in line with the provisions of the Commission Framework Contract. It provided specialist services such as developing a concept outline for INNOVEIT, designing an attractive and coherent programme and moderating/facilitating the three-day event.

According to the information received from the Framework Contractor, they have been working with the subcontractor in question on the organisation of several events for various Directorates-General of the Commission in recent years. The standard rates charged by the subcontractor for those events were 2 500 euro and 900 euro for senior and junior consultants, respectively. In fact, the subcontractor applied a 10 % reduction in the case of INNOVEIT. The Framework Contractor, who cooperates with other moderators as well, assured the EIT that the rates charged are competitive in view of the market prices of such services.

The price of 2 250 euro for a senior consultant is considered thus as a market rate reflecting both the high level of skills and competences needed to deliver the tasks requested and the type of work delivered which was mainly conceptual (and not logistical related to the conference organisation). Finally, it is important to note that the memorandum of understanding signed between DG EAC and EIT related to the procurement of this Framework Contract stipulates that the EIT could not take part in the inter-institutional call for tenders and then procure the same goods or services by other means. The EIT therefore had to use the Commission Framework Contract for the organisation of the INNOVEIT events.