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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 European Union Intellectual Property Office for the financial year 2016 together with the Office's reply

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Delegations will find attached the European Court of Auditors' report on the annual accounts of the European Union Intellectual Property Office for the financial year 2016.

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

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Encl.: Report on the annual accounts of the European Union Intellectual Property Office for the financial year 2016 together with the Office's reply.<sup>1</sup>

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



EUROPEAN  
COURT  
OF AUDITORS

Report on the annual accounts  
of the European Union Intellectual Property Office  
for the financial year 2016

together with the Office's reply

## **INTRODUCTION**

1. The European Union Intellectual Property Office (hereinafter “the Office”, aka “EUIPO”), known as Office for Harmonization in the Internal Market (“OHIM”) until 23 March 2016, was established by Regulation (EC) No 207/2009<sup>1</sup>, last amended by Regulation (EU) 2015/2424<sup>2</sup>. The core business of the Office, which is located in Alicante, is the registration of EU trademarks and registered Community designs, which are valid throughout the EU.

2. **Table 1** presents key figures for the Office<sup>3</sup>.

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

	<b>2015</b>	<b>2016</b>
Budget (million euro) <sup>4</sup>	384,2	421,3
Total staff as at 31 December	848	910

*Source:* data provided by the Office.

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

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

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<sup>1</sup> OJ L 78, 24.3.2009, p. 1.

<sup>2</sup> OJ L 341, 24.12.2015, p. 21.

<sup>3</sup> More information on the Office’s competences and activities is available on its website: <https://euipo.europa.eu>.

<sup>4</sup> Budget figure includes the reserve for unforeseen events.

**OPINION**

4. We have audited:

- a) the accounts of the Office which comprise the financial statements<sup>5</sup> and the reports on the implementation of the budget<sup>6</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).

***Reliability of the accounts****Opinion on the reliability of the accounts*

5. In our opinion, the accounts of the Office for the year ended 31 December 2016 present fairly, in all material respects, the financial position of Office 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.

***Legality and regularity of the transactions underlying the accounts*****Revenue***Opinion on the legality and regularity of revenue underlying the accounts*

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

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<sup>5</sup> The financial statements comprise the balance sheet, the statement of financial performance, the cashflow statement, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes.

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

**Payments***Opinion on the legality and regularity of payments underlying the accounts*

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

***Responsibilities of management and those charged with governance***

8. In accordance with Articles 310 to 325 of the TFEU and the Office'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 controls 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 Office's management bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts.

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

10. Those charged with governance are responsible for overseeing the entity's financial reporting process.

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

11. Our objectives are to obtain reasonable assurance about whether the accounts of the Office are free from material misstatement and the transactions underlying them are legal and regular and to provide, on the basis of our audit, 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.

12. 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 controls relevant to the preparation and fair presentation of the accounts and legality and regularity of underlying transactions, are 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 controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management, as well as evaluating the overall presentation of the accounts.

13. For revenue, we assess the Office's procedures for collecting fees and other income, if any.

14. For expenditure, we examine payment transactions when expenditure has been incurred, recorded and accepted. Advance payments are examined when the recipient of funds provides justification for their proper use and the Office accepts the justification by clearing the advance payment, whether in the same year or later.

**Other matter**

15. Without calling into question its opinion, the Court draws attention to the fact that the United Kingdom (UK) notified the European Council on 29 March 2017 of its decision to withdraw from the European Union. An agreement setting out the arrangements for its withdrawal will be negotiated. The Office's budget is fully financed by fees from economic actors operating in the EU. The amount of fees fluctuates every year depending on the volume of registrations and renewals of trademarks and designs. A future decrease of the Office's revenue resulting from the UK's decision to leave the EU is possible.

16. The comments which follow do not call the Court's opinion into question.

**COMMENTS ON BUDGETARY MANAGEMENT**

17. The Office's budget implementation rate was low at 89 % which indicates an imprecise estimation of its expenditure in the 2016 budget. The preciseness of the Office's budget, where necessary through an amendment, has become more important following the recent changes in its founding and financial Regulations specifying mechanisms such as the

allocation of surpluses to a reserve fund<sup>7</sup> and the related offsetting mechanism<sup>8</sup> which are connected with the budgeted amounts.

### **COMMENTS ON SOUND FINANCIAL MANAGEMENT AND PERFORMANCE**

18. In 2014, the Office launched a call for tender to conclude a four year framework contract (FWC) with an estimated market volume of 30 million euro to procure consultancy services covering a broad range of activities comprising audit services, project management, general consultancy and studies. However the procurement procedure and the subsequent use of the FWC were not properly managed in parts. The objectives and activities to be carried out had not been sufficiently specified to precisely estimate the volume of the FWC. As a consequence, it was fully used within only two years and six months already. Moreover, despite the broad diversity of services to be procured and the largely varying levels of expenditure per activity, no lots had been used. Their use could have encouraged participation of smaller companies for low value activities. Finally, competition on price was neutralised and dependence upon the contractor was increased as a consequence of requesting fixed-price offers from a single contractor using the FWC. The Office should consider concluding agreements with multiple suppliers with reopening of competition whenever appropriate.

### **OTHER COMMENTS**

19. The Office's mandate of registering trademark and designs for the European Single Market produces a large volume of translation work. The Office's founding Regulation establishes that the translation services required for the functioning of the Office shall be

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<sup>7</sup> Article 89(1) of the Office's financial regulation provides that it shall establish a reserve fund having sufficient funds to ensure the continuity of its operations and the execution of its tasks for one year, that is, the equivalent of the estimated appropriations foreseen in Titles 1, 2 and 3 of the Office's budget.

<sup>8</sup> Articles 139(4) and (6) of the Office's founding regulation provide that every year it shall offset the costs incurred by the industrial property offices of the Member States, by the Benelux Office for Intellectual Property and by any other relevant authority to be nominated by a Member State as the result of the specific tasks which they carry out as functional parts of the European Union trade mark system in the context of various services and procedures, whereby this obligation shall only apply to the extent that no budgetary deficit occurs in that year.

provided by the Translation Centre for the Bodies of the European Union (“CdT”), resulting in the Office being CdT’s main client. The Office makes increasing use of in-house solutions such as linguistic and translation memories and related software. These tools aim to improve the Office’s own cost-effectiveness and efficiency. However, from a European Union perspective the current situation may result in a duplication of effort and related costs.

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

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

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 12 September 2017.

*For the Court of Auditors*

Klaus-Heiner LEHNE  
*President*



**Follow-up of previous years' comments**

Year	Court's comments	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2013</b>	The Office has a Business Continuity and Crisis Management Plan in place which stipulates that some 25 roles have to be covered permanently by employees on stand-by duty. Although budget appropriations for stand-by duty allowances are approved annually by the Office's Budget Committee, the amount paid in 2013 (402 458 euro) considerably exceeds such allowances paid by other agencies which need to ensure permanent service.	<b>Completed</b>
<b>2014</b>	In its 2013 Report on the annual accounts of the Office the Court questioned the amount spent on stand-by allowances (0,40 million euro). Such payments were higher in 2014 (0,44 million euro). In November 2014 the Office revised its policy and reduced the number of roles entitled to stand-by duty allowances from 25 to 17, the financial effect of which will be seen from 2015 <sup>1</sup> . Nine staff members received more than 11 000 euro each in stand-by allowances, seven of whom are managers.	<b>Completed</b>
<b>2015</b>	The level of committed appropriations carried over to 2016 was high for Title III at 12,9 million euro, i.e. 36 % (2014: 14,1 million euro, i.e. 38 %). The carry-overs mainly relate to cooperation agreements with National Offices which submit cost claims only after year-end.	<b>N/A</b>

<sup>1</sup> In 2015 the Office paid 285 242 euro for stand-by duty allowances and 13 roles were entitled to it.

Year	Court's comments	Status of corrective action (Completed / Ongoing / Outstanding / N/A)
<b>2015</b>	The procurement of services based on a negotiated procedure without publication of a contract notice limits competition to a single negotiating party and should therefore only be used in exceptional circumstances. The Office, following this procedure, in 2015 extended six framework contracts with a value of extended services of 1,9 million euro (in 2014: 12 framework contracts with a value of extended services of 12,6 million euro) <sup>2</sup> . The Office's use of this procedure cannot be considered as "exceptional" given the number, value and frequency of such contracts and did not fully comply with the formal requirements <sup>3</sup> .	<b>Completed</b>
<b>2015</b>	The Office reimburses part or all of the gross salary of Seconded National Experts ("SNEs") to their employers. This deviates from the Commission's practice that SNEs' employers continue to pay their salaries. In 2015, these reimbursements amounted to 1,9 million euro.	<b>Completed</b>
<b>2015</b>	As at 31 December 2015, nine OHIM staff members were seconded in the interest of the service to the OHIM Board of Appeal. However the EU Staff Regulations do not provide for such secondments <sup>4</sup> .	<b>Completed<sup>5</sup></b>

<sup>2</sup> Framework contracts extended based on Article 134(1)(f) of Commission Delegated Regulation (EU) No 1268/2012 (OJ L 362, 31.12.12, p. 1).

<sup>3</sup> As stipulated in Article 134(3) of Regulation (EU) No 1268/2012.

<sup>4</sup> Article 37(a) of Regulation No 31 (EEC), 11 (EAEC), laying down the Staff Regulations of Officials and the Conditions of Employment of Other Servants of the European Economic Community and the European Atomic Energy Community (OJ 45, 14.6.1962, p. 1385/62).

<sup>5</sup> In 2016 the Office has taken further measures to ensure the Board's independence from the Office.

### THE OFFICE'S REPLY

17. The Office agrees that the preciseness of the Office budget has become more important following the recent changes in its founding and financial Regulations specifying mechanisms such as the allocation of surpluses to a reserve fund, the threshold of the EU Cooperation activities and the off-setting mechanism, as they are connected with the budgeted amounts. For this reason, the Office will put special focus on elaborating more accurate budgets in the future and, where necessary, through amended budgets to be presented to the Governing bodies of the Office at a convenient moment which preserves the forecasting nature of the budget.

18. The Office takes good note of the comments of the Court.

The initial estimation of the volume of the FWC was difficult to calculate at the time of tendering due to the fact that the specification of the objectives and activities to cover the last two years of the contract were directly linked to the Strategic Plan 2020<sup>1</sup> (SP2020) which had not yet been detailed or even developed at that time. However, it should be noted that this was rectified in the following FWC where the volume estimates correspond to a detailed list of underlying activities.

As for the possible use of lots, the Office will consider it, for future tendering of this nature.

With regard to the Court's observation on the issue of neutralized competition on price and the increased dependence on the contractor as a consequence of requesting fixed-price offers from a single contractor, it should be noted that only 50% of specific contracts signed under this FWC are fixed price. In this context, the Office had set up a dedicated team specialised in contract management office-wide and had established a framework for vendor management which allows it to evaluate the correctness of the fixed price offer and, the case arising, to revert to another contract mechanism such as to "Quoted Times & Means" or, as a last resort, to "Times & Means". Moreover, the re-opening of competition

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<sup>1</sup> The SP2020 refers to a multi-annual work programme covering activities and projects for the period 2016-2020

mechanism implies more administrative costs and proves to be more time-consuming than other solutions.

Furthermore, for consequent FWCs the Office is using a mixed multiple framework contract, partially cascade, partially re-opening for the services of this nature.

19. Whereas the basic acts of both the CdT and the EUIPO only lay down that the CdT provides the translation services necessary for the functioning of the Office, the EUIPO has been counting on the CdT services not only for all those necessary translations but also for a number of additional tasks, including editing and terminology work. However, just like any other European agency or body, the Office is bound by the principle of sound financial management and considers that paying for translations already requested and paid for in the past does not accord with this principle.

As pointed out by the Court of Auditors, the EUIPO remains the main client of the CdT contributing to more than half of the revenue in 2016, even though the Office is making use of IP translation memories<sup>2</sup>, which results from records of past IP translations from over the past 20 years. In 2016, 96% of the terms needed for IP translations could be retrieved from those records. The 4% necessary IP translations which required translation by the CdT have cost the Office 15,5 million euro.

In accordance with its mission, the EUIPO has always sought to provide IP users with the best quality at the lowest price possible in order to support EU business. In this regard the Office has reduced trade mark fees by over 50 %, clearly benefitting for our users, in particular the SMEs. The savings related to the above practice played a part in this significant reduction.

With regards to the concern expressed by the Court of Auditors with respect to the possible duplication of efforts and related costs at the European Union level, the Office considers that the maintenance and re-use of EUIPO's available records does not constitute a major effort or cost. The Office is continuously reflecting on ways to guarantee value for money within the existing legal framework.

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<sup>2</sup> The translation memories refers to reusing available translations and is referred to as "pre-translation" in the facts

The CdT is a key partner in fulfilling the mission of the Office and, in view of the progress in the area of automated translations, the Office thinks it is of key importance that actions are taken together in the mutual strategic interest for the near and foreseeable future in order to reach a modern and sustainable business model that benefits all parties involved fairly.