2015 discharge: European Institute of Innovation and Technology (EIT)

2016/2191(DEC) - 13/09/2016 - Court of Auditors: opinion, report

PURPOSE: presentation of the EU Court of Auditors' report on the annual accounts of the European Institute of Innovation and Technology (EIT) for the financial year 2015, together with the Institute's replies.

CONTENT: in accordance with the tasks conferred on the Court of Auditors by the Treaty on the Functioning of the European Union, the Court presents to the European Parliament and to the Council, in the context of the discharge procedure, a Statement of Assurance as to the reliability of the annual accounts of each institution, body or agency of the EU, and the legality and regularity of the transactions underlying them, on the basis of an independent external audit.

This audit focused on the annual accounts of the European Institute of Innovation and Technology (EIT). 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. It awards grants to an increasing number of 'Knowledge and Innovation Communities' (KICs), linking the higher education, research and business sectors with one another and aiming thereby to boost innovation and entrepreneurship.

Statement of assurance: pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU), the Court has audited:

- the annual accounts of the Institute, which comprise the financial statements and the reports on the implementation of the budget for the financial year ended 31 December 2015, and
- the legality and regularity of the transactions underlying those accounts.

Opinion on the reliability of the accounts: in the Court's opinion, the Institute's annual accounts present fairly, in all material respects, its financial position as at 31 December 2015 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.

Qualified opinion on the legality and regularity of the transactions underlying the accounts: the Court notes that the EU contribution to the Institute's budget in the period 2014 to 2020 is provided under the Horizon 2020 financial envelope which implies that the Institute has to apply Horizon 2020 (H2020) rules.

Accordingly, the Institute aligned its Financial Regulation with effect from 1 January 2014 to H2020 rules and as of that date only a uniform flat rate of 25 % is applicable for the calculation of indirect eligible costs related to grants. Following the assessment of the 2014 business plans the EIT had informed the KICs in October 2013 that this might happen. However, the 2014 grant agreements signed in February 2014 with the KICs continue to provide for a flat rate of 40 % for non-profit public bodies, higher education establishments, research organisations and SMEs, which is contrary to the relevant provision.

Furthermore, a transition period for the application of the rules on the flat rate is not provided for in the Horizon 2020.

In the absence of a valid legal basis, the flat rate of 40 % for the reimbursement of indirect eligible cost is **irregular.** The total amount overpaid in applying this flat rate is **EUR 5.5 million, corresponding to 3 % of the 2015 grant transactions.**

The Court also notes the errors found as a result of ex post verification of a sample of 2015 grant transactions lead to a residual error rate of 2 % for the 2014 grant transactions. The combined error rate of the matters described above is 5 % of the 2015 grant transactions or **4.9 % of the total 2015 expenditure.**

Accordingly, the Court gave a **qualified opinion on the legality and regularity of the transactions underlying the accounts of the EIT.**

The report also made a series of observations on the budgetary and financial management of the Institute, accompanied by the latter's response. The main observations may be summarised as follows:

The Court's comments:

- **budgetary management**: the Court noted that the EIT mobilises funds from public and private sources and use its resources in accordance with its Regulation. In spite of this, the contribution from the Horizon 2020 financial envelope accounted for 99 % of its 2015 budget. Even though the Institute is allowed to re-enter unused appropriations (appropriations not committed during the year or de-committed by the year end) in the budgets of the following 3 years, it had not adapted its process in time to re-enter 26.6 million euro available from the 2014 grant agreements in the 2015-2017 budgets. The level of carry-overs for committed appropriations was accordingly and mainly relate to contracts for IT services going beyond year-end;
- **irregularities**: the Court noted that the original target set by the Commission for the Institute to obtain financial autonomy was 2010. However it obtained only partial financial autonomy in June 2011 under the condition of continued ex ante approval of grant related transactions and of procurements above EUR 60 000. The Court also noted that the Institute funds the EIT Digital Master's programme in which 16 European universities participate. The model for reimbursing the universities' costs combines a lump sum maximum EUR 8 000 plus actual costs including flat rate based indirect costs. On average **a total of EUR 15 000 per student** was paid to the universities in 2015 on this basis (including the lump sum). However, the model has never been formally defined and does not allow a distinction between activities covered by the lump sum and those covered by the actual costs. The Institute should move towards a clear and formally defined model based on a single method for declaring costs such as a substantiated single lump sum. Lastly, the Court indicates that one KIC paid **gross bonuses of EUR 646 000 to 55 of its staff** (individual bonuses as much as EUR 100 000), which the Institute reimbursed at 100 %. Paying such bonuses using only public funds is an unusual practice and they should be taken into account in the ceiling for the EIT funding of individual salaries, which will be applied with effect from the 2016 grant agreement.

The Institute's reply:

- **budgetary management**: the EIT **disagreed with the conclusion of the Court of Auditors,** as no 'overpayment' or irregular payment was made for the reimbursement of indirect costs of KICs under the 2014 grant agreements. It indicated that the legislation applicable to the EIT financial assistance on 31 December 2013, the EIT Financial Rules, explicitly allowed the use of a 40 % flat rate for reporting indirect costs by higher education institutions, research organisations, non-profit public bodies and SMEs. Therefore, the use of the flat rate of 40 % by these bodies was legal and regular under the 2014 grant agreements. It also stated that the entry into force of the new Regulation on the Horizon 2020 Rules for Participation and Dissemination should not have affected the continuation of the actions concerned (i.e. the 2014 Business Plans of the KICs, which were established and assessed by the EIT in 2013) until the award of financial assistance by the EIT. This

award should have been carried out under the legislation applicable on 31 December 2013. Consequently, the error rate of 2015 grant transactions, as calculated by the EIT, is 1.46 %, and not that stated by the Court;

- **irregularities**: the EIT indicated that the education activities covered by lump sums and actual costs can be distinguished in the EIT Digital Masters Programme. The lump sum tuition fees cover the costs of the universities related to the participation of students in technical courses. On the other hand, the activities reported based on actual costs relate to the EIT Digital specific learning outcomes and provide added value for students compared to the standard masters programmes offered by the participating universities. The EIT accepted that it should move towards a single lump sum model for financing KICs' Masters programmes in order to simplify the cost reporting.
  With respect to bonuses, the EIT indicated that bonuses, as variable components of the basic remuneration of KIC management staff, comply with all relevant rules and regulations. More precisely, the variable complements were authorised by the employment contracts, they were determined on the basis of objective conditions, which were documented by the KIC Legal Entity and verified by EIT. The net amount actually paid to employees depends on the applicable withholding tax rate and the employees' individual tax situation. On the basis of a tax rate of ca. 40 %-50 % of the gross amount reported by the Court of Auditors, the net amount was on average around EUR 6 000-7 000 per person. While the practice of reimbursing bonuses, as variable and performance-based components of remuneration, may be unusual, the objectives pursued by KICs as business-driven organisations, such as aiming for financial sustainability, are also unusual and cannot be found in other programmes. The use of variable elements as part of the basic remuneration **can provide a strong incentive for good performance and ensure that value for money is achieved**.

Lastly, the report contained a summary of the **EIT's key figures in 2015**:

- **Budget**: EUR 231.7 million (in payment appropriations);
- **Staff**: 50 full time (staff includes officials, temporary and contract staff and seconded national experts).