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**CERTIFICATES ISSUED BY EXTERNAL AUDITORS**

**GUIDANCE NOTES FOR BENEFICIARIES AND AUDITORS**

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## INTRODUCTION

These guidance notes have been compiled to guide research beneficiaries and external auditors in the preparation of Certificates on the Financial Statements and on the Methodology for calculating personnel costs/indirect costs under the European Community's 7<sup>th</sup> RTD Framework Programme (FP7).

In particular, the document considers the following topics and related issues:

- FP7 model Grant Agreement<sup>1</sup>;
- Guide to Financial Issues Relating to FP7 Indirect Actions<sup>2</sup>;
- Frequently asked questions (FAQs) received by the European Commission from external auditors, beneficiaries and the Commission's operational services. The FAQ will be published in a separate document on CORDIS.

The objective of these guidance notes is to give an overview of the requirements and provisions which are of importance in claiming costs for reimbursement and hence in the Certification on the Financial Statements and on the Methodology. These guidance notes do not reflect an official position of the Commission; only the provisions of the signed Grant Agreement are binding.

The text of this document is valid as of the present date however it may be updated if necessary to reflect developments in the Certificate on the Financial Statements and on the Methodology procedures as they occur.

This document is composed of Part I dealing with the Certificates on the Methodology, Part II covering the Certificates on the Financial Statements and Part III which is a common glossary for both types of Certificates.

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<sup>1</sup> See in particular Articles II.4 and II.14-II.19 of Annex II (General Conditions, Part B) of the model grant agreement:

[http://cordis.europa.eu/fp7/calls-grant-agreement\\_en.html](http://cordis.europa.eu/fp7/calls-grant-agreement_en.html)

<sup>2</sup> See in particular Part 2.A, Section 2 of the FP7 Guide to Financial Issues:

[ftp://ftp.cordis.europa.eu/pub/fp7/docs/financialguide\\_en.pdf](ftp://ftp.cordis.europa.eu/pub/fp7/docs/financialguide_en.pdf)

## 1. GENERAL PRINCIPLES

The Certificates on the Financial Statements (CFS) and on the Methodology for both personnel and indirect costs (CoM) and on the Methodology on average personnel costs (CoMAv) are an independent report of factual findings produced by an external auditor (or in the case of a public body it may be provided by a competent public officer) according to the requirements of Article II.4 of the Grant Agreement.

The purpose of the report of factual findings is to give to the Commission relevant elements necessary to assess whether costs (and, if relevant, the receipts and interests generated by the pre-financing) charged under the project are claimed by the beneficiaries in accordance with the relevant legal and financial provisions of the FP7 model Grant Agreement.

**N.B: The submission of a Certificate on the Financial Statements or on the Methodology does not waive the right of the Commission or the European Court of Auditors to carry out their own audits<sup>3</sup>.**

Notwithstanding the procedures to be carried out, the beneficiary remains at all times responsible and accountable for the accuracy of the Financial Statements. A beneficiary that has been guilty of making false declarations or has been found to have seriously failed to meet its obligations under the Grant Agreement shall be liable to financial penalties according to Article II.25 of the Grant Agreement.

The auditor has a contractual relationship solely with the beneficiary. The auditor does not have a contractual relationship with the Commission and the Commission will not intervene in any dispute between the auditor and the beneficiary.

The Auditor shall undertake that his work has been carried out:

- in accordance with the International Standard on Related Services ('ISRS') 4400 *Engagements to perform Agreed-upon Procedures regarding Financial Information* as promulgated by the International Auditing and Assurance Standards Board (IAASB) of IFAC;
- in compliance with the *Code of Ethics for Professional Accountants* issued by the International Ethics Standards Board for Accountants (IESBA) of IFAC. Although ISRS 4400 provides that independence is not a requirement for agreed-upon procedures engagements, the European Commission requires that the Auditor also complies with the independence requirements of the *Code of Ethics for Professional Accountants*.

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<sup>3</sup> "The Commission may, at any time during the grant agreement and up to 5 five years after the end of the project, arrange for audits to be carried out [...]" (Article II.22 of the FP7 Model Grant Agreement).

## 2. AUDITORS ELIGIBLE TO DELIVER THE CERTIFICATE ON THE FINANCIAL STATEMENTS AND ON THE METHODOLOGY (COM AND COMAV)

Each beneficiary is free to choose a qualified external auditor, including its statutory external auditor, provided that the following cumulative requirements are met:

- the external auditor must be **independent** from the beneficiary;
- the external auditor must be **qualified** to carry out statutory audits of accounting documents in accordance with national legislation implementing the Directive on statutory audits of annual accounts and consolidated accounts<sup>4</sup> or any Community legislation replacing this Directive. Beneficiaries established in third countries must comply with equivalent national regulations in the same field and the certificate on the financial statement provided will consist of an independent report of factual findings based on procedures specified by the Community.

The services provided by the auditors to the beneficiaries follow the requirements related to subcontracts in the framework of FP7 Grant Agreements and are therefore subject to the requirements of best value for money (Article II.7 of the FP7 model Grant Agreement). Beneficiaries shall ensure the rights of the Commission and the Court of Auditors to carry out audits are extended to the auditors.

According to the provisions of Article 248 of the Treaty, Article 142 of the Financial Regulation and Article 19§10 of the FP7 Rules for Participation, the Court of Auditors has the right to access the records on the premises of any natural or legal person in receipt of payment. Although this would not automatically include the working documents of the auditors, the external auditors might have to provide access to their working papers if the Court of Auditors requests so and when it is necessary to carry out its task. Therefore, the access to working papers should not be required as a matter of course but because there is a genuine concern about the way in which the funds have been spent by the beneficiary. If this access requested by the Court of Auditors would concern working papers subject to a professional secrecy or confidentiality requirements of the national jurisdiction, the auditors concerned are advised to address this issue in a bilateral manner with the Court of Auditors in order to ensure that the auditor can duly respect his professional obligations.

Public bodies, secondary and higher education establishments and research organisations<sup>5</sup> have the choice between an external auditor and a competent public

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<sup>4</sup> Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

<sup>5</sup> Research organisation, as defined by the FP7 Rules for Participation, means a legal entity established as a non-profit organisation which carries out research or technological development as one of its main objectives.

officer. Where a public body opts to use a competent public officer, the auditor's independence is usually defined as independence from the beneficiary "in fact and/or in appearance". A preliminary condition is that this competent public officer was not involved in any way in drawing up the Financial Statements (Form C). Relevant national authorities must establish the legal capacity of the competent public officer to carry out audits of that specific public body. Although it is not compulsory, based on good practice, it is recommended this be notified by a letter to the relevant research Directorate General and subsequent letter of acknowledgement of receipt from that Directorate General. Reference should be made to this notification in the certificate.

There are no specific independency requirements in relation to the auditors establishing Form E versus the auditors establishing Form D. Either form may be established by one and the same qualified and independent auditor or another one.

The Commission stresses that where a beneficiary (in case of public bodies, research organizations and secondary and higher education establishments) chooses to use its competent public officer (e.g. the internal auditor), the beneficiary must ensure that the competent public officer is fully independent and is sufficiently qualified to perform the related procedures. In many organizations the remit of the internal audit function is not adequate to perform accounting systems tests. In such case, it is essential to have a competent external auditor perform the tasks.

### **3. REIMBURSEMENT OF THE COSTS OF THE CERTIFICATES**

The **cost of the Certificate on the Financial Statements** is an eligible cost in the Grant Agreement for which the certificate is submitted (Article II.16).

The **cost of the Certificate on the Methodology** (CoM and CoMAv) is an eligible cost in any of the financial statements submitted in any FP7 Grant Agreement in which the beneficiary participates after the acceptance of the Certificate on the Methodology by the Commission. The cost of the Certificate on the Methodology, even if it will be used for all FP7 Grant Agreements, can be claimed only once in the lifetime of FP7 unless, due to a change of the methodology, the submission of a new certificate is required.

The FP7 Model Grant Agreement provides that the cost of the Certificate on the Methodology (CoM or CoMAv), which unlike periodic Certificates on the Financial Statements, is not linked to a specific project as such, is an eligible cost. In order to avoid that this type of costs disproportionately weigh on the available EU funding of individual projects under which they are submitted, it is important that consortium partners anticipate their intention to provide such certification and identify the estimated costs already at the proposal stage and again at the negotiation stage. As such, this can be foreseen in due time in the project budget.

- If a competent public officer has provided the certificate, then the identifiable direct actual costs (gross remuneration and related charges) will be considered eligible. The total amount charged shall exclude any profit margin.
- The price charged for a certificate is subject to the general eligibility criteria of the Grant Agreement and should consider relevant market prices for similar services. In order to be eligible, the price should in particular be consistent with the principles of economy, efficiency and effectiveness. Excessive or reckless expenditures will be rejected.

- The auditor invoices directly to the beneficiary giving a breakdown of the amount of fees charged and the VAT applied. The amount of VAT is not an eligible cost for reimbursement by the Community financial contribution.
- The Commission will not pay the cost of building up the methodology. The eligible cost is limited to the performance of the agreed upon procedure (Annex VII) with the exclusion of any costs relating to consultancy for improvement or refinement of the methodology.
- Costs incurred for the Certificates on the Financial Statements and for the Certificates on the Methodology are eligible direct costs charged under "Management costs".

#### **4. PRACTICAL HINTS FOR BENEFICIARIES AND ESSENTIAL BACKGROUND DOCUMENTS**

In order to avoid delays in the submission of the certificates, beneficiaries should select and contract the auditor well in advance. The terms of reference attached as Annex VII of the Grant Agreement should form the mandatory basis of the engagement letter to be agreed and **signed** both by the beneficiary and **by the auditor**. As a first step it is essential that the auditor fully understands the requirements of the certificates and that the auditor is provided with a complete set of the documents necessary for the certification.

In addition to the normal supporting documents needed to perform the required testing procedures, the following documents serve as a basis for certification. The list is not exhaustive.

- Grant Agreement signed between the beneficiary and the Commission including eventual amendments and its Annexes i.e. Annex I ‘Description of Work’ and Annex II ‘General Conditions’ (in particular, part B of Annex II sets out the financial provisions), Annex III (Integrated Projects, Networks of Excellence, Infrastructures, SMEs and Civil Society Organisations) and Annex VII – Forms D and E;
- ‘Guide to Financial Issues relating to Indirect Actions of the Seventh Framework Programmes’. As mentioned above these guidelines have been designed to help both beneficiaries and auditors to understand the financial provisions of the FP7 model Grant Agreement;
- The Frequently Asked Questions;
- The present guidance notes.

## PART I: CERTIFICATES ON THE METHODOLOGY

## 1. REASONS FOR INTRODUCING THE CERTIFICATION ON THE METHODOLOGY

Experience with past framework programmes has evidenced that the main sources of errors in the costs claimed by beneficiaries relate to the personnel costs and indirect costs, often calculated according to a methodology which does not conform to the Grant Agreement provisions.

The objective of the Certification on the Methodology is to promote the use of correct methodologies by beneficiaries when calculating personnel costs and indirect costs, in particular in those cases when average costs for personnel are claimed. This way, the expected error rate detected by Commission services after, for example, an ex-post audit should be limited. This should therefore reassure the beneficiaries that the methodology they use conforms to the FP7 Grant Agreement requirements.

With the view of simplifying and reducing the administrative burden for beneficiaries, beneficiaries receiving approval from the Commission on their certified methodology for both personnel and indirect costs will not have to submit Certificates on the Financial Statements for interim payments. In addition, the final Certificate on the Financial Statements will be prepared by the auditors by verifying, for average personnel costs and indirect costs, only the compliance with the declared methodology as described in Part I of the Guidance Notes for Beneficiaries and Auditors<sup>6</sup>, and for the other costs (such as travel, equipment, etc) the actual costs, thus adding simplification to the procedures foreseen in Form D and performed by the auditor. This should also contribute to the reduction of the cost of the certification system as a whole and in particular for beneficiaries participating in several Grant Agreements.

The ideal target for the provision of this kind of certification is typically beneficiaries of multiple Grant Agreements which have an established methodology for calculating their rates.

As the Certification of the Methodology, once approved, is intended to be valid throughout the whole FP7, it is clear that beneficiaries participating in several Grant Agreements will benefit from this exercise. It is assumed that the methodology used to support the reimbursement of costs claims in the future continues to be the same as the methodology "certified" by the auditor at a certain date until the beneficiary states otherwise.

It should be noted that those beneficiaries who intend to claim average costs for personnel must provide a Certificate on the Methodology they use to calculate averages. The beneficiary will be permitted to claim average costs only if the certified methodology is approved by the Commission. Beneficiaries that do not have a sound

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<sup>6</sup> Refer to paragraph 6.4 on Procedures for CFS under Part II for definition on the compliance checks

control system in place which ensures that average costs are calculated in conformity with the contractual provisions should not opt to declare average costs but should claim individual actual costs.

## 2. ADVANTAGES OF THE USE OF THE CERTIFICATION ON THE METHODOLOGY

WITHOUT CoM/CoMAv	WITH CoM/CoMAv
No use of average costs for direct personnel costs	Use of average costs for direct personnel costs allowed: all beneficiaries who intend to declare average personnel costs must have a certified methodology approved by the EC (see Art. II.14 of the Grant Agreement)
Individual calculation of actual costs for personnel certified	Where average personnel costs have been used, no recalculation of individual actual costs for personnel in the Certificate on the Financial Statements for the final payment or during ex-post audit
Errors in costs claimed are detected when processing payments or during ex-post audits	Early detection and corrections of possible errors in personnel and indirect costs claimed
No certainty that the methodology used by the beneficiary to calculate their claims is conforming to the provisions of the Grant Agreement	Early assessment of compliance to contractual provisions of methodology applied to calculate personnel and indirect costs
Without CoM, one Certificate on the Financial Statements (hereafter referred to "CFS") to be submitted for each interim payment exceeding 375000 € when cumulated with all previous payments for which a Certificate on the Financial Statements has not been submitted (except if the project duration is less than two years; in that case, only at the end)	Waiving of interim CFS only with CoM
CFS valid only for the relevant costs claimed	CoM/CoMAv valid throughout all FP7 projects
	With CoM, reduced costs for the whole certification system
	With CoM, simplification of administrative burden both for beneficiaries and EC operational services (less number of certificates to provide/process)

### **3. SCOPE AND CONTENT OF THE CERTIFICATE ON THE METHODOLOGY**

The Certificate on the Methodology should be addressed by the auditor (or the competent public officer) to the attention of the beneficiary (not to the attention of the Commission).

The auditor undertakes this engagement in accordance with the terms of references of Form E - Annex VII (hereinafter "ToR") and Parts I and III of the document "Certificates issued by External Auditors, Guidance Notes for Beneficiaries and Auditors and:

- in accordance with the International Standard on Related Services ('ISRS') 4400 Engagements to perform Agreed-upon Procedures regarding Financial Information as promulgated by the International Auditing and Assurance Standards Board (IAASB) of IFAC;
- in compliance with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) of IFAC. Although ISRS 4400 provides that independence is not a requirement for agreed-upon procedures engagements, the European Commission requires that the Auditor also complies with the independence requirements of the Code of Ethics for Professional Accountants.

The auditor performs the procedures specified in 1.9 of the ToR ('Scope of Work – Compulsory Report Format and Procedures to be performed') and uses the evidence obtained from these procedures as the basis for the Report of factual findings.

The work which has to be performed by the auditor will be further detailed in point 6 of these guidance notes.

The Certification on the Methodology will consist of one Certificate for the whole Legal Entity, which must account for all the departments and all methodologies in place within the Legal Entity. In no case, a department within a Legal Entity is entitled to request a Certificate on the Methodology separately from the Legal Entity. Therefore it is important that Legal Entities which may apply the special clause n°30 in FP7 Grant Agreements indicate this option in the Certificate on the Methodology which will therefore cover all methodologies applied by the Legal Entity.

### **4. FORM OF THE CERTIFICATE ON THE METHODOLOGY - ANNEX VII**

Use of the reporting format attached as Annex VII (Form E) of the model Grant Agreement by the external auditor or competent public officer is compulsory. The reporting format should include the procedures and findings specified in Annex VII. Specific reference should be made to the Grant Agreement under which the cost of the certificate will be claimed.

Nonetheless, under point 1.9, "Scope of Work – Compulsory Report Format and Procedures to be performed", the title should read as follows: "*Independent Report of factual findings on the methodology concerning Grant Agreements financed under the Seventh Research Framework Programme (FP7).*"

The subsequent paragraph referring to a Grant Agreement [title and number of Grant Agreement] may be the indication where the cost of the audit certificate is to be claimed and/or the basis on which the certificate on the methodology has been established.

In the section "Statements to be made by the beneficiary and corresponding procedures to be carried out by the Auditor", the "Statements to be made by the beneficiary" have to be filled in by the beneficiary and must be signed (signature and stamp or seal) and dated by the beneficiary while the "Procedures to be carried by the Auditor and factual findings" have to be filled in by the external auditor (or competent public officer) and must be signed (signature and stamp or seal) and dated by the external auditor, in order for the auditor to issue an independent report on factual findings on the methodology concerning costs claimed under a Grant Agreement financed under FP7.

With respect to the language of the Certificate on the Methodology, Article 4 of the FP7 model Grant Agreement states that "Any report and deliverable, when appropriate, required by this Grant Agreement shall be in [*insert language*]". Therefore, the report of factual findings on the methodology should be written in the language indicated in Article 4 of the Grant Agreement. In this particular case costs for translation are supposed to be covered by indirect costs.

## 5. SUBMISSION OF THE CERTIFICATE ON THE METHODOLOGY

### 5.1 Steps to be followed

STEPS	Certificate on the Methodology for both personnel and indirect costs (CoM)	Certificate on the Methodology for average personnel costs (CoMAv)
<b>1. Request to the EC</b>	<p>Beneficiaries who consider to meet the below criteria (point 5.2) may send a request to the EC, only by electronic mail to <a href="mailto:RTD-FP7-Cost-Methodology-Certification@ec.europa.eu">RTD-FP7-Cost-Methodology-Certification@ec.europa.eu</a> (functional mailbox), containing the Grant Agreement/contract numbers (FP7 and/or FP6) in which they participate.</p> <p><b>WHEN:</b> at any time during the lifetime of FP7</p>	<p>No request is required as the certificate is mandatory in case of use of average personnel costs</p>
<b>2. Acceptance/rejection of the request by the EC</b>	<p>Within 30 calendar days (possible extension of time-limit).</p>	
<b>3. Submission of the certificate</b>	<p>Possible only in case of acceptance (see steps 1 and 2) by EC.</p> <p><b>WHEN:</b> at any time during the implementation of FP7 and at the earliest on the start date of the project of the first Grant Agreement signed by the beneficiary under FP7.</p> <p>It should be noted that the auditors need a sound basis to carry out their procedures (e.g. a pro-forma statement of costs) and that the certified methodology must be the one which is used for FP7 projects.</p> <p><b>HOW:</b> This certificate can be</p>	<p><b>WHEN:</b> at any time during the implementation of FP7 and at the earliest on the start date of the project of the first Grant Agreement signed by the beneficiary under FP7.</p> <p>It should be noted that the auditors need a sound basis to carry out their procedures (e.g. a pro-forma statement of costs) and that the certified methodology must be the one which is used for FP7 projects.</p> <p>As average personnel costs</p>

	<p>introduced only by electronic mail to the following functional mailbox [<a href="mailto:RTD-FP7-Cost-Methodology-Certification@ec.europa.eu">RTD-FP7-Cost-Methodology-Certification@ec.europa.eu</a>]</p> <p><b>IN WHICH FORM:</b> in the form of a report of factual findings as foreseen in the Grant Agreement (Annex VII to the Grant Agreement, Form E).</p>	<p>can be used only if the methodology is approved by the Commission, it is recommended to submit the certification as soon as possible.</p> <p><b>HOW:</b> This certificate can be introduced only by electronic mail to the following functional mailbox [<a href="mailto:RTD-FP7-Average-Personnel-Rate-Certification@ec.europa.eu">RTD-FP7-Average-Personnel-Rate-Certification@ec.europa.eu</a>]</p> <p><b>IN WHICH FORM:</b> in the form of a report of factual findings as foreseen in the Grant Agreement (Annex VII to the Grant Agreement, Relevant part of Form E).</p>
<b>4. Acceptance/rejection of the certificate by the EC</b>	Within 60 calendar days (possible extension of time-limit)	Within 60 calendar days (possible extension of time-limit)

## 5.2 Specific provisions for the Certificate on the Methodology for both personnel and indirect costs

### 5.2.1 Criteria for submission of the CoM

The submission of this type of certificate is entirely optional. According to the provisions of the model Grant Agreement (Article II.4.4), the Commission may at its sole discretion accept this submission. In addition, this certificate is foreseen for beneficiaries with multiple participations according to the Implementing Rules to the Financial Regulation<sup>7</sup>.

Therefore, only **those beneficiaries having participated in multiple Grant Agreements under FP7** are entitled to submit a CoM. In view of the waiver to which the certification entitles beneficiaries (see point 5.2.2), the Commission will set up the threshold defining the number of participations in FP7 a beneficiary must have in order to be considered a "multiple beneficiary" after a first assessment

<sup>7</sup> Commission Regulation N° 478/2007 of 23/04/2007 amending Regulation N° 2342/2002 laying down detailed rules for the implementation of Council Regulation N° 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, OJ 28/04/2007, L 111/13.

based on historical criteria for FP6. This preliminary assessment is conducted in a way to help multiple beneficiaries take advantage of the certification on the Methodology as soon as possible during their participation in FP7. Therefore, as a transitional measure, **beneficiaries who have participated in at least 8 contracts under FP6** with an EC financial contribution for each of them equal or above 375,000 € can submit a request for certification of their methodologies for both personnel and indirect costs, as from their first participation under FP7.

These guidance notes will be updated with the threshold relating to FP7 participations in the course of 2008.

### *5.2.2 Consequences of the acceptance and use of the Certificate on the Methodology for both personnel and indirect costs:*

- **Intermediate CFS for claims of interim payments:** the requirement shall be waived from the date of the notification to the beneficiary of the acceptance of the certificate by the Commission.
- **CFS for the final payment:** beneficiaries for whom, if cumulatively with previous periods, the EC contribution is superior to EUR 375,000, will only have to submit a CFS for the final payment. This CFS will cover the eligible costs for the total EC contribution, including personnel and indirect costs. However, for average personnel costs and indirect costs, the auditors will only have to focus on checking compliance with the certified methodology and systems, omitting individual calculations.
- **Validity of the certificate:** Once the methodology is accepted, it will be valid for all subsequent Financial Statements submitted by the same beneficiary under the FP7 unless the beneficiary's methodology changes or if an audit or other control performed by the Commission services or on its behalf demonstrates that the methodology certified can no longer be maintained in its present form. The beneficiary has to declare to the Commission any change in its methodology, including the date of the change. In case of change, a new certificate on the methodology has to be submitted, according to the same procedure as under point 5.1 above. Until the acceptance of this amended methodology, the requirement to provide intermediate CFS will not be waived. A beneficiary that has been guilty of making false declarations or has been found to have seriously failed to meet its obligations under this Grant Agreement shall be liable to financial penalties according Article II. 25 of the Grant Agreement.
- **Validity of the certificate approved during the reporting period:** The Certificate on the Methodology approved during a reporting period is valid retroactively at the beginning of the reporting period. This principle also applies in case of invalidity of the certificate decided by the Commission. The Commission shall also consider the date of entry into force of the cost methodology which is certified.
- **Validity of the methodology introduced by the beneficiary during the reporting period:** If the methodology was introduced by the beneficiary before the beginning of the reporting period, then the methodology, if accepted by the Commission, is considered to be valid as of the 1st day of

the reporting period. If the methodology was introduced by the beneficiary during the reporting period, then the methodology, if accepted by the Commission, is considered to be valid as of the 1st day of the next reporting period.

- **The costs for a Certificate on the Methodology for personnel and indirect costs** will be eligible provided that the following cumulative requirements are met :
  1. The Commission has accepted in writing the request for eligibility of the beneficiary for submitting the Certificate on the Methodology for personnel and indirect costs.
  2. The certificate is submitted in due form (Annex VII – Form E) and the qualified auditor has performed the requested procedures. In other words, the procedures have been fully performed by a qualified auditor and the findings duly reported by means of the Form E.
  3. The methodology certified is approved by the Commission. Please note that the auditor's fee is limited to the performance of the agreed-upon-procedures and therefore any cost incurred by the beneficiary in relation to the establishment or adaptation of the methodology (consulting, IT, etc) is not eligible.
  4. The cost fulfils the conditions of eligibility settled in Article II.14 of the Grant Agreement.

### *5.2.3 Consequences of the rejection by the Commission:*

In case the certificate cannot (yet) be accepted a motivated decision will be communicated to the beneficiary. The beneficiary will be invited to submit another Certificate on the Methodology which is compliant with the requirements of the Commission. Until the acceptance of the Certificate on the Methodology, the requirement to provide intermediate Certificates on the Financial Statements is not waived.

## **5.3 Specific provisions for the Certificate on the Methodology on average personnel costs**

### *5.3.1 Consequences of the acceptance and use of the certificate on the average personnel costs:*

- **Costs claimed:** The beneficiary may declare average personnel costs. Average personnel costs charged by this beneficiary according to the certified and accepted methodology are deemed not to significantly differ from actual personnel costs.
- **Intermediate CFS for claims of interim payments:** the Certification on the average personnel costs does not waive the obligation to provide an intermediate CFS (whenever the EUR 375,000 threshold is reached)

unless a complete Certificate on the Methodology on both personnel and indirect costs has been submitted.

- **CFS:** Concerning personnel costs, the auditors will only have to focus on checking compliance with the certified methodology and systems omitting individual calculations. For the costs not covered by the Certificate on the Methodology the auditors will check the actual costs.
- **Validity of the certificate:** Once the methodology is accepted, it will be valid for all subsequent Financial Statements from the same beneficiary submitted under FP7 unless the beneficiary's methodology changes or if an audit or other control performed by the Commission services or on its behalf demonstrates that the certification can no longer be maintained in its present form. The beneficiary has to declare to the Commission any change in its methodology, including the date of the change. In case of change, a new certificate on the average personnel costs has to be submitted, according to the same procedure as under point 5.1 above. Until the acceptance of this amended methodology, the beneficiary cannot charge average personnel costs. A beneficiary that has been guilty of making false declarations or has been found to have seriously failed to meet its obligations under this Grant Agreement shall be liable to financial penalties according Article II. 25 of the Grant Agreement.
- **Validity of the certificate approved during the reporting period:** The Certificate on the Methodology approved during a reporting period is valid retroactively at the beginning of the reporting period. This principle also applies in case of invalidity of the certificate decided by the Commission. The Commission shall also consider the date of entry into force of the cost methodology which is certified.
- **Validity of the methodology introduced by the beneficiary during the reporting period:** If the methodology was introduced by the beneficiary before the beginning of the reporting period, then the methodology, if accepted by the Commission, is considered to be valid as of the 1st day of the reporting period. If the methodology was introduced by the beneficiary in the middle of the reporting period, then the methodology, if accepted by the Commission, is considered to be valid as of the 1st day of the next reporting period.
- **The costs for a Certificate on the Methodology for average personnel costs will be eligible provided that the following cumulative requirements are met :**
  1. The submission of this certificate is compulsory
  2. The certificate is submitted in due form (Relevant part of Annex VII – Form E) and the qualified auditor has performed the requested procedures. In other words, the procedures have been fully performed by a qualified auditor and the findings duly reported by means of the Form E.
  3. The methodology certified is approved by the Commission. Please note that the auditor's fee is limited to the performance of the agreed-upon-procedures and therefore any cost incurred by the beneficiary in relation

to the establishment or adaptation of the methodology (consulting, IT, etc) is not eligible.

4. The cost fulfils the conditions of eligibility settled in Article II.14 of the Grant Agreement.

### *5.3.2 Consequences of the rejection by the Commission:*

In case the certificate cannot (yet) be accepted a motivated decision will be communicated to the beneficiary. The beneficiary will be invited to submit another Certificate on the Methodology which is compliant with the requirements of the Commission. Until the acceptance by the Commission of the certificate on average personnel costs, the beneficiary can not charge average personnel costs.

## **6 PROCEDURES FOR CERTIFICATES ON THE METHODOLOGY ACCORDING TO ANNEX VII - FORM E**

### **6.1 How should the beneficiary fill out Form E?**

The statements described in the left-hand column of the Form E model represent a "benchmark" methodology. It is expected in practice that there may be some differences between this and the existing systems in place.

The left-hand column of Form E must be filled in by the beneficiary and the auditor has to make factual findings in the right-hand column regarding these statements made by the beneficiary. Thus the statements should reflect the current status of the beneficiary's methodology.

For example, if time recording does not exist, this should be stated clearly by the beneficiary in the left-hand column. As a consequence, the auditor will indeed not be able to perform the procedure foreseen in the right-hand column for time-recording and will have therefore to report this scope limitation in his report under the caption "Exceptions".

It is important to note that such reported exceptions relating to deviations from the benchmark methodology as described in the statements made by the beneficiary are used as a mechanism for the Commission services to prioritise the issues to be examined. **They do not give an indication on whether the methodology will or not be accepted by the Commission.** Beneficiaries without full time recording of all activities could eventually obtain a Certificate on the Methodology.

### **6.2 When can the auditor decide to adapt the model findings in the right-hand column and when should he report an exception?**

The procedures and factual findings which have been listed in the right-hand column of the Form E model are based on the "benchmark" methodology and attempt to clearly demonstrate that the beneficiary does indeed in practice implement the appropriate

methodology for preparing its claims to be compliant with the provisions of the FP7 Grant Agreement.

Any deviations from this "benchmark" methodology, even when reported by the beneficiary, or any errors or exceptions noted by the auditor when performing the procedures will affect the acceptance of the methodology by the Commission.

Thus the Commission requires a description of the factual findings which effectively highlight any such deviations and errors or exceptions and which have to be reported by the auditor in his report under the caption "Exceptions".

For auditors, different situations require him to report findings as "Exceptions" in his report:

- Scope limitations: the really existing system of the beneficiary deviates from the benchmark methodology. It is the responsibility of the beneficiary to report this. As a consequence, the auditor is not able to perform the procedure foreseen in the Form E model. In this case, it is understood that the Commission requires the auditor to report such a situation as an exception.
- Errors or exceptions: the auditor performs the procedure required by the Form E model and the findings raise errors or exceptions. The auditor is to report these errors and exceptions in his report.

### 6.3 Use of the methodology by the beneficiary

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<p>The methodology described below has been in use since <i>[date]</i>.</p> <p>The next planned alteration to the methodology used by the Beneficiary will be from <i>[date]</i></p>	<p><b>Procedure:</b> The Auditor has inspected records and documents which support the date given by the Beneficiary.</p> <p><b>Finding:</b> The dates given by the Beneficiary are consistent with the management information provided by the Beneficiary.</p>

#### What is the objective of this procedure?

The Commission, for each Form E, is interested in knowing the starting date of the methodology and for how long the methodology has been in use by the beneficiary, principally to ensure a correspondence can be achieved between the use of the methodology and the relevant cost claims made by the beneficiary.

#### Which documents should the beneficiary prepare for the auditor?

The typical documents to be provided would include minutes of meetings, internal memos, working documents showing calculations from prior years, etc. The auditor is expected to check their consistency with the data provided by the beneficiary.

#### What does the Commission understand by 'alterations to the methodology'?

Alterations to the methodology should be understood as major changes, such as a move from average costs to actual costs, changes in cost drivers, changes in the way productive hours are calculated, etc. It is not intended to cover yearly updates to the most recent financial data, or changes in cost structure caused by the evolution of the institution.

If documentation is not available to support the introduction or alterations of the methodology, this should be listed as an exception in the report.

## 6.4 Personnel

### 6.4.1 Existence of time recording and number of productive hours

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Personnel</b>	
<p>1. Time recording exists, with authorisation, which enables all personnel hours to be allocated to project work, management and administrative time, holidays, etc.</p> <p>The time recording enables the time of employees working on multiple projects to be allocated to those projects, and includes a check to prevent double charging of time.</p> <p>'Productive hours' represent the (average) number of hours made available by the employee in a year after the deduction of holiday, sick leave and other entitlements. This calculation should be provided by the Beneficiary, based on the period(s) corresponding to the Financial Statement.</p>	<p><b>Procedure:</b> For 10 employees selected at random, the Auditor checked: That the employee had recorded management and administrative tasks separately from project time; That an authorisation check exists which checks, inter alia, double-charging of time;</p> <p><b>Finding:</b> For the items checked, the time recording includes separation of time as specified above, and an authorisation including a check for double charging of time. For the most recent full calendar year: The average productive hours for the 10 employees was _____. The average productive hours per employee for the organisation as a whole, as recorded by the Beneficiary's time records was _____.</p>

#### What is the objective of this procedure?

The Commission needs to confirm that time recording really exists, with the necessary separation of research time (which can be directly charged to the project), and other tasks performed by the employee<sup>8</sup> which are not directly relevant to the project. There is frequently a lack of detail in the time recording at beneficiaries, whereby only the time worked on the project is recorded and thus no conclusions can be drawn about the productive hours<sup>9</sup>.

#### Why is the Commission interested in the productive hours calculation?

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<sup>8</sup> Employee means researcher or research-related person or person with certain coordinating tasks (when there is a project coordinator).

<sup>9</sup> See glossary for a definition.

Through this procedure the Commission intends to obtain information (if available) concerning (i) average productive hours for the 10 researchers<sup>10</sup> sampled<sup>11</sup> and (ii) the average productive hours for the organisation as a whole. This will provide the Commission with useful points of comparison between different beneficiaries, and also enable it to compare 'real' productive hours on a specific project with those of the organisation as a whole. For the purpose of this procedure, "full calendar year" means "financial year" (12 months period).

#### Why does the beneficiary need a time recording system?

The beneficiary should have in place a system to correctly apportion research-related time where this is spent on multiple projects, so that it is traceable, and the Commission can ensure that systematic over-claiming can be prevented. From a management perspective, it is not possible to accurately apportion costs without a global overview of how research-related and research-unrelated time is spent.

#### Which documents should the beneficiary prepare for the auditor?

The basic documents will be either paper timesheets filled out by the researchers, or a computer-based approach which may in some cases derive from a spreadsheet, database or a specifically tailored application.

The period in question will be the period of the "pro forma"<sup>12</sup> Financial Statement or actual Financial Statement (Form C<sup>13</sup>) or the most recent financial year to calculate productive hours if this is what has been used to calculate the rates claimed<sup>14</sup>. This Financial Statement will be used as a basis for the procedures which the auditor will carry out in the framework of the engagement.

#### How should time records normally be approved?

For the time recording data to be reliable, some form of check preventing double counting should exist, normally carried out by a hierarchical superior and using the data compiled from the time sheets. The beneficiary should be able to demonstrate to the auditor how this is done, and show how the system prevents double claiming. Normally this will consist of showing that no more than the total actual productive hours of an individual researcher can be charged.

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<sup>10</sup> or research-related person or person with certain coordinating tasks (when there is a project coordinator).

<sup>11</sup> Full coverage with individual checks if less than 10 employees, otherwise a sample of minimum 10 employees

<sup>12</sup> "Pro forma" means the Financial Statement prepared by the beneficiary covering an interim period from the beginning of the project when no actual Financial Statement (Form C) covering a full reporting period for the Grant Agreement is yet available.

<sup>13</sup> Refer to definition on Financial Statements in Part III, Glossary

<sup>14</sup> This relevant period applies to all tests concerning personnel and indirect costs.

For paper based systems where aggregation must be carried out manually, the main form of check is the manager/ supervisor's signature on the time-sheet itself.

What if the beneficiary only records project time and not all productive time on its time records?

If the beneficiary does not require all the time worked (including administrative and management time) to be recorded on the time sheets, it will not be possible to give the average productive hours of the ten employees. This should be described as an exception in Form E.

#### 6.4.2 Components of the personnel costs of the beneficiary

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Personnel</b>	
2. Personnel costs of the employees only include standard salaries, employer's costs, etc. and no special conditions exist for employees on EC projects, unless they are explicitly foreseen in the Grant Agreement.	<b>Procedure:</b> The Auditor reconciled the personnel costs used in the average personnel cost calculation to the payroll system and accounting records. <b>Finding:</b> The amounts used in the costs calculation and those in the accounting records were the same. The costs consisted of standard salaries and statutory employers' costs, and did not include bonuses and confirmation was obtained from the Beneficiary that no special conditions exist for employees on EC projects.

What is the objective of this procedure?

To reconcile the personnel costs used in the (average) personnel cost calculation to the payroll system and accounting records, the calculation can be based on real cost calculation and not only on average personnel cost.

The Commission needs to check that the researchers are being paid in accordance with the normal staff remuneration policy of the beneficiary. The personnel costs should represent the normal employment costs<sup>15</sup> of the personnel (social contributions, pension contributions, payments towards sickness and maternity schemes, etc.). In particular, there should normally be no difference if one compared the amount a researcher is paid when working on a non-EU project compared to an EU project. The Commission has experienced cases of researchers receiving bonuses<sup>16</sup> paid out of the EU budget where this had not been specifically permitted by the Commission in writing.

Which documents should the beneficiary prepare for the auditor?

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<sup>15</sup> See glossary for a definition.

<sup>16</sup> Whilst productivity bonuses or similar which are integrated part of the normal remuneration policy of the entity are commonly accepted, specific bonuses paid only for the participation on EC projects are never eligible.

The period in question will be the period of the "pro forma" Financial Statement or actual Financial Statement (Form C) or the most recent financial year to calculate productive hours if this is what has been used to calculate the rates claimed.

The auditor will have to rely on a written representation by the beneficiary<sup>17</sup> as to the absence of specific bonuses, if none are immediately identifiable from the payroll system. The documentation for checking the employment costs will normally be an output from the payroll system which details the component costs which are used in the calculation providing the hourly rate charged for the researcher<sup>18</sup>.

If the beneficiary considers it would be useful to the Commission, specific aspects of national requirements can be noted in this section. For example, if employers are legally required to accrue a holiday pay as part of the normal accounting of personnel costs, this could be brought to the Commission's attention.

How does the procedure change if the beneficiary calculates hourly rates on an individual basis rather than using average categories?

When the rates are calculated *ad personam* (i.e., using the individual researcher's salary as the basis), the employment costs can also be checked per person for the researchers sampled. If the rates are an average for a category, the aggregated figures extracted from the payroll system can be used to perform the check.

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<sup>17</sup> Included in the model letter of representation.

<sup>18</sup> or research-related personnel

### 6.4.3 Correct calculation of hourly rates<sup>19</sup>

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Personnel</b>	
<p>3. Hourly rates are correctly calculated using one of the following possibilities [choose one]:</p> <ul style="list-style-type: none"> <li>• Actual personnel costs <i>per person</i> divided by actual productive hours <i>per person</i>;</li> <li>• Actual personnel costs <i>per person</i> divided by <i>average/ standard</i> productive hours;</li> <li>• <i>Average</i> personnel costs <i>per person</i> divided by <i>average/ standard</i> productive hours.</li> </ul> <p>For the average costing approach, the Beneficiary should state:</p> <ul style="list-style-type: none"> <li>- How employees are grouped into categories (how many categories, under what criteria);</li> <li>- The pay range in each category from lowest to highest, average and median;</li> <li>- The upper and lower percentage variation within each category from the average;</li> <li>- The upper and lower percentage variation for productive hours from the average (if known);</li> <li>- A list of average rates charged in each category for the prior years (an indication only, of the expected range of rates for the period of the agreement).</li> </ul>	<p><b>Procedure:</b></p> <p>The Auditor reviewed the calculation and confirmed that hourly rates are calculated as specified by the Beneficiary.</p> <p>Where average costs are charged, the Auditor compared the following information with the accounting system of the Beneficiary:</p> <ul style="list-style-type: none"> <li>• The number of categories;</li> <li>• The pay range, median and average of each category;</li> <li>• The upper and lower percentage variation from the average (denominator is the average);</li> <li>• The upper and lower percentage variation for productive hours from the average (if known);</li> <li>• A list of average rates charged in each category for the prior years (an indication only, of the expected range of rates for the period of the agreement).</li> </ul> <p>The Auditor multiplied the average rate for each category by the total productive hours for each category for the period of the Financial Statement(s) and reconciled the result to the accounting records ('chargeable' personnel costs).</p> <p><b>Finding:</b></p> <p>No differences arose from the comparisons listed above.</p> <p>The result of the above recomputation ('chargeable' personnel costs) in all cases did not exceed the actual costs as recorded in the accounting records.</p>

#### What is the objective of this procedure?

The objective is to verify that the hourly rates being charged have been correctly calculated from the underlying information. For average rates, the Commission seeks a number of key figures in order to assess:

- a) whether there are a sufficient number of categories;
- b) whether those categories have been effectively<sup>19</sup> defined to ensure significant deviation is minimised.

The beneficiary should provide in an annex a detailed breakdown of the categories including all necessary information as requested in the Form E allowing the auditor to identify clearly the type of personnel grouped under each category.

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<sup>19</sup> Refer to Part III, Annexes II and III for examples on personnel average system and hourly personnel rate

The auditor's task is to check the figures have been correctly obtained from the relevant source (payroll system and time recording system) and to re-compute the relevant averages, medians, and ranges to ensure that they are accurate.

Is the auditor required to perform a sample check of the average costs?

No. The procedures on averages have to be performed on a 100% basis using the extracts from the beneficiary's payroll system and accounting information. No procedures *ad personam* (e.g. to identify if certain personnel have been correctly classified) are required to be performed as part of this procedure.

Which sections have to be filled in by the beneficiary?

As for all sections, but especially important here, the left-hand section is to be filled in **by the beneficiary** with the figures<sup>20</sup> obtained using their methodology.

What should the beneficiary take into account when fixing its personnel categories for FP7?

The number of categories represents the different classifications used by the beneficiary to charge project-related time to the Commission. The more detailed this classification is, the greater the probability of its being accepted by the Commission as unlikely to differ significantly from actual. It is therefore in the beneficiary's interest to use the maximum level of detail available to it in its normal accounting practices (rather than use a 'combined' rate for researchers who belong to different categories according to the beneficiary's internal classification).

The use of average rates for personnel costs, insofar as this is part of the usual accounting practice of the beneficiary, and if the average rates are sufficiently representative, may be accepted. In order to be sufficiently representative, the average rates must be calculated with sufficient frequency, based on actual costs recorded in the accounting records of the beneficiary, take into account sufficient staff categories and be applied consistently.

Auditors are requested to perform procedures on the accuracy of the average rate calculation.

How to perform the calculations when rates are calculated on an individual basis?

In cases where the actual costs per person are used (actual personnel costs per person divided by actual productive hours per person or by average/standard productive hours), the median, average etc. are **not required**. The auditor should just check the accuracy of the extraction of the individual's employment costs and the productive hours (individual, standard or average), and verify that the division of the costs by the hours to obtain the hourly rate is arithmetically consistent with the rate that is claimed.

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<sup>20</sup> Figures linked to the pro forma or figures linked to the Form C as the case may be

### What is the difference between a median and an average?

It is important to note the difference between a median and an average. The average of the numbers 1, 2, 3, 4 and 20 is **6**, (or 30/5), whereas the median (the number which is the mid point in the population) is **3**.

### How should the range and variation be calculated?

The pay range<sup>21</sup> should be of the form 'EUR 13.75 to EUR 16.37'. The percentage variation for this category where the average is 15 would be:  $(13.75-15)/15 = -8.3\%$  and  $(16.37-15)/15 = +9.1\%$ .

### The beneficiary does not record productive hours individually. How can it provide the variation in productive hours requested?

The variation of productive hours can be calculated for each category in a similar way to the rates, if this data is available. Frequently, a standard productive hours calculation will be used with no detailed record of individual productive hours. Use of a standard productive hours' calculation is not *prima facie* a reason for rejecting a certificate on the methodology.

### What are "accounting records" in this context?

For the recalculation of the 'chargeable' personnel costs, the accounting records will normally be the general ledger/ accounting records used to prepare the statutory financial statements (or equivalent). The check is meant simply to demonstrate that the information in the accounting records can be reconciled to the payroll system and productive hours used. If the product of the available hours which the beneficiary can charge and the corresponding hourly rate is the same or lower than the amounts in the accounting records, there is no risk to the Commission of the beneficiary 'over-recovering' its costs via FP7 Grant Agreements.

### How should the auditor check the rates of prior years?

For the list of rates used in prior years (it is recommended to provide information for at least two years), the auditor should use an appropriate extract from the prior year's payroll information or management accounting as far as it is available. The auditor is not requested to recalculate the average rates charged in each category for the prior years.

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<sup>21</sup> Pay range means in this context the costs of researchers including social security and allowances

## 6.5 Overheads/Indirect Costs<sup>22</sup>

### 6.5.1 Components of overheads/ indirect costs

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Overheads/ Indirect costs</b>	
<p>4. The Beneficiary confirms the following:</p> <p>Indirect costs only include those costs which cannot be allocated to specific projects and support the functioning of the organisation as a whole.</p> <p>The indirect costs do not include costs which relate exclusively to non-research parts of the organisation.</p> <p>If the organisation carries out activities other than research (e.g., manufacturing, education etc), these indirect costs are transparently separated via cost accounting and do not form part of the claim.</p>	<p><b>Procedure:</b> The Auditor obtained the calculation of hourly overhead rates (indirect costs), including a detailed breakdown of the <b>indirect costs to be allocated</b> to research activity;</p> <p><b>Finding:</b> This breakdown did not contain costs relating to direct project activity, such as the cost of research personnel, project consumables and expenses; This breakdown does not contain costs relating to education or manufacturing, or other non-research activities of the Beneficiary; The breakdown of indirect costs used to calculate overhead rates was reconciled to the accounts.</p>

#### What is the objective of this procedure?

This procedure does not apply if a flat-rate<sup>23</sup> on eligible direct costs is used for the calculation of indirect costs.

The Commission wants to ensure that the costs supported under FP7 have been incurred by the beneficiary in its research activity. The concern is that by including non-research related costs in the indirect cost calculation, the beneficiary ends up having parts of its non-research activity funded out of the FP7 budget. This most frequently occurs in universities, which may have education activities, or companies which have trading businesses where they supply goods and services other than research (e.g. a company that carries out applied research but also sells hardware and software to customers and therefore incurs costs supporting the manufacturing, sales and marketing of these products).

#### Which documents should the beneficiary prepare for the auditor?

The beneficiary needs to provide a detailed breakdown of the components of the overhead cost, together with a sufficient narrative description of the individually accounting elements (chart of accounts) to enable the auditor to identify the nature of the

<sup>22</sup> Overheads and indirect costs are synonymous in the context of this document.

<sup>23</sup> As stipulated in the Grant Agreement

cost, and to be able to distinguish costs that are wholly relevant to research, mixed, or not relevant to research. In order to ensure completeness of this breakdown, the reconciliation to the accounting records should be provided in order to link the information provided to the annual accounting records of the beneficiary.

What should the beneficiary consider when evaluating the existence of ineligible items in indirect costs?

Final responsibility for the correct calculation of indirect costs, especially the exclusion of ineligible costs, lies with the beneficiary. This means the beneficiary must examine each indirect cost component to identify whether it is wholly or partially ineligible.

How can the beneficiary distinguish indirect costs which are related to research from non-research items?

Some cases are clear cut, for example the rent and energy costs of building devoted wholly to the research activity of a beneficiary (research laboratory) can be designated as a research cost that can be 100% allocated across the productive time of the researchers.

Similarly, the trading part of a business (e.g. the manufacturing plant, marketing and sales departments), should be 100% excluded from the indirect cost calculation.

The beneficiary should also describe "mixed-use" cases such as libraries in universities, accounting & personnel departments in trading companies, where the costs will have to be allocated to the different activities using a basis such as the staff to student ratio, or the ratio of research staff to staff working in the business side of the organisation. Beneficiaries should use allocation methods that are easy to compute and understand, and take a conservative approach when allocating "borderline" costs to research. Allocation methods should be described in the Beneficiary's statement.

How is the auditor expected to identify exceptions in the types of costs charged?

The auditor will rely on the detailed breakdown provided by the beneficiary and the detailed description of each cost element. The auditor should identify as exceptions, any items that should normally be charged as direct costs (e.g. direct time of researchers, consumables used on projects, etc.). Identification of "education" or "business" expenses is limited to an analysis of the accounting descriptions e.g. an account clearly designated as relating to (say) sales, or support to teaching staff, should be identified as an exception.

What is meant by "reconciled to the accounts"?

The auditor is not required to perform a sample check of the indirect costs but is required to perform a reconciliation of the data on the basis of the accounting records. The individual cost items should be traceable to the beneficiary's accounting records. If the source of the data is not linked to accounting records but for example to analytical accounting records or management information documents, the beneficiary should provide a reconciliation demonstrating how the figures can be linked to the accounting records.

Procedure 4 as described in this section concerns eligible indirect costs, whereas procedure 5 as described in the next section concerns **ineligible** overheads/indirect costs. Please note that procedure 5 also deals with allocation methods in case of shared costs.

6.5.2 Exclusion of ineligible items (including shared costs) from indirect costs

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Overheads/ Indirect costs</b>	
<p>5. The accounting system provides for fully traceable elimination of:</p> <ul style="list-style-type: none"> <li>a) identifiable indirect taxes including value added tax,</li> <li>b) duties,</li> <li>c) interest owed,</li> <li>d) provisions for possible future losses or charges,</li> <li>e) exchange losses, cost related to return on capital,</li> <li>f) costs declared or incurred, or reimbursed in respect of another Community project,</li> <li>g) debt and debt service charges, excessive or reckless expenditure<sup>3</sup>.</li> </ul> <p>With regard to excessive or reckless expenditure, the Beneficiary confirms that purchases are made according to the principles of best value for money (best price-quality ratio), transparency and equal treatment between Community funded grant agreement and any other agreement or convention that the Beneficiary may have.</p> <p>Where the Beneficiary is allocating shared costs, they should provide a list of allocation methods used (usage records, floor space, activity-based-costing, headcount, etc.)</p>	<p><b>Procedure:</b></p> <p>The Auditor inspected the accounting records and chart of accounts.</p> <p>The Auditor found that the breakdown provided by the Beneficiary did not explicitly relate to any of the items specified;</p> <p>The Auditor also confirmed (if necessary also via a written declaration/ representation of the Beneficiary) that no implicit interest was included, e.g., by finance leasing or other credit arrangements.</p> <p><b>Finding:</b></p> <p>The Auditor was able to obtain confirmation that no implicit interest was included, and did not find costs which explicitly relate to any of the items specified.</p> <p>For each allocation method used by the Beneficiary, the Auditor reconciled the amount to be allocated to the accounts, and reconciled the allocation basis to the relevant management accounting information (usage records, floor space, activity-based-costing, headcount, etc.)</p> <p><b>Only the types of excessive and reckless expenditure listed in the Commission's guidance should be considered, the Auditor is not required to exercise professional judgement or provide assurance in this matter.</b></p>

What is the objective of this procedure?

This procedure does not apply if a flat-rate<sup>24</sup> on eligible direct costs is used for the calculation of overheads/indirect costs.

The three objectives of this procedure are to ensure that:

- all the specific types of costs defined as ineligible in the Grant Agreement have in fact been excluded from indirect costs,
- the indirect costs do not include any excessive or reckless expenditure,
- a list of allocation methods was provided where the beneficiary is allocating shared costs.

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<sup>24</sup> As stipulated in the Grant Agreement

### Which documents should the beneficiary prepare for the auditor?

The same accounting extracts used in the prior procedure should be sufficient to identify the types of costs that have been charged. In certain cases, the auditor will have to rely on a written representation of the beneficiary that certain costs have been eliminated (e.g. on a pro-rata basis).

For value for money, transparency and equal treatment, the beneficiary should provide information demonstrating the **existence** of a procedure to ensure these aspects. The only reportable exception is thus that the beneficiary cannot provide evidence of the existence of a procedure (i.e. contracts are awarded effectively on an ad hoc basis).

For the allocation methods, the beneficiary should provide the appropriate management information. For example, for allocating library costs, the beneficiary is expected to have at its disposal internal management information with staff and student numbers, if this is the basis used. For a company, an analysis of the headcount in the research vs. the trading part of the business could be supplied to support the distribution of the costs of the personnel department.

### What kind of costs do beneficiaries often fail to exclude?

Many beneficiaries fail to remove the irrecoverable VAT element of indirect costs where they can be identified (for example, making a percentage reduction to certain lines, such as travel or energy consumption, where a known VAT rate is included in the costs).

Servicing of loans, interest, and also the interest element of finance leases are also common examples of ineligible indirect costs which beneficiaries often fail to exclude.

Provisions for possible future losses or charges are ineligible since they do not represent actual costs (already incurred by the beneficiary) but these provisions refer to losses or potential future liabilities: e.g., provisions for litigations, provisions for works (which are not yet undertaken), etc.

### What kinds of indirect taxes are concerned by this procedure?

In most cases, the key indirect tax is VAT. Other national duties should be raised as exceptions if they are identified as not being excluded.

### What information on cost allocation is needed for this procedure?

In reviewing the breakdown of expenditure to identify ineligible costs, the beneficiary should also make the auditor aware of any shared costs (i.e. costs which arise from the organisation as a whole) and how the allocation approach ensures that the ineligible costs noted in procedure 5 were eliminated.

### Should the auditor analyse whether the cost allocations are reasonable?

No. As this is an agreed upon procedures assignment, the Commission is interested in the existence of the allocation method, but reserves the right to independently assess whether the method is a fair allocation of costs to FP7 project work.

### 6.5.3 Use of estimates in the simplified indirect cost calculation

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Overheads/ Indirect costs</b>	
<p>6. If the organisation is using a simplified indirect cost calculation (either due to the lack of analytical accounting or use of a form of cash-based accounting) all estimates are clearly described and are based on factual criteria which can be objectively confirmed.</p> <p>The Beneficiary must provide a list of cost allocations which are not based on underlying management information.</p> <p>In general costs which cannot be identified and allocated using a traceable source of information should not be included in the indirect cost calculation.</p>	<p><b>Procedure:</b> The Auditor was able to trace all cost allocation to underlying management information.</p> <p><b>Finding:</b> Percentage estimates were traced to the supporting factual criteria used by the Beneficiary and were found to be in agreement.</p>

In the left-hand column, the second sentence "The Beneficiary must provide a list of cost allocations which are not based on underlying management information" should be read as follows: *"The Beneficiary must provide a list of costs allocations which are not based on underlying accounting information"*.

Indeed the beneficiary may use other sources of information than the accounting information to allocate costs such as floor space, number of staff, etc.

In the right-hand column, the first sentence "The auditor was able to trace all cost allocations to underlying management information" should be read as follows: *"The auditor was able to trace all cost allocations to underlying management and accounting information"*.

#### What is the objective of this procedure?

When performing **simplified calculations of indirect costs**, the beneficiary may not have an analytical accounting system which can separate costs of different types as described in the prior procedures. Effectively, it will not be possible to identify or separate certain research costs from those that are related to other activities such as education. The Commission thus wishes to verify that the beneficiary has carried out some procedure to ensure indirect costs charged in the simplified method are not significantly larger than they would be if the true analytical data was known.

#### Which documents should the beneficiary prepare for the auditor?

As above, the beneficiary should provide the appropriate management information. In the case of the simplified method, this can be expected to be based on information from a variety of sources<sup>25</sup>.

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<sup>25</sup> The source of information will depend on the cost-driver used to distribute the shared costs among the different activities. The Auditor will be interested in any document supporting the correctness of the estimated allocation.

What is meant by 'underlying management information'?

Beneficiaries using the simplified method should use the best information available, but which may not be very detailed. For example, the only data the beneficiary may have in order to allocate power consumption is the floor space of the relevant buildings, even though power consumption may in reality be concentrated in certain locations (e.g. the computer research centre). In the absence of real data on consumption, the beneficiary should choose a conservative but objective measure (floor space can be verified by reference to the relevant management information).

What kind of allocation method should give rise to an exception?

Taking the example of the computer centre above, if the beneficiary allocated (say) 30% of its power consumption without having any factual basis, this should be raised as an exception by the auditor. For the Commission the concept of the simplified method does not extend to estimates which do not have a verifiable basis. Thus if the beneficiary cannot demonstrate to the auditor how the 30% was calculated, it should be raised as an exception.

*6.5.4 Allocation of indirect costs to the project*<sup>26</sup>

Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Overheads/ Indirect costs</b>	
7. Allocation of indirect costs to the project is via personnel (hours), either as [choose one] <ul style="list-style-type: none"> <li>- A percentage of personnel costs;</li> <li>- A fixed hourly rate.</li> </ul>	<p><b>Procedure:</b> The Auditor checked that the allocation of indirect costs to the project corresponds with the methodology specified by the Beneficiary;</p> <p><b>Finding:</b> The allocation of indirect costs to the project corresponds with the methodology specified by the Beneficiary; Where percentages are used the Auditor found that, the '<b>chargeable</b>' personnel costs (defined above) multiplied by the overhead percentage does not exceed the total <b>indirect costs to be allocated</b> defined above; Where a fixed hourly rate is used, the productive hours figures used to distribute indirect costs and personnel were found to be the same.</p>

The above paragraph should be read as follows "*Allocation of indirect costs to the project is via personnel ~~hours~~, either as [choose one]*  
- a percentage of personnel costs  
- a fixed hourly rate"

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<sup>26</sup> This procedure is not applicable in case of a flat-rate stipulated in the Grant Agreement. This procedure is applicable in cases of analytical accounting system and of the simplified method as described in further detail in Part III (Glossary) of these guidance notes.

What is the objective of this procedure?

The Commission wants to ensure that the manner in which the beneficiary claims its indirect costs does not permit the beneficiary to 'over-recover' its indirect costs (i.e. charge to various projects more than 100% of the relevant indirect costs).

Which documents should the beneficiary prepare for the auditor?

The period in question will be the period of the "pro forma" Financial Statement or actual Financial Statement (Form C) or the most recent financial year to calculate indirect costs if this is what has been used.

The beneficiary should provide the maximum chargeable hours (if the indirect costs are claimed on a fixed hourly rate) or the maximum chargeable personnel costs (if the indirect costs are charged on a percentage basis).

What calculation is the auditor expected to perform?

*a) For the percentage of personnel costs:*

Take the sum which can be charged (e.g. total chargeable costs of the research staff of the beneficiary) and multiply this by the overhead percentage. Compare this to the research-related indirect costs in the accounting records. If the number is less than or the same in the accounting records, then no exception should be reported. If the number is greater than the number in the accounting records, then it appears possible that over-recovery could take place. An exception should be raised.

*b) For the fixed hourly rate:*

Take the sum of the hours which can be charged (e.g. number of researchers multiplied by average productive hours) and multiply this by the hourly overhead rate. Compare this to the research-related indirect costs in the accounting records. If the number is less than or the same in the accounting records, then no exception should be reported. If the number is greater than the number in the accounting records, then it appears possible that over-recovery could take place. An exception should be raised.

c) Where another cost driver not based on personnel is used, the auditor found that the result of its application does not exceed the total amount of indirect costs to be allocated.

**PART II: CERTIFICATES ON THE FINANCIAL  
STATEMENTS**

## 1. THE CHANGE IN APPROACH FOR CERTIFYING COSTS CLAIMED

In order to clarify the Commission's objectives and requirements regarding certification of cost claims, the Commission in FP7 requests independent auditors to perform 'agreed-upon-procedures' engagements as opposed to assurance engagements as required in previous Framework Programmes. From the perspective of beneficiaries, this change in the nature of the report provided by the auditor does not represent a radical departure in the process of cost statement preparation. As before, the beneficiary is responsible for providing all the underlying documentation that the auditor needs in order to complete its report, including payroll and accounting information, invoices, etc. The main change is that the auditor's role is limited to making only factual findings as opposed to forming an independent opinion on the eligibility of costs. Part of this change involves the fact that the Commission specifies in detail the procedures to be undertaken, and the auditor reports the factual findings observed as a result of performing those procedures, including exceptions<sup>27</sup> as a basis for the Commission to conclude on the eligibility of the claims.

This process seeks to provide the Commission with a more consistent input from auditors and gives greater possibility of identifying irregularities via the exception reporting. In addition, by specifying the procedures in detail, the requirements for documentation and record-keeping will be more transparent to the beneficiaries.

## 2. KEY CHANGES REGARDING CERTIFICATES ON THE FINANCIAL STATEMENTS<sup>28</sup>

CHANGE	RATIONALE
Compulsory Terms of Reference between beneficiary and auditor	In order to ensure comparability between factual findings reported by different auditors, and consistency in the quality of work to be carried out, the Commission considers that auditors should be engaged on the basis of the same minimum terms and requirements.
Compulsory reporting format	Due to difficulties in FP6 with guaranteeing the same level of detail and completeness in the reporting by auditors, the Commission requires all findings to be presented in the same way, to ensure the Commission has sufficient information to draw

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<sup>27</sup> Refer to Part III, Glossary of the present guidance notes for a definition of Exceptions

<sup>28</sup> Financial Statement is defined in Part III, Glossary of the present guidance notes. Financial Statements refer to different Financial Statement(s) covering different periods.

	conclusions based on the report.
Detailed requirements of type and depth of verification	In an assurance engagement, auditors have considerable discretion as to the nature of the verification procedures they undertake in order to arrive at an opinion. In the interests of consistency and comparability, the Commission has set specific requirements regarding what is to be checked and on areas such as the sample size. The auditors are not permitted to reduce the checks below those specified by the Commission.
Reporting of factual findings	In accordance with ISRS 4400, the auditor is required to describe the procedures carried out. To the extent that the auditor is not able to carry out the required procedures e.g., because supporting evidence for a cost item is not available, the auditor will include a description of such scope limitation in his report. For procedures that the auditor is able to perform, the auditor will report whether or not the findings observed as a result of doing so are consistent with the standard findings described in Annex VII. Both of them will be reported under the heading "Exceptions" in his report.

### **3. SCOPE AND CONTENT OF CERTIFICATES ON THE FINANCIAL STATEMENTS**

The beneficiary is required to submit to the European Commission a certificate on the Financial Statements in the form of an independent report of factual findings produced by an auditor in support of the payment requested by the beneficiary under Article II.4 of the Grant Agreement.

Certificates on the Financial Statements shall state that the costs claimed and the receipts declared during the period for which they are provided, as well as the declaration of the interest yielded by the pre-financing meet the conditions required by the Grant Agreement. The Auditor shall include in its certificate that no conflict of interest exists between the auditor and the beneficiary for establishing the certificate.

The auditor undertakes this engagement in accordance with the terms of references of Form D - Annex VII (hereinafter "ToR") and:

- in accordance with the International Standard on Related Services ('ISRS') 4400 Engagements to perform Agreed-upon Procedures regarding Financial Information as promulgated by the IFAC;
- in compliance with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) of IFAC. Although ISRS 4400 provides that independence is not a requirement for agreed-upon procedures engagements, the European Commission requires that the Auditor also complies with the independence requirements of the Code of Ethics for Professional Accountants.

The auditor performs the procedures specified in 1.9 of the ToR ('Scope of Work – Compulsory Report Format and Procedures to be performed') and uses the evidence obtained from these procedures as the basis for the Report of factual findings.

#### 4. SUBMISSION OF CERTIFICATES ON THE FINANCIAL STATEMENTS

Unlike the Certificate on the Methodology (CoM), the Certificate on the Financial Statements are not submitted to the Commission via a mailbox but have to be submitted directly to the responsible person of the Commission together with the related beneficiary's Form C and Management Report (periodic or final).

	Required	Not required
Submission of the certificate	<p>A Certificate on the Financial Statements (CFS) is mandatory for every claim (interim or final) in the form of reimbursement of costs whenever the amount of the EC contribution is equal or superior to EUR 375,000 when cumulated with all previous payments for which a CFS has not been submitted<sup>29</sup>. The CFS must be forwarded in the form of a detailed description verified as factual by its external auditor (Form D – Annex VII).</p> <p><i>Specific case of projects with a duration of 2 years or less:</i></p> <p>When the amount of the EC contribution claimed by the beneficiary is equal or superior to EUR 375,000 (cumulated with all previous payments), <b>only one CFS shall be submitted at the time of the final payment. This CFS has to cover all eligible costs.</b></p>	<p>1. A CFS is not required :</p> <ul style="list-style-type: none"> <li>- for Financial Statements where the amount of EC contribution is lower than EUR 375,000 when cumulated with all previous payments for which a CFS has not been submitted..</li> <li>- for indirect actions entirely reimbursed by means of lump sums or flat rates.</li> <li>- for beneficiaries with costs incurred in relation to the project but without EC contribution (in this case this circumstance will be mentioned in special clause 9 to be included in Article 7 of the Grant Agreement).</li> </ul> <p>2. Intermediate CFS for claims on interim payments are not required when a CoM has been approved by the Commission for the beneficiary</p>

<sup>29</sup> Once a CFS is submitted, the threshold of EUR 375,000 applies again for subsequent EC contributions but the count starts from 0. The threshold is established on the basis of the EC contribution. Examples for the submission of Certificates on the Financial Statements can be found in the Guide to Financial Issues (pages 13 to 15). [http://cordis.europa.eu/fp7/find-doc\\_en.html](http://cordis.europa.eu/fp7/find-doc_en.html)

### **Threshold of EUR 375,000 and third party covered by special clause n°10<sup>30</sup>**

In the case of a third party covered by the special clause n°10, the total EC contribution is the sum of the EC contribution of the beneficiary and the EC contribution of the third party. It has to be recalled that the third party does not appear in the Grant Agreement as beneficiary.

The threshold of EUR 375,000 to submit the CFS includes the total EC Contribution (Beneficiary + Third party(ies)).

According to the special clause 10 of the Grant Agreement, the third parties shall provide their individual Certificates on The Financial Statements independently from those of the beneficiary. However, if the beneficiary and the third party have the same auditor, the Commission could accept one certificate comprising the costs of both but identifying clearly which costs relate to whom.

### **Reimbursement of the costs of the Certificates on the Financial Statements**

The cost of the certificate on the Financial Statements is an eligible cost in the Grant Agreement for which the certificate is submitted (Art. II.16). Nevertheless, if the coordinator decides to submit a certificate voluntarily or if the CFS is not required by the Grant Agreement when the EC contribution is less than EUR 375,000 , the costs of the CFS will not be eligible.

### **Acceptance/rejection of the Certificate on the Financial Statements by the EC**

The agreed-upon-procedures as defined by the European Commission are performed to assist the European Commission in evaluating that the costs claimed by the beneficiary in the accompanying Financial Statements have been claimed in accordance with the provisions of the Grant Agreement. The Authorising Officer of the Commission will use the information included in the Certificate on the Financial Statements (detailed report on factual findings as well as exceptions such as inability to reconcile key information, unavailability of data which prevented the Auditor from carrying out the procedures, etc...) to decide on the amounts to be reimbursed.

## **5. FORM OF CERTIFICATES ON THE FINANCIAL STATEMENTS - ANNEX VII**

The use by the external auditor or competent public officer of the reporting format attached as part of Annex VII (Form D) of the model Grant Agreement is compulsory.

Annex VII is composed of three separate documents:

- A list of the minimum terms required by the Commission to be included in the engagement letter between the Beneficiary and the Auditor. The engagement letter must be dated and signed by both parties.

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<sup>30</sup> For clause n°10, refer to the list of special clauses for FP7 Model Grant Agreement published on CORDIS.

- The model Auditor's Report of Factual Findings to be issued on the Auditor's letterhead and dated, stamped and signed by the Auditor (or competent public officer).
- A detailed description of the procedures to be performed by the Auditor and the findings expected to result there from.

Please note that the beneficiary's Financial Statements (Form C) signed by the beneficiary are attached to the Report of Factual Findings.

Regarding the language of Certificate on the Financial Statements, Article 4 of the FP7 model Grant Agreement states that “Any report and deliverable, when appropriate, required by this Grant Agreement shall be in [*insert language*]”. Therefore, the report of factual findings on the Financial Statements should be written in the language indicated in Article 4 of the Grant Agreement.

## **6. PROCEDURES FOR CERTIFICATE ON THE FINANCIAL STATEMENTS ACCORDING TO ANNEX VII - FORM D**

### **6.1 Procedures to be carried out by the auditor regarding Form D**

The procedures listed on the left hand side of Form D are to be carried out **unaltered** by the auditor. The Commission has designed these procedures in order to obtain standardised and comparable reports from all auditors, who are expected to carry out the procedures without adaptation for the particular circumstances of the beneficiary.

In particular the minimal sample sizes should always be respected, and all procedures should be carried out in full<sup>31</sup>.

### **6.2 When can the auditor change the model answer and when should he report an exception?**

Where the auditor's factual findings are not consistent with the "Standard factual finding" given on the right hand side of the Form, then an exception should be noted. For each standard finding, non-exhaustive examples where the Commission expects exceptions to be noted is indicated in bold under the corresponding factual findings. In general, if the auditor is not able to establish whether the information provided by the beneficiary matches the standard finding defined by the Commission, this should be reported as an exception.

### **6.3 Will all exceptions result in a rejection of costs by the Commission?**

The Commission will consider each exception in the context of the report as a whole and other evidence at its disposal. It will therefore make eligibility decisions on a case by case basis using the evidence provided. The more detail the auditor provides regarding exceptions, the easier it will be to assess the situation and come to a reasoned decision on the claim under consideration. The auditor should report the findings as fully as possible, to facilitate this process.

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<sup>31</sup> Refer to Part III, Glossary for the definition of exceptions to be reported by the auditor

## 6.4 Procedures for Certificates on the Financial Statements according to Annex VII – Form D

When a Certificate on the Methodology (Form E) has been approved by the Commission, the auditor will only have to focus on checking compliance with the certified methodology and systems. In this context, some aspects of the procedures included in the Form D will not have to be performed by the auditor.

**For beneficiaries having a Certificate on the Methodology for average personnel costs (CoMAv) only**, the auditor will have to perform all procedures foreseen in the Form D except for procedure 1 where the auditor will be requested to check only the part related to productive hours.

**For beneficiaries having a Certificate on the Methodology covering average personnel costs and indirect costs (CoM)**, the auditor will have to perform all procedures foreseen in the Form D except for procedure 1 where the auditor will be requested to check only the part related to productive hours and for procedure 10 where the auditor will not be requested to recalculate the indirect costs rate.

The table below indicates the procedures to be performed by auditors in different situations.

**Procedures to be performed by the auditor for establishing the CFS**

Category of costs	Calculation method used by the beneficiary	PROCEDURES TO BE PERFORMED		
		With approved CoM <sup>32</sup>	With approved CoMAv <sup>33</sup>	Without Certificate
<b>Personnel</b>	Individual costs (per employee <sup>34</sup> )	1, 2, 3	Not applicable	1, 2, 3
	Average rates	1 <sup>35</sup> , 2, 3, 4	1 <sup>36</sup> , 2, 3, 4	Impossible <sup>37</sup>
<b>Subcontracting</b>	All cases	5, 6		
<b>Other Direct Costs</b>	All cases	7, 8, 9		
<b>Indirect Costs</b>	Actual Indirect Costs	10 <sup>38</sup>	10	10
	Simplified Method	10 <sup>39</sup> , 11	10, 11	10, 11
	Flat-rate	None	None	None
<b>Exchange rates, receipts and interests yielded</b>	All cases	12, 13, 14		

<sup>32</sup> Certificate on the Methodology (Form E)

<sup>33</sup> Certificate on Average Personnel Costs (Form E only covering average personnel costs)

<sup>34</sup> Employee means researcher or research-related person or person with certain coordinating tasks (when there is a project coordinator).

<sup>35</sup> The auditor is requested to check only the part related to productive hours

<sup>36</sup> The auditor is requested to check only the part related to productive hours

<sup>37</sup> Average Personnel rates can only be used by the beneficiary when a Certificate on the Methodology has been previously approved by the Commission.

<sup>38</sup> The auditor is not requested to recalculate the indirect costs rate

<sup>39</sup> The auditor is not requested to recalculate the indirect costs rate

### 6.4.1 Personnel costs

Procedures	Standard factual findings and basis for exception reporting
<b>Personnel costs</b>	
<p>1. Recalculate hourly personnel and overhead rates for personnel (full coverage if less than 20 employees, otherwise a sample of minimum 20, or 20% of employees, whichever is the greater), indicate the number of productive hours used and hourly rates.</p> <p>Where sampling is used, selection should be random with a view to producing a representative sample.</p> <p><b>'Productive hours'</b> represent the (average) number of hours made available by the employee in a year after the deduction of holiday, sick leave and other entitlements. This calculation should be provided by the Beneficiary.</p> <p>[if average costs are used, a separate independent report is required on the methodology]</p>	<p>For each employee in the sample of ____, the Auditor obtained the personnel costs (salary and employer's costs) from the payroll system together with the productive hours from the time records of each employee.</p> <p>For each employee selected, the Auditor recomputed the hourly rate by dividing the actual personnel costs by the actual productive hours, which was then compared to the hourly rate charged by the Beneficiary.</p> <p>No exceptions were noted.</p> <p>The average number of productive hours for the employees selected was _____.</p> <p><b>If the productive hours or costs of personnel cannot be identified, they should be listed (together with the amounts) as exceptions in the main report.</b></p>

#### What is the objective of this procedure?

The objective of this check is to verify that the hourly rates being charged have been correctly calculated from the actual underlying cost information for the period in question, namely the costs to the employer (salary/ wages including benefits and other employment costs), divided by the productive hours with a reconciliation of the payroll information for the selected employees to the accounting records and payments.

#### Which documents should the beneficiary prepare for the auditor?

The actual payroll information for the period in question (base salary, benefits of all kinds, pension contributions, employers' payroll taxes, etc.) and productive hours figures (see Glossary in Part III of the present guidance notes for a description of productive hours) used to calculate the hourly rates. The beneficiary should also provide a reconciliation/calculation showing how the hourly rates were calculated from the payroll information.

The last sentence of the right-hand column should be read as follows "if the productive hours or costs of personnel cannot be identified *or justified by the beneficiary*, they should be listed (together with the amounts) as exceptions in the main report".

#### What if the beneficiary already has a certificate under Form E?

Where there is a Form E approved by the Commission **on average personnel costs**, the individual calculations and re-computations foreseen under procedure 1 are not

applicable since the auditor is just expected to check the general compliance with the methodology. The auditor is therefore requested to check only the part related to productive hours in this procedure.

Where individual actual costs have been used and certified by the Commission, the entire procedure has to be performed by the auditor (including recalculations).

What employment costs are not considered eligible or should be regarded as exceptions?

Generally all employment costs which are part of the normal remuneration policy of the beneficiary are accepted. Costs which have been charged and which relate specifically to involvement in European projects, and are not part of these normal remuneration and/or accounting principles should be noted as exceptions.

How should sampling be carried out?

The size of the sample proposed in this procedure is based on the population of researchers or research-related persons involved in the project. In this context, the size of the sample has to respect the following:

- if the population is less than 20 employees, full coverage
- if the population is equal or greater than 20 employees
  - a minimum of 20 employees
  - or 20 % of the employees (whichever is the greater)

Procedures	Standard factual findings and basis for exception reporting
<b>Personnel costs</b>	
2. For the same selection examine and describe time recording of employees (paper/ computer, daily/weekly/monthly, signed, authorised).	<p>Employees record their time on a daily/ weekly/ monthly basis using a paper/computer-based system. The time-records selected were authorised by the project manager or other superior.</p> <p><b>If no time records are available which fit the above description, this should be listed as an exception in the main report.</b></p>

What is the objective of this procedure?

This procedure will provide to the Commission the information it needs to assess whether the recording of project time is in line with the requirements of the Grant Agreement. Normally, time recording should be carried out regularly and authorised by the project manager to ensure that the time worked on the project can be traced and charged correctly. For the employees selected, the hours charged to the project should have been accurately recorded in the time recording system. Any discrepancies between the amount charged to the project and the amount in the time sheets (or if time sheets are absent) should be recorded as an exception.

Which documents should the beneficiary prepare for the auditor?

The beneficiary should provide a description of the time-recording system and, for the employees selected for testing, make available all the time sheets or provide full access to the computer system which records the time of the employees. The auditor should be

able to trace the time charged for the sample selected to the time records of each individual employee.

Procedures	Standard factual findings and basis for exception reporting
<b>Personnel costs</b>	
<p>3. Employment status and employment conditions of personnel. The Auditor should obtain the employment contracts of the employees selected and compare with the standard employment contract used by the Beneficiary. Differences which are not foreseen by the Grant Agreement should be noted as exceptions.</p>	<p>For the employees selected, the Auditor inspected their employment contracts and found that they were:</p> <ul style="list-style-type: none"> <li>– directly hired by the Beneficiary in accordance with its national legislation,</li> <li>– under the sole technical supervision and responsibility of the latter, and</li> <li>– remunerated in accordance with the normal practices of the Beneficiary.</li> </ul> <p><b>Personnel who do not meet all three conditions should be listed (together with the amounts) as exceptions in the main report.</b></p>

What is the objective of this procedure?

The Commission seeks to ensure that personnel costs do in fact relate to employees of the beneficiary carrying out the research, and to identify cases where this component may have been effectively "outsourced" to a different entity, where this has not been foreseen in the Grant Agreement with the Commission. The Commission also seeks to ensure that no special employment conditions are applied to employees working in the project which are not normally applied within normal company practices.

Which documents should the beneficiary prepare for the auditor?

Specific employment contracts for the researchers in question, as well as standard employment contracts in use for personnel who perform a variety of work for the beneficiary (i.e. are not exclusively devoted to EU research work).

What kind of information would give rise to exceptions?

Article 15 of Annex II of the model Grant Agreement foresees that with regard to personnel costs, the persons directly carrying out work under the project must:

- be directly hired by the beneficiary in accordance with its national legislation,
- work under the sole technical supervision and responsibility of the latter, and
- be remunerated in accordance with the normal practices of the beneficiaries.

Any difference to the above principles should be highlighted by the auditor as an exception. Please find below some non-exhaustive examples.

**Directly hired:** Exceptions should be raised if there are indications in the contract that the employee is hired by a different legal entity, including a legal entity within the same group (e.g. if the beneficiary is XYZ Research Limited and the contract is with XYZ holdings or XYZ registered in a different country). Another example giving rise to an exception is if the employee's services are being charged via a service company or other consulting type arrangement.

**Sole technical supervision:** An exception should be raised if it is stipulated in the contract that its objective and participation focuses on a specific deliverable or piece of work rather than on the employee's services. This includes indications that the work is not been carried out at the beneficiary's premises<sup>40</sup> but has more of the characteristics of an external or subcontract. Again, the use of a service company indicates that the beneficiary is not directly supervising the technical work and should give rise to an exception.

**Remunerated in accordance with the normal practices of the beneficiary:** Typical examples which should give rise to an exception are being remunerated in a 'lump sum' instead of via a salary arrangement, or any other form of payment/ charging (such as travel expenses) which does not take place within the normal accounting practice of the beneficiary.

Procedures	Standard factual findings and basis for exception reporting
<b>Personnel costs</b>	
4. Use of average personnel costs	<p>The Auditor found that the personnel costs charged to the financial statement:</p> <ul style="list-style-type: none"> <li>- are calculated using average costs in accordance with the methodology as specified in the Report of findings on the methodology dated _____.</li> <li>- have been calculated using amounts derived from the relevant period which can be reconciled to the accounting records of the relevant period.</li> </ul> <p>The Auditor obtained confirmation from the Beneficiary that the rates used were not budgeted or estimated amounts.</p> <p><b>If amounts cannot be reconciled, or if estimates or budgeted amounts were used, this should be reported as an exception in the main report.</b></p>

What is the objective of this procedure?

The procedure to be performed by the auditor in the left-hand column should be as described below.

The auditor is requested to perform a limited check that the methodology which was already approved is in fact being implemented in accordance with the Form E that was approved by the Commission. Thus rather than tracing the costs of the individual researchers back to the payroll records of each individual employee, the auditor simply verifies that the researcher was charged using a rate corresponding to the rate for that employee's category. For example, the auditor checks that for a researcher belonging to

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<sup>40</sup> Tele-working may be accepted if there is a system that allows the identification of the productive hours worked for the project

category III according to the beneficiary's classification system, the rate for the category III rate was used to charge their time.

Which documents should the beneficiary prepare for the auditor?

The most up-to-date classification grid, together with the criteria for classification of employees (based on experience, qualifications, salary, department, etc.). The information should be sufficient to unambiguously categorise each of the researchers in the sample, and to verify that the rates used were applicable for the period to which the claim refers. Thus, it may be necessary to consult the payroll/human resources system in details, and the beneficiary should be able to extract this information.

How should the auditor check the reconciliation?

The beneficiary should be able to show via the calculation of average rates, where the data in the calculation was extracted from the accounts, and in doing so demonstrate that the correct relevant period and accounting information has been used.

*6.4.2 Subcontracting*

Procedures	Standard factual findings and basis for exception reporting
<b>Subcontracting</b>	
5. Obtain a written description from the Beneficiary regarding 3 <sup>rd</sup> party resources used and compare with Annex 1 to the Grant Agreement.	<p>The Auditor compared the description of the 3<sup>rd</sup> party resources provided by the Beneficiary to the specification in Annex 1 to the Grant Agreement, and found them to be the same</p> <p><b>If the descriptions do not clearly match, this should be reported as an exception in the main report.</b></p>

What is the objective of this procedure?

The Commission seeks to ensure that the beneficiaries have honoured the structure of the Grant Agreement as originally agreed. In particular, the Commission normally carefully negotiates to which extent third party resources can be used by the beneficiary to ensure that the grant supports its policy objectives. Any discrepancy from this original agreement is therefore of interest to the Commission, and having the auditor report on this information adds value in identifying possible breaches of the Grant Agreement. The final decision on action to take is up to the Commission, depending on how significant the variations from the original Grant Agreement commitments might be.

Which documents should the beneficiary prepare for the auditor?

The check includes a documented comparison between the 3<sup>rd</sup> party resources foreseen in the Grant Agreement (Annex 1 - Description of Work) and the resources actually contracted between the beneficiary and the 3<sup>rd</sup> party. The beneficiary should therefore provide the contracts signed with 3<sup>rd</sup> parties and is expected to show how these fulfil their commitments under the Grant Agreement. In essence the 3<sup>rd</sup> party contracting should match these commitments in terms of the type and quantity of the products and services, as well as the supplier, where this is specified in the Grant Agreement. In these cases the auditor is not expected to provide an analysis of the services, but to note differences, which can be subsequently analysed by the Commission.

Procedures	Standard factual findings and basis for exception reporting
<b>Subcontracting</b>	
<p>6. Inspect documents and obtain confirmations that subcontracts are awarded according to a procedure including an analysis of best value for money (best price-quality ratio), transparency and equal treatment.</p> <p>Full coverage if less than 20 items, otherwise a sample of minimum 20, or 20% of the items, whichever is the greater.</p>	<p>The Auditor obtained tendering documents for each subcontract entered into and found that the tendering process was followed and that a written analysis of value-for-money had been prepared by the Beneficiary in support of the final choice of subcontractor, or that the contract had been awarded as part of an existing framework contract entered into prior to the beginning of the project.</p> <p><b>If the Auditor is not provided with evidence of either of the above situations, the amount of the subcontract should be listed as an exception in the main report.</b></p>

What is the objective of this procedure?

In order to ensure that research funds are efficiently spent, the Commission expects subcontracts to be awarded according to the principle of best value for money, transparency and equal treatment. The objective of this procedure is to verify that such a procedure was undertaken (in particular it may be the case that the beneficiary is unable to provide evidence of fair tendering). The model Grant Agreement also permits contracts to be awarded under existing framework contracts in the interests of efficiency, if in accordance with the beneficiary's usual management principles. In this case the objective is simply to confirm the existence of such a framework contract prior to the beginning of the project.

Which documents should the beneficiary prepare for the auditor?

The auditor should be provided with a report which describes how the offers from subcontractors were obtained and assessed, including an explanation on the criteria used, and showing that the tender was awarded to the contractor who best fulfilled these criteria. The auditor is not expected to analyse the judgemental decisions taken by the beneficiary, but rather to report on the existence of documentation fitting this description for the subcontracts in question.

Please note that the last sentence of the left-hand column "full coverage if less than 20 items, otherwise (...) is the greater" refers to the size of the sample.

The size of the sample proposed in this procedure has to respect the following:

- if the population is less than 20 items, full coverage
- if the population is equal or greater than 20 items
  - a minimum of 20 items
  - or 20 % of the items (whichever is the greater)

What is the most frequent error in this context?

Insufficient documentation to show the existence of fair procurement procedures<sup>41</sup> (e.g., no offers from other parties) or of a framework contract with the supplier in addition to the specific contract connected with the project.

*6.4.3 Other direct costs (equipment, travel costs, consumables)*

Procedures	Standard factual findings and basis for exception reporting
<b>Other Direct Costs</b>	
7. Allocation of equipment subject to depreciation is correctly identified and allocated to the project. Full coverage if less than 20 items, otherwise a sample of minimum 20, or 20% of the items, whichever is the greater.	The Auditor traced the equipment charged to the project to the accounting records and the underlying invoices. The Beneficiary has documented the link with the project on the invoice and purchase documentation, and, where relevant, the project accounting. The asset value was agreed to the invoice and no VAT or other identifiable indirect taxes were charged. The depreciation method used to charge the equipment to the project was compared to the Beneficiary's normal accounting policy and found to be the same.  <b>If assets have been charged which do not comply with the above, they should be listed (together with the amounts) as exceptions in the main report.</b>

What is the objective of this procedure?

Beneficiaries are permitted to charge assets to research Grant Agreements in line with their normal accounting policy. The objective of this procedure is to ensure that the individual fixed assets have been charged according to the normal accounting policy using amounts which can be traced from the accounting records and using the related depreciation rate.

Which documents should the beneficiary prepare for the auditor?

The documents relate to the invoices of the assets concerned and to the extracts from the accounting records showing the relevant entries, as well as the relevant policies for depreciation of the assets (period, straight line or reducing balance, etc.).

Please note that the last sentence of the left-hand column "full coverage if less than 20 items, otherwise (...) is the greater" refers to the size of the sample.

The size of the sample proposed in this procedure has to respect the following:

- if the number of equipments is less than 20 items, full coverage
- if the number of equipments is equal or greater than 20 items
  - a minimum of 20 items

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<sup>41</sup> For details on procurement procedures, refer to Guide to Financial Issues

- or 20 % of the items (whichever is the greater)

What is the most frequent error in this context?

Beneficiaries, having incurred the cash outflow to acquire the asset, try to charge the entire amount in the first period, despite the fact that the asset may be depreciated in their accounts through a number of years. In this case, only the depreciation relevant to the period in question (the period of the cost statement under consideration) can be charged. Another common error is the charging of VAT.

Procedures	Standard factual findings and basis for exception reporting
<b>Other Direct Costs</b>	
<p>8. Travel costs correctly identified and allocated to the project (and in line with Beneficiary's normal policy for non-EC work regarding first-class travel, etc.) Full coverage if less than 20 items, otherwise a sample of minimum 20, or 20% of the items, whichever is the greater.</p> <p>The Beneficiary should provide written evidence of its normal policy for travel costs (e.g. use of first class tickets) to enable the Auditor to compare the travel charged with this policy.</p>	<p>The Auditor inspected the sample and found that the Beneficiary had allocated travel costs to the project by marking of invoices and purchase orders with the project reference, resulting in traceable allocation in the project accounts.</p> <p>The costs charged were compared to the invoices and found to be the same. No VAT or other identifiable indirect taxes were charged.</p> <p>The use of first class travel was in line with the written policy provided by the Beneficiary.</p> <p><b>Costs which are not allocated to project accounts and do not have a clear attribution (normally by writing the project number on the original invoice) should be listed (together with the amounts) as exceptions in the main report.</b></p>
<p>9. Consumables correctly identified and allocated to the project. Full coverage if less than 20 items, otherwise a sample of minimum 20, or 20% of the items, whichever is the greater.</p>	<p>The Auditor inspected the sample and found that the Beneficiary had allocated consumable costs to the project by marking of invoices and purchase orders with the project reference, resulting in traceable allocation in the project accounts.</p> <p>The costs charged were compared to the invoices and found to be the same. No VAT or other identifiable indirect taxes were charged.</p> <p><b>Costs which are not allocated to project accounts and do not have a clear attribution (normally by writing the project number on the original invoice) should be listed (together with the amounts) as exceptions in the main report.</b></p>

The wording "project accounts" in the above procedure is defined in Part III, Glossary of the present guidance notes.

### What is the objective of this procedure?

To ensure that travel and consumable<sup>42</sup> costs are accurately charged to the project without any identifiable indirect taxes<sup>43</sup> (including VAT) and that only those costs relevant to the project are charged.

### Which documents should the beneficiary prepare for the auditor?

Extracts from the accounting records together with the relevant **original** invoices are the basis for performing this procedure. The company policy on travel costs should be made available where first class or business class travel has been used. Only when a policy is in place in general terms and not being used exclusively for EC projects, the costs can be considered. Otherwise, an exception should be noted. The auditor is not expected to make an assessment of project relevance in the absence of information provided by the beneficiary. Invoices should have a clear designation as relating to the project, and the burden of sufficient documentation is on the beneficiary. The auditor is expected to report their findings based on the documentary evidence, and should not take into account supplementary explanations by the beneficiary when these are not supported by the relevant documentation.

Please note that the last sentence of the left-hand column "full coverage if less than 20 items, otherwise (...) is the greater" refers to the size of the sample.

The size of the sample proposed in this procedure has to respect the following:

- if the population is less than 20 items, full coverage
- if the population is equal or greater than 20 items
  - a minimum of 20 items
  - or 20 % of the items (whichever is the greater)

### What is the most frequent error in this context?

For travel, the most frequent error is failure to deduct ineligible VAT (for example from hotel & transport costs incurred in other countries). VAT should be deducted in all cases, whether it is recoverable by the beneficiary or not, and whether it relates to the VAT regime applying to the beneficiary or not.

For consumables, failure to make a clear link to the project is a common error, assuming VAT has been deducted. The Commission requires a sufficient audit trail which unambiguously ties an invoice to the project, and is thus not able to accept costs which were not linked to the project at the time of processing.

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<sup>42</sup> Refer to pages 43 and 44 of the Guide to Financial Issues for details on consumables

<sup>43</sup> Refer to Part III, Glossary for definition of indirect taxes

#### 6.4.4 Indirect costs

Procedures	Standard factual findings and basis for exception reporting
<b>Indirect costs</b>	
<p>10. Obtain and review a detailed breakdown of Indirect costs (reconciled to the financial accounts) and confirm that the following costs are not present:</p> <ul style="list-style-type: none"> <li>a) identifiable indirect taxes including value added tax,</li> <li>b) duties,</li> <li>c) interest owed,</li> <li>d) provisions for possible future losses or charges,</li> <li>e) exchange losses, cost related to return on capital,</li> <li>f) costs declared or incurred, or reimbursed in respect of another Community project,</li> <li>g) debt and debt service charges, excessive or reckless expenditure<sup>44</sup>.</li> </ul>	<p>The Auditor obtained the total overhead amount which was allocated and reconciled this to the accounting records for the period in question.</p> <p>The Auditor recalculated the ratio of indirect costs [<i>choose one</i>: as a percentage of personnel costs/ as an hourly rate] and agreed it to the rate used in the Financial Statement(s).</p> <p>The Auditor obtained a detailed breakdown from the accounting system of the indirect costs which have been charged to the contract, and reconciled the individual amounts to the general ledger of the Beneficiary.</p> <p>The Auditor found that costs for the non-research activities of the Beneficiary, such as manufacturing, education, marketing of products or services, etc., had not been included in the calculation.</p> <p>For each element of the breakdown, the Auditor obtained the Beneficiary's confirmation that it contained none of the ineligible costs specified (typical examples are leasing costs, loan charges, provisions for doubtful debt (but not normal accruals), local business and property taxes, customs duties, exchange losses from billing in a foreign currency).</p> <p><b>Only the types of excessive and reckless expenditure listed in the Commission's guidance should be considered, the Auditor is not required to exercise professional judgement or provide assurance in this matter.</b></p> <p><b>Amounts which do not meet the above criteria or where the Auditor is not provided with sufficient information in order to inspect and compare the types of cost should be listed (together with the amounts) as exceptions in the main report.</b></p>

#### What is the objective of this procedure?

*This procedure does not apply if a flat-rate<sup>45</sup> on eligible direct costs is used for the calculation of overheads/indirect costs.*

In addition to the procedure 10 described in the left-hand column where the auditor checks that all the specific types of costs defined as ineligible in the Grant Agreement have in fact been excluded from indirect costs, the auditor will have to check :

<sup>44</sup> See definition in the Guide to Financial Issues page 38.

<sup>45</sup> As stipulated in the Grant Agreement

- that a list of allocation methods was provided where the beneficiary is allocating shared costs.
- that the costs supported under FP7 have been incurred by the beneficiary in its research activity. The concern is that by including non-research related costs in the indirect cost calculation, the beneficiary might include elements related to its non-research activity. This most frequently occurs with universities, which may have educational activities, or companies which have trading businesses where they supply goods and services either than research (e.g. a company that carries out applied research but also sells hardware and software to customers and therefore incurs costs supporting the manufacturing, sales and marketing of these products).

#### What if the beneficiary already has a certificate under Form E?

Where a Certificate on the Methodology has been approved by the Commission, the auditor will not have to recalculate the ratio of indirect costs but will have to perform the other checks of this procedure to ensure that the certified methodology has been correctly applied.

#### Which documents should the beneficiary prepare for the auditor?

The beneficiary needs to provide a detailed breakdown of the components of the overhead cost, together with a sufficient narrative description of the individually accounting elements (chart of accounts) to enable the auditor to identify the nature of the cost, and to be able to distinguish costs that are wholly relevant to research, mixed, or not relevant to research. In order to ensure completeness of this breakdown, the reconciliation to the accounts should be provided in order to link the information provided to the annual accounts of the beneficiary.

For the allocation methods, the beneficiary should provide the appropriate management information. For example, for allocating library costs, the beneficiary is expected to have at its disposal internal management information with staff and student numbers, if this is the basis used. For a company, an analysis of the headcount in the research vs. the trading part of the business could be supplied to support the distribution of the costs of the personnel department.

#### What should the beneficiary consider when evaluating the existence of ineligible items in indirect costs?

Final responsibility for the correct calculation of indirect costs, especially the exclusion of ineligible costs, lies with the beneficiary. This means the beneficiary must examine each indirect cost component to identify whether it is wholly or partially ineligible.

#### How can the beneficiary distinguish indirect costs which are related to research from non-research items?

Some cases are clear cut, for example the rent and energy costs of building devoted wholly to the research activity of a beneficiary (research laboratory) can be designated as a research costs that can be 100% allocated across the productive time of the researchers.

Similarly, the trading part of a business (e.g. the manufacturing plant, marketing and sales departments), should be 100% excluded from the indirect cost calculation.

The beneficiary should also describe "mixed-use" cases such as libraries in universities, accounting & personnel departments in trading companies, where the costs will have to be allocated to the different activities using a basis such as the staff to student ratio, or the ratio of research staff to staff working in the business side of the organisation. Beneficiaries should use allocation methods that are easy to compute and understand, and take a conservative approach when allocating 'borderline' costs to research.

#### How is the auditor expected to identify exceptions in the types of costs charged?

The auditor will rely on the detailed breakdown provided by the beneficiary and the detailed description of each cost element. The auditor should identify as exceptions, any items that should normally be charged as direct costs (e.g. direct time of researchers, consumables used on projects, etc.). Identification of "education" or "business" expenses is limited to an analysis of the accounting descriptions (e.g. and account clearly designated as relating to (say) sales, or support to teaching staff, should be identified as an exception.

#### What is meant by "reconciled to the accounts"?

The auditor is not required to perform a sample check of the indirect costs but is required to perform a reconciliation of the data on the basis of the accounting records. The individual cost items should be traceable to the beneficiary's accounting records. If the source of the data is not linked to accounting records but for example to analytical accounting records or management information documents, the beneficiary should provide a reconciliation demonstrating how the figures can be linked to the accounting records).

#### What kind of costs do beneficiaries often fail to exclude?

Many beneficiaries fail to remove the irrecoverable VAT element of indirect costs where they can be identified (for example, making a percentage reduction to certain lines, such as travel or energy consumption, where a known VAT rate is included in the costs).

Servicing of loans, interest, and also the interest element of finance leases are also common examples of ineligible indirect costs which beneficiaries fail to exclude.

#### What kinds of indirect taxes are concerned by this procedure?

In most cases, the key indirect tax is VAT. Other national duties should be raised as exceptions if they are identified as not being excluded.

#### What is meant by excessive or reckless expenditure<sup>46</sup>?

The auditor will have to rely on a written declaration by the beneficiary<sup>47</sup> as to the absence of excessive or reckless expenditure.

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<sup>46</sup> The Guide to Financial Issues does not refer to a list of excessive or reckless expenditure but provides definitions.

Excessive expenditure should be understood as paying significantly more for products, services or personnel than the prevailing market rates, resulting in an avoidable financial loss to the project. Reckless expenditure means failing to exercise care in the selection of products, services or personnel resulting in an avoidable financial loss to the project.

Should the auditor give an opinion whether the cost allocations are reasonable?

No. As this is an agreed upon procedures assignment, the Commission is interested in the existence of the allocation method, but reserves the right to independently assess whether the method is a fair allocation of costs to FP7 project work.

Procedures	Standard factual findings and basis for exception reporting
<b>Indirect costs</b>	
<p>11. Assess use of a simplified method of calculation of overheads at the level of the legal entity.</p> <p>The Beneficiary may use a simplified method of calculation (either due to the lack of analytical accounting or legal requirement to use a form of cash-based accounting). This does not permit the use of a generalised estimate, or the use of a 'standard' rate that is not derived from the financial accounts of the period in question. Thus the rate (but not the methodology) should be updated for each accounting period.</p>	<p>The Beneficiary's accounting system does not permit indirect costs to be separately identified for the individual departments. <b>[and/ or]</b></p> <p>The Beneficiary's accounting system is cash-based and year-end adjustments are made using accounting estimates in order to charge certain accrued costs.</p> <p>The Auditor obtained the breakdown of overhead costs and the adjusting entries together with the source of the relevant accounting entries.</p> <p>The Beneficiary provided the Auditor with underlying calculations showing the basis for additional accounting entries. The Auditor agreed these calculations to the relevant sources of management information.</p> <p><b>Any elements of a simplified calculation which represent percentage estimates and which cannot be compared to underlying data should be listed (together with the amounts) as exceptions in the main report.</b></p>

What is the objective of this procedure?

The procedure "to assess" should mean the following: when performing **simplified calculations of indirect costs**, the beneficiary may not benefit from an analytical accounting system which can separate costs of different types as described in the prior procedures. Effectively, it will not be possible to identify or separate certain research costs from those that are related to other activities such as education. The Commission thus wishes to verify that the beneficiary has carried out some procedure to ensure

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<sup>47</sup> Included in the model letter of representation (see Annex I of Part III, Glossary of the present guidance notes).

indirect costs charged in the simplified method are not significantly larger than they would be if the true analytical data was known.

Which documents should the beneficiary prepare for the auditor?

As above, the beneficiary should provide the appropriate management information. In the case of the simplified method, this can be expected to be based on information from a variety of sources<sup>48</sup>.

What is meant by 'relevant sources of management information'?

Beneficiaries using the simplified method should be using the best information available, but which may not be very detailed. For example, the only data the beneficiary may have in order to allocate power consumption is the floor space of the relevant buildings, even though power consumption may in reality be concentrated in certain locations (e.g. the computer research centre). In the absence of real data on consumption, the beneficiary should choose a conservative but objective measure (floor space can be verified by reference to the relevant management information).

What kind of allocation method should give rise to an exception?

Taking the example of the computer centre above, if the beneficiary allocated (say) 30% of its power consumption without having any factual basis, this should be raised as an exception by the auditor. For the Commission the concept of the simplified method does not extend to estimates which do not have a verifiable basis. Thus if the beneficiary cannot demonstrate to the auditor how the 30% was calculated, it should be raised as an exception.

*6.4.5 Exchange rates used*

Procedures	Standard factual findings and basis for exception reporting
<b>Exchange rates</b>	
12. Inspect and compare exchange rates into Euros.	<p>The Auditor compared the exchange rates used for conversion with the applicable official exchange rates established by the European Communities and the Beneficiary used [choose one]:</p> <ul style="list-style-type: none"> <li>• the conversion rate of the date where the actual costs were incurred</li> <li>• the rate applicable on the first day of the month following the end of reporting period</li> <li>•</li> </ul> <p><b>Where rates cannot be agreed, an exception should be noted, (together with the amount) in the main report.</b></p>

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<sup>48</sup> The source of information will depend on the cost-driver used to distribute the shared costs among the different activities. The Auditor will be interested in any document supporting the correctness of the estimated allocation.

What is the objective of this procedure?

The auditor is expected to compare the rates used for foreign currency conversion to the official rates established by the European Central Bank so that the Commission can confirm that they were accurately calculated.

**It is imperative that** costs be reported in EUR in the Financial Statements and that beneficiaries with accounts/transactions in currencies other than EUR report in EUR on the basis of the **exchange rate** that would have applied either:

- on the date that the actual costs were incurred or
- on the basis of the rate applicable on the first day of the month following the end of the reporting period.

The auditor should therefore check that the exchange rate used in the Financial Statements conforms to one of the two above-proposed options, the European Central Bank website being the official source for the exchange rate to be applied: [www.ecb.eu/stats/exchange/eurofxref/html/index.en.html](http://www.ecb.eu/stats/exchange/eurofxref/html/index.en.html).

If the exchange rate chosen by the beneficiary does not correspond to one of the two above options, the auditor should report an exception on the exchange rate used as a reference. It is not expected the auditor to quantify and report the differences between the exchange rate used by the beneficiary and one of the two options.

*6.4.6 Identification of receipts*

Procedures	Standard factual findings and basis for exception reporting
<b>Receipts</b>	
13. Identification of receipts. The Beneficiary is obliged to deduct from its claim any receipts related to the project (income from events, rebates from suppliers, etc.)	The Auditor examined the relevant project accounts and obtained representations from the Beneficiary that the amounts listed represent a complete record of the sources of income connected with the project. The amount included in the claim regarding receipts is the same as the amount recorded in the project accounting.  <b>Any discrepancies in the receipts noted in the accounts and those reported by the Beneficiary should be noted (together with the amount) as exceptions in the main report.</b>

What is the objective of this procedure?

The procedure has to be read as follows: "*the beneficiary is obliged to **declare** in its claim any receipts related to the project (income from events, rebates from suppliers,*

etc.)". The objective is to ensure that the receipts related to the project have been correctly declared.

The wording "Project accounting" in the procedure means the entire process to establish the project accounts<sup>49</sup>.

Which documents should the beneficiary prepare for the auditor?

Extracts from the project accounting should be made available showing all income entries. In addition to this, a declaration from the beneficiary should be obtained that receipts reported to the Commission are complete and the beneficiary has taken sufficient steps to ensure their completeness according to its normal accounting practices.

*6.4.7 Identification of interest yielded*

Procedures	Standard factual findings and basis for exception reporting
<b>Interests yielded</b>	
14. Identification of interest yielded on pre-financing. The Beneficiary, when it is the coordinator of the project, is obliged to declare interest yielded on pre-financing	The Auditor compared the relevant project accounts with the interest shown in the bank statements and found them to be the same.  <b>Any discrepancies in the interest noted in the accounts and those reported by the Beneficiary should be noted (together with the amount) as exceptions in the main report.</b>

What is the objective of this procedure?

The objective is to ensure that all interest yielded on pre-financing has been correctly declared in the claim for the Commission.

Which documents should the beneficiary prepare for the auditor?

Extracts from the project accounting and the relevant bank statements should be made available showing all interest income entries. In addition to this, a declaration from the beneficiary should be obtained that interest income reported to the Commission is complete.

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<sup>49</sup> Refer to Part III, Glossary for details on project accounts

## PART III: GLOSSARY

## ACCOUNTING RECORDS

Refer to the accounting entries and the documents supporting the statutory financial statements and/or reporting requirements, as well as, the internal procedures, reports or other documents necessary to understand the accounting system of the beneficiary.

The accounting records include, among others:

- Accounting entries:
  - Accounting journal
  - General ledger
  - Cash book
  - Inventory register / Fixed assets register
- Supporting documents
  - Sales and purchase invoices
  - Delivery notes, in particular for fixed assets
  - Credit notes
  - Salary slips
  - Bank statements
- Other documents
  - Rules applied for depreciation
  - Method of allocation of indirect costs
  - Internal rules for reimbursement of travel expenses

## AVERAGE PERSONNEL RATES

Calculated rates charged by the beneficiary for each category of personnel. These rates correspond to the weighted average of the salaries included under each category. The average rates should not lead to a systematic deviation in favour of the beneficiary or to a significant deviation from the actual costs. In addition, the result of multiplying the average rate for each category by the total productive hours for that category can not be greater than the actual costs according to the accounting records:

*Example 1- Personnel average rates:*

*Example of calculation of the average rate for category "Assistant 5":*

	A	B	C	D	E	F
	Annual cost for the employer (accounting records)	Working time (Full time=100%)	Months worked in the year	% of year worked (C / 12)	Full time equivalent (B * D)	Equivalent annual cost for full year (A / E)
Ms. B.	27.990,70	100%	12	100%	1,00	27.990,70
Mr. C.C.	3.572,21	50%	3	25%	0,13	28.577,68
Mr. P.	29.222,00	100%	12	100%	1,00	29.222,00
Ms.V.	15.726,94	100%	6	50%	0,50	31.453,88
Mss. M	5.440,20	33%	6	50%	0,17	32.970,91
Ms. T.	34.105,29	100%	12	100%	1,00	34.105,29
Mr. Z	35.832,14	100%	12	100%	1,00	35.832,14
<b>TOTAL</b>	<b>151.889,71</b>				<b>4,79</b>	

**Average annual cost: 31.709,75** (151.889,71 / 4,79)

**Average rate = 31.709,75 / 1680 = 18,87**

In this example, 1680 represents the productive hours. For further reference on productive hours please see the definition included in this glossary.

An example of a complete average personnel system is available in Annex 2 of this glossary.

### **EXCESSIVE OR RECKLESS EXPENDITURE**

The auditor will have to rely on a written representation by the beneficiary<sup>50</sup> as to the absence of reckless or excessive expenditure.

Excessive expenditure should be understood as paying significantly more for products, services or personnel than the prevailing market rates, resulting in an avoidable financial loss/charge to the project. Reckless expenditure means failing to exercise care in the selection of products, services or personnel resulting in an avoidable financial loss/charge to the project.

### **EXCEPTION**

In the context of the Forms D and E, matters to be reported by the auditor in his report under the caption "Exceptions" include the following:

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<sup>50</sup> Included in the model letter of representation

- Error or exception: Any fact detected by the auditor while performing a procedure which prevents him from using the standard text of the findings proposed in the model Form. Therefore, whenever the standard text of the findings needs to be modified by the auditor following the application of the procedure, this should be reported as an *exception*.
- Scope limitation: Any fact or event which impedes the auditor to perform any of the procedures. This includes any modification made by the beneficiary in the standard model statements of the model Form to reflect the real situation which would prevent the auditor from carrying out the corresponding procedure.

For instance in procedure 1 of the table of statements and procedures of the Form E, the standard statement by the beneficiary reads:

*"Time recording exists, with authorisations, which enables all personnel [...]"*

If the beneficiary states that there is no time recording, the related procedure described in the right-hand column (verification of the time recorded) can not be carried out. Therefore this scope limitation should be reported as an exception in the auditor's report.

#### **FINANCIAL STATEMENT (IN RTD CONTEXT)**

Refers solely to Form C (Annex VI to the EC FP7 Grant Agreement) via which the Beneficiary declares costs to the Commission in the frame of the Grant Agreement. In this context, Financial Statements are not the beneficiary's statutory financial statements (or equivalent).

Models of Form C can be found at:

[http://cordis.europa.eu/fp7/calls-grant-agreement\\_en.html#standard\\_ga](http://cordis.europa.eu/fp7/calls-grant-agreement_en.html#standard_ga)

#### **GENERAL LEDGER**

The double-entry accounting in which the financial movements are registered at the level of each individual account. It presents the chart of accounts of the beneficiary and provides the information on the debit and credit entries made in the individual accounts. The general ledger is the primary source from which the statutory financial statements (or equivalent) are prepared.

#### **INDIRECT TAXES<sup>51</sup>**

Identifiable<sup>52</sup> indirect taxes including value added tax (either recoverable or not by the beneficiary) are not eligible according to the Grant Agreement provisions. An

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<sup>51</sup> For additional details on the subject, refer to the "Guide to Financial Issues relating to FP7 Indirect Actions", section "Article II.14.3 of GA – Non-eligible costs"

identifiable indirect tax is a tax charged on the cost of a good or service and paid by the purchaser in the form of an increase of the price.

However indirect taxes will be allowed when not identifiable. This may be for example the case with foreign invoices where the price indicated is gross without identifying the value added tax. In any case, the beneficiary should be able to justify this in the event of an audit.

## **NORMAL ACCOUNTING POLICY**

Standards and criteria used by the beneficiary to prepare its statutory financial statements (or equivalent). The accounting policy applied by the beneficiary for FP7 Grant Agreements should not differ from its normal accounting policy. Whenever adjusting entries are necessary to comply with the eligibility criteria of the Grant Agreement, these should be duly documented<sup>53</sup> and reconciled to the accounting records.

The normal accounting policy can never be adapted ad-hoc in order to overcharge the EC Grant Agreement compared with the normal practices of the beneficiary.

### ***Example:***

The term "normal accounting policy" is referred in procedure 7 of the Form D concerning the depreciation of the equipment. In this procedure it is explicitly demanded that the depreciation method normally applied by the beneficiary should be the same as the depreciation method applied for the assets charged to the Grant Agreement.

Situations as the follow are, therefore, not permitted:

Beneficiary X applies an annual depreciation of 25 % for IT equipments.

Two new computers for a total of 3.000 € are purchased to be used exclusively for the EC Grant Agreement "Y". The project covered by this Grant Agreement has duration 2 years.

The beneficiary decides to apply yearly depreciation of 50 % in order to charge the full cost of the equipments to the project.

Annual depreciation according to the "normal accounting policy" =  $3.000 * 25 \% = 750$

Total depreciation charged to the Grant Agreement =  $750 * 2 \text{ years} = \mathbf{1.500}$

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<sup>52</sup> Identifiable means clearly indicated on the purchase invoice.

<sup>53</sup> Adjusting entries refer to the corrections aimed at eliminating costs included in the indirect costs but which are ineligible under FP7 (e.g. provisions for future losses, exchange losses, interest owed, etc).

Annual depreciation according to the ad-hoc accounting policy =  $3.000 * 50 \% = 1.500$

Total depreciation charged to the Grant Agreement =  $1.500 * 2 \text{ years} = 3.000$

The concept of "**normal policy**" can be extended to other areas of costs, for instance travel costs, meaning that no internal rule for allocation of expenses should be modified in order to overcharge the FP7 Grant Agreement.

*Example for travel costs:*

The internal policy of Beneficiary X concerning the flight tickets is that all its researchers should travel in economy class.

However, Beneficiary X realises that they have overestimated the budget necessary for travel for the FP7 Grant Agreement in which it is participating.

Beneficiary X decides then to accept its researchers travelling in business class because the costs will be charged to the Grant Agreement. In addition, they decide that the daily allowance generally paid to the researchers will be increased by 10 % for these trips since there will be sufficient budget.

Derogation of this kind from the internal rules is **not** permitted.

## **NORMAL EMPLOYMENT COSTS**

Refers to all costs components related to personnel. These include the basic salary, sickness, pension and social contributions as well as any kind of allowances or benefits granted to the employees. The notion of "normal" implies that those are the standards commonly applied by the beneficiary.

## **PRODUCTIVE TIME**

The productive time for an employee is the time actually spent on direct work. Productive hours have to be clearly justified and should match the underlying time records.

The productive time should exclude annual leave, public holidays, training and sick leave. Productive hours must be calculated according to the beneficiary's normal practices and will vary depending on the personnel category, industry sector, unions, contracts and national legislation.

A figure of 210 working days per year could be considered representative in most cases.

*Example:*

Total days in a year	365
Weekends	-104

Annual holidays	-21
Statutory holidays	-15
<u>Illness/Others</u>	-15
Workable days in a year	210

\* 8 working hours/day = 1.680 *Productive hours*

If the productive hours actually performed (as supported by the time-records) are greater than the productive hours budgeted, the first shall be used for the calculation of the personnel costs, unless overtime is paid.

### **PROJECT ACCOUNTS**

Normally project accounts for FP7 projects are management account codes allocated solely to individual FP7 projects which are integrated in the double entry accounting system of the beneficiary. This integration with the double entry system reduces the likelihood of double counting and makes it easier to reconcile the costs with the accounting records. Thus the invoices (say for travel) which are allocated to the project are posted via double entry to the individual project accounts, so that the travel costs incurred for a particular project in a particular period can be correctly identified. Other forms of recording project expenditure (e.g. spreadsheets) are not considered as reliable as management accounting directly linked to the double-entry accounting system.

### **"PRO FORMA" FINANCIAL STATEMENT**

The "pro forma" financial statement is a Form C prepared by the beneficiary covering an interim period from the beginning of the project in order to be used as a basis for analysis of the Certification on the Methodology when no actual Form C (covering a full reporting period for the Grant Agreement) is yet available.

The "pro forma" Form C is not an official document and should not be submitted to the Commission. It is only to be used by the auditor as the supporting evidence in the absence of the Financial Statement (Form C).

### **REPRESENTATION LETTER<sup>54</sup>**

The representation letter is a document clearly dated in which the Beneficiary confirms in writing all representations made to the Auditor during the course of the procedures specified. The purpose of this letter is to document the responsibility of the Beneficiary with regard to the information presented during the procedures.

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<sup>54</sup> See FP7 Grant Agreement- ANNEX VII – Form E paragraph 1.1

*Example:*

An example of Representation Letter is given in the Annex to this glossary.

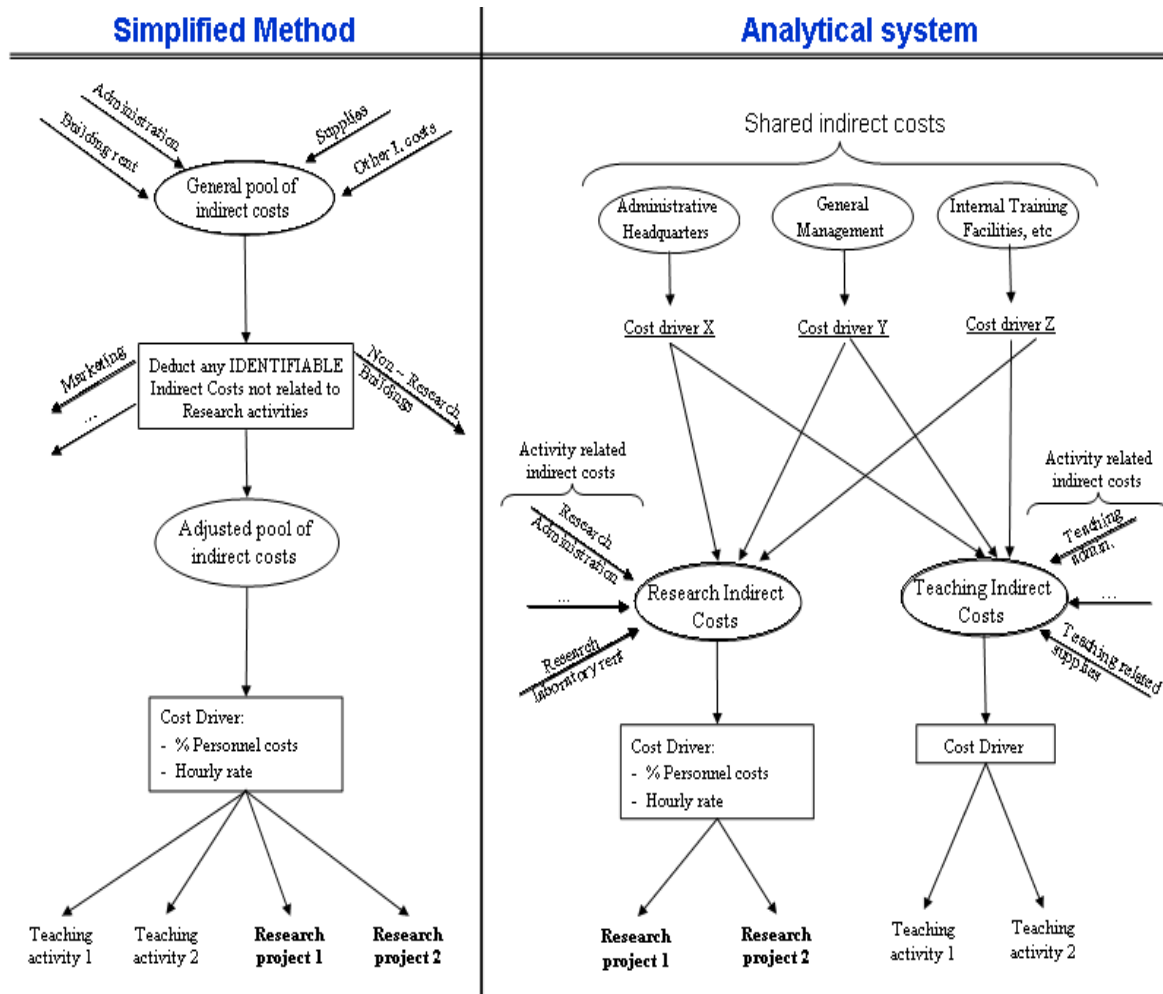
**SIMPLIFIED METHOD<sup>55</sup>**

The simplified method is a way of declaring indirect costs applicable to organisations which cannot provide an analysis of their indirect costs at a **detailed level** (centre, department), but can aggregate their indirect costs **at the level of the legal entity**.

This requires that the beneficiary has an accounting system enabling it to determine the total indirect costs (overheads) of the entity as a whole. However, the same system would not permit the share of the indirect costs generated by the research activities to be identified separately from the other indirect costs. Therefore, the indirect costs of the beneficiary should be treated altogether and allocated using a cost driver which accounts for all the productive hours of the entity and not only for the research productive hours.

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<sup>55</sup> For further explanation on the simplified method, please refer to the "Guide of Financial Issues relating to FP7 Indirect Actions" [ftp://ftp.cordis.europa.eu/pub/fp7/docs/financialguide\\_en.pdf](ftp://ftp.cordis.europa.eu/pub/fp7/docs/financialguide_en.pdf)



**UNDERLYING MANAGEMENT INFORMATION<sup>56</sup>**

**Accounting policies, internal accounting procedures and supporting documents (working papers, details on calculations, etc) constitute the basis for the normal calculation of the indirect costs for the beneficiary.**

**The beneficiary must provide the auditor with the additional information and underlying calculations enabling the reconciliation between the normal calculation and the basis of calculation of the amounts charged to the Grant Agreement. The adjusting entries applied by the beneficiary must be substantiated by the underlying calculations which are to be agreed by the auditor to the relevant sources of management information.**

<sup>56</sup> In the context of the simplified indirect costs calculation (Form E, procedure 6)

## ANNEX 1– EXAMPLES OF LETTERS OF REPRESENTATION

### 1.A Related to the Certificate on the Methodology (Form E)

#### Letter of Representation

(Beneficiary letterhead)  
(Date-same as date of the factual findings report)  
(Addressed to the Audit firm)

Dear Madam, dear Sir,

Taking into consideration our responsibility as mentioned in the Article 1.1 of Annex VII-Form E of the FP7 Grant Agreement N° xxxxx (Project Title Acronym) with the European Commission and in connection with your engagement to perform agreed upon procedures regarding the Methodology (Form E) as at [date] or covering the period from [date] to [date], we hereby confirm the following representations made to you during your engagement:

- We are responsible for the preparation of the statements made in the Form E a,d for their accuracy and completeness. All the statements cover the methodology used as at (date) or for the period starting (date) and ending (date) to prepare the cost Financial Statements in accordance with the Grant Agreement.
- We have made available to you all records, documents, statements and significant information that we believe are relevant for the purpose of the agreed-upon-procedures you have performed.
- All information given to you regarding personnel and their remuneration, division of their time, and qualifications is accurate, complete and in line with the historic data.
- Costs that we have reported as eligible costs are actual costs excluding any profits<sup>57</sup> and are determined in accordance with our usual accounting principles and allocation methods in place.
- *(if applicable)* We have complied with the conditions of the consortium agreement.
- Personnel costs used in the calculation of average or individual personnel cost to be charged to the EU projects do not include bonuses or special conditions for employees working on European Commission funded projects.
- Indirect costs only include those costs which cannot be allocated to specific projects and support the functioning of the organisation as a whole.

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<sup>57</sup> As could be the case, for instance, of internal invoicing, inter-departmental charges, etc

- No implicit interest is included in the expenditures in relation to European Commission funded projects.
- Purchases are made according to the principles of best value for money (best price-quality ratio), transparency and equal treatment. No excessive or reckless expenditure is included.
- No event has occurred after [ending date of period covered by statements], which would have a significant impact upon those statements.

Nothing has come to our attention during the period under review, including management actions and/or other matters of importance that might be considered to represent financial irregularities, fraud or an illegal act which would have an impact on the statements OR the following financial irregularities, fraud or illegal acts which have an impact on the statements have occurred : [...] and sufficient measures have been taken to correct them and to prevent repetition, and they have all been fully disclosed to you.

....

(Name of the Beneficiary)

(Stamp and Signature)

## **1.B Related to the Certificate on the Financial Statements (Form D)**

### **Letter of Representation**

(Beneficiary letterhead)  
(Date-same as date of the factual findings report)  
(Addressed to the Audit firm)

Dear Madam, Dear Sir,

Taking into consideration our responsibility, as mentioned in Article 1.1 of Annex VII - Form D of the FP7 Grant Agreement N° xxxxx (Project Title Acronym) with the European Commission and in connection with your engagement to perform agreed-upon procedures regarding the Financial Statement (Form D) covering the period from [date] to [date] (the “Financial Statement”), we hereby confirm the following representations made to you during your engagement:

- We are responsible for the preparation of the Financial Statement covering the period starting (date) and ending (date) in accordance with the Grant Agreement and for their accuracy and completeness.
- We have made available to you all records, documents, statements and information that we believe are relevant for the purpose of the agreed-upon-procedures you have performed.
- *(if applicable)* We have complied with the conditions of the consortium agreement.
- Personnel costs:
  - (Option 1) Personnel costs reported in the Financial Statement are not based on budgeted or estimated amounts. They are calculated using rates based on actual costs, and reflect the time actually worked on the [ ] project during the period covered by the Financial Statement. OR
  - (Option 2) Personnel costs reported in the Financial Statement are not based on budgeted or estimated amounts. They are calculated using average rates which do not significantly deviate from the actual costs and which are compliant with the method approved by the European Commission and reflect the time actually worked on the [ ] project during the period covered by the Financial Statement.
- Subcontracts and contracts to suppliers of goods and services are awarded in accordance with a procedure including an analysis of best value for money (best price-quality ratio), transparency and equal treatment.
- Indirect costs reported in the Financial Statement do not include any of the following costs:

- Identifiable indirect taxes including value added tax (for instance local business and property taxes);
  - Duties (for instance customs duties);
  - Interest owed;
  - Provisions for possible future losses or charges (for instance provisions for doubtful debt (but not normal accruals);
  - Exchange losses, cost related to return on capital (for instance exchange losses from billing in a foreign currency);
  - Costs declared or incurred, or reimbursed in respect of another Community project;
  - Debt and debt service charges,
  - Excessive or reckless expenditure (for instance loan charges);
  - Implicit interest (leasing costs or other credit arrangements);
  - Costs attributable to activities other than the research activities covered by the [ ] project, such as manufacturing, education, marketing of products or services, etc.
- Purchases in connection with the [ ] project are made according to the principles of best value for money (best price-quality ratio), transparency and equal treatment. No excessive or reckless expenditure is included in the Financial Statement.
  - The receipts declared in the Financial Statement represent a complete record of the sources of income connected with the European Commission funded project (for example, income from events, rebates from suppliers...), and have been recorded in accordance with our normal accounting practices.
  - All interest yielded on pre-financing of the [ ] project during the period covered by the Financial Statement has been reported in the Financial Statement.
  - No event has occurred after [ending last day of the period covered by the Financial Statement], which would have a impact upon the Financial Statement.
  - Nothing has come to our attention during the period under review, including management actions and/or other matters of importance that might be considered to represent financial irregularities, fraud or an illegal act which would have an impact on the Financial Statement OR the following financial irregularities, fraud or illegal acts which have a impact on the Financial Statement have occurred: [...] and sufficient measures have been taken to correct them and to prevent repetition and they have all been fully disclosed to you.
  - [Other matters, as applicable].

....

(Name of the Beneficiary)

(Stamp and Signature)

## **ANNEX 2 – EXAMPLE OF AVERAGE PERSONNEL SYSTEM**

Any beneficiary participating in FP7 Grant Agreements can opt to declare average rates for the personnel costs<sup>58</sup>. However, the methodology used by the beneficiary to calculate these rates must be approved by the Commission. The Commission services will analyse, in particular, that the methodology complies with the next two basic principles:

1. It corresponds to the usual management principles and accounting practices of the beneficiary
2. The use of the average rates does not lead to significant deviations from actual costs

The approval of the methodology is a pre-condition for the eligibility of the costs declared using personnel average rates. In practice, this means that the beneficiary is obliged to use actual costs per person until the Commission approves the proposed average methodology. Failure to respect this principle would result on the rejection of the personnel costs declared by the beneficiary.

The present document is intended to guide the beneficiaries on the preparation of the statements corresponding to the procedure 3 of the Form E when average personnel costs are applied. Thus, examples of information, tables and processes expected are provided in these guidelines.

The following example, however, should not be taken as a rule. The number and distribution of categories, as well as, the percentage deviations are only intended to illustrate an eligible methodology and the process for reporting this. Grouping of personnel may significantly differ from one beneficiary to another without this being necessarily an impediment for the acceptability of the methodology.

Nevertheless, it is worth underlining that the number of categories, the range of salaries, and the deviation of the median from the average, are key factors for the acceptability of the method.

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<sup>58</sup> Natural persons and owners of SME not receiving a salary should opt for the use of average personnel rates.

**Information to be included in procedure 3 of the Form E concerning the average personnel system**

The following table is an example of presentation including all numeric data requested in procedure 3 of the Form E when an average personnel methodology is applied. This example uses standard productive hours. An example on the additional information to be provided when individual productive hours (per person) are used can be found also at the end of this document.

		A	B	C	D	E	F	G	H	I
	Category	Number of employees	Lowest pay	Highest pay	Average	Median	Lower % variation with the average	Upper % variation with the average	Annual Productive hours	Average rates
Heads of department	16	6	163.317,24	187.623,18	176.231,46	177.331,19	-7,33%	6,46%	1600	110,14
	15	12	96.230,09	108.878,16	103.452,78	104.487,42	-6,98%	5,24%	1600	64,66
Senior Researchers	14	27	85.051,33	108.878,16	96.351,79	95.574,42	-11,73%	13,00%	1650	58,40
	13	45	75.171,21	85.051,33	80.813,27	81.621,49	-6,98%	5,24%	1650	48,98
Junior Researchers	12	3	66.438,77	85.051,33	75.266,26	74.659,01	-11,73%	13,00%	1680	44,80
	11	30	58.720,81	75.171,21	66.522,82	65.986,08	-11,73%	13,00%	1680	39,60
	10	75	51.899,37	66.438,77	58.795,06	58.320,70	-11,73%	13,00%	1680	35,00
Technicians	9	30	45.870,42	51.899,37	49.313,26	49.806,42	-6,98%	5,24%	1680	29,35
	8	18	40.541,79	51.899,37	45.928,40	45.557,86	-11,73%	13,00%	1680	27,34
	7	66	35.832,14	45.870,42	40.593,04	40.265,55	-11,73%	13,00%	1680	24,16
	6	12	31.669,67	40.541,79	35.877,47	35.587,99	-11,73%	13,00%	1680	21,36
Assistants	5	7	27.990,70	35.832,14	31.709,70	31.453,88	-11,73%	13,00%	1680	18,87
	4	30	24.739,12	31.669,67	28.026,10	27.799,99	-11,73%	13,00%	1680	16,68
	3	3	21.865,26	27.990,70	24.770,38	24.570,52	-11,73%	13,00%	1680	14,74
Trainees	2	15	19.325,23	24.739,12	21.892,88	21.716,27	-11,73%	13,00%	1680	13,03
	1	6	17.080,26	19.325,23	18.362,25	18.545,86	-6,98%	5,24%	1680	10,93
		385								

It is strongly recommended that this table is also attached in spreadsheet format to the electronic version of the certificate when submitted to the Commission. This will facilitate a faster analysis of the average rates methodology.

## Description of the Columns

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### A – Number of employees

Headcount of the employees grouped in each category.

In addition to the information provided in the table, the beneficiary should include a short description of the staff grouped in each category. For instance:

- *Technicians: personnel with a technical background and/or at least five years experience as an Assistant. They carry out technical tasks under direct supervision of one or several researchers. Technicians are divided in four categories depending on their level of experience and/or seniority in the post.*

**NOTE for the following columns:** the table describes the methodology used to calculate the average personnel costs, therefore, any reference made in procedure 3 of the Form E, or in this example, to "pay" (lower pay, pay range, etc) should be read as "cost" (including salary, social charges, etc).

### B – Lowest pay

Lowest of the individual costs of the personnel grouped in each category.

Please note that the individual costs must be homogeneous in order to be comparable. For instance, if the cost of an employee working part-time is considered, it is highly probable for it to be the lowest cost of the category. However, it is obvious that it can not be compared "as such" with another full-time individual in order to determine the lowest cost. In this case, the cost must be normalized in order to obtain the full time equivalent of the part-time cost.

### C – Highest pay

Highest of the individual costs of the personnel grouped in each category.

Please note that the individual costs must be homogeneous in order to be comparable. Part-time costs can not be compared "as such" with full time individuals. Please refer to column B.

### D – Average

Average annual costs calculated by the beneficiary for each category of personnel. These figures correspond to the weighted average of the costs included under each category and must be based on full time equivalents.

**Example of calculation of the average rate for category "Assistant 5":**

	A	B	C	D	E	F
	Annual cost for the employer (accounting records)	Working time (Full time=100%)	Months worked in the year	% of year worked (C / 12)	Full time equivalent (B * D)	Equivalent annual cost for full year (A / E)
Ms. B.	27.990,70	100%	12	100%	1,00	27.990,70
Mr. C.C.	3.572,21	50%	3	25%	0,125	28.577,68
Mr. P.	29.222,00	100%	12	100%	1,00	29.222,00
Ms.V.	15.726,94	100%	6	50%	0,50	31.453,88
Mss. M	5.440,20	33%	6	50%	0,165	32.970,91
Ms. T.	34.105,29	100%	12	100%	1,00	34.105,29
Mr. Z	35.832,14	100%	12	100%	1,00	35.832,14
<b>TOTAL</b>	<b>151.889,71</b>				<b>4,79</b>	

**Average annual cost:** 31.709,75 (151.889,71 / 4,79)

**Average rate = 31.709,75 / 1680 = 18,87**

**E – Median**

It is the annual cost of the employee who is the mid-point of the category.

In practical terms: the beneficiary shall order (increasingly or decreasingly) the equivalent annual costs (normalized) for a full year of the employees of the category. The median will be the annual cost for the employee being the mid-point of the list.

In the example used above (D -Average), seven employees are grouped in category "Assistant 5". In the table those are ordered increasingly by their annual costs. The median would be, therefore, the value for the employee 4 (three employees are above, three are below); Ms. V. = 31.453,88 €

If the number of employees grouped in the category is an even number, the Median will be equal to the average of the two middle values. For instance, if six employees are grouped:

$$\text{Median} = (\text{value of employee 3} + \text{value of employee 4}) / 2$$

**F - Lower % variation with the average**

This column is the percentage resulting of dividing the difference between the lowest pay and the average by the average in each category.

$$F = (B - D) / D$$

**G - Upper % variation with the average**

This column is the percentage resulting of dividing the difference between the highest pay and the average by the average in each category.

$$F = (C - D) / D$$

**H - Annual productive hours**

Average or standard productive hours for the category concerned.

If standard productive hours are applied, a detailed calculation should be made available in this procedure. For instance, in certain countries standard productive hours are made public by means of an agreement between Trade Unions and Employers.

Other example on the settling of standard productive hours would be:

Total days in a year	365
Weekends	-104
Annual holidays	-21
Statutory holidays	-15
Illness/Others	-15
<u>Workable days in a year</u>	<u>210</u>

\* 8 working hours/day = 1.680 Productive hours

### I - Average rates

Hourly average rate applied by the beneficiary for each category. This column is the result of dividing the average rate of the category by the productive hours of the same category.

$$I = D / H$$

### Non-eligible methodology

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The eligibility of a methodology can not be decided only on the basis of the averages table. Other key information is also taken into account when deciding on the acceptance of the method.

For instance, some "non-numeric" criteria, as the exceptions described by the auditor or the results of previous audits performed by the Commission on the same method, could play a role in the final decision.

Nevertheless, methodologies with too few categories (meaning that the salary ranges are excessively wide) and/or methodologies in which the deviation of the medians from the averages is significant, can be seen as potentially ineligible.

This would be the case presented in the next table. This methodology is based on the same data used for the first example of this document (eligible methodology) but the number of categories has been strongly reduced.

Category	Number of employees	Lowest pay	Highest pay	Average	Median	Lower % variation with the average	Upper % variation with the average	Annual Productive hours
Heads of projects	18	96.230,09	187.623,18	139.842,12	136.097,70	-31,19%	34,17%	1600

Researchers	180	51.899,37	108.878,16	75.123,08	69.325,01	-30,91%	44,93%	1650
Technicians	126	31.669,67	51.899,37	42.267,51	38.287,15	-25,07%	22,79%	1680
Assistants	61	17.080,26	35.832,14	25.486,59	24.739,12	-32,98%	40,59%	1680

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### Other information requested in procedure 3 of the Certificate on the Methodology (Form E) concerning the average system

#### ⇒ Example of list of average rates charged in each category for prior years

When available, the beneficiary should provide a table with the information of the rates charged in prior years. It is recommended to provide, at least, the data for the last two years.


	Category	Number of employees	Average Rates		
			Year n	Year n-1	Year n-2
Heads of department	16	6	110,14	107,98	104,33
	15	12	64,66	63,39	61,25
Senior Researchers	14	27	58,40	57,25	55,31
	13	45	48,98	48,02	46,39
Junior Researchers	12	3	44,80	43,92	42,44
	11	30	39,60	38,82	37,51
	10	75	35,00	34,31	33,15
Technicians	9	30	29,35	28,78	27,80
	8	18	27,34	26,80	25,90
	7	66	24,16	23,69	22,89
	6	12	21,36	20,94	20,23
Assistants	5	7	18,87	18,50	17,88
	4	30	16,68	16,36	15,80
	3	3	14,74	14,46	13,97
Trainees	2	15	13,03	12,78	12,34
	1	6	10,93	10,72	10,35
		385			

⇒ **Example of upper and lower percentage variation for productive hours from the average**

When available, particularly in the case of beneficiaries with a full time-recording system, a table with the upper and lower percentage variations for productive hours from the average is to be provided.

**Example:** the table would have to be filled reporting all categories. "*Actual productive hours*" refers to the actual hours per person according to the time records.

	Average/Standard productive hours	Upper Variation	Lower Variation
...	...	...	...
Technician 6	1680	3,05%	-2,57%
<b>Assistant 5</b>	1680	2,56%	-4,17%
...	...		



<b>Assistant 5</b>	Average/Standard productive hours	Actual productive hours	% Variation
Ms. B.	1680	1715	2,08%
Mr. C.C.	1680	1665	-0,89%
Mr. P.	1680	1672	-0,48%
Ms.V.	1680	1680	0,00%
Mss. M	1680	1723	● <b>2,56%</b>
Ms. T.	1680	1695	0,89%
Mr. Z	1680	1610	<b>-4,17%</b> ●

**ANNEX 3– TEMPLATE MODEL FOR CALCULATION OF HOURLY PERSONNEL RATE**

Calculation of hourly personnel rate				
Salary details per person or category		Gross salary (1)	Employer's social charge (2)	Others (3)
Month 1				
Month 2				
Month 3				
Month 4				
Month 5				
Month 6				
Month 7				
Month 8				
Month 9				
Month 10				
Month 11				
Month 12				
Month 13, 14 or other (4)				
Month 13, 14 or other (4)				
Month 13, 14 or other (4)				
<b>Sub-totals</b>		<b>0</b>	<b>0</b>	<b>0</b>
<b>Total salary + Social charges + Others</b>	<b>A</b>			<b>0</b>
Productive hours details				
Number of working hours per week (5)				
Number of weeks during the period (6)				
<b>Sub-total Working hours for the period</b>	<b>B</b>			<b>0</b>
<b>Deduction for : (in days)</b>				
Annual holidays (7)				
Statutory holidays (8)				
Illness/others (9)				
sub-total absence for the period (days)				<b>0</b>
Average numbers of working hours per day (10)				
<b>Total absence in hours</b>	<b>C</b>			<b>0</b>
<b>Total Productive hours for the 12 months period</b>	<b>D = B-C</b>			<b>0</b>
<b>Hourly personnel rate</b>	<b>A/D</b>			<b>0</b>

(1) The gross salary as shown on the salary slip for the month

(2) Social charge paid by employer as required by law

(3) Other components of the salary not included in the gross salary but declared to the Tax Authorities.

**Please explain** what it is e.g. company car, company contribution to pension scheme, lunch vouchers.

(4) Please add here holiday pay, 13th month, bonus, etc.. **Use one line per item and describe the nature of the salary component**

(5) Following the working contract or the normal practice of the company

(6) Standard 52 weeks for a year

(7) As per contract, including seniority, etc. **Please explain** the number of holidays based on the normal practice of your company.

The relevant information to report is the number of days of holidays for which the right was generated during the period covered by the salary, not the days actually taken during the period.

(8) As per law, at country, region or sector level. **Please explain** of the statutory holidays according to your company

(9) The **average** number of days of illness that can be considered as **normal** for your company

Days for specific training in the context of the project should **not** be deducted here

(10) Following the labour contract or the **normal practice** of the company

**ANNEX 4 – BEST PRACTICE FOR FORM E - TABLE PRESENTATION – ANNEX VII OF FP7 GRANT AGREEMENT**

**Benchmark methodology, statements to be made by the Beneficiary and corresponding procedures to be carried out by the Auditor with examples of factual findings.**  
*For a methodology to be considered compatible with the requirements of the Grant Agreement a positive answer should be provided to all of the statements below regarding the Beneficiary's methodology. Any exception should be highlighted in the main summary of the Report.*

Benchmark methodology	Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<p>The methodology described below has been in use since [date].                      The next planned alteration to the methodology used by the Beneficiary will be from [date]</p>		<p><b>Procedure:</b>                      The Auditor has inspected records and documents which support the date given by the Beneficiary.  <b>Finding:</b>                      The dates given by the Beneficiary are consistent with the management information provided by the Beneficiary.</p>
<p><b>Personnel</b></p> <p>1. Time recording exists, with authorisation, which enables all personnel hours to be allocated to project work, management and administrative time, holidays, etc.                      The time recording enables the time of employees working on multiple projects to be allocated to those projects, and includes a check to prevent double charging of time.</p> <p>'Productive hours' represent the (average) number of hours made available by the employee in a year after the deduction of holiday, sick leave and other entitlements. This calculation should be provided by the Beneficiary, based on the period(s) corresponding to the Financial Statement.</p>		<p><b>Procedure:</b>                      For 10 employees selected at random, the Auditor checked:                      That the employee had recorded management and administrative tasks separately from project time;                      That an authorisation check exists which checks, inter alia, double-charging of time;</p> <p><b>Finding:</b>                      For the items checked, the time recording includes separation of time as specified above, and an authorisation including a check for double charging of time.                      For the most recent full calendar year:                      The average productive hours for the 10 employees was _____.                      The average productive hours per employee for the organisation as a whole, as recorded by the Beneficiary's time records was _____.</p>

<b>Benchmark methodology</b>	<b>Statement to be made by Beneficiary</b>	<b>Procedure to be carried out by the Auditor &amp; factual findings</b>
<p>2. Personnel costs of the employees only include standard salaries, employer's costs, etc. and no special conditions exist for employees on EC projects, unless they are explicitly foreseen in the Grant Agreement.</p>		<p><b>Procedure:</b> The Auditor reconciled the personnel costs used in the average personnel cost calculation to the payroll system and accounting records.</p> <p><b>Finding:</b> The amounts used in the costs calculation and those in the accounting records were the same. The costs consisted of standard salaries and statutory employers' costs, and did not include bonuses and confirmation was obtained from the Beneficiary that no special conditions exist for employees on EC projects.</p>
<p>3. Hourly rates are correctly calculated using one of the following possibilities [choose one]:</p> <ul style="list-style-type: none"> <li>• Actual personnel costs <i>per person</i> divided by actual productive hours <i>per person</i>;</li> <li>• Actual personnel costs <i>per person</i> divided by <i>average/ standard</i> productive hours;</li> <li>• <i>Average</i> personnel costs <i>per person</i> divided by <i>average/ standard</i> productive hours.</li> </ul> <p>For the average costing approach, the Beneficiary should state:</p> <ul style="list-style-type: none"> <li>- How employees are grouped into categories (how many categories, under what criteria);</li> <li>- The pay range in each category from lowest to highest, average and median;</li> <li>- The upper and lower percentage variation within each category from the average;</li> <li>- The upper and lower percentage variation for productive hours from the average (if known);</li> <li>- A list of average rates charged in each category for the prior years (an indication only, of the expected range of rates for the period of the agreement).</li> </ul>		<p><b>Procedure:</b> The Auditor reviewed the calculation and confirmed that hourly rates are calculated as specified by the Beneficiary. Where average costs are charged, the Auditor compared the following information with the accounting system of the Beneficiary:</p> <ul style="list-style-type: none"> <li>• The number of categories;</li> <li>• The pay range, median and average of each category;</li> <li>• The upper and lower percentage variation from the average (denominator is the average);</li> <li>• The upper and lower percentage variation for productive hours from the average (if known);</li> <li>• A list of average rates charged in each category for the prior years (an indication only, of the expected range of rates for the period of the agreement).</li> </ul> <p>The Auditor multiplied the average rate for each category by the total productive hours for each category for the period of the Financial Statement(s) and reconciled the result to the accounting records ('<b>chargeable</b>' personnel costs).</p> <p><b>Finding:</b> No differences arose from the comparisons listed above. The result of the above recomputation ('<b>chargeable</b>' personnel costs) in all cases did not exceed the actual costs as recorded in the accounting records.</p>

Benchmark methodology	Statement to be made by Beneficiary	Procedure to be carried out by the Auditor & factual findings
<b>Overheads/ Indirect costs</b>		
<p>4. The Beneficiary confirms the following:            Indirect costs only include those costs which cannot be allocated to specific projects and support the functioning of the organisation as a whole.            The indirect costs do not include costs which relate exclusively to non-research parts of the organisation.            If the organisation carries out activities other than research (e.g., manufacturing, education etc), these indirect costs are transparently separated via cost accounting and do not form part of the claim.</p>		<p><b>Procedure:</b>            The Auditor obtained the calculation of hourly overhead rates (indirect costs), including a detailed breakdown of the <b>indirect costs to be allocated</b> to research activity;</p> <p><b>Finding:</b>            This breakdown did not contain costs relating to direct project activity, such as the cost of research personnel, project consumables and expenses;            This breakdown does not contain costs relating to education or manufacturing, or other non-research activities of the Beneficiary;            The breakdown of indirect costs used to calculate overhead rates was reconciled to the accounts.</p>
<p>5. The accounting system provides for fully traceable elimination of:</p> <ul style="list-style-type: none"> <li>a) identifiable indirect taxes including value added tax,</li> <li>b) duties,</li> <li>c) interest owed,</li> <li>d) provisions for possible future losses or charges,</li> <li>e) exchange losses, cost related to return on capital,</li> <li>f) costs declared or incurred, or reimbursed in respect of another Community project,</li> <li>g) debt and debt service charges, excessive or reckless expenditures.</li> </ul> <p>With regard to excessive or reckless expenditure, the Beneficiary confirms that purchases are made according to the principles of best value for money (best price-quality ratio), transparency and equal treatment between Community funded Grant Agreement and any other agreement or convention that the Beneficiary may have. Where the Beneficiary is allocating shared costs, they should provide a list of allocation methods used (usage records, floor space, activity-based-costing, headcount,</p>		<p><b>Procedure:</b>            The Auditor inspected the accounting records and chart of accounts. The Auditor found that the breakdown provided by the Beneficiary did not explicitly relate to any of the items specified;            The Auditor also confirmed (if necessary also via a written declaration/ representation of the Beneficiary) that no implicit interest was included, e.g., by finance leasing or other credit arrangements.</p> <p><b>Finding:</b>            The Auditor was able to obtain confirmation that no implicit interest was included, and did not find costs which explicitly relate to any of the items specified.            For each allocation method used by the Beneficiary, the Auditor reconciled the amount to be allocated to the accounts, and reconciled the allocation basis to the relevant management accounting information (usage records, floor space, activity-based-costing, headcount, etc.)</p> <p><b>Only the types of excessive and reckless expenditure listed in the Commission's guidance should be considered, the Auditor is not</b></p>

etc.)		<b>required to exercise professional judgement or provide assurance in this matter.</b>
<b>Benchmark methodology</b>	<b>Statement to be made by Beneficiary</b>	<b>Procedure to be carried out by the Auditor &amp; factual findings</b>
<p>6. If the organisation is using a simplified indirect cost calculation (either due to the lack of analytical accounting or use of a form of cash-based accounting) all estimates are clearly described and are based on factual criteria which can be objectively confirmed.</p> <p>The Beneficiary must provide a list of cost allocations which are not based on underlying management information.</p> <p>In general costs which cannot be identified and allocated using a traceable source of information should not be included in the indirect cost calculation.</p>		<p><b>Procedure:</b> The Auditor was able to trace all cost allocation to underlying management information.</p> <p><b>Finding:</b> Percentage estimates were traced to the supporting factual criteria used by the Beneficiary and were found to be in agreement.</p>
<p>7. Allocation of indirect costs to the project is via personnel (hours), either as [choose one]</p> <ul style="list-style-type: none"> <li>- A percentage of personnel costs;</li> <li>- A fixed hourly rate.</li> </ul>		<p><b>Procedure:</b> The Auditor checked that the allocation of indirect costs to the project corresponds with the methodology specified by the Beneficiary;</p> <p><b>Finding:</b> The allocation of indirect costs to the project corresponds with the methodology specified by the Beneficiary; Where percentages are used the Auditor found that, the '<b>chargeable personnel costs</b>' (defined above) multiplied by the overhead percentage does not exceed the total <b>indirect costs to be allocated</b> defined above; Where a fixed hourly rate is used, the productive hours figures used to distribute indirect costs and personnel were found to be the same.</p>