Financial errors in FP7.
How to improve the quality of financial statements?

Vienna, 21 June 2012

Introduction

*This presentation is addressed to **beneficiaries** of FP7 projects and to the **auditors** and **Competent Public Officers** (CPO) who sign Certificates on Financial Statements (CFS).*

*We will present you with **typical errors** that affect the quality and reliability of cost statements (Forms C) filed with the European Commission.*

*By explaining practical aspects of the application of the underlying **legal and financial rules**, we will show you how you can detect and avoid these errors.*

*Our presentation will refer to ex ante checks and procedures to be performed by the certifying auditors and documented in **Forms D**.*

Errors. Why do they occur?

- *Misunderstandings of the rules;*
- *Lack of attention to the detail of the provisions of the FP7 grant agreements.*

Errors. How can we detect them?

Ex ante controls:

- *EC officers review Forms C before the costs are reimbursed*
- *Certifying auditors perform agreed upon procedures on Forms C and issue Certificates on Financial Statements (Forms D)*

Ex post audits:

- *Up to 5 years after the end of the project*
- *Concern financial, legal as well as technical issues*

The consequences of errors:

Beneficiaries

- *Non-optimal use of funding available*
- *Delayed payments*
- *Liquidated damages*
- *Recoveries*
- *Extrapolation*
- *Bankruptcy*

European Commission

- *Scrutiny of the Budgetary Authority and ECA*
- *Increased error rate*
- *Increased ex post audit efforts*
- *Corrective measures*

The goal of our campaign

- ***To minimise the error rate in cost statements (Forms C);***

- ***To improve the quality of CFS prepared by certifying auditors/CPO.***

Our Agenda for today

9.30 – 10.00	*Registration and coffee*
10:00 - 10:15	*Welcome and Introduction*
10.15 – 13.00	*The most common errors - plenary presentation* *Specific Issues (ERCEA, SMEs....)* *(Coffee break of 30 minutes in presentation)*
13.00 – 14.00	*Lunch break*
14.00 – 15.45	*How to avoid mistakes – practical examples – Q&A session for beneficiaries*
14.00 – 15.45	*Questions and practical issues in preparation of Form D – workshop for auditors*
15.45 – 16.00	*Wrap-up session (plenary)*

General rules for eligibility of costs (1/2)

To be considered eligible, the costs must be:

- ***Actually incurred*** *(not estimated, budgeted or imputed)*

  When actual costs are not available at the time of establishment of the financial statement, the closest possible estimate may be declared in conformity with the accounting principles of the beneficiary. However, these estimates should be adjusted when the actual costs are available.

- ***Incurred by the beneficiary***

  Supporting documents proving occurrence, the bookkeeping and the payment must be kept by the beneficiary

- ***Incurred during the duration of the project***

General rules for eligibility of costs (2/2)

To be considered eligible, the costs must be:

- ***mined according to the usual accounting and management principles and practices of the beneficiary***
  However, the beneficiary must adjust its usual accounting and management practices if they are not in line with the FP7 rules

- ***Used for the sole purpose of the project under the principles of economy, efficiency and effectiveness***
  The standard of "good housekeeping" in spending public money.

- ***Recorded in the accounts of the beneficiary***
  Exemptions exist for certain cases involving third parties

- ***Annex I should include a general description of costs. Some types of costs (such as subcontracts) must be clearly identified in the estimated budget of the project (Annex 1)***

Direct and indirect costs

Direct costs:

*Are all those eligible costs which can be **attributed directly** to the project and are identified by the beneficiary as such in accordance with its **accounting principles** and its **usual internal rules.***

Indirect costs:

*Are all those eligible costs which cannot be identified by the beneficiary as being directly attributed to the project, but which can be identified and justified by its accounting system as being **incurred in direct relationship** with the eligible direct costs attributed to the project.*

Personnel costs: underlying principles

- ***Only the costs related to participation in the EU co-funded project may be reimbursed,*** *hence the beneficiary has to record time spent by their personnel.*

- ***Generally, the calculation of personnel costs is based on hourly rates.*** *They are based on all eligible personnel cost elements and the total productive hours.*

- ***The EU co-finances the projects carried out by the entities with appropriate research resources.*** *Beneficiaries need to demonstrate that the project personnel is in fact their personnel.*

Personnel costs: checks and evidence

Beneficiary ensures:

- *Staff has employment contracts*
- *They are on the payroll*
- *Salary related charges appear on the payslip*
- *Time records exist*
- *The calculation of productive hours reflects reality*

Beneficiary provides*:

- *Internal rules/legislation (salaries/bonuses/social charges, time recording, working hours/overtime, etc.)*
- *Employment Contracts*
- *Payslips*
- *Time records*
- *Productive hours calculation*
- *Calculation of hourly rates*

Certifying Auditor checks and verifies:

- *The calculation of the hourly rate.*
- *The number of productive hours used*
- *The reliability of the time records*
- *The remuneration is calculated in compliance with internal practices and legislation*
- *The project personnel is the beneficiary's personnel, hired under valid employment contracts*
- *Time spent on the project is justified (based on documents)*
- *The certifying auditor reconciles claims to accounts.*

*The list of evidence is not exhaustive, but reflects good practices and examples

Personnel costs: common errors

Issues related to time recording:

- ***Time records without the required elements***
  - *No description of related activity, insufficient detail (e.g. only monthly activities)*
  - *Not signed*
  - *Not individual*
  - *Time records absent or incomplete*
  - *Not subject to the supervision /authorisation by superiors / project manager*

- ***Errors in transfer of the data from time records to cost claims***
  - *Time records not reconciled with HR (e.g. absences).*
  - *Declared project time includes work hours on another activity*

Personnel costs: common errors

Issues related to the calculation of the hourly rate:

- ***Total remuneration includes ineligible bonus & overheads elements***
- ***The calculation of the total productive hours do not reflect reality***
  - *Productive time is incorrectly reduced by "non-billable" time*

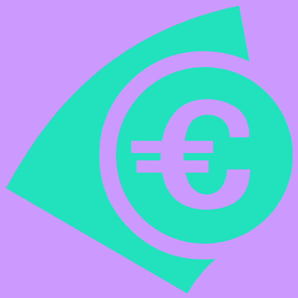
Personnel costs: common errors

Internal control issues:

- *Project personnel not directly employed or paid by the beneficiary (unless use of 3rd party resources fulfilling certain conditions and included in Annex I)*
- *Costs reported in project accounts only (not recorded in the statutory accounts)*
- *Usual accounting or management principles and practices not applied to the EU project*
- *Use of budgeted figures instead of actual costs*

Personnel costs:
How to get things right

PERSONNEL direct costs declared



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Number of HOURS spent on EC project

x

HOURLY PERSONNEL RATE

Personnel costs:
How to get things right

HOURLY PERSONNEL RATE **of an employee**

=

$$\frac{\textit{Total Annual Personnel Costs of an employee}}{\textit{Total Annual Productive hours of an employee}}$$

Personnel costs: How to get things right

- *Time recording* ***is necessary*** *in order to justify personnel time spent on the project (estimates of hours worked are not allowed)*

- *We strongly recommend using* ***full time recording****, which allows to identify time spent on all activities (research & non – research, EU & non-EU) and makes it easier to reconcile non-productive time (sick leave, holidays) with HR records.*

- *Irrespective of the system chosen for time recording (integrated computerised system, excel or paper timesheets, etc.), the beneficiaries should ensure that the* ***time is recorded and reported regularly, and is verified*** *by the personnel and the supervisor (i.e., the timesheets are signed).*

Personnel costs: Productive hours
How to get things right

Productive hours calculation	
Total days in a year	365
Less: Weekends	104
Subtotal	**261**
Less: Annual Holidays	21
Less: Statutory Holidays	15
Less: Illness & Others	15
Productive days per year	**210**
Hours per day	**8,0**
Productive hours per year	**1.680**

If you use standard productive hours ensure that these reflect fairly the reality of your organisation as regards productive time.

Do not use billable (commercial hours) as they do not represent the total productive time of the personnel.

Personnel costs: How to get things right

Salary Top-ups/Bonus Payments:

Acceptable if part of normal salary and benefits package, and ALL of the following criteria are met:

- *Based on internal regulations*
- *Applied to all projects of the same kind (EU and non EU, national and international) Implemented in a consistent manner for the same type of activities/projects*
- *Level of remuneration remains consistent with market conditions for same category/grade/experience*
- *Recorded in accounts as "Personnel" cost and subject to taxes and social security charges*
- *Paid as part of employees gross remuneration (added to the basic salary for the calculation of the hourly rate)*

Personnel costs: in-house consultants How to get things right

Eligible as personnel cost if ALL of the below conditions are met:

- *A contract to engage a physical person is in place;*
- *The in-house consultant works **under the instructions** of the beneficiary;*
- *The in-house consultant works **in the premises of the beneficiary;***
- *The **result of work** belongs to the beneficiary;*
- *No **excessive costs** paid (not significantly different from those of employees of similar category);*
- *Personnel cost registered in the accounts.*

Personnel costs : Other issues

- *Direct taxes and social charges related to personnel costs*
- *"Teleworking"*
- *Overtime payments*
- *Benefits in kind*
- *Redundancy provisions*
- *Statutory parental leave payments*

Average Personnel costs: criteria

- ***Changes:***
  - *the criteria on maximum deviations between averages and individual actual costs*
  - *No obligation for ex-ante CoMAv (becomes an optional)*

- ***New criteria (Com 24 Jan 2011):***
  - *usual accounting practice*
  - *averages based on actual costs in statutory accounts*
  - *exclusion of ineligible costs as defined in the FP7 Rules and no double charging of costs*
  - *productive hours: usual practice, verifiable and reflecting actual working standards*

Average Personnel costs: checks

The beneficiary provides:*

- *Internal manuals describing averages*
- *List of all average personnel rates*
- *Employees groupings*
- *Productive hours calculation*
- *Accounting records*
- *List of all relevant employees (working on EU projects and not working on EU projects) based on which the average personnel rate is calculated*

The certifying auditor checks:

- *The average personnel costs reflect the usual accounting practice*
- *Persons are allocated to the appropriate groups*
- *No items are claimed twice (e.g. cost centres: indirect costs included in personnel costs and make sure they are not claimed again in indirect costs)*
- *Productive hours are calculated based on reality*
- *Numerical reconciliation cost claims/account*

*The list of evidence is not exhaustive, but reflects good practices and examples

9. SME owners

SME owners may choose to:

Pay themselves a salary *For their research work*	No salary
↓	↓
Claim the salary as a cost under the FP7 project	***Charge Marie Curie flat rates to the FP7 project***

Subcontractors and 3rd parties

A third party is a legal entity which is not a beneficiary of the ECGA and is not a signatory to it

Types of third parties:

Third parties making available resources to the beneficiary

- *The resources made available are under the full and direct control of the beneficiary*
- *Work carried out is attributed to the beneficiary*
- *Resources may be provided free of charge or for remuneration*
- *Special cases (foundations, spin-off companies created in order to manage the administrative task of the beneficiary)*

Third parties carrying out part of the work themselves

- *Subcontractors*
- *other third parties linked to the Beneficiary (entities identified in the ECGA via special clause 10)*

  Examples: Joint Research Units (JRU), European Economic Interest Grouping (EEIG), Affiliates and Groupings

Subcontractors and 3rd parties

Third parties making available resources to the beneficiary

- *if resources are made available free of charge **costs** may be declared by the beneficiary in its Form C if those costs were incurred and recorded by the third party in its accounts.*
- *if the Beneficiary reimburses the third party costs are eligible if payment recorded by the Beneficiary in its accounts and no profit contained therein*

Third parties carrying out part of the work themselves and covered by special clause 10

- *Each third party fills in its costs in an individual Form C and, where necessary, shall provide its individual certificate on financial statements.*

Sub-contracting

The subcontractor is a type of third party:

The responsibility vis-à-vis the EU for the work subcontracted lies fully with the beneficiary

Subcontracting between partners of the consortium is not permitted under any circumstances

Characteristics:

- *The agreement is based on "business conditions"*
- *Work carried out without the direct supervision of the beneficiary*
- *The subcontractor's motivation is pecuniary, not the research work itself*
- *Usually subcontracts do not concern the research work itself*
- *Subcontractors do not carry out a core part of the work*

Eligibility of costs:

- *Transparent, non-discriminatory selection following best value for money*
- *Tasks to be subcontracted and its cost estimation described in Annex I of the GA*

Sub-contracting & 3rd parties

The beneficiary provides:*

- *Description of the third parties used*
- *Contracts with the subcontractor (s)*
- *Annex I of the GA*
- *Invoices*
- *Proof delivery or services*

The certifying auditor checks:

- *That all claimed 3rd parties/subcontracts are mentioned in Annex I*
- *The tendering procedures were performed for each subcontract and a value for money analysis exists*
- *If the subcontracting comes from a framework contract that existed prior to the signature of the GA, that such framework contracts exist*

*The list of evidence is not exhaustive, but reflects good practices and examples

Subcontracting : how to get things right

- *Do not charge for subcontracts between partners of the consortium*

- *The Beneficiary must not calculate indirect costs on subcontracting costs (and 3rd parties not working on the premises of the beneficiary). In these cases the overheads are born by the subcontractors or and are deemed to be already included in their remuneration*

- *If you receive resources free of charge do not charge the EC the notional value of these.*

- *Subcontracts with respect to minor tasks (not identified in Annex I) must follow the same best value for money and transparency principles and be in accordance with the usual practice of the beneficiary*

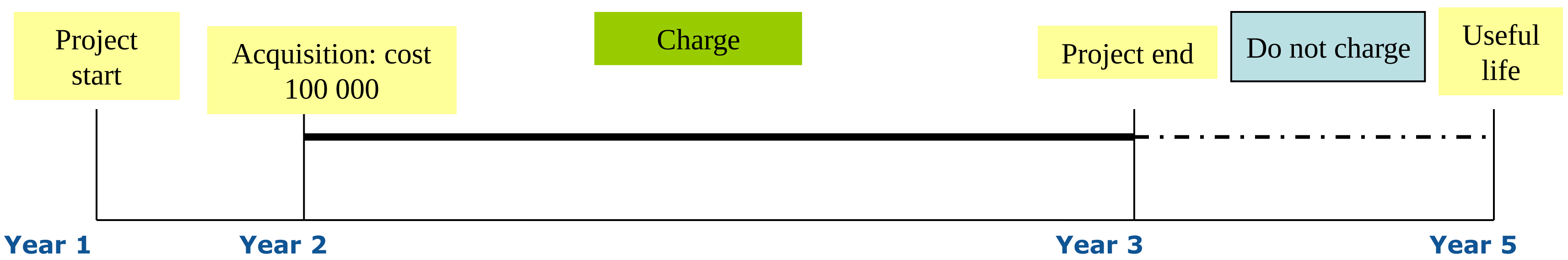
Durable equipment

As a rule:

- *Usually the equipment purchased for the project can qualify as eligible (possible to charge equipment bought before the start of the project, but used for the project)*
- *Only depreciation charges can be charged to the EC*

  (exceptions exists for certain specific programmes and demonstration equipment)
- *Only the portion used on the project may be charged*
- *Leasing costs of equipment may be eligible under specific conditions.*

3. Depreciation



Beneficiary's policy is straight line depreciation

Useful economic life of equipment: 5 years

Depreciation cost per year =€ 100 000/5 years = € 20 000

Equipment used on EU project for 2 Years if used 100% on the project

Eligible cost for equipment = €20 000 * 2 years = €40 000

Durable equipment: checks

The beneficiary provides:*

- *Proof of the purchase of the equipment (date and cost)*
- *Proof of existence and the use on the EC project(s)*
- *Description of the depreciation policy and purchase of durable equipment*
- *In the case of rented equipment: rental contract*
- *Equipment's usage diary/register*

The certifying auditor checks:

- *The entry of the cost in the accountancy system*
- *The use of the equipment on the project (s)*
- *VAT is excluded from the cost claim*

*The list of evidence is not exhaustive, but reflects good practices and examples

Durable equipment - How to get things right

- *Consider % use during the duration of the project and the equipment's useful economic life*
- *Apply your normal depreciation policy*
- *Do not charge any residual values*

Consumables:

- *Must be necessary for the projects*
- *If the accounting practice of the beneficiary considers consumables as indirect cost, they cannot be charged as direct cost under the project*
- *Eligible cost only if consumables purchased after the start date of the project*
- *When charged internally (with or without an internal invoice), no mark-up or profit element can be added to their costs*

Consumables: checks

The beneficiary provides:*

- *Procedures for accounting for consumables*
- *Invoices with reference to the EU project*
- *Inventory register/ledger*

The certifying auditor checks:

- *Costs are in the accounts*
- *No VAT is charged*
- *Are not inventoried as durable equipment*
- *Are not capital expenditure*
- *Have short life expectancy*
- *Are not charged through indirect costs*

*The list of evidence is not exhaustive, but reflects good practices and examples

Travel costs

- *Must be related to the project*
- *Must comply with the beneficiary's usual practices and be adequately recorded*
- *Must reflect the actual expenses of the beneficiary: the actual travel costs or lump sums/per diems if the latter are used to reimburse travel costs to the personnel*
- *Participants may claim daily subsistence costs and accommodation related to travel (but not travel costs itself) based on flat rates approved by the Commission*
- *Upper finding limits described in art. II.16 of the Grant Agreement*

Travel costs: checks

The beneficiary provides:*	*The certifying auditor checks*
▪ *Internal guidelines/procedures Policy on charging accommodation and subsistence allowances (EC flat rates, actual costs or own flat rates)* ▪ *List and dates of trips by project personnel* ▪ *Proof and reason of the travel (in relation to the project)*	▪ *That the travel has been allocated to the appropriate project* ▪ *Cost were charged in line with beneficiary's policies* ▪ *No VAT is included in the cost claim*

*The list of evidence is not exhaustive, but reflects good practices and examples

Travel costs: how to do things right

- *Do not charge costs to travel which is not project specific*
- *Do not charge travel for persons not working on the project*
- *Keep proof of travel expenses*
- *Keep proof of relationship of the travel with the project*

Methods of calculation and reporting of indirect costs

- ***Full cost accounting (actual indirect costs) including the simplified method***

- ***Flat rates (20% and 60%)***

The beneficiaries who have analytical accounting system that can identify and group their indirect costs have a choice between reporting actual indirect costs or 20% flat rate.

The beneficiaries who can only identify indirect costs at the level of the organisation can use the simplified method

The beneficiaries who are eligible for the use of 60% flat rate may continue to use it provided they do not have an analytical accounting system

Indirect Costs - Ineligible items

When actual indirect costs are calculated – all ineligible items have to be removed from the pool of indirect costs.

Examples of ineligible items:

- *Marketing & sales costs;*
- *Financing costs;*
- *Exchange rate losses;*
- *Costs declared or reimbursed by another EU project*
- *Costs with no relationship to the project.*

Indirect costs: checks

The beneficiary provides:*

- *Description of the methodology*
- *Reconciliation with the profit & loss accounts (P&L)/general ledger*
- *Calculation of overhead rates (cost centre/project/personnel)*

The certifying auditor checks:

- *Use or non use of flat rate*
- *The total amount of costs were reconciled to the account*
- *Verified eligibility of costs included in overheads*
- *Their link to the research activity*
- *Allocation keys*

*The list of evidence is not exhaustive, but reflects good practices and examples

Exchange rates: Check

The beneficiary provides:*

- *List of currencies used*

The certifying auditor checks:

- *Use of the correct exchange rate (ECB)*
- *At date of incurring the cost or*
- *the first day after the end of reporting period*

*The list of evidence is not exhaustive, but reflects good practices and examples

Interest on pre-financing

- *An interest bearing account exists*
- *Interest is declared:*
  - **on pre financing by the co-ordinator**
  - For **mono-partner actions** the whole amount paid by the Commission to the beneficiary
- *Exemption from obligation to open interest bearing account if:*
  - *opening and/or operating an interest-bearing bank account is not in line with the principle of sound financial management and a derogation is requested and obtained from the EC.*

10. VAT

- *VAT, whether recoverable or not, is ineligible;*

- *Please ensure that VAT is always excluded from your cost claims.*

Receipts:

The beneficiary provides:*

- *List of income/contributions received*

The certifying auditor checks:

- *Receipts declared in cost statement*
- *Reconcile amounts between project account and cost claim.*

*The list of evidence is not exhaustive, but reflects good practices and examples

Key message from today

- *Observe the rules and pay attention to the details*
- *Ensure collaboration with your certifying auditor/CPO*
- *Keep reliable proof your expenses*
- *Document the link of your expenses with the FP7 project*
- *If in doubt call, inform your Project/Financial officer well in advance*

European Commission

Thank you very much for your attention!

Open Discussion