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Making the Most of External Consultants

Thank you, Chairperson, for giving me the opportunity to speak to such a named circle of science administrators here in this pleasant venue at a most well organized workshop. Let me express my hope that this series of workshops will go on from its beginning in Paris via Beijing, Dublin, Bonn and The Hague to (Washington?) – but this already tackles the next item on our agenda, and I am expected to stay with mine.

To give you the very last presentation in a long row of outstanding ones during this workshop makes me rather nervous. It is like being the seventh husband of Zsa Zsa Gabor in the wedding night: It is absolutely clear, what I am expected to do; but the question is: How can I do it differently?

Should I start by changing the headline of my presentation? It might read better:

“Value for Money”.

This is a headline external professional consultants like to use; it sounds like a word of a real Yedi Knight in a Star Wars story, while the title in our agenda has that Sith-Lord language-style public officials tend to use.

I might try to act like an external consultant for the next hour and tell you about the simple and secure way how to get value for money from external consultants – and hide from you, that I am indeed still struggling to find such way.

But sorry, I am afraid I would not get along well with that. So please let me be what I am: A financial officer having his good and bad experiences with external consultants; and let me share a few of these experiences with you.

I would like to do this in three steps:

Step one is to give you an overview over the German public procurement law, because it rules the awarding of contracts to external consultants by the DFG, too.

Step two is to depict the role of the certified public accountants auditing the annual accounts of DFG, because the CPAs are our by far most important external consultants and distinguish them from other players like the tax authorities, the auditing courts of the federation and the states, the internal auditors and our the statutory auditors.

Step three will be to give you an outright look at a case at DFG, that is not closed yet: The Federal Auditing Court in a report from the year 2000 really has proposed to abolish the annual audit of the DFG accounts by CPAs! That case study will tie up all the loose ends I will have produced by then. Even though my last name is Kuhn and not Altman, I hope the short cuts I will have lead you through will at least then make sense to you. So, please, try to stay with me until the end of this presentation!

German Public Procurement Law as applied by the DFG:

Sec. 55 of the German Federal Budget Code says: “The conclusion of contracts for supplies and services shall be preceded by a public invitation to tender, unless the nature of the transaction or special circumstances justify an exception. Contracts shall be governed by uniform guidelines.” The budget codes of all 16 states have identical clauses. These clauses are binding for every public authority except for the local authorities and contracting with external consultants is within their scope.

But: The DFG is not a public law body. You have probably heard this before, because DFG-staff try to mention this everywhere and anytime: The DFG is an association under civil law. So, looking at it just from our legal status, we do not have to fulfill German public procurement law requirements. But as you all know: Who pays the piper, calls the tune ... The DFG is almost completely financed by the federation and the 16 states; less than 1 % of our 2006 budget of almost 1.6 billion € comes from private sources. Within the annual budget that we call “Wirtschaftsplan” the federation and the states impose on us a set of special budgetary rules, so called “Bewirtschaftungsgrundsätze”.

Budgetary rule no. 10 of the DFG-Wirtschaftsplan reads: The procurement of supplies or services – except building contracts - is ruled by the **DFG’s procurement guidelines**, that require the consent of the federation and the states.

It is already at this relative clause, where the gap between rule and reality appears: Such procurement guidelines do exist at DFG, but neither have I ever asked the federation and the states for such consent nor have I found such consent in our files. Instead of seeking formal prior consent, DFG just closely follows the respective up-to-date public procurement regulations and everybody is pleased and quiet.

The DFG- procurement guidelines provide us with two different sets of rules and regulations, one set for the procurement of scientific instruments which we do not only finance, but generally buy for our grantees, and the other set for supplies and services procured by the DFG’s office. The latter set makes a rather simple reference as a whole to the “Verdingungsordnung für Leistungen”, abbreviated as “**VOL/ A**” the official contracting terms for award of service performance contracts entered by public authorities. This VOL /A basically has the legal quality of an administrative guideline, not of a law or a statutory order. It dates back to the year 1921, so it is 85 years old and still going strong! Following a resolution of the “Reichstag”, the former German parliament, a procurement committee was nominated including representatives of the big trade and industry associations. This committee then made a draft that until today is the backbone of German procurement law.

To these basic rules some regulations were added to transform EC-guidelines on procurement - namely guidelines 93/36 of June 14, 1993 and 92/50 of June 18, 1992 - into national law – with parts of the EC-guidelines themselves matched to the procurement agreement of the World Trade Organisation. These EC-based regulations are often called “**a- sections**” because they have been simply put into the existing text behind each relevant section; for example: as sec. 3 of the VOL / A rules the ways of procurement, sec. 3 a rules the ways of procurement within the scope of the EC-guideline.

The EC-based a-sections in the VOL / A together with the fourth part of the German Gesetz gegen Wettbewerbsbeschränkungen, the law against restraints on competition, have a legal quality different from the “traditional” sections of the VOL / A: The a-sections act not only as internal guidelines for the public authorities, but as claim-basis for a special litigation of competitors against the public authority who made the procurement. The distinction between the field of the traditional sections and the a-sections is drawn by **threshold values** for several types of procurement defined in a statutory order on tender, the **Vergabeverordnung**. The threshold value for services is fixed at 200.000 € or, if the tender is made by a federal ministry, 130.000 €.

I have mentioned the gap between rules and reality above. Here is another proof: In 1993 for **services rendered by freelancers** like attorneys, tax consultants or certified public accountants special official contracting terms for awarding of service performance contracts entered by public authorities were put into force. Transforming EC-guidelines into national law, the Verdingungsordnung für freiberufliche Leistungen, VOF. The DFG follows these terms, even though until today they are not mentioned in the DFG procurement guidelines.

Now, what do these procurement rules ask us to do?

I will spare you the manifold procedural rules. Instead, I will only refer to the basic material content and even leave aside the rather different wording and the slightly different details in the EC-level-a-sections. The general principle of all these procurement rules is, that the conclusion of contracts for supplies and services shall be preceded by an **invitation to tender open to the public**. Such public invitation is usually made by detailed announcement in newspapers asking for formalized offers. For supplies and services above the threshold values the EC-based a-sections ask for an announcement in a supplement of the official gazette of the EC. In any way, the procedure is both time-consuming and complicated. Offers coming in within the set time-limit are opened and compared on criteria named before in the public invitation. The contract will be awarded to the most economical offer, which is not in any case the cheapest. The complete reasoning for the awarding decision has to be documented in the files.

Things are only slightly easier, if a **limited invitation to tender** is allowed: In this case no public announcement has to be made. Instead, one has to find a number of possible suppliers – in praxi not less than three, on the EC-level not less than five, but sometimes well above a dozen - and ask them to make an offer.

The subsequent decision-taking-procedure is almost the same for open and limited invitations to tender. The only element of this procedure I want to mention is the strict interdiction of any negotiation after the tenders are formally received and opened. Even for the little facilitation a limited invitation gives, one of a closed list of preconditions has to be documented, e.g. that a preceding public invitation to tender has had no economically sound outcome or that a case of special urgency or necessity for secrecy is given or that there is a disproportion between the cost of a public invitation to tender and the possible benefit or the value of the supply or service.

It has to be mentioned as a trace of wisdom, that the VOF generally only requires a limited invitation to tender for services rendered by freelancers – or could you e.g. imagine an open call for legal help by DFG? Flocks of poor and underworked lawyers would respond

Even stricter preconditions have to be fulfilled for a **single tender action**, Such single tender action is just the way a reasonable man buys goods or services: You manage to get some information on what you have to buy and who is offering it at sound conditions and then you start negotiating with two or three and finally you buy, no big procedural requirements. Obviously too simple for public authorities, so it must be almost forbidden. Hence, the closed list of preconditions for single tender actions is extremely restrictive, e.g. if intellectual property rights on the supply or service are with only one company or if for whatever other reason it is absolutely clear that only one company can deliver or if a repeat order not above 20% of the volume of the foregoing order has to be made. Fortunately, there is a petty-sum provision as well: The ministries of the federation and the states are empowered to fix a bagatelle-amount up to which a single tender action is allowed without any further justification. For the Bundesministerium für Bildung und Forschung, the federal ministry of Education and Research, the bagatelle-amount for single tender actions is fixed at 8,000 € plus VAT. So it is fixed at the same amount in the DFG procurement guidelines – without the formal consent of the federation and the states, as I have already mentioned above.

At this point, let me express my personal opinion on the rules I have just described to you: In my former job at the Northrhine-Westphalian ministry of finance I learned that the public procurement law is not within the competence of the ministries of finance, but of the ministries of trade and industry. A well-experienced colleague then explained to me, why: Because, opposite to its wording, German procurement law is deemed more to support small and medium enterprises than to guarantee, that public authorities get value for money! I have already given you the proof for that: The strict interdiction of any negotiation after the tenders are formally received and opened is precisely not what any reasonable man would do. If e.g. you were going to renovate your bathroom at home, wouldn't you ask a few craftsmen for offers and re-negotiate the offer of the best craftsman by showing him the cheapest offer of his respective competitors? Furthermore, by adjusting the criteria of an invitation to tender it is almost always possible to conclude the contract with the partner you had in mind before.

To come to an end with this first step, let me summarize: DFG is not free to hire external consultants, but has to follow German public procurement law. DFG tries to do this "British" – reasonable and with a skeptical approach.

If a remuneration below 8,000 € is expected, we just hire the external consultant we trust most. If the remuneration is expected to be higher, we are to check, whether the service we need is one offered by freelancers or by commercial enterprises. Services of lawyers, tax consultants and cpas are freelance, but e.g. some IT-consultants services are commercial. The distinction has to be made by the criteria of the sec. 15 and 18 of the Einkommensteuergesetz, the German law on income tax. Simplified one can say, that freelancers need a university degree for their profession.

If the services are freelancer's ones, we still are allowed to hire the consultants of our choice as long as the expected remuneration does not exceed the respective threshold values of 130,000 € or 200,000 € according to sec. 2 para.2 VOF. If these threshold values are exceeded, we have to undergo the painstaking procedure of a maybe even EC-wide limited invitation to tender.

If the consultants services needed are commercial with an expected remuneration between 8,001 € and 130,000 € or 200,000 €, we have to apply the basic VOL /A rules. Then we carefully scrutinize the possibility of a single tender action or at least of a limited invitation to tender. In most of the cases, we manage to find a way to avoid at least invitations to tender open to the public. For consultants services of commercial character and with an expected remuneration exceeding 130,000 € or 200,000 € we would have to manage an EC-wide invitation to tender open to the public. But, deo gratia, this has until today never happened.

The role of the certified public accountants auditing the annual accounts of DFG:

Looking at auditing the annual account of the DFG, there are several players in the field: The tax authorities, the auditing courts of the federation and the states, the internal auditors, the statutory auditors and last but not least the CPAs. Now, who does what?

I must start with it once more: The DFG is legally constituted as a private law association, not a public authority. The legal form of a private association is designed for soccer or tennis or rabbit breeder clubs, but it serves somehow as well for the DFG since 1920.

A German private law association is not necessarily a non-profit organization in the tax-law sense, but always a non-commercial organization, because according to sec. 22 of the Bürgerliches Gesetzbuch, the German Civil Code, associations whose main statutory purposes are commercial activities, need a permission by the public authorities, and such permission is steadily refused with the argument, that for commercial activities special legal structures like e.g. the Gesellschaft mit beschränkter Haftung, a private company limited by shares, or the Aktiengesellschaft, a stock corporation, exist.

Aktiengesellschaften and Gesellschaften mit beschränkter Haftung have to have their annual accounts audited by cpas pursuant to sec. 316 and 267 of the Handelsgesetzbuch, the German commercial code, if they have a balance volume above 4 mio €, an annual turnover above 8 mio € and a staff of more than 50. The DFG would exceed all these threshold sizes by far; but no such obligation exists for associations.

The choice of the type of accounting for associations is free, too; there is no obligation for them to practice double-entry commercial bookkeeping with annual accounts comprising of a balance sheet, a statement of income and a situation report.

Tax authorities:

Most associations practice a simple and sufficient cash-accounting pursuant sec. 4 paragraph 3 of the German income tax law, they list up the yearly income and expenses in cash in chronological order and calculate the annual surplus or loss. Such simple cash-accounting does fulfill the tax-law requirements from DFG. As any non-profit association in Germany every three years DFG has to submit its annual accounts to the financial administration for the three years passed by and in return receives a renewed statement of its non-profit status.

In a sporadic time-spans tax inspections are held at associations by the inspection service of the financial authorities. I managed to survive such an inspection almost unwounded in my very first year with DFG and about a fortnight ago I received the announcement of the next inspection in august this year.

The tax inspection services staff are generally trained to inspect commercial enterprises and to investigate and discover additional sources or amounts of taxation there. Their performance is measured by the amount of additional tax raised subsequent to an inspection. With regard to the DFG, this would mean corporate income tax, which goes to the federation and the states in equal shares. Since the DFG is funded almost exclusively by the federation and the states equally divided as well, a result of additional taxation is a perfect joke, but: Who cares...Needless to say, that the tax inspection staff is not deemed to support our performance; they are not what one might call an external consultant.

Auditing courts:

You remember the saying about who pays the piper..? Of course the federation and the states as DFG's financiers impose on us the obligation to run our accounting in strict compliance with the Bundeshaushaltsordnung, the German budgetary law. Fortunately the traditional German public accounting system called Kameralistik is basically identical with the single-entry cash-accounting required from associations by tax law, so we can run one comprehensive bookkeeping for both tax and public reporting purposes. By the way, the same comprehensive bookkeeping manages to feed a quite advanced cost-performance-accounting-system that has been presented to you the meeting before last.

The federation and the states reserve the right to audit and hold inspections at the DFG to the Federal Auditing Court and the Auditing Courts of the states.

It seems to have become a silent agreement between the auditing courts, that the Federal Auditing Court is in charge for the DFG: For decades no state auditing court has shown up at the DFG, but about every ten years we have visitors from the Federal Auditing Court who are welcome although not invited. It looks like the frequency of occurrence of such audits is increasing since the Federal Auditing Court has moved from Frankfurt to Bonn - dangerously close to the DFG:

The last visit of the Court at the DFG was made but six years ago and last week I received the announcement of the next visit for this years autumn. This is especially remarkable, because the last audit report is not yet formally finished. I will come back to that later. Seen through the Federal Auditing Courts eyes, the accuracy of the DFG annual account seems to be a rather petty point. Paramount important for the Court seems the accrual of the funding competences of the federation and the states at the DFG:

Subsequent to the Grundgesetz, the German constitutional law, the funding of universities is generally within the responsibility of the states; the federation may only give funds to universities through DFG within the scope of the empowerment of article 91 b Grundgesetz, that allows the federation to finance research projects of supra-regional importance. So the Federal Auditing Court tends to concentrate its investigations on the question, whether DFG funds go directly or indirectly into teaching at universities. Please do not ask me, how this approach fits into the world-wide accepted Humboldtian concept of university unity of teaching and research. Just take it as a justification for the fact, that in Germany today joint workshops of university provosts and auditing court members are titled: Universities and Auditing Courts: Two worlds clashing ... So, like the tax inspection staff, I would not quite call the Federal Auditing Court an external consultant for the DFG.

Internal audit division:

From the very wording, the internal audit division of the DFG is no external consultant. Of course, the head of the DFG internal audit division, who is with us today, Florian, is as well qualified in business administration as any external consultant – or even better as most of them. And, sometimes, members of his division may tend to feel and act like externals – but that is not my topic. There is a serious reason, why I mention the internal audit division in connection with our annual account: According to German budgetary law, the annual account is part of the reporting obligation imposed on DFG by the notifications of allocation of the federation and the states. And these notifications of allocation comprise the requirement, that the annual accounts have to be audited and approved by the internal audit division before presented to the federation and the states.

Statutory auditors :

There are very few statutory demands to the DFG accounting: As regards the content of the annual account, the statutes remain completely silent. This makes sense, because the members of the association DFG - which are the named ones amongst the German universities and research institutions - are all “non-paying members” and they act wisely not to interfere in accounting matters. As regards procedure, article IV paragraph 4 of the DFG statutes says that the Members of DFG shall receive and approve the annual account and approbate the Executive Committee and that the annual account shall be reviewed in advance by three auditors commissioned by the General Assembly.

The role of these statutory auditors is delicate: With the DFG-members all being non-paying ones their entitlement in the end is substantially a limited one and such is the deducted one of the statutory auditors. Traditionally there is one seat for a jurist, one for an economist and one for an engineer, all three being university researchers and teachers either active or retired.

We provide the statutory auditors with the report of our CPAs on our annual account as soon as we have received it and offer them a draft for their summary report to the General Assembly. This draft report is not limited to the facts and figures of the CPA's report, but contains recommendations and remarks on the general situation of the DFG, on its program and performance. If the draft is accepted by the statutory auditors, their report will be presented to the General assembly by DFG's Secretary General.

Our CPAs:

As I have mentioned before: The CPA's audit of the annual DFG account is not obligatory because of the legal form of DFG as a private law association.

Nevertheless I believe it is absolutely essential to have a continuous outside look at an organization with a staff of about 740 people, an annual budget exceeding 1.5 billion € and hundreds of thousands entries per year in the books. This is even more right, because the remit of the DFG is not to execute laws and act as a classical intervening administration, but to make at least predominantly right decisions on allocations and to organize payments to and reports from recipients. The reason to make a CPAs audit of the annual accounts mandatory for private companies limited by shares or stock corporations is, that from a certain size of the company on there is public interest in the trust and fairness of its annual account. Isn't this even more the case for an organization that is financed by taxpayers money?

To my mind, it is neither the remit nor the occupational qualification of the Federal Auditing Court to inspect bookkeepings of the DFG's size annually. With the given staff, for the Federal Auditing Court this would be simply not feasible. And with the Federal Auditing Court there cannot be such broad experience in drawing samples of bookkeepings and evaluating organizational structures, operational procedures and potential risks like CPAs have from their different customers.

The German CPAs are definitively one of the highest qualified professional guilds. Precondition for the vocational training as CPA is a university degree in business administration – about 90 percent of the CPAs hold this degree - or law – only about 10 percent hold such degree: another proof for the old saying *iudex non calculat!* After three years of training a CPA-candidate normally undergoes the state examination as tax consultant and after another two years he makes the first try to pass the CPA-examination. 'With average "success"-rates between 25% and 33 % it is absolutely normal to repeat the examination at least once. In the professional guild of the CPAs there is an old saying: Kids, please be quiet, papa has to prepare for the examination!', because it is average to pass this examination in one's mid- or for lawyers late-thirties with an already founded family.

For a mandate of the size and complexity of the DFG, in the end only one of the "big four" CPA-firms have the knowledge, resources and, last but not least, the professional liability insurance cover. Namely, these are the respective German firms of C&L, KPMG, E&Y and BDO.

In Germany there has been a CPA-firm with a special relationship to companies or institutions owned by public authorities, the “Deutsche Revision”, later named “Treuarbeit”, who itself was partially owned by public authorities. The “Treuarbeit” after several mergers ended up in the “C & L Deutsche Revision”. The DFG annual accounts have been audited by this CPA-firm ever since the DFG restarted in 1949 – with of course many different CPAs being the auditors in charge; we still mind for a change of the auditor in charge every five years, as it is the professional standard for CPAs in Germany, too.

Our CPAs carry out their audit in a team consisting of one senior CPA as auditor in charge, who, despite his name, does not attend the audit fulltime in the DFG office and a second qualified CPA who is with us fulltime together with between two or four assistants out of which one or two are in their vocational training for a CPA and the others specialists. A pre-audit is held for seven up to ten days in early December to define and scrutinize special auditing fields. The main audit is performed in four or five weeks starting in late January immediately after we ourselves have managed to close the books for the year gone by. The main audit starts and ends with a discussion between the CPAs and our executive board members. During the audit the CPAs usually have questions not only, but first and foremost to the staff of the financial department, they ask for files or IT-data - and they ask for coffee and soft drinks, too. I would even say, they are having a good time with us, because the probability of mistakes or irregularities is considerably lower with us than with a company. Usually we receive the final report in early March and send it to our statutory auditors as soon as we have completed our draft for their summary report. One last word about the billing: Until today we engage C&L Deutsche Revision on an annual basis and pay them on hourly rates dependent on the qualification level of the respective staff. We give them one or two advanced payments corresponding to the progress of the audit. Finally, for the last years, the remuneration for our cpas totaled some 80,000 €.

The Federal Auditing Courts recommendation to abolish the annual audit of the DFG account by CPAs:

Finally, here is the case study I promised to you:

In autumn 1999 the Federal Auditing Court inspected the DFG. In his inspection report from February 2000 he recommended to cease the auditing of the DFG annual account by CPAs! Here is the very simple reasoning of the Court: The Court stated, that there is neither a legal nor a statutory obligation to have CPAs auditing the annual accounts of DFG. The Court plainly said, that the single-entry-bookkeeping according to German budgetary law as practiced by the DFG to him seemed so clear and reliable, that no CPA audit was necessary. For him, the statutory auditors and the internal audit division could sufficiently fulfill the auditing needs of the DFG.

When I read this, first I laughed out loud. Then, for a moment, I wondered whether the DFG, especially the finance department, should put aside all doubts and just take this as one of the few big chances to get rid of a lot of work. But the heart of the former public official from the budget department of a ministry of finance soon regained control over me and I started to organize our defense:

First we spoke to our statutory auditors. They immediately – and obediently - declared to resign, if they could no longer rely on the CPAs auditing report. Then we discussed all the points mentioned above with the public officials from both the ministries of science and finance of both the federation and the states: Why the CPA's professional audit was indispensable and neither the statutory auditors nor the internal audit department nor the Federal Auditing Court itself could replace the work of the CPAs. And, of course, we made three or four submissions to the Court during the ongoing discussion, that lasted more than four years. With the Court, we failed completely. But we managed to get the public officials, even the ones from the ministries of finance, on our side.

So, in our Wirtschaftsplan, our budget for the year 2005, we introduced a new Bewirtschaftungsgrundsatz, the second sentence of budgetary rule no. 15 saying: "The audit of the annual account is based on the report of a CPA-firm." This made the Federal Auditing Court go hopping mad and there was a rumor going round that the Court considered to bring our case to the Haushaltsausschuss des Deutschen Bundestages, the budget committee of the German Parliament. Personally, I would have enjoyed that, but, as at the parliament's budget committee only the public officials of the Federal Ministry of Finance are allowed to appear, I had to accept, that my former colleagues instead made a deal with the Federal Auditing Court to settle the matter. The deal was such: The Court no longer attacked the CPA's audit as such and in return we were both kindly and seriously asked to undertake a public invitation to tender for the CPA's services in a five-year contract. There was no way out of this, so we agreed.

We are preparing that public invitation to tender for autumn 2006. Due to the volume of the contract, it will be an EC-wide one, so the a-sections of VOL/A will rule the procedure. As a good knowledge of the single-entry-bookkeeping pursuant to German budgetary law is indispensable, only German CPA-firms have a chance to compete. Because of the liability volume, only the big German CPA-firms will apply.

(Official version:)

So it is in the end a very limited contest and one may wonder, whether the foreseeable outcome justifies all the work.

(oral version)

I have my personal experiences with two of the competitors of our CPA-firm, that make me doubt whether they could satisfy our demands. And I can assess the quality of the reports of the third competitor, because I am to comment on these reports for our President who is a board member of several scientific institutions audited by the third competitor. So I know quite well, what the result of the EC-wide public invitation to tender is likely to be.

Its in situations like this, that I sometimes wonder, whether I should stay in this Sith-Lord world of the public officials or change sides to the Yedi-Knight-world of the external consultants.

Thank you all for listening!