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Report of the Court of Auditors for the financial year 2017

Board of the Governors of the European Schools
Meeting of 4-7 December 2018 – Brussels

EUROPEAN
COURT
OF AUDITORS

Report on the annual accounts of the European Schools for the financial year 2017

together with the Schools' replies

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EXECUTIVE SUMMARY

What is this report about?

I. Pursuant to the Financial Regulation of the European Schools, we have reviewed the Schools' consolidated annual accounts for the 2017 financial year. We have also reviewed the accounts and the internal control systems (recruitments, procurements and payments) of the Central Office and two Schools (Brussels IV and Munich).

What did we find?

II. Our review did not reveal material errors in the final consolidated financial statements for 2017.

III. All the Schools and the Central Office prepared their annual accounts within the legal deadline. Our review of the accounts of the Central Office and the two selected Schools revealed errors in the calculation and booking of employee benefits, the recording of payables and receivables and the clearing of old booking entries that might no longer be valid. The errors were caused by weaknesses in accounting procedures. The Central Office has corrected most of them in the final accounts.

IV. Our review of the internal control systems of the Central Office and the two selected Schools revealed weaknesses in payment systems and in the control environment, including the management of extra-budgetary items, and in the documentation of the recruitment procedures. We also found that they often did not fully comply with the rules on staff recruitment.

V. As a result, we are unable to confirm that the Schools' financial management in 2017 was compliant with the Financial Regulation[1], its implementing rules[2] and staff regulations[3].

What do we recommend?

VI. The Board of Governors, 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 their accounting and internal control systems.

VII. In particular, we recommend that the Schools address the weaknesses detected in their accounting procedures, continue to provide training and support to those involved in the preparation of the accounts, and develop guidelines to improve budgetary management and the management of extra-budgetary items.

VIII. As regards internal control systems, we reiterate our recommendations for improving recruitment and payment procedures.

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

[2] Rules for implementing the Financial Regulation (Ref: 2014-12-D-11-en-1).

[3] Regulations for Members of the Seconded Staff of the European Schools (Ref: 2011-04-D-14-en-5), Service Regulations for the Locally recruited teachers in the European Schools (Ref: 2016-05-D-11-en-1), Service Regulations for the Administrative and Ancillary Staff (AAS) of the European Schools (Ref: 2007-D-153-en-7).

INTRODUCTION

Background

1. The primary legal basis for the European Schools is the Convention setting out their Statute[4]. The Schools' financial and operational management tasks are governed by their Financial Regulation[5], its implementing rules[6] and a set of staff regulations[7]. Together these make up the 'General Framework' of rules.

2. Each School is responsible for its own annual accounts[8], and the Office of the Secretary-General (the 'Central Office') draws up consolidated annual accounts and forwards them to us under Articles 90 to 92 of the Schools' Financial Regulation[9].

3. Appropriations of €307,9 million[10] were available in the 2017 budget (€297,7 million in 2016). The European Commission's 2017 contribution was €189,9[11] million (€177,8 million in 2016).

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

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

6 Rules for implementing the Financial Regulation (Ref: 2014-12-D-11-en-1).

7 Regulations for Members of the Seconded Staff of the European Schools (Ref: 2011-04-D-14-en-5), Service Regulations for the Locally recruited teachers in the European Schools (Ref: 2016-05-D-11-en-1), Service Regulations for the Administrative and Ancillary Staff (AAS) of the European Schools (Ref: 2007-D-153-en-7).

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

9 The accounts for 2017 were submitted to us according to the provisions of Articles 71 to 73 of the new Financial Regulation, applicable as of 1st January 2018 (2017-12-D-2-en-1).

10 Draft consolidated accounts of the European Schools.

11 Annual Report of the Financial Controller for the year 2017 (Ref: 2018-02-D-21-en-2).

4. By 30 November of each year, under Article 94 of the Financial Regulation[12], we send a report on the Schools' annual accounts, together with their replies, to the European Parliament, the Council, the Commission and the Board of Governors, the last of which is responsible for giving discharge.

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

5. In September 2017, the Board of Governors adopted a new Financial Regulation, which entered into force on 1 January 2018[13].

6. In 2017, for the third year in a row, the Schools prepared their accounts using the accrual 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 which we have consistently reported (e.g. weaknesses in the consolidation process, no automatic link between the accounting and payment systems, inefficient financial circuits).

7. In 2017, the Commission's Internal Audit Service (IAS) carried out an in-depth follow-up audit of outstanding recommendations and began a consulting engagement on the management of extra-budgetary accounts. The follow-up audit is completed and the Schools agreed on an action plan. The aim of the consulting engagement, which was completed in June 2018, was to help the Schools to close the remaining recommendations relating specifically to the management of extra-budgetary accounts.

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[12] Under Article 86 of the new Financial Regulation.

[13] Changes with respect to the current Financial Regulation include (a) the Secretary-General becomes authorising officer for the European Schools; (b) a new function of Accounting Officer for the European Schools will be phased in at the Central Office; (c) the timing of the Commission's contribution changes; (d) procurement rules are aligned with those of the EU; (e) the text of the Financial Regulation now includes the former implementing rules.

Scope and approach of our engagement

8. It is our responsibility to issue an annual report on the consolidated annual accounts[14].

9. We reviewed the consolidated annual accounts in accordance with International Standard on Review Engagements 2400. This standard requires reviews to be planned and performed 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 staff and to analytical procedures applied to financial data; it thus provides less assurance than an audit. As we did not audit the consolidated accounts, we do not express an audit opinion on them.

10. We also reviewed the individual accounts and internal control systems of the Central Office and two of the fourteen Schools (Brussels IV and Munich)[15]. This included an examination of staff recruitment, procurement procedures and payments.

11. In addition to our own findings, we drew on reports by the IAS at the Commission and reviewed the work of the Schools' independent external auditor, which examined the accounts and internal control systems of seven Schools[16] before consolidation took place.

12. The ***Annex*** shows the follow-up to our recommendations for the 2016 financial year (Alicante and Karlsruhe Schools and the Central Office).

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[14] Pursuant to Articles 93 and 94 of the Schools' Financial Regulation.

[15] Budget appropriations in 2017: Central Office €11,87 million, Brussels IV €25,46 million, Munich €25,62 million. See Annual Report of the Financial Controller for the year 2017 (Ref: 2018-02-D-21-en-2).

[16] The independent external auditor examined the accounts of the Schools of Culham, Frankfurt, Bergen, Varese, Mol, Luxembourg I and Luxembourg II for 2017. Four Schools were audited for the 2016 closure.

ACCOUNTING

13. When preparing the 2017 accounts, the Schools applied accrual accounting principles, as defined in the IPSAS. All Schools and the Central Office prepared their accounts within the legal deadline (31 March 2018).

14. An external consultant assisted the Schools in preparing the consolidated accounts. The latest version, which we received in July 2018, included corrections proposed by the independent external auditor for the seven Schools we audited as well as corrections of the errors we identified at the Central Office and the two Schools we visited.

15. Although the quality of the accounts has improved, both we and the external auditor detected a number of weaknesses:

- The Munich School paid invoices for goods worth a total of €16 311 without confirming that the goods had been received and were as ordered.
- The Schools' calculations of short-term employee benefits and post-employment benefits are based on staff data. These calculations are complex and are prone to error.
- The Central Office erroneously classified accounts receivable and accounts payable as negative balances in the balance sheet. These errors were corrected in the final accounts.
- The Central Office did not clear payables totalling €127 998 from the periods before the transition to accrual accounting. Due to a lack of documentation, it is often unclear what these payables represent and whether they are still payables.

INTERNAL CONTROL SYSTEM

Recruitment

16. When we examined recruitment procedures at the Munich and Brussels IV Schools, we found several anomalies in the appointment of pre-selection and selection committees and the performance of their duties. At both Schools, the members of one selection committee

did not sign the final report setting out the committee's decision. In addition, the only external member of the Brussels IV selection committee was no longer present when the committee took its decision. In two cases, one at the Central Office and one in Munich, a selection committee did not keep on file why it selected certain candidates for interview without due consideration of their results at the previous stage of the selection procedure.

17. On examining staff files at the Central Office and the Munich School, we also found that some documentation on recruitment decisions was missing or incomplete. As a result, some selection committee decisions have no documentary support. In one case, the Munich School invited only one of two candidates for interview, although both had reached the same ranking in the pre-selection tests. The same School had also accepted the applications of two candidates that were late by more than two weeks.

Procurement

18. We did not detect any significant weaknesses in procurement procedures completed in 2017. This improvement compared with previous years resulted from the creation of a procurement cell at the Central Office, which developed detailed guidelines and model documents for the Central Office and the Schools to apply. For amounts up to €144 000, the Schools also made more use of framework contracts produced by the Commission or other public entities[17].

Payments

General

19. In our annual reports on the Schools for 2012 to 2016, we criticised the absence of an automatic link between accounting and payment systems. All Schools put such a link in place during the first half of 2017. However, they were unable to configure their electronic

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[17] See Article 70b of the current Financial Regulation.

payment systems in such a way as to accept only payments from the accounting software[18]. Therefore, despite the automatic link, staff can still manually introduce payments in the system.

20. To reduce the risk of making payments outside the accounting system, in previous years the Schools applied a system requiring two staff members to sign each payment. In 2013[19], the Secretary-General set an indicative threshold of €60 000, above which one of the two signatories had to be the authorising officer. The dual signature arrangement should have remained in place during 2017. However, in the three German Schools[20] this was not the case for much of 2017 and early 2018[21], which created a major risk for their payment systems.

Sample of payments

21. Most of the errors we found in payment transactions at the Central Office and the two Schools we visited related to the management of commitments.

22. Due to its specific legal framework[22], the Munich School has to reimburse to Member States an amount corresponding to the national part of salaries paid to seconded teachers. These payments are made without a commitment. Neither the Central Office nor the School

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18 Paragraph 26(f) of our 2015 Annual Report.

19 Memorandum 2013-10-M-1-en-1/KK.

20 Frankfurt, Karlsruhe and Munich.

21 See Annual Report of the Financial Controller (2018-02-D-21-en-2). The three Schools ceased to use the double signature procedure in spring 2017, when the automatic link between the accounting and payment systems became effective. This situation lasted until mid-November 2017 in Karlsruhe and spring 2018 in Frankfurt and Munich.

22 The Munich School is mostly financed by the European Patent Office (not by the Commission). The contribution received from the EPO is intended to cover all costs, including the full amount of seconded teachers' salaries. Since Member States continue to pay national teachers during their tenure at a School, the Munich School has to reimburse these amounts. No other School has a similar set-up.

has yet developed a procedure for making these payments with the Member States concerned.

23. At the Central Office and Brussels IV, some commitments did not cover the estimated amount of legal and contractual obligations for the whole year, although sufficient budgetary appropriations were available. For instance, the Central Office's initial commitment for 2017 end-of-secondary-school examination ("baccalauréat") expenses ran out in September 2017 whereas some invoices were still to be paid. At Brussels IV, the provisional commitments made in January for operating expenses such as cleaning and security, as well as staff expenses (insurance and salaries), were much lower than the expected costs for the whole year. In the case of buildings expenditure, the initial commitment covered only 20 % of the available budget. In all cases, the Central Office and the School had to make additional commitments at a later stage in the financial year.

24. We found weaknesses and inconsistencies in the procedure for managing expenditure linked to the baccalauréat. The only budget line for this expenditure was at the Central Office, which committed an estimated amount for all Schools. The Central Office also sent out invitations to jury members. Some Schools[23] asked the Central Office to pay jury members direct, although most first checked the amounts due before making payment and then applying for reimbursement from the Central Office. Before reimbursing the Schools, the Central Office would check the amounts again. This procedure did not reflect the Central Office's budgetary responsibility for such payments. In addition, we found serious weaknesses in the checks performed by the Brussels I and Bergen Schools, as well as errors in the amounts reimbursed. As the Central Office did not spot these errors, there were some over-payments to jury members.

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[23] According to documents received from the Central Office, these are the Brussels I, Brussels IV and Mol Schools. However, a payment to Brussels I for baccalauréat oral exams was among the transactions we audited at the Central Office.

25. The Central Office found itself unable to pay the full amount it owed a supplier following a Belgian Court judgement. In 2016, it had registered the amount owed to the supplier (€370 000) as a provision. However, when the judgement was pronounced at the end of 2017, no budget was available to pay the invoices and accrued interest. The Central Office was only able to pay 40 % of the amount due by using funds from other budget lines. We saw no documentation showing that the other party formally agreed with this partial payment or what impact it would have on the accrued interest. The register of exceptions contained no reference to the transaction.

26. Other weaknesses concerned the control environment: in the Munich School, checks on the invoices were not documented, and the invoices reviewed were paid despite not carrying the "certified correct" endorsement ; moreover, there was no register of exceptions, and some extra-budgetary expenses incurred by teachers or students were reimbursed without proof of payment or other supporting documentation. At Brussels IV, invoices for indexed contracts were not always checked to ensure that the updated amounts tallied with the index.

Management of extra-budgetary items and cash flows

27. We found weaknesses in the management of extra-budgetary items. They were handled differently in each School because there are no guidelines on their budgetary and accounting management and on their reporting. This resulted in the same type of expenditure being booked under different items depending on the School. The consolidation of extra-budgetary items therefore did not give accurate information about the different categories of extra-budgetary spending, such as pedagogical activities and social activities.

28. The weaknesses we detected in the management of extra-budgetary items also impacted the Schools' accountability towards stakeholders. For example, although the Culham School closed in 2017, a £17 468 surplus for school trips and sports activities remained on a bank account and could not be traced to the contributing parents. At the Mol School, the external auditor found bank accounts with about €229 000 for extra-budgetary items that were not entered in the accounts. This was corrected in the final accounts.

29. Both the Brussels IV and the Munich Schools experienced cash-flow problems during the year. As a result, Brussels IV had to make late payments to suppliers and Munich postponed the payment of teachers' departure allowances to January 2018[24].

Annual activity reports

30. The Central Office has issued authorising officers with guidance for drawing up statements of assurance and making reservations in their annual activity reports. This guidance, which has been mandatory since 2017, also aims to harmonise the various formats used at present to report on the activities of the Schools and their implementation of internal control standards.

31. The accounting officer for the Luxembourg I School made a reservation to his declaration of assurance for 2017[25]. While the other Schools did not make reservations, they brought various points to the attention of their administrative boards.

CONCLUSIONS

Accounting

32. Based on our limited assurance review, we did not identify any material errors in the final consolidated financial statements for 2017.

33. We found weaknesses in the application of accrual accounting to the accounts of the Central Office and the Brussels IV and Munich Schools. These particularly affected provisions for employee benefits, the recording of payables and receivables and the clearing of bookings from previous periods.

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[24] The School paid the departure allowances in January 2018 and charged them to the 2018 budget.

[25] The bases for the reservation are incomplete records of fixed assets and unreconciled balance sheet accounts.

34. An independent external auditor had previously audited seven Schools and given an unqualified audit opinion. Our examination of these audit reports and the underlying working papers did not reveal material weaknesses.

Internal control systems

35. While the internal control system at Brussels IV showed limited weaknesses, there are still significant weaknesses in the systems of the Central Office and the Munich School. The independent external audit reports also revealed some weaknesses in internal control procedures. We are thus unable to confirm that the European Schools' financial management was compliant with the General Framework of rules.

RECOMMENDATIONS

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

Accounting

37. We recommend that the Schools address the weaknesses described in paragraph 15 and develop adequate procedures, guidelines and training measures to improve their accruals-based accounting.

Internal control systems

Recruitment procedures

38. We reiterate our recommendation from previous years that the Schools apply rigorous staff selection rules and properly document each stage of the recruitment procedure.

Payment procedures

39. We recommend that the Central Office develop guidelines for the management of extra-budgetary items to ensure they are handled identically throughout the European School system.

40. We reiterate our recommendation from previous years that the Central Office and the Schools implement payment procedures more rigorously for all types of financial transactions, and ensure that all the necessary steps are taken to guarantee that the dual signature arrangement continues to apply until a valid alternative can be found.

41. We recommend that the Central Office clarify its guidelines to the Schools regarding provisional commitments to ensure that, from the start of the year, these commitments fully cover contracts and other obligations that run for the whole financial year.

This Report was adopted by Chamber V, headed by Mr Lazaros S. LAZAROU, Member of the Court of Auditors, in Luxembourg at its meeting of 21 November 2018.

For the Court of Auditors

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Klaus-Heiner LEHNE

President

__Annex__

Follow-up to the recommendations in our 2016 Annual Report

The following table provides information on follow-up to the recommendations in last year's Annual Report.

Our recommendations (paragraph 32 of the rReport on the accounts of the European Schools for the financial year 2016)	European Schools		Central Office	Comments
	Karlsruhe	Alicante		
	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	Implemented Yes/No/NA/in progress	
Recommendations on accounting issues				
The Court reiterates its recommendation from previous years that 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 requirements of accruals accounting under IPSAS and meeting the legal deadlines for issuing them.	In progress			Progress has been made in improving the quality of accounts, but weaknesses persist (see also paragraph 15).
Recommendations on staff issues				
The Schools should reduce the number of exceptions applied to the full selection procedure for the recruitment of administrative and ancillary staff and duly document and justify them.	In progress			Some progress has been made, but significant weaknesses remain (see also paragraphs 16 and 17).
Recommendations on procurement issues				
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	Yes			The procurement cell has developed guidelines and templates. The Schools can also use framework contracts from other public institutions (see also paragraph 18).

criteria and improve the documentation for the procedures, so that transparency and equal treatment are ensured.		
Recommendation on payment controls		
The Central Office and the Schools should implement payment procedures more rigorously for all types of financial transactions.	In progress	A link has been established between the accounting software and the payment system for all Schools. However, payments can still be introduced manually (see also paragraphs 19 and 20).

Schola Europaea / Office of the Secretary-General

2018-10-D-71-EN-1
Original.

REPLIES OF THE EUROPEAN SCHOOLS TO THE RECOMMENDATIONS OF THE COURT OF AUDITORS IN THE FRAMEWORK OF ITS ANNUAL REPORT FOR THE FINANCIAL YEAR 2017 (document of the Court "Preliminary observations with a view to a Report on the annual accounts of the European Schools for the financial year 2017").

Accounting

The OSG has issued procedures and guidelines on accounting procedures and organizes regular information and training sessions with the accountants of the schools. As a result, the overall quality of the accounts has improved and is prepared within the legal deadlines, as the Court points out in paragraphs 13 and 15. Efforts will continue in this direction in order to minimize weaknesses in the future. In particular, a project has been launched in October 2018 to review the existing chart of accounts and to produce an accounting manual, in order to support the continuous improvement of the quality of the financial statements produced by the Schools, in line with the requirements of the International Public Sector Accounting Standards (IPSASs).

The European Schools would like to underline that seven Schools were subject to an audit of their financial statements 2017 by an independent external auditor (Deloitte), performed in accordance with International Standards on Auditing. No material errors were found in any of these audits that could put into question that the accounts provided a true and fair view of the financial situation of the corresponding Schools.

Internal control systems

Recruitments procedures

The OSG takes good note of the Court's recommendations and express its commitment to continue efforts to ensure that staff selection rules are fully respected and that an appropriate documentation of the processes is kept.

Payments procedures

Concerning extra budgetary items, the OSG takes good note of the Court's recommendation and will prioritize this area in the future, taking also into consideration the results of the report of June 2018 resulting from the consulting engagement performed by the Internal Audit Service of the European Commission.

As per payment procedures are concerned, the absence of a double signature for payments for a period in the German schools can be explained by a misinterpretation of the instructions given by the OSG in those schools. When detected, the OSG immediately instructed the Directors and Deputy Directors for Finance and Administration of these schools to correct this abnormal situation. The double signature has been reinstated as a result. In this context it may be also underlined that as from November 2018 will go live the project where the profiles of all financial actors and related workflows have been revised and adjusted in the accounting software SAP, in order to fully meet segregation of duties as defined in the financial rules and principles in SAP including the centralization of the roles of the Authorizing Officer and Accounting Officer functions.

Regarding the management of provisional commitments, the OSG takes note of the Court's recommendation and will pursue efforts to improve in this area. The OSG notes that even though no irregularities have been detected in this domain, the improved management of commitments would further mitigate the risk of errors. Guidance was provided in 2016, in the framework of the meeting with the Deputy Directors for Finance and Administration, about how to correctly manage provisional commitments and, more generically, to help ensure full compliance with the requirements of Article 33 of the Financial Regulation of 2006 and Articles 32-34 of its Implementing Rules. The issue has been recently put to the attention of the Authorizing Officers at its meeting of October 2018. The OSG will review and adapt if necessary the mentioned guidance account taken of the recommendations of the Court.

In addition to the previous replies to the specific recommendations of the Court, the OSG would like to underline that it takes good note of the Court's comments and will continue efforts to ensure that the rules in the different areas are fully respected.

The OSG would also like to underline the overall improvement in the respect of rules, as compared to previous years' reports in terms of amount and the nature of the Court's remarks and recommendations. In particular, the OSG takes good note of the very positive comment from the Court on paragraph 18 to report that no any significant weaknesses were detected in procurement procedures completed in 2017. The Procurement cell and network intend to continue efforts to systematize the full respect of procurement rules.

The OSG notes that despite the recognized improvements, particularly in the area of procurement but also in the area of payments, the Court's conclusion related to internal control systems on paragraph 35 remains however unchanged in its 2017 provisional report.

Giancarlo MARCHEGGIANO
Secretary-general