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Report of the Court of Auditors for 2015

Board of Governors

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EUROPEAN
COURT
OF AUDITORS

**Report on the annual accounts of the European Schools for the
financial year 2015**

together with the Schools' replies

CONTENTS

	Paragraph
Executive summary	
Introduction	1-14
Background	1-4
Changes in the Financial Regulation and in the accounting /control environment	5-10
Engagement, scope and approach	11-14
Accounting	15-17
Internal control systems	18-31
Recruitment	18-19
Procurement	20-23
Internal control standards (ICS) - annual Activity Reports	24-25
Payments	26-31
General	26-30
Sample of payments	31
Conclusion	32-34
Accounting	32-33
Internal control systems	34
Recommendations	35

Annex : Follow-up to Court's recommendations raised in the Annual Report 2014

EXECUTIVE SUMMARY

What is this report about?

I. The Court reviewed the consolidated annual accounts of the European Schools for the financial year 2015 in accordance with the Financial Regulation of the Schools. This review took place at the Central Office and in two Schools (Luxembourg I and Frankfurt), and covered both the accounts and the internal control systems (recruitments, procurements, payments and internal control standards).

What did the Court find?

II. The Schools did not prepare their annual accounts within the legal deadline. Numerous errors were found, most of which were corrected (as a result of the review) in the final version of the accounts. They constitute systematic weaknesses in the accounting procedures.

III. Our review did not however reveal material errors in the final financial statements for 2015.

IV. The payment systems of the two selected Schools were affected by significant weaknesses: no automatic link between the accounting and payment systems and no strict segregation of duties, payments made outside the accounting system not automatically rejected by the system and a poor level of control generally. These weaknesses represent a significant risk in terms of the legality and regularity of payments.

V. The Court also found several significant weaknesses in procurement procedures, which risked compromising the principles of transparency and equal treatment.

VI. In a few cases, the Court did not find evidence of the qualifications of recruited staff and noted omissions in their personal files.

VII. As a result, the Court was unable to confirm that the financial management was sound.

What does the Court recommend?

VIII. The Board of Governors, together with the Central Office and the Schools, should take immediate action to implement a series of recommendations made in this and previous years' reports to improve the accounting and internal control systems. In particular, the

Court recommends that the Schools correct the weaknesses detected in accounting procedures and continue to provide training and support to those involved in the preparation of the accounts. As regards internal control systems, the Court reiterates its recommendations to improve recruitment procedures and procurement procedures and to reinforce payment procedures and ex ante controls.

INTRODUCTION

Background

1. The primary legal basis for the European Schools ('the Schools') is the Convention¹ which sets out their Statute. The financial and operational management of the Schools is carried out according to the Financial Regulation², its Implementing Rules³ and the Staff Regulations⁴ (which make up the 'General Framework').
2. The individual Schools are responsible for the annual accounts⁵, and the consolidated annual accounts are drawn up by the Office of the Secretary-General of the European Schools ('the Central Office') and forwarded to the Court of Auditors under Articles 90 to 92 of the Financial Regulation of the Schools.
3. The appropriations available in the 2015 budget amounted to 288,8⁶ million euro (289,9 million euro in 2014). The European Commission's 2015 contribution was 168,4 million euro (167,2 million euro in 2014).
4. The Court sends (in accordance with Article 94 of the Financial Regulation of the Schools) to the authorities responsible for giving discharge, including the Board of Governors, by 30 November, its annual report accompanied by the replies.

¹ Convention defining the Statute of the European Schools – (OJ L 212, 17.8.1994, p. 3).

² Financial Regulation of 24 October 2006 applicable to the budget of the European Schools - Ref: 2014-12-D-10-en-1.

³ Rules for implementing the Financial Regulations - Ref: 2014-12-D-11-en-1.

⁴ Regulations for Members of the Seconded Staff of the European Schools (Ref: 2011-04-D-14-en-5), Conditions of employment for part-time teachers (Ref: 2011-06-D-29-en-2, 2011-06-D-24-en-2 and 2011-04-D-13-en-2), Service regulations for the administrative and ancillary staff (AAS) of the European Schools (Ref: 2007-D-153-en-7).

⁵ Articles 86, 88 and 89 of the Financial Regulation.

⁶ *Source*: Financial Controller of the Schools.

Changes in the Financial Regulation and in the accounting / control environment

5. The revised Financial Regulation entered into force on 1 January 2015. The main changes were the introduction of an accruals-based accounting system, the abolition of cash payments and the decentralization of ex-ante checks.

6. In 2015, the Schools prepared their accounts, for the first time, on the basis of the accruals accounting principles set out in the International Public Sector Accounting Standards (IPSAS). The new accounting / financial system has been operational since 1 January 2015; it provides the technical means to address several weaknesses reported repeatedly by the Court (e.g. weaknesses in the consolidation process, no automated link between the accounting and payment systems and inefficient financial circuits).

7. The ex-ante checks were partially decentralized in 2015, based on a risk assessment for each School. Full decentralization will take place after the validation of each School's internal control system by the Financial Controller⁷. Moreover, on 31 July 2015, the Secretary-General issued new guidelines for the segregation of duties in the financial circuits. The new financial circuits will be applicable as from the 2016 financial year.

8. The working group⁸ for the revision of the Financial Regulation continued its activities in 2015. It focused on the role of the Accounting Officer of the Central Office and the overall financial architecture (the role and responsibilities of the Secretary-General regarding financial management and the creation of a governing body for budgetary matters at the Central Office).

9. In November 2015, the Commission's Internal Audit Service (IAS)⁹ issued an audit report on 'Treasury and Revenues Management'. The IAS concluded that the internal control system did not provide reasonable assurance as to the appropriate and effective

⁷ As required by Article 19.6 of the Financial Regulation.

⁸ Paragraph 5 of the 2014 Annual Report.

⁹ In accordance with the service level agreement concluded with the Schools, the IAS fulfils the role of internal auditor of the Schools.

management and accounting treatment of revenue and treasury. There were significant weaknesses in four areas: checks on vendors' databases, access rights to the online banking system, invoicing and extra-budgetary accounts. The Central Office and the Schools are implementing an action plan for the correction of these weaknesses.

10. In recent years, five audits (four forensic and one financial/compliance) took place after allegations of suspected fraudulent activities. In four cases¹⁰, the audits did not confirm these allegations, although other cases of non-compliance were identified; one case¹¹ is under judicial consideration.

Engagement, scope and approach

11. The Court's responsibility is to issue an annual report on the consolidated annual accounts¹².

12. It conducted its review in accordance with the International Standard on Review Engagements (2400). This standard requires that the review should be planned and performed so as to obtain limited assurance as to whether the accounts as a whole are free of material misstatement. A review is limited primarily to inquiries into European School personnel and the analytical procedures applied to financial data and thus provides less assurance than an audit. The Court did not audit the consolidated accounts, and, accordingly, it has not expressed an audit opinion on them.

13. The Court also reviewed the control systems and the individual accounts of the Central Office, and two of the fourteen European Schools (Luxembourg I and Frankfurt)¹³. In this context, it examined staff recruitment, procurement procedures, payments, accounts and the application of the Internal Control Standards.

¹⁰ Paragraph 16 ((a), (b) and (e)) of the 2014 Annual Report and paragraph 5 of the 2013 Annual Report.

¹¹ Paragraph 4 of the 2013 Annual Report.

¹² As required by Articles 93 and 94 of the Financial Regulation.

¹³ The budget appropriations in 2015 were: Central Office – 11,39 million euro, Luxembourg I – 29,05 million euro, Frankfurt – 13,93 million euro (*Source*: Financial Controller of the Schools).

14. **Annex** shows the follow-up to recommendations made in the 2014 financial year (Luxembourg II and Mol Schools and the Central Office).

ACCOUNTING

15. The Schools applied (for the first time) the accruals accounting principles set out in IPSAS for the preparation of the 2015 accounts and introduced a new financial system¹⁴. At the time of the audit, the Schools visited could not produce a final version of the accounts due to technical reasons. Several versions of the accounts with different results were produced. These differences could not be explained.

16. The Schools did not prepare the consolidated accounts under IPSAS within the legal deadline (1st June 2016). So, the Court could not consider them when preparing its preliminary report. Three versions were prepared as a result of the identification of errors in the accounts. The final version of the 2015 accounts was adopted on 29 September 2016.

17. The review revealed the following problems:

- (a) the conversion of accounts to IPSAS resulted in several significant errors and weaknesses which were corrected as a result of our review. Moreover, several other errors were found (e.g. 'Cash flow statement' – 400 000 euro and 'Statements of changes in net assets / equity' – 346 000 and 10 000 euro) which were corrected as a result of our review of the final accounts;
- (b) several inconsistencies between figures in the budgetary reports and in the fixed assets table;
- (c) 76 accounts were selected for confirmation: for 25 a reply was not received and for 5 (in the Frankfurt School) unexplained differences were found;
- (d) the Central Office and the Frankfurt and Luxembourg I Schools have not performed a physical inventory as required by the Financial Regulation (Article 71). Moreover the follow-up of previous observations made to the Mol School showed that no physical

¹⁴ See paragraph 6.

inventory of its fixed assets has been performed and that no record of extra-budgetary accounts has been kept in the financial system.

INTERNAL CONTROL SYSTEMS

Recruitment

18. In two cases (Central Office and Luxembourg I School), there is no evidence that the recruited candidates met all the requirements of the vacancy notices. At the Central Office, several errors were detected concerning the supporting documentation for recruitment decisions.

19. In addition, several omissions were found in the personal staff files (e.g. no job descriptions, no compulsory performance evaluations and no consultation with the national inspector).

Procurement

20. In order to implement a poorly designed 'framework contract' for the purchase of the new accounting system¹⁵, the Central Office launched nine negotiated procedures which did not meet the provisions of Articles 61 - 99 of the Implementing Rules of the Financial Regulation.

21. In the Central Office, in two other cases, several significant errors were found in the evaluation procedure, although they did not have an impact on the final ranking of the offers. These included the mixing of exclusion and award criteria, and selection and award criteria, no disclosure of award criteria weighting and an unclear evaluation report.

22. Several other weaknesses were found in procurement procedures organised by the Central Office, such as the absence of a standstill period, no award decision, the lack of basic elements in the signed contract, the booking of budgetary commitments after the signature of the contract and the absence of evidence for ex-ante checks.

¹⁵ Paragraph 28 of the 2013 Annual Report.

23. In the only procurement procedure organised by the Frankfurt School, the implementation of the contract started before it had been signed and the documentation for the evaluation was not complete. Other errors included irregularities in the appointment of the Opening and Evaluation Committee, the absence of a formal award decision, the failure to publish an award notice and no evidence of ex-ante checks.

Internal control standards (ICS) – Annual Activity Reports

24. The Internal Control Standards were adopted by the Board of Governors in October 2007¹⁶. The Central Office and the Luxembourg I and Frankfurt Schools have not carried out for the year 2015 a review of compliance with the ICS (as required by ICS no 18). Moreover the Central Office and the Luxembourg I School do not have a formalised risk management procedure as required by ICS no 7.

25. No guidance is available to the Authorising Officers for drafting the Declaration of Assurance and making reservations in their Annual Activity Reports. The Authorising Officer of the Luxembourg I School did not prepare an Annual Activity Report.

Payments

General

26. The Court's Annual Reports for the years 2012, 2013 and 2014 criticized the absence of an automatic link between the accounting and payment systems. The new accounting system, implemented in 2015, includes a technical solution for providing such a link. However, in the Frankfurt and Luxembourg I Schools, the link is not fully automatic and the data is transferred by two officials with modification rights, using a flash drive. According to the Financial Controller's annual report for the financial year 2015, this situation applies to all Schools outside Belgium.

27. For technical reasons, the payment system does not reject payments outside the accounting system. Such payments were found in all locations visited.

¹⁶ Ref.: 2007-D-29-en-2.

28. The principle of segregation of duties in the new accounting system is not guaranteed in the Central Office or in the Luxembourg I School. The system allows the Accountant and two other accounting clerks to perform the following actions on their own: create, modify and validate accounts, introduce and validate a payment order, send the payment to the payment system and execute the payment.

29. In the Frankfurt and Luxembourg I Schools, payments can be executed without the intervention of the Authorising Officer (contrary to the Memorandum¹⁷ on payments sent to the Schools by the Secretary General). The bank authorisations provide that the Accounting Officer may execute payments together with another staff member. However in three transactions in the Frankfurt School, the payments were executed by two staff members not including either the Accounting Officer or the Authorising Officer.

30. The above-described weaknesses in the payment system represent a significant risk in terms of the legality and regularity of the payments executed.

Sample of payments

31. Several weaknesses were noted in a sample of payments audited at the Central Office and at the Luxembourg I and Frankfurt Schools:

- (a) in October 2015, the Central Office established a procedure under which any change in a vendor's data needed to be verified ex-ante by a second authorised staff member. Before October 2015, such changes could be made without any ex-ante verification. A similar observation was made in 2012¹⁸.
- (b) changes to vendors' data in the payment system¹⁹ are possible by one person without any further verification (Frankfurt School);
- (c) budgetary commitments were made after signing the legal commitment;

¹⁷ 2013-10-M-1-en-1/KK.

¹⁸ Paragraph 39 of the 2012 Annual Report.

- (d) purchase orders and budget commitments were processed without the intervention of the Authorising Officer;
- (e) payments were made for goods and services with an invalid contract or with no contract at all;
- (f) payments were made late or without complete and accurate supporting evidence;
- (g) insufficient checks were made before the validation of payments (price per unit, quantities, suppliers' bank account number, etc.).

CONCLUSION

Accounting

32. The limited assurance review performed by the Court did not reveal material errors in the final financial statements for 2015.

33. The observations about the internal control systems, the late production of the accounts, the nature and frequency of the errors described in paragraphs 15 to 17 represent significant weaknesses in the accounting procedures.

Internal control systems

34. Based on its review, given the effects of the significant and persistent weaknesses described in paragraphs 18 to 31, the Court is unable to confirm that the financial management has been performed in accordance with the General Framework.

RECOMMENDATIONS

35. The Board of Governors, together with the Central Office and the Schools, should take immediate action to implement the following recommendations:

Accounting

The Schools should provide in-depth training and effective support for all those involved in the preparation of the accounts, in order to ensure that they are capable of meeting the

legal deadlines for issuing them. Moreover the weaknesses mentioned above should be analysed and the possible effects on the 2016 accounts should be mitigated.

Internal control systems

Recruitments

The Central Office and the Schools should improve recruitment procedures (documentation should ensure legality, transparency and equal treatment).

Procurement procedures

The Court reiterates its recommendation from previous years for the Central Office to provide more guidance to the Schools on planning and designing procurement procedures. The Central Office and the Schools should follow the Financial Regulation and its Implementing Rules strictly, simplify selection and award criteria and improve the documentation for the procedures, so that transparency and equal treatment are ensured.

Payments

The Central Office should ensure that the segregation of duties is respected in the payment procedure and that an effective link is implemented between the new accounting system and the payment system in each individual School. Moreover the ex-ante controls applied should strictly follow the requirements of the General Framework.

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 22 November 2016.

For the Court of Auditors



Klaus-Heiner LEHNE

President

Annex**Follow-up to the Court's recommendations in the Annual Report 2014**

The following table provides information on follow-up to the Court's recommendations in the Annual Report 2014:

Court's recommendations (paragraph 46 of the Report on the accounts of the European Schools for the financial year 2014)	European Schools		Central Office	Comments
	Luxembourg II	Mol		
	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	
Recommendations on accounting issues				
(i) The Central Office and the Schools should ensure effective application of accruals accounting and of all changes introduced by the revised Financial Regulation; and provide in-depth training for all those involved in the implementation of these changes.	In progress			Several structural changes were introduced (application of the revised FR, introduction of accruals accounting, operation of new financial and accounting system, new financial circuits). See paragraphs 5, 6, 7 and 15-17.
(ii) The Central Office and the Schools should ensure the accurate, efficient and effective operation of the new accounting / financial system.	In progress			The new accounting / financial system has been operational since 1 st January 2015. Further developments are underway. See paragraphs 6 and 15 - 17.
(iii) The Schools should comply with the legal deadlines for transmitting the revenue and expenditure account and the Balance Sheet.	no	no	no	All Schools and the Central office approved their 2015 accounts after the legal deadline of 1 April 2016. See paragraphs 15 - 16.
(iv) The Central Office should check the completeness and accuracy of the data used to consolidate the Schools' accounts and fully document this process.	In progress			See paragraph 15 - 16.
(v) The Court reiterates paragraph 5 of its Opinion No 4/2014 as regards the need for an independent external audit of the Schools' accounts.	In progress			In the 2016 Budget, appropriations were approved for the external audit of a limited number of Schools.

Recommendations on staff issues		
(vi) The Court reiterates its recommendation to the Board of Governors to implement a rotation system for sensitive posts	In progress	A compulsory system of rotation was discussed at the Board of Governors meeting of April 2014, but no final agreement has been reached and a new proposal is under development.
(vii) The Central Office and the Schools should document recruitment procedures better so as to ensure transparency and equal treatment. Moreover, the legal requirement for performance evaluation of staff should be complied with by all Schools.	In progress	Progress has been made, but weaknesses are reported every year. See also paragraphs 18 and 19.
(viii) The Central Office should implement a Staff Regulation for the part-time teachers which would provide a solid legal framework for managing them.	Yes	The Board of Governors adopted in April 2016 the Service Regulations for Locally Recruited teachers in the European Schools which entered into force on 1 September 2016.
Recommendations on procurement issues		
(ix) The Central Office should provide more guidance to the Schools on planning and designing procurement procedures. The Central Office and the Schools should follow the Financial Regulation and its Implementing Rules strictly, simplify selection and award criteria and improve the documentation of the procedures so that transparency and equal treatment are ensured.	In progress	The 2015 audit found similar weaknesses to those found in previous years. A new procurement cell was created in 2015 at the Central Office. See also paragraphs 20 – 23.
Recommendations on internal control standards		
(x) The Central Office should be actively involved in the implementation of the Internal Control Standards and provide guidance to the Schools.	No	See paragraphs 24 - 25.
Recommendation on payments control system		
(xi) The Central Office should ensure that segregation of duties is respected in the payment procedure and that an effective link is implemented between the new accounting system and the payment system.	In progress	See paragraphs 26 -31.

<p>Similar weaknesses have been repeatedly reported by the Court in recent years. Their frequency and persistency puts at risk the basic principles of sound financial management. The Central Office should implement procedures and controls that ensure compliance with the Financial Regulation and the Implementing Rules and, from a wider perspective, that respond to Opinion No 4/2014 of the Court as regards the financial control architecture.</p>	<p>In progress</p>	
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REPLIES OF THE OFFICE OF THE SECRETARY-GENERAL OF THE EUROPEAN SCHOOLS TO THE RECOMMENDATIONS OF THE COURT OF AUDITORS IN THE FRAMEWORK OF ITS ANNUAL REPORT FOR THE FINANCIAL YEAR 2015

Accounting

The European Schools have undergone a substantial effort to provide training and support for all schools regarding 2015 closure activities. The Central Office is aware that this effort needs to be continued regarding the 2016 closure and for this purpose specific training will be provided also during 2017. The objective is indeed to meet the deadlines as foreseen in the Financial Regulation.

Internal control systems

Recruitments

The improvement of recruitment procedures is a permanent process. New Guidelines dealing with the recruitment process and its requirements has been reviewed in the light of the Court of Auditors recommendations (document 2015-08-D-8-en-1). These new Guidelines are in place since autumn 2015.

Procurement procedures

As for the procurement procedures, the following measures have been taken:

Firstly, the Secretary General released on the 30th September 2016 a Memorandum on the procedures for the purchase of goods and services (Ref. No.: 2016-09-D-83-en-1) that contains practical guidance for the Schools about the implementation of the basic requirements for procurement procedures stated on the financial rules.

Secondly, the establishment of a procurement network has been launched, and this network is now being constituted in order to provide guidance and training and to ensure more coherent application of the procurement rules amongst the Schools.

Thirdly, a decision has been taken in the framework of the working group for the review of the Financial Regulation to propose to fully align with the EU procurement rules stemming from Regulation No 966/2012 and its Rules of Application (1268/2012). The full alignment and direct applicability will offer the Schools the possibility to use the Commission's Help Desk and the related services in interpreting and applying properly the relevant rules on tendering procedures.

Payments

The Memorandum explaining the principle of segregation of duties and providing instructions to the Schools and the Central Office was transmitted in July 2015 (document annexed to letter to the Directors 2015-07-LD-37/JEB/KK/hm). Accordingly, the creation and modification of bank related master data corresponding to regular vendors is currently performed by an initiator (not by the Accounting officer) and validated by the Authorizing officer, based on documentation from the bank. In turn, invoices leading to payment orders go through the process of initiation, verification and authorization before the payment is initiated by the Accounting Officer and the actual payment in the online banking software is done by the Accounting Officer, and the Authorizing officer (at any rate for payments above the threshold of 60.000 euro). Whereas there may have been situations where the segregation of duties was not fully respected prior to July 2015, appropriate measures to safeguard this principle have been taken as from that date.

As concerns the automatic link between the new accounting software SAP and the payment systems in the schools, it is being gradually set up since the beginning of 2015. At the moment, eight schools and the Central Office, covering 73 % of the total budget, have such an automatic payment system. For the remaining five schools a technical solution has been found and such a system should be in place before the end of this year.



Giancarlo MARCHEGGIANO
Secretary-general