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COVER NOTE

From:	Mr Klaus-Heiner LEHNE, President of the European Court of Auditors
date of receipt:	28 November 2017
To:	Mr Märt KIVINE, President of the Council of the European Union
Subject:	Report on the annual accounts of the European Joint Undertaking for ITER and the Development of Fusion Energy for the financial year 2016 together with the Joint Undertaking's reply

Delegations will find attached the European Court of Auditors' report on the annual accounts of the European Joint Undertaking for ITER and the Development of Fusion Energy for the financial year 2016.

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

Encl.: Report on the annual accounts of the European Joint Undertaking for ITER and the Development of Fusion Energy for the financial year 2016 together with the Joint Undertaking's reply.¹

¹ 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 Joint Undertaking for ITER and the Development of Fusion Energy
for the financial year 2016

together with the Joint Undertaking's reply

CONTENTS

	Paragraph
Introduction	1 - 6
Establishment of the F4E Joint Undertaking	1 - 2
Governance	3 - 4
Objectives	5
Resources	6
Opinion	7 - 29
Opinion on the reliability of the accounts	8
Opinion on the legality and regularity of revenue underlying the accounts	9
Opinion on the legality and regularity of payments underlying the accounts	10 - 19
Emphasis of matter	11 - 20
Responsibilities of management and those in charge of governance	21 - 23
Auditor's responsibilities for the audit of the accounts and underlying transactions	24 - 28
Budgetary and financial management	30
Implementation of the 2016 budget	31
Internal controls	31 - 35
Monitoring of operational procurement contracts and grants	31 - 34
Anti-fraud strategy	35
 Annex - Follow-up of previous years' comments	

INTRODUCTION

Establishment of the F4E Joint Undertaking

1. The European Joint Undertaking for ITER¹ and the Development of Fusion Energy ('F4E Joint Undertaking') was set up in March 2007² for a period of 35 years. While the main fusion facilities were to be developed at Cadarache in France, the Joint Undertaking is located in Barcelona.
2. The founding members of the Joint Undertaking are Euratom, represented by the Commission, the Euratom Member States and Switzerland (which has concluded a cooperation agreement with Euratom).

Governance

3. The governance structure of the F4E Joint Undertaking includes the Governing Board, Director and other bodies. The Governing Board is responsible for the supervision of the Joint Undertaking in the pursuit of its objectives. The Director is responsible for the day-to-day management of the Joint Undertaking.
4. The other governance bodies of the Joint Undertaking are the Bureau, the Technical Advisory Panel, the Procurement and Contracts Committee, the Administration and Management Committee, the Audit Committee and the Internal Review Panel.

Objectives

5. The objectives of the F4E Joint Undertaking are:
 - (a) to provide the contribution of the European Atomic Energy Community (Euratom) to the ITER International Fusion Energy Organisation (ITER IO);

¹ International Thermonuclear Experimental Reactor.

² Council Decision 2007/198/Euratom of 27 March 2007 establishing the European Joint Undertaking for ITER and the Development of Fusion Energy and conferring advantages upon it (OJ L 90, 30.3.2007, p. 58), amended by Council Decision 2013/791/Euratom of 13 December 2013 (OJ L 349, 21.12.2013, p. 100) and Council Decision 2015/224 of 10 February 2015 (OJ L37, 13.02.2015, p. 8).

- (b) to provide the contribution of Euratom to Broader Approach activities with Japan for the rapid realisation of fusion energy;
- (c) to prepare and coordinate a programme of activities in preparation for the construction of a demonstration fusion reactor and related facilities, including the International Fusion Materials Irradiation Facility.

Resources

6. In 2016, the payments budget for the F4E Joint Undertaking was 720 million euro (2015: 586 million euro) and the commitments budget was 459 million euro (2015: 467,9 million euro)³. At 31 December 2016, the Joint Undertaking employed 415 staff (2015: 383)⁴.

OPINION

7. We have audited:

- (a) the accounts of the Joint Undertaking which comprise the financial statements⁵ and the reports on the implementation of the budget⁶ for the financial year ended 31 December 2016, and
- (b) the legality and regularity of the transactions underlying those accounts, as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

³ Second amendment to the Budget approved by the Governing Board in December 2016.

⁴ Further information about the F4E Joint Undertaking and its activities are available at its website: <http://www.fusionforenergy.europa.eu>.

⁵ The financial statements comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes.

⁶ The reports on implementation of the budget comprise the reports which aggregate all budgetary operations and the explanatory notes.

Opinion on the reliability of the accounts

8. In our opinion, the accounts of the Joint Undertaking for the year ended 31 December 2016 present fairly, in all material respects, the financial position of the Joint Undertaking at 31 December 2016, the results of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with its Financial Regulation and with accounting rules adopted by the Commission's accounting officer. These are based on internationally-accepted accounting standards for the public sector.

Opinion on the legality and regularity of revenue underlying the accounts

9. In our opinion, revenue underlying the accounts for the year ended 31 December 2016 is legal and regular in all material respects.

Opinion on the legality and regularity of payments underlying the accounts

10. In our opinion, payments underlying the accounts for the year ended 31 December 2016 are legal and regular in all material respects.

Emphasis of matter

11. Without calling into question the opinions expressed above, we wish to draw attention to the following. The EU Council conclusions adopted on 7 July 2010⁷ approved 6,6 billion euro (in 2008 values) for the Joint Undertaking's contribution to the ITER construction phase of the project, with completion initially planned for 2020. This figure did not include the 663 million euro proposed by the European Commission in 2010 to cover potential contingencies⁸.

⁷ Council conclusions on ITER status of 7 July 2010 (Ref. 11902/10).

⁸ Communication from the Commission to the European Parliament and the Council of 4 May 2010 on ITER status and a possible way forward (COM(2010) 226 final).

12. In November 2016, the ITER Council⁹ approved a new ITER project baseline (scope, schedule and cost). The overall project schedule¹⁰ was approved by all ITER Members¹¹, and the overall project cost was approved ad referendum, meaning that each Member had to seek approval for project costs through their respective government budget process.

13. The new schedule endorsed by the ITER Council set out a four-stage approach, making December 2025 the deadline for achieving the first strategic milestone of the project construction phase ('First Plasma') and December 2035 the estimated completion date for the whole construction phase, a delay of 15 years compared to the original baseline. The aim of the new staged approach is to better align the project implementation with the priorities and constraints of all ITER IO Members.

14. Following the approval of the new ITER project baseline, the F4E Joint Undertaking set the new timetable and recalculated the related cost at completion ('EAC') of the Joint Undertaking's contribution to the project construction phase.

15. The results, which were presented to the Joint Undertaking's Governing Board in December 2016, indicated an expected funding requirement for the construction phase after 2020 of 5,4 billion euro (82 % increase in relation to the approved 6,6 billion euro budget). The amount of 6,6 billion euro adopted by the Council of the EU in 2010 now serves as a ceiling for the Joint Undertaking's spending up to 2020.

16. It must be noted that, in addition to the construction phase, the Joint Undertaking will have to contribute to the ITER operational phase after 2035¹² and to the subsequent ITER deactivation and decommissioning phases. These contributions are not yet estimated.

⁹ 19th ITER Council on 16-17 November 2016. The ITER Council is the governing body of the ITER IO.

¹⁰ The ITER Council reviewed the complete updated project construction schedule through First Plasma (2025) and up to Deuterium-Tritium operation (2035) as proposed by ITER IO.

¹¹ The People's Republic of China, Republic of India, Japan, Republic of Korea, Russian Federation, United States of America and European Union.

¹² The operational phase of the ITER project is expected to last until 2037.

17. While the F4E Joint Undertaking's forecasts for First Plasma are compatible with the ITER IO timetable for the project, the schedule is considered to be the earliest possible technically-achievable date¹³.

18. In June 2017, the Commission issued a communication on the EU contribution to a reformed ITER project¹⁴, seeking the support of the European Parliament and a mandate from the Council of the EU for the Commission to approve the new baseline¹⁵ on behalf of Euratom.

19. Even though the new baseline does not include a contingency, in its communication the Commission suggested that a contingency of up to 24 months in terms of schedule and 10-20 % in terms of budget would be appropriate¹⁶. In addition, the measures taken to respect the 6,6 billion euro capped budget included postponing the procurement and installation of all components not essential to First Plasma. While positive steps have been taken to improve the management and control of the ITER project construction phase, there remains a risk of further cost increases and delays in project implementation compared to the new proposed baseline.

20. On 29 March 2017, the United Kingdom notified the European Council of its decision to withdraw from the EU and Euratom. An agreement setting out the arrangements for its withdrawal will be negotiated. This may have a significant effect on the future activities of the F4E Joint Undertaking and the ITER project.

¹³ As stated in the fifth annual assessment by an independent Review Group (31 October 2016) and in the report by the F4E Joint Undertaking's Head of Project Management to the Governing Board in December 2016.

¹⁴ COM(2017)319 final of 14.6.2017 (accompanied by Commission Staff Working Document SWD(2017) 232 final of 14.6.2017).

¹⁵ The Euratom contribution is without prejudice to the proposals of the Commission, the outcome of the negotiations on the withdrawal of the United Kingdom from Euratom and the Multiannual Financial Framework after 2020.

¹⁶ COM(2017)319 final of 14.6.2017 (accompanied by Commission Staff Working Document SWD(2017) 232 final of 14.6.2017), chapter V "ITER: the way forward".

Responsibilities of management and those in charge of governance

21. In accordance with Articles 310 to 325 of the TFEU and the Joint Undertaking's Financial Regulation, management is responsible for the preparation and presentation of the accounts on the basis of internationally-accepted accounting standards for the public sector and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Joint Undertaking's management bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts.

22. In preparing the accounts, management is responsible for assessing the Joint Undertaking's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

23. Those in charge of governance are responsible for overseeing the entity's financial reporting process.

Auditor's responsibilities for the audit of the accounts and underlying transactions

24. Our objectives are to obtain reasonable assurance about whether the accounts of the Joint Undertaking are free from material misstatement and the transactions underlying them are legal and regular and, on the basis of our audit, to provide the European Parliament and the Council or other respective discharge authorities with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions underlying them. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit will always detect a material misstatement or non-compliance when it exists. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these accounts.

25. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the European Union, whether due to fraud or error. In making those risk assessments, internal control relevant to the preparation and fair presentation of the accounts and legality and regularity of underlying transactions is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by the management and the overall presentation of the accounts.

26. For revenue, we verify the subsidy received from the Commission and other stakeholders and assess the Joint Undertaking's procedures for collecting fees and other income.

27. For expenditure, we examine payment transactions when expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined when the recipient of funds provides justification for their proper use and the Joint Undertaking accepts the justification by clearing the advance payment, whether in the same year or later.

28. In preparing this report and Opinion, we considered the audit work of the independent external auditor performed on the Joint Undertaking's accounts as stipulated in Article 208(4) of the EU Financial Regulation¹⁷.

29. The comments which follow do not call the ECA's opinions into question.

¹⁷ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

BUDGETARY AND FINANCIAL MANAGEMENT

Implementation of the 2016 budget

30. The final 2016 budget available for implementation included commitment appropriations of 488 million euro¹⁸ and payment appropriations of 724 million euro¹⁹. The utilisation rates for commitment and payment appropriations were 99,8 % and 98 % respectively.

INTERNAL CONTROLS

Monitoring of operational procurement contracts and grants

31. The F4E Joint Undertaking has a system for performing audits at contractors' premises with the aim of checking compliance with its quality assurance requirements²⁰.

32. In September 2016, the Commission's Internal Audit Service (IAS) completed an audit on the implementation of procurement arrangements. The F4E Joint Undertaking is implementing an action plan in response to the resulting recommendations. The IAS also followed up its audit on contract management and concluded that all its related recommendations had been adequately implemented by the Joint Undertaking.

33. In 2016, the F4E Joint Undertaking Internal Audit Capability (IAC) followed up its audit of procurement in the area of ITER buildings. The IAC acknowledged the important work

¹⁸ The changes to the final 2016 approved budget mainly relate to 15 million euro in assigned revenue from the ITER Reserve Fund, 13,5 million euro for commitments carried over from the previous years and 0,5 million euro of recoveries of payments made in excess on operational contracts.

¹⁹ The changes to the final 2016 approved budget mainly relate to 4 million euro in payments from the ITER Reserve Fund.

²⁰ The audits cover numerous aspects of implementation, including the quality plan, any situations of non-compliance with a specific requirement, purchase control and subcontracting management, documentation and data management, change and deviation management, the civil works quality control plan, the detailed project schedule, contract risk management and the technical works quality control plan. The 29 audits carried out in 2016 identified 47 situations of non-conformity with the quality assurance requirements and 202 areas for improvement.

performed by the Joint Undertaking in formalising and designing the process, guidelines, rules and tools related to procurement activities. The IAC also made six further recommendations for improvements in procedures.

34. A residual error rate for grant payments is not calculated, due to their low share of the F4E Joint Undertaking's budget²¹ and the small number of ex-post audits carried out²². In 2016, the European Research Agency launched an ex-post audit of a beneficiary on behalf of the F4E Joint Undertaking. The Joint Undertaking has taken the necessary action to correct errors identified in previous years' audits.

Anti-fraud strategy

35. In June 2015, the F4E Joint Undertaking's Governing Board adopted an anti-fraud strategy and corresponding action plan. Most of the actions were implemented in 2016. However, the Joint Undertaking has not set up a specific tool to facilitate the monitoring of its actions in relation to procurement procedures, in particular those related to risk assessment and the evaluation, negotiation and award phases of the procedures.

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 3 October 2017.

For the Court of Auditors

Klaus-Heiner LEHNE
President

²¹ From its founding until the end of 2016, the Joint Undertaking had awarded 150 grants for a total of 81 million euro. The Joint Undertaking awarded six grants for a total of 5 million euro in 2016.

²² Six beneficiaries and a total audited amount of 6 million euro, representing respectively 8 % of total beneficiaries and 7 % of total signed grant agreements since the founding of F4E.

Follow-up of previous years' comments

Year	Court's comment	Status of corrective action (Completed / Ongoing / Outstanding)
	<u>COMMENTS ON BUDGETARY AND FINANCIAL MANAGEMENT</u>	
	<i>Presentation of the accounts</i>	
2015	In the notes to the financial statements, the table and the information included under heading 4.3.1.1. 'ITER Procurement Arrangement (ITER IO)', reflect the procurement arrangements signed (column 3) and those credited so far (column 4). However, the table does not show the actual degree of advancement of the works in progress. In the 2015 annual accounts, F4E has supplemented this information with an estimate of the work in progress taking into account the total value of spending on contracts linked to PAs, and a chart showing the achievement of milestones for each procurement arrangement signed with ITER IO. Despite the estimate presented in the 2015 accounts, further work is needed to present more accurate information on the status and value of the activities carried out so far by the Joint Undertaking.	Ongoing
	<u>COMMENTS ON KEY CONTROLS IN THE JOINT UNDERTAKING'S SUPERVISORY AND CONTROL SYSTEMS</u>	
2015	F4E is further developing a central and uniform system for the integration of all the operational, financial and budgeting data, which will allow regular monitoring and control of estimates, costs and deviations. At its meeting of 8-9 June 2015, the Governing Board endorsed a proposal by the Director to implement an Enterprise Resources Planning (ERP)	Ongoing

	system within two years.	
2015	The system to provide information on the value of the degree of the implementation of activities (Earned Value Management) is under discussion with ITER IO with a view to improving the distribution of credit milestones during the life of a procurement arrangement.	Ongoing
	Operational procurement and grants	
2015	Negotiated procedures constituted 45 % of the 84 operational tendering procedures launched in 2015 (58 % in 2014). Although the Joint Undertaking reduced the percentage of negotiated procedures in 2015, efforts are needed to increase the competitiveness of its operational procurement procedures. For grants, the average number of proposals received was 1,4 per call.	Ongoing
	<u>OTHER MATTERS</u>	
	Legal framework	
2015	On 2 December 2015, the F4E Governing Board finally amended its Financial Regulation and Implementing Rules to align them with the new EU Financial Framework. In February 2016, the European Commission issued a positive opinion on the amendments introduced by F4E in its financial rules, but requested the Joint Undertaking to consider further developing certain provisions in its Implementing Rules relating to specific derogations from the EU Financial Regulation and from the framework financial regulation applicable to the Article 208 bodies.	Ongoing
	Intellectual property rights and industrial policy	
2015	The Decision on the implementation of the Fusion for Energy Industrial Policy and the policy on intellectual property rights and dissemination of information were adopted by	Ongoing

	<p>the Joint Undertaking's Governing Board on 27 June 2013.</p> <p>The Joint Undertaking has developed a procurement strategy document for each procurement action. A checklist for monitoring the implementation of the procurement strategy as regards the ownership of the foreground for each procurement action has been drawn up.</p>	
	<p>At the time of the audit (April 2016), F4E had implemented the majority of the provisions in the Governing Board Decision of 27 June 2013, though five were not yet fully implemented and three were still pending.</p>	Completed
	<p>An impact assessment on the implementation of these policies is planned but has not yet been carried out.</p>	Ongoing
	<p>Host State agreement</p>	
2015	<p>According to the Host State Agreement signed with the Kingdom of Spain on 28 June 2007, permanent premises should have been made available to the Joint Undertaking by June 2010.</p> <p>Following contacts between F4E and the Spanish Government, a formal offer was presented to the Joint Undertaking on 10 March 2015. In December 2015, the Host State informed the F4E Governing Board that the discussions at ministerial level to formalise the offer of 10 March 2015 had not been concluded, and offered instead to start negotiations with the owner of the building where F4E is currently located with a view to making it the permanent headquarters of the Joint Undertaking. At the time of the audit (April 2016) this new proposal was under examination by the Joint Undertaking.</p>	Completed
	<p>Rules implementing the Staff Regulations</p>	

2015	During 2015, the Joint Undertaking continued with its adoption by analogy of several EU rules implementing the Staff Regulations. However, certain specific rules for the implementation of the Staff Regulations still remain to be adopted.	Completed
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THE JU'S REPLY

33. As of July 2017, five out of the six new IAC recommendations have been implemented. The ongoing recommendation relates to the redefinition of the role of the Internal Review Panel (IRP). Its expected date for completion is October 2017 as this action is part of a wider improvement project geared at optimising the open procurement procedures.

35. F4E is currently defining the requirements to parametrize the tool that will allow F4E to collect systematically information relating to Anti-Fraud indicators on procurement procedures. This tool will also offer the possibility to F4E staff to insert additional information related to red flags on any procurement procedure.

Follow up of previous years' comments

2015 – Presentation of the accounts

EU uses the ITER credit as its Earned Value Management (EVM) system. The value of the achieved credit versus the planned value provides the progress of F4E toward the completion of the EU share of the procurements. The credit profile is intended to represent the value of the real work done through the various project phases (i.e. design, manufacturing, delivery, installation).

F4E and ITER IO have agreed to readjust this profile for each Procurement Arrangement (PA) in order to make sure that the right credit weight is given all throughout the PA duration and as close as possible to reality. Such changes have already been made for some past PA's and are expected to be completed by the end of October 2017.

2015 – Comments on key controls in the Joint Undertaking's supervisory and control systems

First paragraph: In March 2016 the new F4E Director commissioned an independent consultancy study on the development of a concept for an integrated cross functional and integrated commercial and financial controlling system. The report of this study was issued in mid-June 2016 and the recommendations contained therein have been reviewed and accepted.

F4E is now working on the implementation of an Enterprise Project Control System, this being considered as a lower complexity and lower cost means to achieve a greater degree of integration of the F4E financial information.

F4E has selected the Ecosys system, and is currently finalising contract negotiation with the supplier. F4E will then implement a pilot phase, with a target date for full implementation of first quarter of 2018.

F4E (EN)

Fusion for Energy

Second Paragraph: EU uses the ITER credit as its Earned Value Management (EVM) system. The value of the achieved credit versus the planned value provides the progress of F4E toward the completion of the EU share of the procurements. The credit profile is intended to represent the value of the real work done through the various project phases (i.e. design, manufacturing, delivery, installation).

F4E and ITER IO have agreed to readjust this profile for each Procurement Arrangement (PA) in order to make sure that the right credit weight is given all throughout the PA duration and as close as possible to reality. Such changes have already been made for some past PA's and are expected to be completed by the end of October 2017.

2015 – Operational procurement and grants

In spite of renewed communication and dissemination efforts, notably in the context of integrating the new Financial Regulation, the figures for negotiated procedures remained during 2016 similar to previous years (49% of total in 2016, vs 45% in 2015 and 58% in 2014). Nevertheless, it has to be noted that the majority of these procedures were for low value negotiated procedures performed below the Directive's publication threshold and fully in line with the F4E financial regulations.

Negotiated procedures with low value represent around 40% of F4E's yearly number of contracts (2016: 41% in number and 0.8% in value; 2015: 43% in number and 0.3% in value) but only correspond to around 1% of the annual budget.

Using negotiated procedures in these cases (within the limits imposed by F4E's Financial Regulations) responds to a concern of sound financial management, as this allows F4E to engage internal resources more effectively in high value procurement. Therefore F4E considers that no action is needed to further reduce low value negotiated procedures as it is in compliance with the Financial Regulations' principles and provisions.

The remaining negotiated procedures, typically higher value contracts, (5% of the total number of procedures in average) are an expression of the complex and innovative context in which F4E operates. The characteristics of the fusion technology market are such that in many cases very limited competition is present in the market. This often results in low competition or (in extreme cases) to monopoly or even lack of participation to calls for tender.

Since 2012, F4E increased its dissemination efforts but participation remained low. In F4E's opinion, the main root cause is not lack of visibility but rather the sporadic nature of F4E purchases. F4E came to the conclusion that the nature of the activities related to the scope of large science and technology projects is such that limited competition is regrettably a matter of fact, on which a single contracting authority can have only a modest impact.

As a consequence, during 2016 F4E started to look for ways to address the issue, in collaboration with other contracting authorities managing similar projects in Europe and facing the same lack of competition. In order to increase the impact of initiatives aimed at ensuring more industrial competition and engagement, F4E has been the initiator of a forum comprising similar, first of a kind high-tech frontier projects in Europe (CERN, ESA, ESS, ESRF, ESO, ...). Through this forum different organizations with similar project challenges can work together to address them in a more coordinated and effective way. This is an attempt to foster a single market for large scientific projects, which is more stable and larger and therefore more capable of attracting companies' interest.

F4E (EN)

Fusion for Energy

An event hosted by Denmark in February 2018 will be the first opportunity for the forum participants to put in practice their new collaboration.

2015 – Legal Framework

In cooperation with the European Commission (DG BUDG and DG ENER), the Joint Undertaking has developed the requested specific provisions to be added to the Implementing Rules to the Joint Undertaking's Financial Regulation relating to four derogations which the Joint Undertaking had been granted in its Financial Regulation from the EU General Financial Regulation and the Framework Financial Regulation applicable to the Article 208 bodies.

On 4 July 2017, the Joint Undertaking's Governing Board adopted the amendment to the Implementing Rules which is now subject to a positive formal opinion from the European Commission. Once a positive opinion is issued, the four implementing provisions will enter into force on 1 August 2017.

2015 – Intellectual property rights and industrial policy

With regards to the impact assessment of the Industrial Policy, F4E intends to use the results of the assessment of F4E's activities (and the ITER project as a whole) that will be performed by the European Commission during 2017 and 2018.