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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:	28 November 2017
To:	Mr Märt KIVINE, President of the Council of the European Union
Subject:	Report on the annual accounts of the Shift-2-Rail Joint Undertaking for the financial year 2016 together with the Joint Undertaking's reply

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Delegations will find attached the European Court of Auditors' report on the annual accounts of the Shift-2-Rail Joint Undertaking 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*.

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Encl.: Report on the annual accounts of the Shift-2-Rail Joint Undertaking for the financial year 2016 together with the Joint Undertaking'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  
Shift-2-Rail Joint Undertaking  
for the financial year 2016  
  
together with the Joint Undertaking's reply



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## **INTRODUCTION**

### ***Establishment of the Shift2Rail Joint Undertaking***

1. The Shift2Rail (S2R) Joint Undertaking, located in Brussels, was set up in June 2014<sup>1</sup> for a period of ten years and started working autonomously on 24 May 2016. As the Joint Undertaking began autonomous operations in 2016, this year's accounts are the first set of S2R financial statements audited by the ECA.
2. The S2R Joint Undertaking is a public-private partnership in the rail sector. The founding members are the European Union (EU), represented by the Commission and rail industry partners (key stakeholders, including rail equipment manufacturers, railway companies, infrastructure managers and research centres). Other entities may participate in the Joint Undertaking as associated members.

### ***Governance***

3. The governance structure of the S2R Joint Undertaking includes the Governing Board, the Executive Director, the Scientific Committee, and the States Representatives Group.
4. The Governing Board is composed of twenty-two members, with two representatives from the Commission and one representative from each industry member. It is responsible for the strategic orientation and operations of the Joint Undertaking and supervises the implementation of its activities. The Executive Director is responsible for the day-to-day management of the Joint Undertaking.
5. The Scientific Committee and the States Representatives Group are advisory bodies. The Scientific Committee provides advice on the scientific and technological priorities to be addressed in the Joint Undertaking's annual work programmes. The States Representatives Group represents EU Member States and countries associated with the Horizon 2020 Research Framework Programme. The Group may offer opinions on the strategic

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<sup>1</sup> Council Regulation (EU) No 642/2014 of 16 June 2014 establishing the Shift2Rail Joint Undertaking (OJ L 177, 17.6.2014, p. 9).

orientations of the Joint Undertaking and on the links between S2R activities and relevant national or regional research and innovation programmes.

6. The Statutes of the S2R Joint Undertaking also stipulate:

- a specific advisory role for the European Union Agency for Railways in contributing to the definition and implementation of S2R work plans, and ensuring that S2R activities lead to technical standards guaranteeing interoperability and safety;
- the establishment of Innovation Programme Steering Committees, comprising representatives of the founding members and associated members, and of the S2R Programme Office, in charge of the technical input and implementation of each Innovation Programme;
- the possibility of creating working groups of experts to assist the Joint Undertaking in carrying out its tasks.

### **Objectives**

7. The S2R Joint Undertaking is intended to provide a platform for the rail sector to work together to drive forward innovation. The Joint Undertaking seeks to develop, integrate, demonstrate and validate innovative technologies and solutions that uphold the strictest safety standards, with a view to achieving:

- a 50 % reduction in the life-cycle cost of rail transport;
- a 100 % increase in the capacity of the railway transport system;
- a 50 % increase in the reliability and punctuality of rail services;
- the removal of the remaining technical obstacles to interoperability and efficiency;
- a reduction in negative externalities linked to railway transport, in particular noise, vibrations, emissions and other environmental effects.

8. The objectives are: to achieve a Single European Railway Area; to enhance the attractiveness and competitiveness of the European railway system; to ensure a modal shift

from road transport; and to maintain the European rail industry's leading position in the global market.

### **Resources**

9. The maximum EU contribution to the activities of the S2R Joint Undertaking is 450 million euro<sup>2</sup>, to be paid from Horizon 2020. The industry members of the Joint Undertaking are to contribute resources of at least 470 million euro<sup>3</sup>, consisting of at least 350 million euro of in-kind and cash contributions to the Joint Undertaking's operational activities and administrative costs, together with at least 120 million euro of in-kind contributions to additional activities<sup>4</sup>.

10. The administrative costs of the S2R joint Undertaking are limited to 27 million euro, to be covered by the cash contributions of the members, divided equally on an annual basis between the EU and the industry members<sup>5</sup>.

11. In 2016, the payment budget for the S2R Joint Undertaking was 51,4 million euro. At 31 December 2016, the Joint Undertaking employed 17 staff<sup>6</sup>.

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<sup>2</sup> Article 3(1) of Regulation (EU) No 642/2014.

<sup>3</sup> Article 4(1) of Regulation (EU) No 642/2014.

<sup>4</sup> As provided for in Article 4(2)(b) of Regulation (EU) No 642/2014, additional activities are outside the work plan and budget of the Joint Undertaking but contribute to the objectives of the S2R Master Plan. In line with Article 4(4) of the same regulation, the costs of additional activities must be certified by an independent external auditor and are not subject to audit by the Joint Undertaking, the ECA or by any EU body.

<sup>5</sup> Article 16(2) of the Statutes of the S2R Joint Undertaking (Annex I of Regulation (EU) No 642/2014).

<sup>6</sup> Further information on the Joint Undertaking's activities is available on its website: <http://shift2rail.org>.

## **OPINION**

12. We have audited:

- (a) the accounts of the Joint Undertaking which comprise the financial statements<sup>7</sup> and the reports on the implementation of the budget<sup>8</sup> 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).

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

13. 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***

14. 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***

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

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<sup>7</sup> 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.

<sup>8</sup> The reports on the implementation of the budget comprise the reports which aggregate all budgetary operations and the explanatory notes.

### ***Responsibilities of management and those in charge of governance***

16. 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.

17. 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.

18. 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***

19. 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.



20. 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.

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

22. 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) at the point they are made.

23. In preparing this report and Opinion, we considered the audit work which the independent external auditor performed on the Joint Undertaking's accounts as stipulated in Article 208(4) of the EU Financial Regulation<sup>9</sup>.

24. The comments which follow do not call the ECA's opinion into question.

## **BUDGETARY AND FINANCIAL MANAGEMENT**

### ***Implementation of the 2016 budget***

25. Taking into account unused payment appropriations from previous years (0,9 million

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<sup>9</sup> Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

euro), the final 2016 budget included commitment appropriations of 50,2 million euro and payment appropriations of 52,3 million euro. The utilisation rates for commitment and payment appropriations were 94 % and 82 % respectively. Most of the payments made by the Joint Undertaking in 2016 were pre-financing payments for Horizon 2020 projects selected under the 2015 and 2016 calls for proposals.

### ***Multiannual budget implementation under Horizon 2020***

26. Out of the 450 million euro of Horizon 2020 funds assigned to the S2R initiative, 52 million euro were earmarked for the Horizon 2020 Transport Work Programme 2014-2015 managed by the European Commission, resulting in 398 million euro allocated to the S2R Joint Undertaking. By the end of 2016 the Joint Undertaking had made commitments of 92,4 million euro<sup>10</sup> and payments of 42,7 million euro (10,7 % of the allocated funds) for the implementation of its first wave of projects.

27. Out of the 350 million euro of contributions to be made by the industry members to the operational activities and administrative costs of the Joint Undertaking, by the end of 2016, four months after the S2R Joint Undertaking had launched its first Horizon 2020 projects, the members had reported in-kind contributions of 4,5 million euro for operational activities, of which 3 million euro had been certified. In addition, the Governing Board had validated cash contributions to the Joint Undertaking's administrative costs of 3,2 million euro.

28. Out of the 120 million euro of industry members' contributions to be made to additional activities, by the end of 2016 the members had already reported 55 million euro (45,8 %), of which 35,2 million euro had been certified.

29. Consequently, by the end of 2016, the total contributions from industry members amounted to 62,7 million euro, compared to the EU's cash contribution of 48,5 million euro.

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<sup>10</sup> This amount includes unused commitments of 45,1 million euro approved by the Commission in the previous year and carried over to 2016 to be implemented by the S2R Joint Undertaking.

## **INTERNAL CONTROLS**

### ***Internal control framework***

30. The S2R Joint Undertaking has set up an action plan for the implementation of its internal control framework, which takes into account the results of a risk assessment completed by the Commission's Internal Audit Service in December 2016. Ex-post audits of project cost claims by independent external auditors are to be launched after the validation of the first cost claims in the course of 2017.

### ***Anti-fraud strategy***

31. The Commission's research anti-fraud strategy is mandatory for the S2R Joint Undertaking. However, at the end of 2016, the Joint Undertaking had not yet performed a specific anti-fraud risk assessment, nor had it established an action plan for the implementation of its own anti-fraud strategy, based on the methodology provided by the Commission.

### ***Assessment of applications under calls for proposals***

32. In two cases out of the eight we audited, the Joint Undertaking awarded grants to project consortia, despite the fact that the checks of the financial viability of the beneficiaries performed by the Research Executive Agency indicated that the financial capacity of the coordinating industry members of the consortia was weak. This implies a high financial risk to the completion of those projects. The financial risk was particularly high in one case, in which the coordinating partner had been assigned over 45 % of the total project funding.

### ***Procurement procedures***

33. In its procedures for the procurement of services, the Joint Undertaking sets a maximum contract budget. There was no evidence that this maximum amount was based on a cost estimation process and a reasonable market price reference system. This may not ensure the cost-effectiveness of its multi-annual service contracts, as experience shows that most of the bids received were close to the maximum budget.

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 19 September 2017.

*For the Court of Auditors*

Klaus-Heiner LEHNE

*President*

**THE JU'S REPLY**

31. In 2017 the S2R Joint Undertaking made the first steps to establish its own anti-fraud action plan, i.e. an anti-fraud awareness session for S2R JU staff organised by OLAF, and an anti-fraud risk assessment. This will be followed by an impact assessment establishing the key objectives to mitigate the main weaknesses (Q4 2017) and an evaluation of the anti-fraud strategy and the action plan (June 2018).

32. In both cases, the S2R decision took into account the broader relationship of the JU with the two concerned Founding Members and the necessary follow up.

After the first control gate (project interim payment in May 2017), both projects have demonstrated positive operational achievements. In addition, one of the two entities has been re-assessed for the need of its role of project coordinator in a new 2017 project and the result of the financial viability check is now "acceptable".

33. The approach followed by the S2R Joint Undertaking is in line with the provisions of the Commission Procurement Vademecum and the principles of the Financial Regulation. Nevertheless, the Joint Undertaking will implement in addition a method to document during the planning phase the result of the market price research performed, on a case by case approach.