

EARTO Feedback on EU Audit & Control Approach

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In view of on-going and future exchanges with the European Commission and European Court of Auditors, the EARTO Working Group Financial Experts has prepared a feedback on the European Union's Audit & Control Approach. Accordingly, EARTO will continue the dialogue on such issues with EU Institutions and look forward to developing the below recommendations in future meetings.

In general

1. Audits and control perceived by beneficiaries of EU research & innovation programs – through the behavior and actions of the European Court of Auditors (ECA), European Commission (EC) Audit services, Project and Financial Auditors and auditors working on behalf of the EC – are different, depending on cultural and historic differences.
2. The approach is often rule based and not principle based. Even examples in the guidelines used for clarification will become a guideline in itself.
3. The rule based approach leads to act in distrust instead of trust.

=> Audits should be based on principle and trust.

Legal framework

4. Legal framework is laid down in various regulations (H2020, EIT, competitive aid regulation etc.), and do not always use the same definitions and principles (i.e. regarding calculations of hourly rates)
5. On top of these regulations, new rules and annotations for simplification purposes have been issued making the original "official" legislative texts less transparent and manageable.
6. The "official" regulations have been further detailed in extensive guidelines (i.e. financial guidelines).
 - a. Guidelines were not available at the start of the Framework Programme;
 - b. In some cases, they have been changed during the course of the Programme (i.e. as a result of simplification or due to the restoring of exiting loopholes); and
 - c. They have been differently interpreted during the course of the Programme (i.e. different interpretation between EC DG's, but even between individual project officers)
7. In the legal framework the term "beneficiary" is used, in which a distinction between companies and knowledge institutes is made. No distinction is made for the specific character of Research and Technology Organisations (RTOs). This leads to unacceptable outcomes in pricing and eligible costs declaration.
8. Legal certainty could be increased by aligning different levels of audit in order to foster similar interpretation of guidelines throughout all EC bodies. For example it has been experienced, that the ECA overrules previous outcomes of DG's or project officers). **=> Rules should be clear and consistent and provide legal certainty.**

Project officers

9. Once trust has been built up, it is easier to work based on principles (in specific projects with specific cases). But due to the rapid change of staff within auditing bodies and services this becomes very difficult (i.e. a new project officer is designated for almost every project and will question and often reject any principle based agreement).
10. Submitted cost statements are supported by a report on factual findings by the auditor. This report states factual findings (up to Eurocents), but does not give any legal assurance (as it is not requested in the relevant EU regulation). Thus, it can still lead to additional information requests by project officers on proof of direct costs for small amounts. The project officers have shown growing distrust regarding the outcome of audit statements performed by respectable audit firms.
11. Project officers do not work with the acknowledgement of what is called "materiality" in audit and accounting regulation. "Materiality" means that an issue only becomes an issue when it is above a certain (financial) threshold. This results in endless questions by project officers on irrelevant financial matters which do not actually change the assurance of the cost statement
12. Small administrative adjustments from one period to another (even when costs remain eligible!) are often being requested in order to accept costs. In some cases a new audit report is necessary, if the total of the cost-statement has been changed. The balance between administrative burden and all effort made by both beneficiary and project officer is lost during these actions.

13. Project officers as well as their managers have repeatedly not been informed by decisions of audits performed by higher DG management, leading to communication inaccuracies (i.e. previously agreed audit outcome by TNO and higher DG management on FP6 ex-post audits were not correctly transmitted to other EC services, leading to long and unnecessary communication on the approval of the methodology used by TNO with project officers).

=> Project officers should be guided by the question of materiality and be informed timely about audit results in order to avoid unnecessary administrative work.

Audit services (ECA/EC/third parties)

14. In most cases, no interest is shown by audit services in the outcome of the project or the results that have been achieved with EU budget.
15. In most cases the audit parties will establish an audit strategy, plan or approach. This strategy will develop over the years to include lessons learned at different audits. Beneficiaries have to deal with the guidelines as applicable, while this audit strategy is often not known to them. One could think of the situation where every year the focus point in audit strategy slightly changes from one topic to another, based on risk assessment. If these risk assessments are in place, they are often not known to beneficiaries (i.e.: the Dutch Income Tax Authorities publishes yearly a specific audit topic, towards the ending of the fiscal year and thereby try to persuade the public to behave "tax friendly".)
16. Audit findings always immediately strike back to the start of the Framework Programme. Since guidelines and their interpretation develop during a Framework Programme, a two way approach could be chosen:
- a. adjustments to the start of the Programme in case of gross negligence or severe mistakes in cost declaration
 - b. adjustments in future cost declaration only in case of minor deviations or minor misinterpretation of guidelines
17. It is sometime unclear what the basis is for auditing certain beneficiaries. Is it risk-based per beneficiary or the result of a monetary sample? And if it is the result of a monetary sample, one could ask whether this is the most efficient auditing strategy.

=> Auditors should provide more transparency about their audit strategy and offer reliability in their interpretations and findings over the course of a Framework Programme.

Fair and Equal Treatment of Beneficiaries

18. Auditors regularly state that fair and equal treatment of beneficiaries is one of their overarching goals. EARTO strongly supports this objective. However the conduct of the audits and the results they yield may not always contribute to this and some instances even contradict it.

Example in FP7 and Horizon 2020: Looking at the rules of FP7 (and also Horizon 2020) some rules offer different options: option (a) describes a simple procedure with little room for interpretation, while another option (b) takes into account the professional accounting systems some beneficiaries operate. To achieve professionalisation, systems are designed and operated with a certain level of complexity. The wording of option (b) being more flexible than the wording of option (a), option (b) will be more likely subject to extensive auditing leading to inconsistent and evolving interpretations. Consequently, fair and equal treatment may be compromised by disproportionately investigating into option (b) targeting beneficiaries with professional systems – while from tax-payers perspective the level of risk is at least identical in both options.

Framework Programme	Topic	Option (a) "simple system"	Option (b) "professional system"
FP7/Horizon 2020	Proof of employees working for the project	Declaration signed once per reporting period that employee is exclusively working on EU project	Comprehensive, detailed time recording system with ever tightening rules and interpretations

=> Auditors should ensure fair and equal treatment of all beneficiaries.

Summary: Different layers of beneficiaries' issues with rules and auditing

Setting of Rules

Rules are not completely available / defined at the start

As the setting of rules evolves over time, it can turn out that rules become to be unclear or partly inconsistent

Rules are modified / added over time

Interpretation of Rules

Annotations and examples offer no reliable interpretation of rules

Interpretations offered by various EU services can have different focus and can therefore lead to inconsistencies

Interpretations offered change over time

Auditing of Rules

Audit process and focus should be shifted to a more principle based notion putting more focus on project

Different EU audit services with different findings / changing findings over time

Audit findings communicated and sanctioned late in the programme

Case study 1: Setting, interpretation and auditing of rules put pressure on the RTO business model

The RTO business model is based on the principle that research projects are reimbursed at full cost by customers and funding bodies. Conducting research for third parties is the core business activity of RTOs, not "extra money" as many universities and companies may see it. Funding deficits in public and EU projects can be compensated only to a limited extent. In Horizon 2020, there is a great risk that funding deficits in EU projects will further increase due to different effects:

- **Setting of Rules.** Examples: The switch to a flat-rate overhead funding scheme means painful cuts in the effective funding rate for RTOs, particularly given that at some places the compensation offered by the Large Research Infrastructure (LRI) scheme is still in question. While especially universities benefit from the option of a declaratory assignment of employees to projects, flexible assignments as standard at RTOs bear an increasing burden of accompanying requirements.
- **Interpretation of Rules.** Examples: RTOs have been confronted by the EC and ECA with demands to increase the share of overhead activities documented in the time recording of rank and file research employees. Overhead expenses, however, are only reimbursed via flat-rate. RTOs cannot recover 100% of salary of employee working only for EU project (in contrast to universities with only declaratory assignment of employees to projects.)
- **Auditing of Rules.** Examples: Audit Service of EC shows expectations that EU projects are significantly over- or under booked as further proof of "actual cost". Careful planning and allocation of human resources is, however, a key management task for an RTO in order to achieve the best possible result within the range of available budget.

Result: In combination, these developments start to undermine the business model of an RTO as they are independently all depressing the effective funding rate of EU projects – though probably unintended by the many entities involved in setting, interpreting and auditing the rules.

Conclusion: It is important to view audit strategy, findings and enforcement in the larger context if they reflect the political goals and contribute to fair and equal treatment of beneficiaries.

Note to the reader:

EARTO - European Association of Research and Technology Organisations

EARTO is the European trade association of the research and technology organisations (RTOs), a non-profit organisation founded in 1999. EARTO groups over 350 RTOs with a combined staff of 150,000, an annual turnover of €23 billion, special equipment and facilities to a value of many €billions and more than 100,000 customers from the public and private sectors annually.

EARTO Working Group Financial Experts: composed of 20 Financial Controllers and Specialists working within our membership. Established in 2013, this Working Group is following the financial and legal aspects of Horizon 2020 implementation, including the new Large Research Infrastructure scheme.

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