



FP6 Ex-post-audits: Audit Cycle and frequent findings

Austrian Research Promotion Agency (FFG)

FP 7 Cost Reporting Conference

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European Commission - DG Research - A.04



Agenda

- Audit Cycle and Audit Phases
- Frequent findings and problems encountered
- Implementation of audit results (i.e. extrapolation)



Audit Cycle and Audit Phases



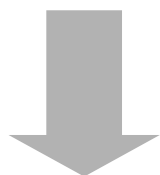
Audit Cycle





Audit Cycle - Timeline

**Audit Strategy
& Selection**



**Planning &
Preparation**

3 months



**Examination
on site**

1-3 months



**Reporting &
Audit Closure**



**Implementation
of Audit Results**



FP6 Audit Strategy - Objectives

- **Assess the regularity and legality of transactions and provide input to the annual declaration of assurance of the Directorate General**

- **but also:**
 - ➔ Formulate **corrective actions** through feedback to the relevant operational services

 - ➔ Contribute to the assessment of the effectiveness of the system of audit certificates

 - ➔ Raise general control awareness within the population of potential auditees thus helping to protect the EC financial interest



FP6 Audit Strategy – Selection Methods

- **Individually significant contractors (“top 200”)** Maximise the impact of the audits and the audit coverage, with the use of both extrapolation and follow-up procedures
- **Representative** The use of a representative selection method (e.g. 'Monetary Unit Sampling' –MUS-) will allow the extrapolation of the audit results to the whole population with a preset level of confidence, materiality and precision
- **Risk-Based** Provide additional audit information supporting assurance to management based on the analysis of the risk profile of both the population as a whole and also for the individual contractors
- **Specific Audits** (Follow-up audits, requests, ...)



FP6 Audit Strategy – Inhouse / Outsourcing

Ex post Audits by EC auditors (RTD-A.04)

- Approx. 25% of audits
- i.e. audits of top beneficiaries
- Specific audits (follow-up, requests, ...)

Ex post Audits by Contracted audit firms (RTD-A.05)

- Approx. 75% of audits
- i.e. representative selection and risk based
- Supervision of the audit process by EC services



FP6 Audit Strategy – Audit Scope

- Audit of **financial statements** submitted (Form C) to ascertain that costs have been properly incurred and are eligible costs as defined under the contract
- **FAIR** approach – also aspects in favor of the audited organisation will be considered where discovered
- Usually selection of **3 contracts** to be audited per audit assignment and entity



Planning & Preparation: General

- Initial contact by the responsible auditor approx. 2-3 month before examination on site to agree on dates and logistics
- Formal letter to announce the audit including detailed annex on information and documentation to be provided
- Collection of audit information (internal and external)

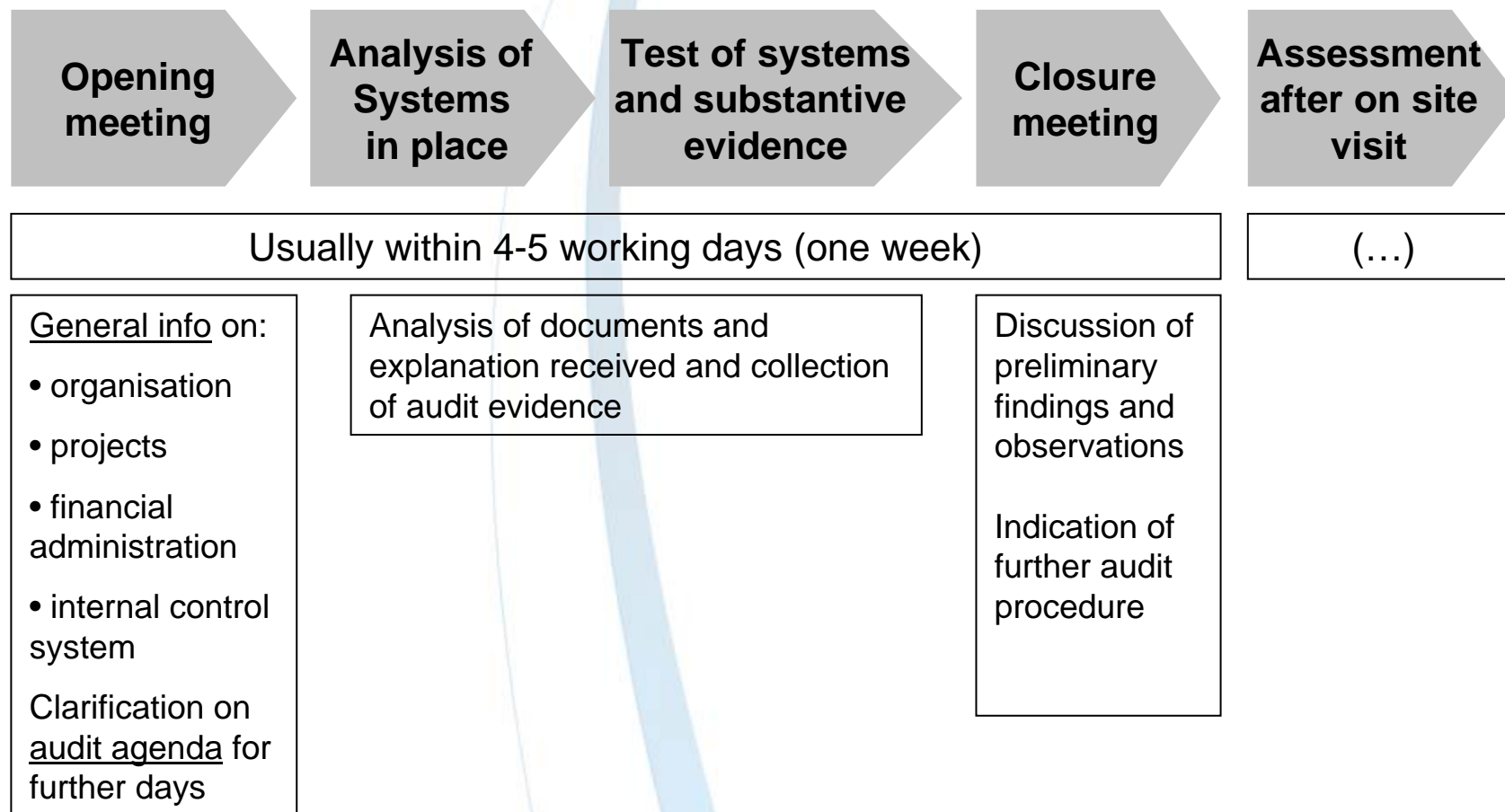


Planning & Preparation: Information requested

- Detailed annex to announcement letter includes precise list of information to be provided either
 - Prior to the audit examination on site (by mail)
 - At the time of the audit examination
- Most relevant information in the early preparation are the detailed project accounts matching the total as claimed in the financial statements (Form C)
- Exact information requests to be provided in advance also depending on the individual project(s) and auditor in charge



Examination on site





Reporting and Closure of the Audit

- Transmission of Draft audit report (after internal consultation of the operational directorate managing the project) for comments by the audited organisation
 - Usually based on the preliminary conclusions communicated
 - Delay (30 days) to provide comments to the draft
- Consideration of comments (if any) and finalisation of the audit report
- Formal closure of the audit by formal letter indicating the further procedures on the implementation of audit results



END OF THE AUDIT



Frequent Findings encountered (FP6)



Frequent Findings – General principles

Contract/ Grants are given on a « fair » cost sharing basis:

- Costs = **actual cost** <-> not budgeted or estimated costs
- Cost shall be : economic, non-excessive, not reckless, not include any profit (exception subcontracting)
- Necessary for & linked to the project



Frequent Findings – General principles

- Charged in accordance with usual accounting principles of the beneficiary
- Not explicitly disallowed by contractual provisions
- Incurred and recorded in the books during the project lifetime
- Sufficiently and reliably documented (audit trail)



Frequent Findings – Direct vs Indirect Costs

- Direct costs = Directly attributable to the relevant project
- Indirect costs = Only attributable to more than one project
- Problem: consideration under one category only !
- Link to the project needs to be substantiated - also for indirect costs !



Frequent Findings – Actual vs Average Costs

- Average Costs can reflect Actual Costs (if based on those)
- Problem: Significant deviation of (total of) costs charged for EC funded research project



Frequent Finding – Personnel Cost

- Average or standard cost systems (hourly rates) instead of actual costs -> significant deviation
- Calculation of productive hours
- Insufficient Time Recording or evidence on working times
- Specific cases: Maternity leave, Bonus payments, Inhouse-consultants, owner managers
- Contractual status of personnel employed and charged to the project according to cost model



Frequent Finding – Indirect Cost

- Average or standard cost systems (hourly rates) instead of actual costs -> significant deviation
- Inclusion of ineligible cost items/ categories (cost of sales, self-funded research, provisions, costs of capital, ...)
- Allocation keys or procedures not respecting the general principles



Frequent Finding – Subcontracting Cost

- Exception to the non-profit philosophy of the EC grants
 - Requirement of prior approval in the contract or by the project management in the EC (as of 20% of the amount)
- Audit Certificates are considered accepted as subcontracting
- Impact on the audit process: Verification of the documents and calculations of the subcontractor in case of significant amount to be granted (foreseen in subcontracting provisions)
- Ineligibility of VAT on subcontracts



Frequent Finding – Equipment

- Potential conflicts between general principles and usual accounting rules of the beneficiary (i.e. cash-based accounting) if economic use longer than the project life-time
- Substantiation of calculation of depreciation
- Ineligible cost items for depreciation (i.e. VAT, duties)
- Respect of internal procurement policies



Frequent Finding – Other Cost Items

- **Consumables and Travel cost**
 - Ineligibility of direct taxes (i.e. visible VAT)
 - Necessity and plausibility of purchases (not reckless)
 - Separation of direct and indirect cost items
 - « Entertainment » costs
- **Services bought**
 - Internal invoicing - intercompany services
 - (Inhouse-) consultants
- **Interests incurred on project funds**



Implementation of Audit Results

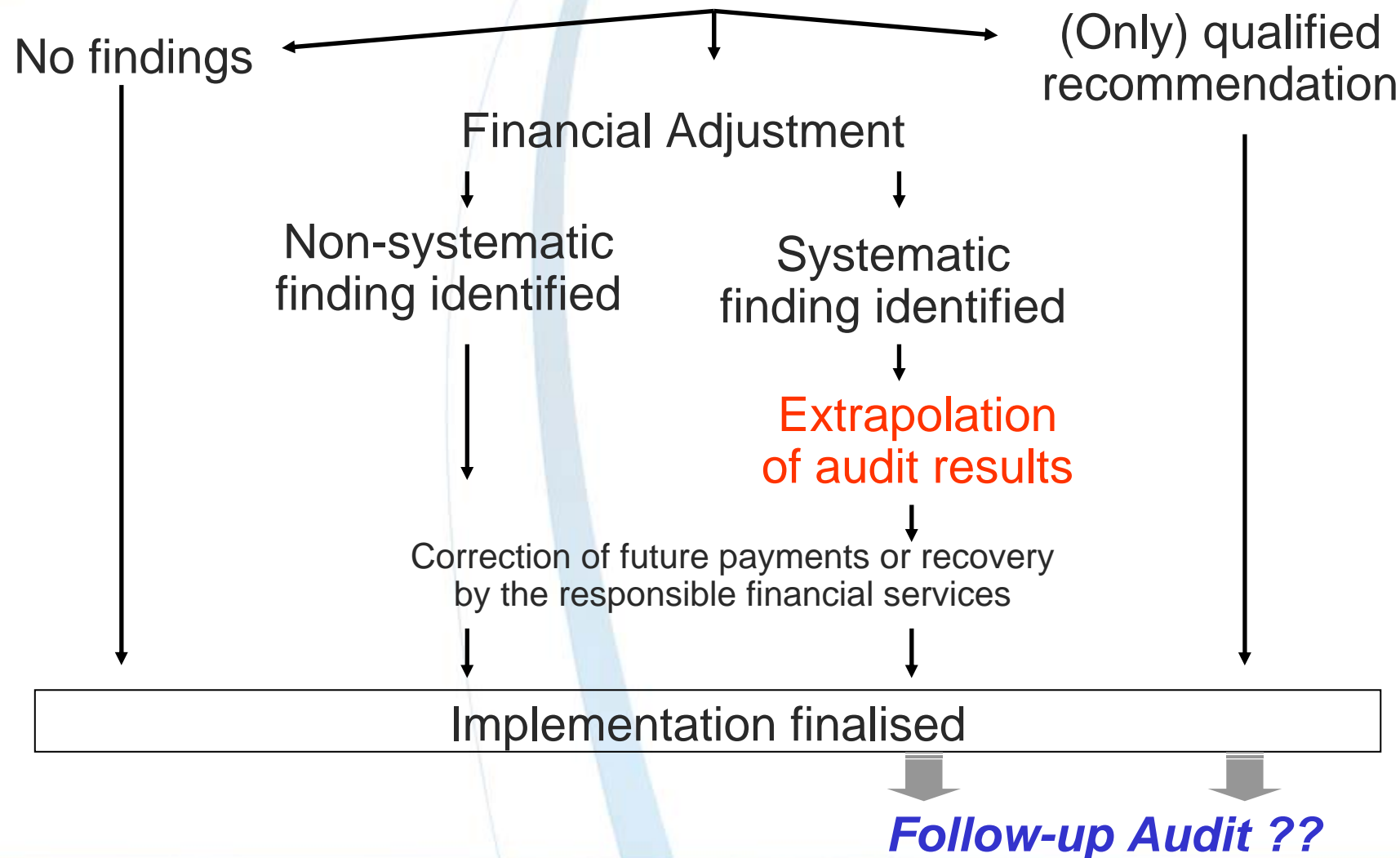


Implementation of Results - General

- Financial findings administered by the operational EC service in charge of the project management (decentralised)
- Adjustments return to the available budget of the contract
- Besides adjustment possibility of liquidated damages
- Consideration of serious audit findings (i.e. high adjustments) in future project and contract negotiations



Implementation of Results: Cases





Implementation of Results – Systematic Finding

- Definition:
 - ➔ Errors that are considered repetitive and recurring. The implication of this type of error is that the contractor is not complying with his contractual obligation in a systematic way.
- Assumption:
 - ➔ Can imply that all currently open and closed contracts under the same framework program (FP) are affected and might need to be (retrospectively) adjusted
- Impact:
 - ➔ Contractor will be asked to reconsider all financial statements handed in under the same FP and where necessary recalculate and revise the statements



Implementation of Results – Extrapolation procedure I

- Common decision of all Research DGs (RTD, INFSO, ENTR, TREN) which are concerned by having contracts with the organisation audited.
 - However, decentralised follow-up of implementation of results
- Detailed formal Letter of Closure of the Audit indicating procedures to be followed and including a list of contracts subject to extrapolation (consolidated for all Research DGs)
- 45 days delay to hand in revised financial statements or appropriate explanations on the listed contracts



Implementation of Results – Extrapolation procedure II

- EC analysis answers received
 - Completeness
 - Sufficiency
 - Necessity of follow-up checks (e.g. audit)
- After 45 days in case of non or incomplete reaction, reminder letter and legal consequences where needed
- Financial adjustments by the financial services in charge according to the revised statements received



The End

Thank you for your attention!

