

CERN/2841/Corr.  
CERN/FC/5338/Corr.  
Original: English  
11 June 2009

ORGANISATION EUROPÉENNE POUR LA RECHERCHE NUCLÉAIRE  
**CERN** EUROPEAN ORGANIZATION FOR NUCLEAR RESEARCH

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<i>Action to be taken</i>		<i>Voting Procedure</i>
TAKE NOTE	<b>FINANCE COMMITTEE</b> 325 <sup>th</sup> Meeting 17 June 2009	-
TAKE NOTE	<b>COUNCIL</b> 151 <sup>st</sup> Session 19 June 2009	-

**Report by the External Auditors  
on the accounts of CERN for the Financial Year 2008**

Report by Auditors from the Italian Court of Audit



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## 1. INTRODUCTION

The legal basis for the audit carried out by the External Auditors is given in the Financial Protocol annexed to the Convention for the establishment of a European Organization for Nuclear Research of 1 July 1953, as modified on 17 January 1971 and in the Financial Rules as approved by the Council (Rule 11 – Audit – and Annex II – Auditors -).

After the recent transition of the accounting and financial statements to IPSAS, the revision of the current rules governing CERN's financial administration (Financial Rules and Internal Financial Regulations) was approved by the Council on 12 December 2008.

This revision was recommended by the previous External Auditors and was completed after a long procedure in compliance with the conclusions of the Council Working Group on CERN Governance (CERN/FC/5228/Rev. – CERN/2777/Rev.) and of the Finance Committee Working Group on the Review of CERN Purchasing Policy and Procedures (CERN/FC/5259 - CERN/2797).

We have carried out the audit of the accounts for the Financial Year 2008 based on generally accepted international auditing standards and, in particular, on IPSAS regime.

We have planned the working activities according to our audit strategy to obtain a reasonable assurance that the Financial Statements are free from material misstatement.

We have tested, on a sample basis, a number of transactions and relevant documentation and we have obtained sufficient and reliable evidence in relation to the accounts and disclosures in the Financial Statements.

We have evaluated the new accounting principles and related estimates made by management and we have assessed the adequacy of the presentation of information in the Financial Statements.

Thus, we have obtained through the audit a sufficient basis for the opinion given below.

A Letter of Representation referring to the Accounts for the Financial Year 2008, signed by the Director of Administration and General Infrastructure and the Head of Finance and Procurement Department, was handed over and it is an integral part of the audit documentation.

2. AUDIT CERTIFICATE**AUDIT CERTIFICATE**

In accordance with Article 8 of the Financial Protocol annexed to the Convention, with Article 21 of CERN Financial Rules and with Article 21 of Regulations for the Implementation of CERN Financial Rules, and for approval by the Council, the report is presented to the Finance Committee to certify the correctness of the Financial Statements as follows:

“The Financial Statements of the Organization for the financial year ending 31 December 2008 have been examined in accordance with the instructions given to us. We have obtained all the information and explanations that we required and we certify, as result of the audit, that in our opinion the Financial Statements give a true and fair view of the state of affairs of the Organization, subject to the observations in our report”

f. y. ending 31 December 2008

Rome 22 May 2009

Bartolomeo Manna

Franco Franceschetti

External Auditors of the Italian Court of Audit

### 3. ENFORCEMENT OF IPSAS AND REVISED FINANCIAL RULES

#### 3.1 Implementation of IPSAS

In 2008 the implementation of IPSAS into the Financial Statements, which started in the year 2007, was consolidated thanks to the efforts of the Finance Department. It also follows the recommendation of the External Auditors who during the past years had consistently recommended the adoption of an accounting system compliant with IPSAS.

From the analysis of the annual accounts and following the interviews with the CERN management we concluded to the correct implementation of IPSAS 1, 2 and 3 regarding:

##### IPSAS 1): Presentation of the Financial Statements

The objective of this Standard is to prescribe the manner in which general purpose financial statements should be presented in order to ensure “Understandability, Relevance, Reliability and Comparability”.

The annual Accounts forming CERN Financial Statements are prepared and presented on the assumption that the Organization is a going concern and will continue in operation according to IPSAS.

##### IPSAS 2): Cash Flow Statements

A cash flow statement, by means of transparent information on cash inflows and cash outflows during the reporting period, has the objective to identify the ability of the Organization to generate cash flows in the future and to fund changes in the scope and nature of its activities. Moreover, this standard, foresees that the cash flow statement, when used in conjunction with other financial statements, provides information that enables users to evaluate the changes in net assets/equity of an entity, its financial structure including its liquidity and solvency.

Such a document, providing information on the historical cash flow variations classified by operating, investing and financing activities, is fully compliant with the rules.

IPSAS 3): Net surplus or deficit for the period, fundamental errors and changes in accounting policies.

The objective of this Standard is to enhance transparency and comparability of the Financial Statements by prescribing the classification, disclosure and accounting

treatment of certain items on a consistent basis, in such a way to illustrate the financial performance, disclosing separately extraordinary items.

The analysis of the implementation of other IPSAS is deferred to the paragraphs examining the Accounts of the Organization.

### 3.2 Revised Financial Rules and Regulations

As specified above, the revised CERN<sup>1</sup> Financial Rules and Regulations came into effect in December 2008.

Such a process of revision arose from the awareness of the necessity to update and improve the Financial Rules and Internal Financial Regulations and bring them into compliance with the conclusions of the CERN Working Groups, the IPSAS and the recommendations made by the Austrian External Auditors in their Reports.

Actually, some of the new Provisions simply implemented improvements already in use such as, for instance, the Statement of Comparison of Budget and Actual Amounts, provided in article 9 of the revised Financial Rules; the set up of CHIS Fund exclusively dedicated to CERN employees' (retired and active) health insurance scheme, provided in article 13; the option of having recourse to short-term loans to cover temporary cash exposure, provided in article 17.

## 4. BUDGET OUT-TURN 2008

The table "Statement of Comparison of Budget and Actual Amounts" is compliant with IPSAS 24 which requires a comparison of budget amounts and actual amounts arising from execution of the budget to be included in the Financial Statements. The Standard also requires disclosure of the reasons for material differences between budget and actual amounts.

### 4.1 Budget and actual Amounts

#### Total expenditure

In 2008 the difference between budget expenses (910,9 MCHF) and expenditure (892,8 MCHF) resulted in a reduction of 18,1 MCHF (-2%). In relation to this we

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<sup>1</sup> CERN/FC/5305 – CERN 2822 17 November 2008.



observed a decrease in Materials expenses and in the Debts<sup>2</sup> and an increase in the Personnel expenses.

As a matter of fact, comparing the 2008 total expenditure (892,8 MCHF) to the 2007 total expenditure (986,9 MCHF)<sup>3</sup> a reduction of 94,1 MCHF (9,5%) can also be obtained, due to a decrease in the expenses of Materials (79,6 MCHF), Personnel (11,4 MCHF) and Debts (3,1 MCHF).

With reference to the LHC Programme (324,7 MCHF), in 2008 the expenditures related to Personnel and Materials weighted 71,4% in the Financial Year Expenditure for all scientific programmes<sup>4</sup>.

#### Personnel expenditure

The Personnel expenditure amounted to 493,0 MCHF, with a decrease of 11,4 MCHF as compared with 2007. This can be explained by the fact that the total number of posts as at 31 December was reduced from 2.544 in 2007 to 2.400 in 2008, while the number of fellows, associates and apprentices increased to 9,7 units FTE. Details to Personnel expenses are given in the Financial Statements, Part II, note 21.

#### Total revenue

Total revenue amounted to 1.158,7 MCHF showing an increase of 3,7% as compared with the previous year end (1.117,5 MCHF in 2007). For the most part it consisted of Contributions from Member States (92,8%). Details of income are given in the Financial Statements, Part I, page 4.

### 4.2 Net Accounting Surplus

Total revenue minus total expenses led to a Budget Surplus of 265,9 MCHF. After deduction of 13,1 MCHF for capital repayment, 252,8 MCHF were allocated to the Budget Balance to reduce the accumulated budget deficit. Details are given in the Financial Statements, Part II, note 7.

2008 was the second year in which CERN had a Budget Surplus after a number of years of Deficit. This indicates a positive trend reversion compared to the past as shown in the table below:

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<sup>2</sup> Particularly in the interests on short-term loans, as stressed in 2008 Financial Statement Part I, note 4.

<sup>3</sup> Financial Statements for the year 2007 page 2, Total expenses :451.8 + 504.4 + 30.7 = 986.9 MCHF

<sup>4</sup> Refer to Financial Statements, Part I, note 1 table (b).

<i>Years</i>	<b>Budget</b>	<b>Results</b>
2005	-332,03	-323.62
2006	-183,90	-184.28
2007	105,10	130,60
2008	229,40	265,90

The accounting reconciliation followed the table “Statement of Comparison of Budget and Actual Amounts” and shows the transition from the Budget Surplus (265,9 MCHF) to the Net Accounting Surplus for the year 2008 (1.594,9 MCHF), by integrating in the first item those amounts, in surplus or deficit, not present in the Budget but recorded in the Financial Year 2008. The accounting reconciliation is given by expenditure transferred to fixed assets and variations of provisions.

#### 5. STRUCTURE OF THE ACCOUNTING STATEMENTS

The Financial Statements of CERN prepared and presented in compliance with IPSAS 1 included the following elements:

- A Statement of Financial Position, showing Current and Non-current assets and Current and Non-current liabilities;
- A Statement of Financial Performance, showing the Surplus/Deficit for the financial year;
- A Statement of Changes in Net Assets, showing the Net surplus or Deficit for the Financial Year including expenses and revenue directly recorded in Net credit without being transferred to the profit and loss;
- A Cash Flow Statement, showing the inflow and outflow of cash and cash equivalents, purposely regarding the operational, investments and financing transactions and the treasury totals at the end of the Financial Year;
- Notes providing information about accounting policies and additional information necessary for a fair presentation.

Note 1 to the Financial Statements described the implementation of the accounting principles.

## 6. STATEMENT OF FINANCIAL POSITION 2008

### 6.1 Assets

Assets - mostly consisting of non-current assets (98,5%) - totalled to 8.487,9 MCHF at the end of 2008, showing an increase of 22,9% as compared to 2007 (6.906,1 MCHF).

#### 6.1.1 Non-current Assets

Non-current assets as at 31 December 2008 amounted to 8.363,6 MCHF, showing an increase of 1.576,8 MCHF as compared to the end of 2007 (6.786,8 MCHF) (23,2%), mainly due to the capitalization of 2008 costs related to the completion of LHC<sup>5</sup>.

They included fixed assets (8.269,4 MCHF) and financial assets (94,2 MCHF).

##### a) Fixed assets (8.269,4 MCHF)

They comprised infrastructure and services buildings, PS consolidation, SPS consolidation and CNGS for an amount of 8.162,7 MCHF - corresponding to 98,7% of the fixed assets - plus fixed assets in progress amounting to 106,7 MCHF (1,3% of fixed assets)<sup>6</sup>.

As far as the LHC machine was concerned, it started its functioning on 10 September 2008 and it was recorded for 7.874,2 MCHF (95,2% of fixed assets) under fixed assets, in compliance with IPSAS.

As for the incident which occurred to LHC on 19 September 2008, an amount of 22,8 MCHF for repair in sector 3-4 and reconstruction of the spares inventory costs was allocated in the non-current liabilities - "Other Provisions".

As already clarified in the 2007 External Auditor's Report, starting from 2007, CERN has recorded as fixed assets all main complex assemblies relating to the construction of accelerators and auxiliary apparatus. Such assets were depreciated starting from the operating date (10 September 2008). This is compliant with IPSAS 17 which, though not prescribing a unit of measure for recognition, requires judgment when applying the recognition criteria to an entity's specific circumstances. This approach was evaluated "simple and adequate" to the Organization's requirements by the External Auditors in 2007.

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<sup>5</sup> Refer to note 3, Part II of the Financial Statements.

<sup>6</sup> Refer to note Financial Statements, Part II, note 3.5.

The 2008 format of the Statement of Financial Position, which was adopted for the first time in 2007, ensured the Understandability and Comparability of fixed assets data.

b) CHIS Fund (94,2 MCHF)

In December 2007 a capitalized fund for the Health Insurance Scheme was set up so as to tackle the issue of the aging of the insured population by means of a system of dedicated reserves. These reserves aim at guaranteeing employees and pensioners an insurance equivalent to Switzerland's Social Security<sup>7</sup>. This objective was also achieved thanks to the recommendations to implement IPSAS made by the External Auditors.

During the year 2007, reserves accumulated from preceding contributions were transferred to the capitalized fund. The full amount of the fund fluctuated depending on the investments' performance as well as on the ratio contributions/services and the management expenses.

In 2008 we observed a decrease of 2,1 MCHF in the Fund assets as compared to 2007; in fact, the financial performance suffered directly from last year's financial crisis.

The Fund financial assets amounted to 94,2 MCHF and consisted of equities, bonds, deposits and bank accounts, UNIQA deposits and credits stemming from taxation at source through anticipated deductions to be reimbursed. CHIS Fund had its exact counterpart in the liabilities and its net present value increased by debts for benefits/allowances paid during the previous financial year.

We retraced the corresponding entries and transition procedures for non-current assets accounts and we examined the bookkeeping entries of expenditure accounts and fixed assets accounts, including depreciations. We did not observe errors and the amounts recorded in the Financial Statement are thus verified and confirmed.

### 6.1.2 Current Assets

The total of inventories, receivables, cash and cash equivalents increased from 119,3 MCHF in 2007 to 124,2 MCHF in 2008 or by 4,2 %. A breakdown of Current assets is shown in the Financial Statements, Part II, notes 4 to 6; the basis for the evaluation of current assets is given in the Accounting Principles (Accounting Statements, Note 1).

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<sup>7</sup> Agreement between the Swiss Federal Council and CERN dated 11 June 1961 in CERN/115/Rev.3, 11 June 1961.

We observed that the item with the highest value recorded into the Current Assets was “cash and cash equivalent” totalling to 61,8 MCHF (equivalent to 49,8% of the current assets). It included all the balances of CERN banks current account as at 31 December 2008 and - for a non material amount (less than 0,01%) - cash CERN maintained for petty cash expenses.

We asked all the banks having a business relation with CERN to confirm the current accounts’ balance as at 31 December 2008 and we verified that they were properly recorded into the accounts. All variances detected have been explained and justified.

However, we found that the exchange rates for certain foreign currencies at the closing date used by CERN differed from those same currencies utilized by the Pension Fund and, what is more, in some cases they both differed from the Swiss National Bank’s official exchange rates. Since IPSAS have the objective to enhance, among other issues, Comparability of financial statements and considering the fact that the two Financial Statements are interrelated, we therefore recommend that, at the closing date, both CERN and PF use a foreign exchange rate generally world-wide accepted as official rates published by a public institution such as, for example, the Swiss National Bank, the European Central Bank, etc.

Current assets also comprised inventories amounting to 5,5 MCHF (around 4,4% of the Current Assets - gross value as at 31.12.2008 equal to 7,1 MCHF minus a depreciation of 1,6 MCHF). The low stock values were mainly due to the Store Management commitment to a policy of minimization of items in store through direct delivery to users. We carried out a physical stock-checking of a sample of items randomly selected by us. No major problems which can have an impact on the accounts at the closing date (31 12 2008) were identified. We traced that all the tested items were properly recorded into the Stores’ accounts.

Receivables, totalling to 56,9 MCHF (45,8% of the Current Assets value) corresponded to the amounts that Member States owed CERN as contributions (7,2% of current Assets) and for taxes paid by CERN to be refunded in consequence of CERN exemptions regime (16,1% of current Assets), and amounts owed by teams and collaborations (14,6% of current Assets).

In relation to the above mentioned receivables, on a sample basis, we asked direct confirmation of the amounts declared by CERN as due at the year-end. Some of the clients did not answer to our confirmation letters. In these cases, again on a sample basis, we checked the subsequent payment after the year-end closing and no major problems have been identified.

As already stated by the Austrian External Auditors in their 2007 Report “the heading 5.4 Other Receivables and Prepayments”, totalling 9,7 MCHF (equivalent to 7.8% of the Amount of the Current Assets) includes an amount of 2,5 MCHF committed to the costs of repair of the inner triplet magnet to be invoiced to Fermilab in 2008. There is no sufficient evidence that the amount was notified to and agreed by the debtor”. In the Financial Statements CERN Management also declared that “negotiations are in progress for in-kind contributions from Fermilab to the LHC Improvement Project. Accordingly, as at 31 December 2008, CERN has continued to record this amount in its entirety”. We thus confirm the Austrian Court of Audit recommendation, i.e. the amount to be received by the Organization has to be adequately supported by an agreement between the parties.

## 6.2 Liabilities and Net Assets

### 6.2.1 Net Assets

This heading corresponded to the difference between liabilities and assets and it included contributed capital, accumulated surpluses - or deficits - and reserves, as shown in the Statement of Changes in Net Assets<sup>8</sup>.

### 6.2.2 Non-current liabilities

This heading included long term debts, contributions in advance from Member States, liabilities against a capitalized fund for the CERN Health Insurance Scheme (CHIS) and provisions covering obligations of uncertain amount and timing mainly related to post-employment benefits.

- a) In 2008 total long-term debts decreased to 451,9 MCHF from 664,9 MCHF in 2007 (-32%) and included FORTIS BANK and FIPOI bank loans. The remaining part of the EIB loan, amounting to 200 MCHF, will be repaid during 2009.
- b) Liabilities against Member States and special contributions: in 2008 liabilities against the Swiss Confederation for an advance on its contributions were settled, while special contributions based on loans received from Member States slightly increased as compared to 2007.
- c) Post-employment benefits corresponded to<sup>9</sup> the estimated liability of defined-benefit plans for pension benefits and post-employment Health Insurance Scheme benefits

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<sup>8</sup> Financial Statements, Part II, page 23

<sup>9</sup> According to IPSAS 25, in force as of 28 February 2008.

towards active employees and retired members of CERN as at the reporting date<sup>10</sup>. The provision for post-employment benefits is based on the calculation of the present value of defined-benefit obligations, backed up by actuarial expertises. The following table shows the trend from 2006.

in MCHF			
<b>Post-employment benefits</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>
Pension benefits	1.523,9	829,7	2.397,6
HIS Benefits	1.474,3	1.214,9	1.438,7
Net Liabilities	2.998,2	2.044,6	3.836,3

In 2008 we observed an increase in the liabilities, as compared to 2007, linked to the discount rate reduction from 3,34% in 2007 to 2,59% in 2008 and to the decrease of both funds' assets by reason of the effects of the financial crisis.

We analyzed the two actuarial reports and we verified that the actuarial estimates were correctly reflected into the accounts. In line with the external auditors' 2007 Report, we validate the practice of performing the actuarial reviews on a yearly basis. We expect this review to be performed, as stated, annually and we shall monitor the state of works in the future (refer to annex I).

Other provisions We verified the supporting documents for the estimates of the radioactive waste management and the repair of the LHC sector 3-4. With reference to other provisions not recognized in the Financial Statements, such as dismantling costs already pointed out by our predecessors, we would like to draw the Management's attention to the fact that dismantling of equipment would probably generate very significant costs in the future.

### 6.2.3 Current liabilities

The statement of liabilities and the corresponding notes were examined on the basis of supporting documentation concerning the underlying transactions. The total amount under this heading stood at 1.041,2 MCHF as at 31 December 2008, representing an increase of 1,1 MCHF as compared to 2007 (1.040,1 MCHF).

- a) The total of short-term debt and bank overdrafts referred to long-term debts falling due next year (214,8 MCHF) added to short term borrowings from banks (411,3 MCHF). It

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<sup>10</sup> Refer to Financial Statement, Part II, note 11, table a).

reflected the tight financial situation of the Organization at the year-end. As most of the borrowings are normally repaid within a few months, this put an emphasis on the importance of timely payments of Member States' contributions.

- b) Other liabilities referred to suppliers (42,1 MCHF), advances received from teams and collaborations (139,8 MCHF) and accruals of employee benefits from paid leaves and termination allowances (171,3 MCHF); the latter stood for the estimates concerning the accumulated present value of CERN liability towards its staff. Deferred revenues (60,2 MCHF) referred to advances to be further recognized as revenue.

We did not observe errors and the amounts recorded are thus verified and confirmed.



## 7. STATEMENT OF FINANCIAL PERFORMANCE 2008

This Statement showed the Organization's operating and financial revenue and expenses classified, disclosed and presented on a consistent basis in order to explain the year's net deficit or surplus<sup>11</sup>.

- a) Total operating revenue amounted to 2.901,9 MCHF with a significant increase as compared to 2007 (1.608,8 MCHF), mainly owing to "Transfers to the Fixed Assets" related to LHC. It is important to remind that this item does not represent a "pure" revenue, but it is to be regarded as suspended costs capitalized the same as assets<sup>12</sup>.
- b) Total operating expenses amounted to 1.278,0 MCHF with an increase of 31,6% as compared to the previous year, explained by the first depreciation allowance for the LHC and by the provision variation relating the removal of radioactive waste. Besides, we observed a decrease in the Personnel expenses as a result of the reduction of 144 units, although counterbalanced by an increase of 9,7 FTE units among fellows, associates and apprentices<sup>13</sup>.
- c) Net surplus from operating activities totalled to 1.624,0 MCHF as compared to 637,9 MCHF in 2007.
- d) Financial activities showed a deficit amounting to 29,1 MCHF, not so differently from 2007. In fact, detailed data showed a decrease both in revenue and expenses, as shown in the Financial Statements, Part II, note 22.

We verified the sums paid by CERN to FORTIS related to the year 2008 and we traced the operations into the Accounts.

- e) The net surplus for the year 2008 was 1.594,9 MCHF and it presented a significant increase as compared to 2007 (608,6 MCHF), primarily attributable to the capitalization of fixed assets.

We examined the composition of the Statement of Financial Performance based on the balance and consolidation of corresponding annual accounts and, also throughout interviews in the Accounting Department, we did not detect any extraordinary

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<sup>11</sup> IPSAS 1: "As a minimum, the face of the statement of financial performance should include line items which present the following amounts: revenue, surplus or deficit from operating activities, financial costs and extraordinary items. Net surplus or deficit for the period."

<sup>12</sup> A detailed analysis of all operating revenue is in the Financial Statement, Part II, notes 16 to 19.

<sup>13</sup> Refer to Financial Statement, Part II, notes 20 and 21.

operations. We thus certify the amounts recorded in the Financial Statements and the relevant net surplus for the period 2008.

8. STATEMENT OF CHANGES IN NET ASSETS 2008

Differing from 2007, when IPSAS had been introduced originating adjustments in accounting policies and revaluation, in 2008 the changes in the net assets (269,5 MCHF) resulted from the recognition of the expenses directly recorded in the net assets (1.864,3 MCHF - accruals for shift-work compensation, variations due to actuarial estimates regarding health care and pensions) and 1.594,9 MCHF which was the Net surplus for the period.

As far as the accounting reconciliation was concerned, we found that the entries were properly backed-up by supporting documentation and correctly settled into the corresponding accounts.

9. CASH FLOW STATEMENT 2008

The cash flow statement identified the sources of cash inflows, the items on which cash was spent during the reporting period, and the cash balance as at the reporting date. In 2008 the Organization reported cash flows from operating activities using the direct method, i.e. whereby major classes of gross cash receipts and gross cash payments were disclosed. Net cash-flows from operating activities showed a surplus from receipts and payments amounting to 550,1 MCHF. Net cash flows from investing activities, which included personnel and materials expenditure and the CHIS Fund capitalization (see paragraph 6.1.1), added up to 261,3 MCHF. Net cash flows from financing activities accounted for 251,1 MCHF. In consequence, the net increase in cash and cash equivalents was 37,8 MCHF; adding cash and cash equivalents at the beginning of period (24,1 MCHF) led to cash and cash equivalents amounting to 61,8 MCHF as at 31 December 2008.

We checked the underlying entries by selecting samples from some accounts. The result was that all transactions chosen were properly backed-up by supporting documentation. The Cash Flow Statement is thus verified and confirmed.

10. FOLLOW UP OF THE EXTERNAL ASSESSMENT OF THE ORGANIZATION'S INTERNAL AUDIT FUNCTION

In their 2007 Report (CERN/FC/5246), the Austrian Court of Audit made, according to the IIA Standards (Standard 1312) an external quality assessment of the Organization's Internal Audit (IA) function, based on an internal self assessment performed by the IA service.

In order to assess whether the conclusions reached by the Austrian Court of Audit were still applicable for 2008, we performed a follow-up of the data analysis, indicators used in last year's External Quality assessment report and the related recommendations.

While the data analysis performed by the external auditors for the year 2007 included quantitative and qualitative elements, showing a very good rate of compliance with the IIA Standards, the indicators on which the external auditors based their analysis for 2007 were more "quantitative" rather than "qualitative", mostly owing to the fact that agreeing on general common qualitative indicators it was quite a complex matter.

Last year, quantitative indicators used by the External Auditors were:

- a. The ratio between number of auditors and CERN budget (refer to § 10.3a CERN/FC/5246);
- b. The ratio between number of auditors and the number of staff members at year-end (refer to § 10.3a CERN/FC/5246);
- c. The comparison with the past years based on the number of Full Time Equivalent (FTE) working at the IA Service (refer to § 10.4 CERN/FC/5246);
- d. The number of audit Reports, related recommendations and audit Certificate for EU funded projects issued during a reference year (refer to § 10.4 CERN/FC/5246);
- e. The average audit duration from starting date to presentation and the average number of man-days per audit (refer to § 10.4 CERN/FC/5246);

Compared to last year's figures, one of the most significant indicators is represented by the FTE value (see point c), which lowered to 2,7 FTEs (see also ANNEX 1) from a value of 3,5 FTEs (as reported by the External Auditors in § 10.4 CERN/FC/5246) registered in 2007, due to the departure of the Head of Internal Audit in August 2008.

The IA Service was able to limit the impact of this departure and this is confirmed by the fact that in 2008 the completion rate of the IA Audit Plan was around 85%, compared with the 75% reached in 2007.

In May 2009 – at the time of our reporting - the IA Service is still composed of only 2 auditors (1 joined in January 2009, 1 left in March 2009). A third auditor, with a professional internal auditor certification, has been recruited as of July 2009, which will bring the staffing level to 3 FTEs then.

As regards the indicators stated in the above-mentioned points a) and b), it is worth mentioning that these indicators, too, are influenced by the staffing level and, in particular, by the lowering of the FTE ratio in 2008. Consequently, on 31.12.2008 the Organization had one internal auditor for 570 MCHF of budget and one auditor for 1200 staff members.

In order not to further impact the Service' capabilities and strategic role, we recommend to maintain the staffing level to a minimum of 3 experienced and professional auditors, also so as to minimize further disruption in case of departure. In case Internal Audit should be in charge again of internal auditing activity on the Pension Fund, after having been discharged in February 2008, we recommend that its staffing level could be further increased according to the audit risks which will be identified.

As for quantitative indicators stated in the above-mentioned points d) and e), even though the number of Reports decreased from 9 to 6 - a fact that could point to reduced performance - a further analysis of this indicator, jointly with other indicators such as the average man-days per audit (which decreased from 67 in 2006, to 37 in 2007 and to 27 in 2008) and the historical series of number of Reports issued (5 in 2005, 4 in 2006, 9 in 2007, 6 in 2008), actually showed that the number of reports issued remains comparable with that of the past years.

Furthermore, it is worth mentioning that it is not simple to compare other quantitative indicators, such as the number of audit recommendations issued, also because of their implicit qualitative nature which cannot be easily measured. A raw qualitative indicator that can be possibly used in this sense, it is the percentage of recommendations agreed

and implemented by the Management. As a general rule, qualitative indicators should be carefully analyzed as part of the complete set of performance data available.

For instance, last year the percentage of agreed recommendations showed an increase: from 45% in 2007 to more than 95% in 2008.

We therefore support the renewed priority and higher attention given by Internal Audit and top Management to the follow up of internal audit recommendations and we recommend that Internal Audit performs the follow up of their recommendations and the status of their implementation by the Management at least on an annual basis (see also ANNEX 1).

The follow-up of the recommendations issued by the Austrian Court of Audit in their 2007 Report (see paragraph 10.6) is presented in ANNEX 1. Based on our analysis, we have come to the same conclusion expressed by our predecessors (see paragraph 10.6).

We also share last year's view of the Austrian Court of Audit that the Internal Audit "has provided the necessary support to the CERN Audit Committee and the External Auditors in conducting their mandate" and that "IA has provided [the External Auditors] with technical help with CERN specific systems and tools and ensured that requests for information were met by the Organization".

IA's main role is to provide an independent assurance and consulting to the Director-General, and indirectly to Council, on the risk management, control and governance processes of the Organization. Beyond the support and technical help that IA provides to them, full and free access by IA to the External Auditors and the CERN Audit Committee is an additional guarantee of Internal Audit's independence.

## 11. FOLLOW UP OF RECOMMENDATIONS 2003 - 2007

Following the request of the Council regarding the examination and adoption of the external auditors' past recommendations, we have reviewed the External Auditors Reports of the Austrian Court of Audit for the period of time from 2003 to 2007<sup>14</sup> and the corresponding comments by the Management<sup>15</sup>.

In Annex 1 are listed only two categories of recommendations:

- a) the recommendations that are still pending (not considered as completed by the Austrian Court of Audit and by us);
- b) the recommendations considered by the Austrian Court of Audit as "pending" but considered as completed by us.

The recommendations already considered as closed by the Austrian Court of Audit in their 2007 Report have not been inserted in the Annex again.

In addition, Annex 1, also includes the comments received from CERN Management at the time of the issuance of the corresponding Report and the latest status on actions taken by Management.

It is worthwhile mentioning that the majority of the Austrian's recommendations were completed therefore we have appreciated the willingness and interest of the Management to improve the effectiveness and efficiency of financial and administrative matters.

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<sup>14</sup>See CERN/2559 - CERN/FC/4810, CERN/2609 - CERN/FC/4923, CERN/2668 - CERN/FC/5043, CERN/2721 - CERN/FC/5140, CERN/2788 - CERN/FC/5246.

<sup>15</sup> See CERN/2560 - CERN/FC/4811, CERN/2610 - CERN/FC/4924, CERN/2669 - CERN/FC/5044, CERN/2722 - CERN/FC/5141.

**ANNEX 1**

<b>Report</b>	<b>Recommendation raised By Austrian Court of Audit</b>	<b>Comments received from CERN Management at the time of the issuance of the report</b>	<b>Status on actions taken by Management as reported by Austrian Court of Audit</b>	<b>Status on actions taken by Management as evaluated by Italian Court of Audit</b>
2003	<p><b>Debtors</b></p> <p>a) With reference to outstanding Member State contributions of 50,8 MCHF at the end of 2003, the External Auditors encouraged the Management to discuss more effective alternatives – such as charging interest on late payment – to ensure payment in time.</p>	<p>The Management intends to make a proposal later this year for a change in the Financial rules with respect to charging interest on outstanding contributions from Member States. The proposal of the Management will be to charge interest on the outstanding balances some six weeks after the due dates in February and June of each year. (2003)</p> <p>The Management pointed out that the incidence of payment of contributions on time has improved and was less 56% 2004 compared to 2003. (2004)</p>	<p>Pending - The revised Financial Rules will be submitted to the Governing Bodies in 2008. However, as the payment discipline has improved, it could well be that the rule on charging interest for late payments will remain unchanged.</p> <p>It has to be noted that interest has been charged to Member States in 2004, 2005 and 2008.</p>	<p>Completed- Revised Financial Rules approved in December 2008 in article 10 provides: “CERN shall be authorized to charge interest and contribution arrears”.</p>

Report	Recommendation raised By Austrian Court of Audit	Comments received from CERN Management at the time of the issuance of the report	Status on actions taken by Management as reported by Austrian Court of Audit	Status on actions taken by Management as evaluated by Italian Court of Audit
2004	<p><b><u>Human Resources Management</u></b></p> <p>a) Associated Members of the Personnel: The External Auditors recommended that the personnel administration for visiting scientists, engineers and students and the Users' office should be consolidated.</p> <p>b) Social &amp; Statutory Conditions: (...)</p>	<p>a) Concerning the consolidation of the personnel administration, including the Users Office, this will be included in a study within the framework of the manpower review. (2004)</p> <p>b) (...)</p>	<p>a) Currently Management does not identify sufficient savings' opportunities to envisage a consolidation of the personnel administration performed by the Users Office with the services in Human Resources Department.</p> <p>b) Completed –</p>	a) Pending



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2005 2006 2007 (see § 3.4)	<p><b><u>General Accounting Policy, Financial Rules and Regulations</u></b></p> <p>The External Auditors recommended reviewing and revising the Financial Rules and Internal Financial Regulations starting with instructions for particular subjects as funding policy, liquidity management and foreign exchange transactions.</p>	<p>The Management agreed that it would be desirable to modernize the Financial Rules and Regulations as soon as resources permit. (2005)</p> <p>The Management acknowledged that the Financial Rules and Regulations will have to be updated to take into account current practice and the adoption of the IPSAS standards. A revised version for approval by the Council in 2008 at the latest will be prepared. (2006)</p>	<p>Ongoing - Management is currently revising the Financial Rules. A proposal will be submitted to the Finance Committee and Council in the second half of 2008.</p>	<p>Completed- Revised Financial Rules approved in December 2008</p>

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2006	<p><b><u>Funds and Reserves</u></b> Other Reserves (CHIS):</p> <p>a) The External Auditors recommended to consider the assignment of the health insurance scheme to the insurance company in full.</p> <p>b) (...)</p>	<p>a) The Management will issue a new market survey to evaluate the possibility of a complete outsourcing of the insurance risk. (2006)</p> <p>b) (...)</p>	<p>a) Ongoing - A market survey should be launched in 2008.</p> <p>b) Completed.</p>	Ongoing
2006 2007 (see § 6.2.2 lit.c)	<p><b><u>Long-term debts</u></b></p> <p>c) ppbar contributions: the External Auditors recommended entering into negotiations with the Member States concerned to write-off the outstanding amounts.</p>	The Management accepted the recommendation and will take the necessary steps.	Pending - It has been decided to defer action until 2010.	Pending - It has been decided to defer action until 2010.

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2007 (see § 6.1.2)	<p><b><u>Other Receivables</u></b></p> <p>The heading “5.4 Other Receivables and Prepayments” includes an amount of 2.49 MCHF committed for the repair of the inner triplet magnet to be invoiced to Fermilab in 2008. There is no sufficient evidence that the amount was notified to and agreed by the debtor. The External Auditors recommend that the amount to be received by the Organization is adequately supported by an agreement between the parties.</p>			<p>Pending – as reported in the Financial Statements 2008 in Note 5 page 37 § 5.4 “ (...) Negotiations are in progress for in-kind contributions from Fermilab to the LHC Improvement Project. Accordingly, as at 31 December 2008, CERN has continued to record this amount in its entirety.”</p>

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2007 (see § 6.2.2 lit.e)	<p><b><u>Post-employment Benefits</u></b></p> <p>To ensure the best estimate of the expenditure required for a rational settlement of the present obligation at the reporting date, we recommend to ensure to draw up the actuarial reviews on a yearly basis.</p>			<p>Completed for 2008.</p> <p>In financial year 2008 an actuarial review was drawn up by an independent actuarial. In line with the Austrian recommendation, we recommend to “draw up the actuarial reviews on a yearly basis.</p>

Report	Recommendation raised By Austrian Court of Audit	Comments received from CERN Management at the time of the issuance of the report	Status on actions taken by Management as reported by Austrian Court of Audit	Status on actions taken by Management as evaluated by Italian Court of Audit
2007 (see § 10.5)	<p><b>Internal Audit</b></p> <p>“Based on the issued reports we found that the Internal Audit Service possesses a team of experienced, motivated and professional auditors. All auditors are certified. <i>However the high level of audit work will be more difficult to maintain with only 3 FTE compared to 6 FTE previously. By consequence, any staff departure would have a major impact on the Service’s capabilities.</i>”</p>			<p>Pending- The FTE value (see point c), which lowered to 2.7 FTEs (see also ANNEX 1) from a value of 3.5 FTEs (as reported by the External Auditors in § 10.4 CERN/FC/5246) registered in 2007, due to the departure of the Head of Internal Audit in August 2008.</p> <p>The IA Service was able to limit the impact of this departure and this is shown by the fact that in 2008 the completion rate of the IA Audit Plan was around 85%, compared with the 75% reached in 2007.</p> <p>Still, in May 2009, the IA Service is composed of 2 auditors only (1 joined in January 2009, 1 left in March 2009). A third auditor, with a professional internal auditor certification, has been recruited as of July 2009, which will bring the staffing level to 3 FTEs then.</p> <p>As regards the indicators stated in point a) and b) above mentioned, it is worthwhile mentioning that also these indicators are influenced by the staffing level and, in particular by the lowering of the FTE ratio in 2008. Consequently, on 31.12.2008 the Organization had one internal auditor for 570 MCHF of budget and one auditor for 1200 staff members.</p> <p>In order not to further impact the Service’ capabilities and strategic role, we recommend to maintain the staffing level to a minimum of 3 experienced and professional auditors, and to minimize further disruption in case of departure. In case Internal Audit should be in charge again of internal auditing at the Pension Fund, after having being discharged in February 2008, we recommend that its staffing level should be further increased according to the audit risks that will be identified.</p>

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2007 (see § 10.5)	<p><b><u>Internal Audit</u></b></p> <p>With reference to the Standards we noted that actually there is no full compliance with respect to the following:</p> <p><b>a)Standard 1130.A2</b>  <i>“Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.”</i></p> <p>Engagements performed by the Head of IA are not reviewed by a party outside. We understand that it is difficult to comply with this standard in a small structure and therefore we agree with the suggestion of the Head of IA to compensate this weakness by the current control in place requiring a peer review.</p>			Ongoing – As long as Internal Audit is not involved in operational tasks, the risk of impaired independence and objectivity during audits of such activities is minimal. However, in case Internal Audit should be, on an exceptional basis, involved in operational tasks, appropriate disclosure ought to be made and an oversight by an external party foreseen on related assurance engagements.

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2007 (see § 10.5)	<p><b><u>Internal Audit</u></b>                      With reference to the Standards we noted that actually there is no full compliance with respect to the following: <b>b) Standard 2110.A1</b>  <i>“The internal audit activity should monitor and evaluate the effectiveness of the Organization’s risk management system.”</i>                      We observe that an Organizational risk management system is currently in the process of being implemented. However, it is too early to be independently assessed by the IA. The first Organizational wide risk management exercise has been performed in the second and third quarters of 2007 and all departments have communicated their departmental risks registers to the Director-General. More than a 1,000 risk have been identified within the departments and were analyzed by IA. Doing so the highest risks were predominantly detected related to safety and security and the aging and consolidation of the Organization’s infrastructure and equipment.                      We appreciate that specific assistance has been provided by IA for the implementation of the Organization’s risk management system and we encourage IA to continue supporting activity for a timely completion of the risk register.</p>			<p>Ongoing- It is worth mentioning that a full-fledged risk management system is not in place yet. We welcome the efforts of the Management in implementing a Risk Register. As long as there is no risk management in place, IA can not assess it.                      However, being aware that IA is providing active assistance in designing a strategy for risk management, with reference to the above listed recommendation and due to the fact that sometimes there is little margin between consultancy and operational task, we recommend IA to preserve their independence and objectivity by disclosing cases of potential impairment.</p>

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2007 (see § 10.5)	<p><b><u>Internal Audit</u></b></p> <p>With reference to the Standards we noted that actually there is no full compliance with respect to the following: <b><u>c) Standard 2500.A1</u></b> “The chief audit executive should establish a follow up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.” We noted that Internal Audit does not monitor and ensure if management actions have been effectively implemented and what is their status. By not monitoring the status of the action plans agreed by the departments, there is a risk that actions are actually not taken. To cover this weakness, IA has started to engage in a systematic process of monitoring on the status of all recommendations issued since 2004 starting in the second semester of 2007. In consequence of this action, the status on all 199 observations and recommendations will be obtained and the results communicated to the Director-General. We recommend the timely implementation of a systematic follow up of the management action plans outlined in the IA reports. We encourage Internal Audit to commensurate the procedure of audit follow up as foreseen in the Internal Audit Manual.</p>			<p>Completed- IA issued a specific Report on Follow-up of their past recommendations in September 2008.</p> <p>We support the renewed priority and higher attention given by Internal Audit and top Management to the follow up of audit recommendations and we recommend that Internal Audit would perform the follow up of their recommendations at least on an annual basis.</p>