



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

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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**.*





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.*





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

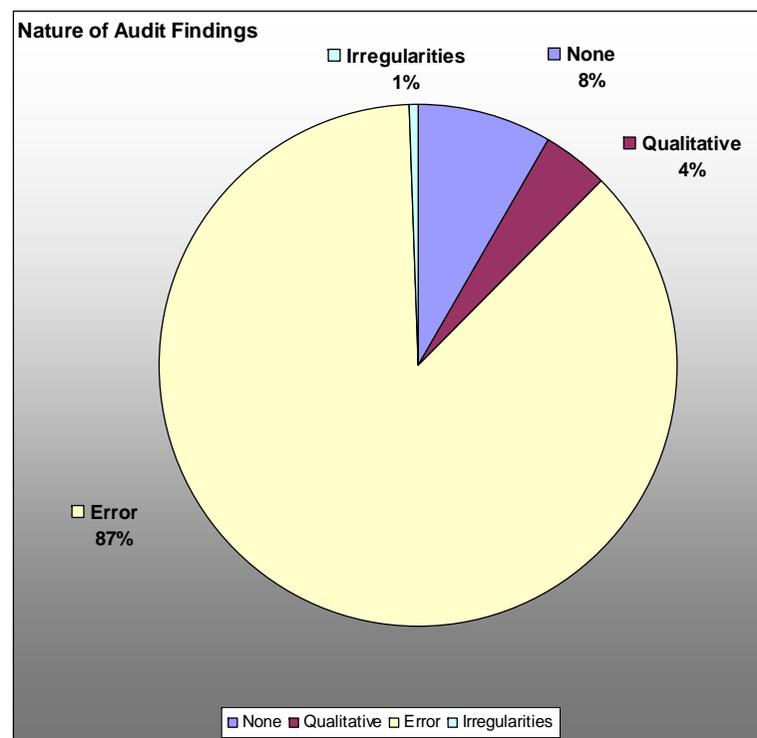
- *Non-optimal use of funding available*
- *Delayed payments*
- *Liquidated damages*
- *Recoveries*
- *Extrapolation*
- *Bankruptcy*

European Commission

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



Audit findings



87% of audit findings are the result of errors



How to avoid common errors identified in FP7 cost claims

To help you we have prepared a document containing the 10 most recurrent errors you will find it in your welcome pack and it will be published on CORDIS

Most of these errors occur due to:

- *misunderstanding of the rules; or*
- *lack of attention to the detail of the provisions of the FP7 grant agreement.*



1. Costs claimed not linked to project and not substantiated

All costs claimed should be based on the actual costs incurred:

- *They must be supported by proper documentation*
- *They must be linked to the funded project*
- *Neither budgeted, nor estimated amounts*

2. Sub-contracting

The use of sub-contractors should be identified in the Description of the Work as defined in Annex I of the Grant Agreement:

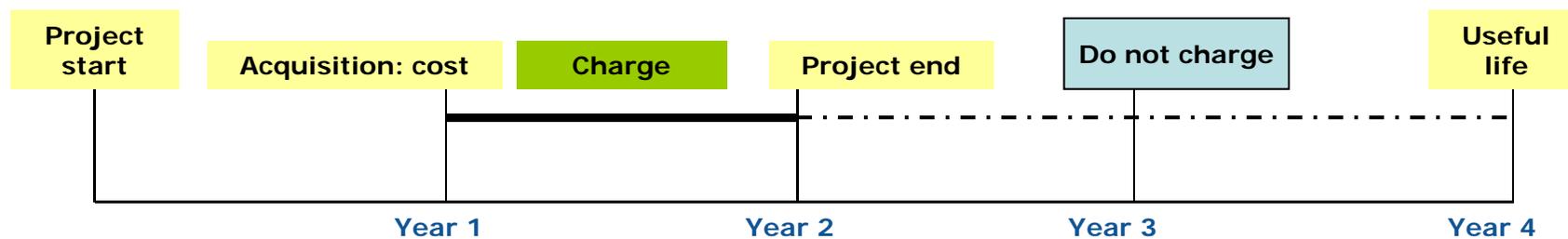
- *If this is not the case then send an amendment request to the Commission*
- *Subcontracting between partners of the consortium is not allowed*

3. Depreciation

Do not charge the full cost of equipment at acquisition:

- *Depreciate durable equipment over its useful life*
- *Spread the cost over the duration of the project*
- *Do not charge any residual values*

3. Depreciation



4. Indirect Cost Model

- *If a full cost accounting system is used then indirect costs claimed must be actual (neither estimated nor budgeted) and linked to the project*
- *If the actual indirect costs can not be established then use a flat rate for charging indirect costs to the project (20% or 60% depending on the status of the organisation)*

5. Indirect Costs - Ineligible items

- *Remove any ineligible items from the pool of indirect costs*

- *Examples of ineligible items:*
 - *Marketing & sales costs*
 - *Financing costs*
 - *Exchange rate losses*
 - *Costs with no relationship to the project*

6. 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*

6. 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*

7. Hours charged to the project

Time charged to the project:

- *Ensure a reliable time-recording for all employees charged to FP7*
- *List hours charged by activities: RTD, Management, Demonstration, Others*
- *Sign and have the time charged approved*

Do not charge time when:

- *The person is on leave*
- *Attending conferences unrelated to the project*

8. Use of average personnel cost

- *It is now permitted to use average personnel costs for the calculation of staff costs under the condition that:*
- *They reflect the usual cost accounting practice **declared by the beneficiary***
 - ***They are based on** actual personnel costs as registered in the statutory accounts **(without estimated or budgeted elements)***
 - *They exclude ineligible cost items **and any costs claimed under other cost categories (to avoid double funding of the same costs)***
 - ***The number of productive hours corresponds to usual management practice***

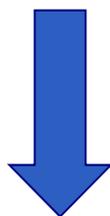
If the criteria for the use of average personnel costs can not be met, then actual costs should be declared.

9. SME owners

SME owners may choose to:

Pay themselves a salary

For their research work



**Claim the salary as a cost
under the FP7 project**

No salary



**Charge Marie Curie flat rates to
the FP7 project**

10. VAT

- *VAT, whether recoverable or not, is ineligible*
- *Please ensure that VAT is always excluded from all cost claims*

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





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*





Special Clause 10 - Joint Research Units (UMR)

Characteristics:

Research laboratories/ infrastructures created/owned by 2 or more different legal entities in order to carry out research

NO LEGAL PERSONALITY different from that of its members

ONLY PHYSICAL EXISTENCE (premises, equipment, resources)

Conditions:

Scientific and economic unity

Last a certain length of time

Recognised by a public authority under the relevant national law

Beneficiary in the project -> a member of the JRU (acting on behalf of the JRU), any other member of the JRU (not a beneficiary but contributing to the project) → third party identified in the SC 10





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



Average Personnel costs: criteria

➤ **Changes:**

- *the criteria on maximum deviations between averages and individual actual costs do not apply any more*
- *No obligation for ex-ante CoMAv (it becomes an option)*

➤ **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:*

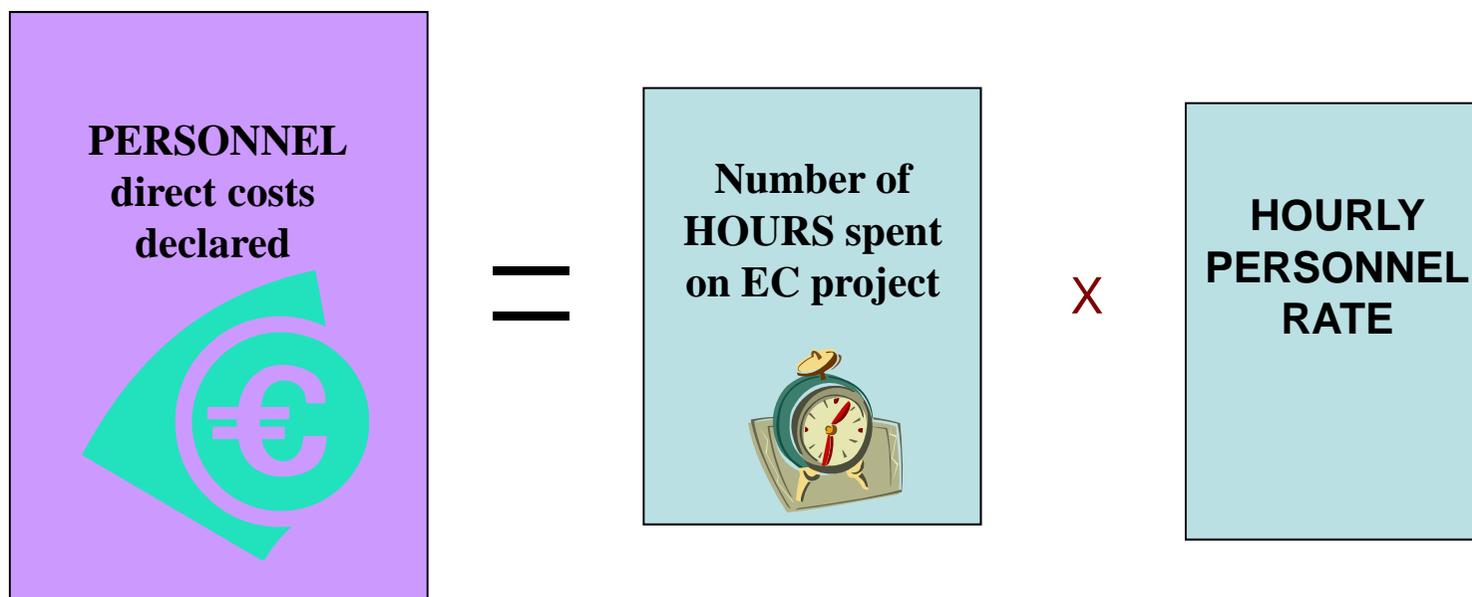
- *Internal manuals describing averages*
- *List of all average personnel rates*
- *Employees groupings*
- *Productive hours calculation*
- *Accounting records*
- *List of all relevant employees (working on EU projects and not working on EU projects) based on which the average personnel rate is calculated*

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

Personnel costs: How to get things right



Personnel costs: How to get things right

**HOURLY
PERSONNEL
RATE**
of an employee

==

Total Annual Personnel Costs of an employee

Total Annual Productive hours of an employee



Personnel costs: Productive hours

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

- *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: 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 payments vs. redundancy provisions*
- *Statutory parental leave payments*





ADDITIONAL INFORMATION



How to avoid common errors identified in cost claims

In the welcome pack and soon on CORDIS



Guide to FP7 Financial Issues

http://cordis.europa.eu/europa.eu/pub/fp7/docs/financialguide_en.pdf



And in case of doubts, do not forget: RESEARCH HELPDESK

<http://ec.europa.eu/research/enquiries>

Thank you very much for your attention!

Questions?

