



**COUNCIL OF
THE EUROPEAN UNION**

**Brussels, 26 November 2013
(OR. en)**

16524/13

FIN 825

COVER NOTE

From:	Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt:	5 November 2013
To:	Mr Linas LINKEVICIUS, 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 2012 together with the Institute's replies

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 2012.

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

Encl.: Report on the annual accounts of the European Institute of Innovation and Technology for the financial year 2012 together with the Institute's replies.¹

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

ЕВРОПЕЙСКА СМЕТНА ПАЛАТА
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EVROPSKÝ ÚČETNÍ DVŮR
DEN EUROPÆISKE REVISIONSRET
EUROPÄISCHER RECHNUNGSHOF
EUROOPA KONTROLLIKODA
ΕΥΡΩΠΑΪΚΟ ΕΛΕΓΚΤΙΚΟ ΣΥΝΕΔΡΙΟ
EUROPEAN COURT OF AUDITORS
COUR DES COMPTES EUROPÉENNE
CÚIRT INIÚCHÓIRÍ NA HEORPA



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EUROPEISKA REVISIONSRÄTTEN

Report on the annual accounts
of the European Institute of Innovation and Technology
for the financial year 2012

together with the Institute's replies

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 Council¹. 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 three “Knowledge and Innovation Communities” (KICs), linking the higher education, research and business sectors with one another and thereby boosting innovation and entrepreneurship². KICs coordinate the activities of hundreds of partners. The grants provided by EIT reimburse partners’ costs and costs stemming from the KICs’ coordination activities.

INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE

2. 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 control systems. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations.

STATEMENT OF ASSURANCE

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

¹ OJ L 97, 9.4.2008, p. 1.

² **Annex II** summarises the Institute’s competences and activities. It is presented for information purposes.

- (a) the annual accounts of the Institute, which comprise the financial statements³ and the reports on the implementation of the budget⁴ for the financial year ended 31 December 2012, and
- (b) the legality and regularity of the transactions underlying those accounts.

The management's responsibility

4. In accordance with Articles 33 and 43 of Commission Regulation (EC, Euratom) No 2343/2002⁵, 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:

- (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 officer⁶; 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

³ These include the balance sheet and the economic outturn account, the cash flow table, the statement of changes in net assets and a summary of the significant accounting policies and other explanatory notes.

⁴ These comprise the budgetary outturn account and the annex to the budgetary outturn account.

⁵ OJ L 357, 31.12.2002, p. 72.

⁶ 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.

information and established a note to accompany the accounts in which he declares, *inter alia*, 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

5. The Court's responsibility is, on the basis of its audit, to provide the European Parliament and the Council⁷ 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.

6. 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

⁷ Article 185(2) of Council Regulation (EC, Euratom) No 1605/2002 (OJ L 248, 16.9.2002, p. 1).

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.

7. 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

8. In the Court's opinion, the Institute's annual accounts present fairly, in all material respects, its financial position as at 31 December 2012 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 a qualified opinion on the legality and regularity of the underlying transactions

9. In 2012, the Institute made final payments and clearings of pre-financings (transactions) for grants amounting to 11,3 million euro (2010 activities) and 48,6 million euro (2011 activities).

10. All grant transactions are subject to review by the Commission before authorisation by EIT. The Institute itself made considerable efforts to implement effective ex ante verifications with the aim of providing reasonable assurance on the legality and regularity of grant transactions. About 80 % of grant expenditure claimed by KIC's is covered by certificates issued by independent audit firms contracted by the KICs and their partners. EIT itself carried out

ex ante verifications consisting of comprehensive desk checks. Supporting documents obtained from the KICs and their partners were reviewed by EIT initially only in the case of particular risks identified.

11. The Court found however that the quality of the audit certificates is inadequate in many instances⁸. In order to have a second layer of assurance on the legality and regularity of grant transactions, at the end of 2012 the Institute introduced complementary ex post verifications for grants related to 2011 activities. They were carried out by independent audit firms contracted by EIT and are assessed as reliable. Ex post verification results confirmed that ex ante verifications are not fully effective. The Institute has however recovered the irregular payments found and the residual error rate for 2011 grant transactions is not material.

12. No ex post verifications have been carried out yet for the transactions related to grants for 2010 activities (11,3 million euro). In addition, given the limited assurance that can be drawn from ex ante verifications, there is no reasonable assurance as to the legality and regularity of these transactions. The Court could not obtain sufficient appropriate audit evidence on the legality and regularity of the audited grant transactions related to 2010 activities.

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

13. In the Court's opinion, except for the possible effects of the matters described in the basis for a qualified opinion paragraphs 9 to 12, the

⁸ I.e. Audit certificates did not always indicate the cost claim audited. Not all cost categories had to be audited in sufficient detail (as an example, actual indirect costs, which can be declared without threshold, was not checked on the basis of original supporting evidence). The risk of double funding of equipment declared as cost was not comprehensively checked. Most audit certificates did not mention the coverage of costs audited and there was no common methodology to identify the overall error in the cost claims.

transactions underlying the annual accounts for the year ended 31 December 2012 are legal and regular in all material respects.

14. The comments which follow do not call into question the Court's opinion on the reliability of the accounts or its qualified opinion on the legality and regularity of the underlying transactions.

COMMENTS ON INTERNAL CONTROLS

15. 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 did not set individual thresholds for specific cost categories (i.e. staff costs, sub-contracting, legal services, etc.) and did not include rules for the procurement of goods and services by the KICs and their partners.

16. 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.

COMMENT ON BUDGETARY MANAGEMENT

17. 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).

FOLLOW-UP OF PREVIOUS YEAR'S COMMENTS

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

This Report was adopted by Chamber IV, headed by Dr Louis GALEA, Member of the Court of Auditors, in Luxembourg at its meeting of 10 September 2013.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

Follow-up of previous year's comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2011	The rate of execution of the Institute's budget for the audited period of financial autonomy (see paragraph 2) was low. Comparing payments with appropriations committed, the rate was 56 % for title I (staff expenditure), 30 % for title II (administrative expenditure) and 11 % for title III (operational expenditure).	Completed
2011	Grant agreements resulting in payments in 2011 were systematically signed by the European Commission (Directorate General for Education and Culture) and the Institute after most of the activities had already been implemented. Between September and December 2011, the Institute made final payments ¹ , amounting to 4,2 million euro, related to three grant agreements that were signed well after the start of activities ² . This is an issue in terms of good financial management.	Ongoing

¹ Advance payments had been made by the European Commission.

² In one case, the contract was signed 14 days before the end of the 13-month implementation period.

European Institute of Innovation and Technology (Budapest)***Competences and activities***

Areas of Union competence deriving from the Treaty <i>(Article 173 of the Treaty on the Functioning of the European Union)</i>	<p>The Union and the Member States shall ensure that the conditions necessary for the competitiveness of the Union's industry exist.</p> <p>For that purpose, in accordance with a system of open and competitive markets, their action shall be aimed at:</p> <ul style="list-style-type: none"> – speeding up the adjustment of industry to structural changes, – encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, particularly small and medium-sized undertakings, – encouraging an environment favourable to cooperation between undertakings, – fostering better exploitation of the industrial potential of policies of innovation, research and technological development.
Competences of the Institute <i>(Regulation (EC) No 294/2008 of the European Parliament and of the Council)</i>	<p>Objectives</p> <p>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 Community. It shall do this by promoting and integrating higher education, research and innovation of the highest standards.</p> <p>Tasks</p> <p>In order to achieve its objective, the Institute shall:</p> <ul style="list-style-type: none"> (a) identify its priority fields; (b) raise awareness among potential partner organisations and encourage their participation in its activities; (c) select and designate KICs in the priority fields and define their rights and obligations by agreement; provide them with appropriate support; apply appropriate quality control measures; continuously monitor and periodically evaluate their activities; and ensure an appropriate level of coordination between them; (d) 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; (e) encourage the recognition in the Member States of degrees and diplomas which are awarded by higher education institutions that are partner organisations and which may be labelled EIT degrees and diplomas; (f) promote the dissemination of good practices for the integration of the knowledge triangle in order to develop a common innovation and knowledge transfer culture; (g) seek to become a world class body for excellence in higher education, research and innovation; (h) ensure complementarity and synergy between the Institute's activities and other Community programmes.
Governance	<p>Governing Board</p> <p><i>Composition</i></p> <p>The Institute's Governing Board (GB) consists of 18 appointed members providing a balance between experience and excellence in business, higher education and research, and four representative members proposed by the Knowledge and Innovation Communities (KICs). The European Commission has observer status.</p> <p><i>Tasks</i></p> <p>The Governing Board is responsible for steering the activities of the Institute, for the selection, designation, grant allocation to and evaluation of the KICs, and for all other strategic decisions.</p> <p>Executive Committee</p>

	<p><i>Composition</i></p> <p>The Executive Committee consists of five Governing Board members, including the Chairperson and Vice-Chairperson. It is chaired by the Chairperson of the Governing Board.</p> <p><i>Tasks</i></p> <p>The Executive Committee oversees the running of the Institute and takes such decisions as are necessary between meetings of the Governing Board.</p> <p>Director</p> <p>Appointed by and responsible to the Governing Board for the administrative and financial management of the Institute; the Institute's legal representative.</p> <p>External audit</p> <p>European Court of Auditors.</p> <p>Discharge authority</p> <p>European Parliament acting on a recommendation from the Council.</p>
Resources made available to the Institute in 2012 (2011)	<p>Final Budget</p> <p>95,30 million euro for commitment appropriations and 77,09 million euro for payment appropriations.</p> <p>Staff as at 31 December 2012</p> <p>Authorised posts: 52 (52)</p> <p>Posts occupied: 47 (40)</p> <p>Other posts: 0 (0)</p> <p>Total staff: 47 (40) assigned to the following duties:</p> <ul style="list-style-type: none"> – operational tasks: 26 (19) – administrative and support tasks: 21 (21)
Products and services in 2012	<ul style="list-style-type: none"> – Organisation of three EIT Forum meetings with KICs (a platform created to establish regular dialogue between the Director of the Institute and the KIC CEOs). – Decision of the Governing Board on the 13 December 2012 for the allocation in the year 2013 of a budget totalling 120 million euro to the funding of KIC Value Added Activities for the three KICs, after the implementation for the first time of a process of Competitive Funding corresponding to 1/3 of the overall budget. – In 2012 the three KICs managed a total budget of 89 814 878 euro for EIT funding of KIC Value Added Activities and a budget of 300 009 659 euro for non-EIT Funding of KAVA activities and complementary activities. – For the first time the KICs provided consolidated data for Key Performance Indicators (KPIs) in Innovation Value Added Activities and retroactively for the years 2010 and 2011 and estimates for 2012. – In 2012 the total number of KIC partners involved in the three KICs came to 293 institutions from EIT ICT Labs (87), Climate KIC (100) and KIC InnoEnergy (106). – Joint contribution by the Chairman of the Institute's Governing Board, the Institute's Director and Head of Unit KIC Operations and KIC CEOs at the Cyprus Presidency of the European Union EIT Stakeholders Conference organised by the European Commission, in Larnaca, 8-9 November 2012. – A large number of success stories following the implementation of KIC activities.

Source: Information supplied by the Institute.