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## COVER NOTE

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From:	Mr Vítor CALDEIRA, President of the European Court of Auditors
date of receipt:	30 October 2014
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 2013 together with the Institute's replies

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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 2013.

This report is accompanied by the Institute's replies 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 2013 together with the Institute's replies.<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/>.

ΕΒΡΟΠΕΪΣΚΑ ΣΜΕΤΗΑ ΠΑΛΑΤΑ  
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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 2013

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 Council<sup>1</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 three “Knowledge and Innovation Communities” (KICs), linking the higher education, research and business sectors with one another and aiming thereby to boost innovation and entrepreneurship<sup>2</sup>. 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:

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

<sup>2</sup> ***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 statements<sup>3</sup> and the reports on the implementation of the budget<sup>4</sup> for the financial year ended 31 December 2013, and
- (b) the legality and regularity of the transactions underlying those accounts.

*The management's responsibility*

4. 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>5</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>6</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

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<sup>3</sup> 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.

<sup>4</sup> These comprise the budgetary outturn account and the annex to the budgetary outturn account.

<sup>5</sup> Articles 39 and 50 of Commission Delegated Regulation (EU) No 1271/2013 (OJ L 328, 7.12.2013, p. 42).

<sup>6</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.

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 Council<sup>7</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.

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 transactions with the requirements in the legal framework of the European Union, whether due to fraud or error. In assessing these risks, the auditor

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<sup>7</sup> Article 107 of Regulation (EU) No 1271/2013.

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 2013 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***

No reasonable assurance on the legality and regularity of grant transactions

9. In 2013, the Institute made final payments and clearings of pre-financings (transactions) for grants amounting to 84,1 million euro (2012 activities). Grant expenditure represents some 97 % of total 2013 expenditure. All grant transactions are subject to review by the Commission before authorisation by EIT. The Institute itself continued to make considerable efforts to implement effective ex ante verifications with the aim of providing reasonable assurance on the legality and regularity of grant transactions. About 87 % of grant expenditure claimed by the KICs 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 in the case of particular risks identified. The Court found however that, although the quality of the audit certificates is improving, in part due to better guidance, there is room for further improvement in the work of the independent audit firms, in general.

10. In order to have a second layer of assurance on the legality and regularity of grant transactions, EIT contracted complementary ex post verifications for grant transactions that were carried out by an independent audit firm. The cost claims of 29 of the 300 KIC partners were verified ex post, corresponding to 29 % of the total grant transactions made in 2013. Ex post verification results confirmed that ex ante verifications are improving, but not yet fully effective. On the basis of the errors detected by the ex post verifications, EIT decided in 2014 to recover a total amount of 575 593 euro, corresponding to 3 % of the audited 2012 grants.

#### Material procurement errors

11. Payments amounting to some 665 000 euro and 105 000 euro, in respect of two framework contracts which had been concluded in 2010 and 2012 using a negotiated procedure, were made in 2013. From the audit it emerged that the use of a negotiated procedure was not justified, the resulting payments are therefore irregular.

12. The combined error rate of the matters explained in paragraphs 9 to 11 is between 2 % and 3 % of total 2013 expenditure.

#### ***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 (see paragraphs 9 to 12), the transactions underlying the annual accounts for the year ended 31 December 2013 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 THE LEGALITY AND REGULARITY OF TRANSACTIONS**

15. 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.

### **COMMENTS ON BUDGETARY MANAGEMENT**

16. In 2013 the overall level of committed appropriations was 97 %, indicating that overall commitments were made in a timely manner. The budget implementation rate was low, however, at 74 % of the EU contributions for title I (staff expenditure), which is mainly related to the high turnover of staff and the outstanding adoption of the regulations on salary adjustments.

17. The Institute carried over committed appropriations under title II (administrative expenditure) amounting to 193 420 euro (24 %). Carry-overs mainly concerned invoices not yet received and ongoing IT projects. It did not implement 91 918 euro (29 %) of the committed appropriations carried over from 2012 to 2013 under this title, which were largely due to overestimated costs for a Governing Board meeting.

18. The Institute had budgeted 34 078 025 euro under title III (operational expenditure) for KIC grants. The relatively low execution rate of 82 % is due to the fact that the KICs did not fully absorb the available funding for 2012 activities (2012 grants).



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

19. 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 Pietro RUSSO, Member of the Court of Auditors, in Luxembourg at its meeting of 16 September 2014.

*For the Court of Auditors*

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)
2012	<p>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).</p> <p>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.</p> <p>The Court found however that the quality of the audit certificates is inadequate in many instances<sup>1</sup>. 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</p>	Completed

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
	<p>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.</p> <p>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.</p>	

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
2012	<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 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.</p> <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> <p>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).</p>	Ongoing

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
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 <sup>2</sup> , amounting to 4,2 million euro, related to three grant agreements that were signed well after the start of activities <sup>3</sup> . This is an issue in terms of good financial management.	Completed

<sup>1</sup> 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.

<sup>2</sup> Advance payments had been made by the European Commission.

<sup>3</sup> 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**

<p><b>Areas of Union competence deriving from the Treaty</b></p> <p><i>(Article 173 of the Treaty on the Functioning of the European Union)</i></p>	<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"> <li>– speeding up the adjustment of industry to structural changes,</li> <li>– encouraging an environment favourable to initiative and to the development of undertakings throughout the Union, particularly small and medium-sized undertakings,</li> <li>– encouraging an environment favourable to cooperation between undertakings,</li> <li>– fostering better exploitation of the industrial potential of policies of innovation, research and technological development.</li> </ul>
<p><b>Competences of the Institute</b></p> <p><i>(Regulation (EC) No 294/2008 of the European Parliament and of the Council)</i></p>	<p><b>Objectives</b></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><b>Tasks</b></p> <p>In order to achieve its objective, the Institute shall:</p> <ul style="list-style-type: none"> <li>(a) identify its priority fields;</li> <li>(b) raise awareness among potential partner organisations and encourage their participation in its activities;</li> <li>(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;</li> <li>(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;</li> <li>(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;</li> <li>(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;</li> <li>(g) seek to become a world class body for excellence in higher education, research and innovation;</li> <li>(h) ensure complementarity and synergy between the Institute's activities and other Community programmes.</li> </ul>

<p><b>Governance</b></p>	<p><b>Governing Board</b></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><b>Executive Committee</b></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><b>Director</b></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><b>External audit</b></p> <p>European Court of Auditors.</p> <p><b>Discharge authority</b></p> <p>European Parliament acting on a recommendation from the Council.</p>
<p><b>Resources made available to the Institute in 2013 (2012)</b></p>	<p><b>Final Budget</b></p> <p>142,20 million euro for commitment appropriations and 98,76 million euro for payment appropriations.</p> <p><b>Staff as at 31 December 2013</b></p> <p>Authorised posts: 58 (52)</p> <p>Posts occupied: 41 (47)</p> <p>Other posts: 0 (0)</p> <p>Total staff: 41 (47) assigned to the following duties:</p> <ul style="list-style-type: none"> <li>– operational tasks: 25 (26)</li> <li>– administrative and support tasks: 16 (21)</li> </ul>
<p><b>Products and services in 2013</b></p>	<ul style="list-style-type: none"> <li>– Organization of four EIT Forum meetings with KICs (a platform created to establish regular dialogue between the Director of the Institute and the KIC CEOs) and a Spring Workshop with KICs and EIT Governing Board.</li> <li>– Decision of the Governing Board on the 5 December 2013 for the allocation in the year 2014 of a total of 180 million euro budget to the funding of KIC Value Added Activities for the three KICs after the implementation of a process of Competitive Funding corresponding to 36 % of the overall budget. The Governing Board also decided to defer a supplementary budget allocation to the KICs of 40 million euro for 2014 to be allocated separately and equally split on the basis, inter alia, of the follow-up of strategic recommendations.</li> <li>– The three KICs have managed in the year 2013 a total budget of 125 615 015 euro for EIT funding of KIC Value Added Activities and a budget of 750 535 096 euro for non-EIT Funding of KAVA activities and complementary activities.</li> </ul>

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- The total number of KIC partners involved in the three KICs in 2013 reached a maximum of 487 organisations from Climate-KIC (187), EIT ICT Labs (105), and KIC InnoEnergy (195).
  - In 2013, KICs provided EIT with 6 consolidated Key Performance Indicators and their respective supporting documents for the year 2012; they were assessed and validated by EIT, as part of the KICs past performance assessment in view of the competitive funding process for the 2014 allocation. The KICs also provided EIT with estimates for their 2013 Key Performance Indicators.
  - Organisation of 'Fostering Innovation and Strengthening Synergies within the EU' Conference in Dublin, Ireland on 29 and 30 April 2013 under the auspices of the Irish Presidency of the Council of the European Union.
  - Publication of 'Analysis of Synergies fostered by the EIT in the EU Innovation Landscape' study.
  - Roundtable of Entrepreneurs on the topic "Matching Entrepreneurship with Venture Capital" was organised from July 11 to 13 in Grundlsee, Austria.
  - Launch of the EIT Alumni Community on 11 November in Budapest, Hungary.
  - 2013 EIT Awards with three winners of the EIT Venture Award and three winners of the new EIT CH.A.N.G.E. Awards on 12 November in Budapest, Hungary.
  - Dissemination of a larger number of success stories derived from the implementation of KIC activities.
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*Source:* Annex supplied by the Institute.

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