



**AUDIT CERTIFICATE GUIDANCE NOTES**  
**6<sup>TH</sup> FRAMEWORK PROGRAMME**

**WORKING NOTES FOR CONTRACTORS AND CERTIFYING  
ENTITIES**

**MATERIALS PREPARED BY**  
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# AUDIT CERTIFICATE WORKING NOTES

## INTRODUCTION

These working notes have been compiled to guide research contractors and certifying entities in the preparation of audit certificates under the European Commission's 6<sup>th</sup> Framework Programme (FP6).

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

- Frequently asked questions (FAQs) received by the European Commission from certifying entities, contractors and the Commission's operational services.
- FP6 model contract<sup>1</sup> and the Guide to Financial Issues Relating to Indirect Actions of the 6<sup>th</sup> Framework Programmes<sup>2</sup> (FP6 Guide to Financial Issues)
- Frequent errors in financial statements (see Annex 3)
- Indicative model of an audit programme for certifying entities (see Annex 4)

N.B: The proposed model audit certificate in Annex 2 is the same as that found in the FP6 Guide to Financial Issues.

The objective of these working notes is to give an overview of the requirements and contractual provisions which are of importance in claiming costs for reimbursement and hence in the certification of financial statements. In the event that this concentration of information should lead to inconsistencies, the stipulations of the FP6 model contract and its annexes together with the Guide to Financial Issues Relating to Indirect Actions of the 6<sup>th</sup> Framework Programmes would take precedence.

These working notes have been prepared and developed by representatives from each of the research DGs. The text of this document is valid as of the present date however it may be updated if necessary to reflect developments in the audit certificate procedures as they occur (in particular, the FAQs contained in Annex 1).

## VERSION 2 CHANGES:

Apart from some minor clarifications in different sections, mainly section 4.2(1) regarding the usage of estimate/average hourly rates has been updated to reflect developments and best practices within the audit certificate system.

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<sup>1</sup> See in particular Articles 7-9 of the FP6 model contract and Articles II.19-II.31 of Annex II (General Conditions, Part B) of the model contract  
([http://ec.europa.eu/research/fp6/index\\_en.cfm?p=0\\_contracts](http://ec.europa.eu/research/fp6/index_en.cfm?p=0_contracts))

<sup>2</sup> See in particular Section 3.2.3.1.2. (pages 93-99) and Section 6.7 - Annex 7: Proposed model for an Audit Certificate (pages 216-222) of the FP6 Guide to Financial Issues  
([http://ec.europa.eu/research/fp6/model-contract/pdf/fp6-guide-financial-issues-feb05\\_en.pdf](http://ec.europa.eu/research/fp6/model-contract/pdf/fp6-guide-financial-issues-feb05_en.pdf))

To further support the audit certification procedure to be carried out by certifying organisations an additional annex (no. 5) providing an overview on recommended procedures and related examples of findings has been attached to the guidance notes.

## 1. GENERAL PRINCIPLES

The audit certificate is a document provided by an external auditor (or in the case of a public body it may be provided by a competent public officer) certifying that the costs claimed during a specific period meet the contractual requirements established by the FP6 model contract, in particular those stated in Articles II.19-II.31 of Annex II.

The purpose of an audit certificate is to give to the Commission reasonable assurance<sup>3</sup> that eligible costs (and, if relevant, the receipts and interests generated by the pre-financing) charged under the project are claimed by the contractors in accordance with the relevant legal and financial provisions of the FP6 model contract.

The Commission will use the audit certificate as a main assurance mechanism in the processing of costs claimed and their subsequent payment. Consequently, the provision of a non-qualified audit certificate at the end of a reporting period will allow the Commission to consider the corresponding amounts as acceptable and settled, in accordance with the provisions of Article 8.2 of the FP6 model contract.

N.B: The submission of an audit certificate does not waive the right of the Commission to carry out its own audits<sup>4</sup>.

An audit certificate is a project deliverable (Article 7 of the contract) which is presented by the contractor through the co-ordinator to the Commission together with a Financial Statement (Form C) at the end of reporting periods as determined by the contract. For Integrated Projects and Networks of Excellence, the submission of one audit certificate per contractor is in principle mandatory at the end of each reporting period. For other instruments, the requirements for submission will be fixed at the time of negotiations<sup>5</sup>.

As the audit certificate is a project deliverable, the European Anti Fraud Office (OLAF) and the Court of Auditors may have access to the certificates.

Each contractor will remain responsible to the Commission for the costs it has claimed after payment by the Commission and even after submission of an audit certificate (see last sentence of Article II.26 of Annex II to the FP6 model contract).

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<sup>3</sup> Reasonable assurance is an accounting expression meaning a high degree of confidence that information is valid and unaltered.

<sup>4</sup> “The *Commission* may, at any time during the *contract* and up to 5 five years after the end of the *project*, arrange for audits to be carried out [.....]” (Article II.29 of Annex II of the FP6 model contract).

<sup>5</sup> The terms of the contract should be consulted (Article 9) to determine whether one of the special clauses on timing and nature of audit certificates has been used. The two special clauses are numbers 32 and 39 and can be consulted at the website:  
([http://ec.europa.eu/research/fp6/index\\_en.cfm?p=0\\_contracts](http://ec.europa.eu/research/fp6/index_en.cfm?p=0_contracts))

The auditor has a contractual relationship solely with the contractor. 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 contractor.

Certifying auditors must carry out the audits in compliance with International Standards of Auditing (ISA). However, auditors must bear in mind, that for the establishment of an audit certificate, they have to carry out a compliance audit and not a normal statutory audit. The eligibility criteria of the FP6 model contract always override normal accounting practices.

The Commission expects results of a high professional level when relying on certification of costs by professional auditors.

## **2. AUDITORS ELIGIBLE TO DELIVER AUDIT CERTIFICATES**

Each contractor is free to choose a qualified external auditor, including its usual external auditor, provided that the following cumulative requirements are fulfilled:

- the external auditor must be **independent** from the contractor;
- the external auditor must be **qualified** to carry out statutory audits of accounting documents in accordance with the 8th Council directive 84/253/EEC of 10 April 1984 or similar national regulations.

Independence is one of the qualities which permit the auditor to apply unbiased judgement and objective consideration to established facts in arriving at an opinion or a decision. Independence also means that the auditor's work is carried out without direction or interference of any kind from the contractor concerned.

The services provided by the auditors to the contractors are regarded as provided under the qualification of subcontracts in the framework of FP6 contracts and are therefore subject to the requirements of selection of the bid offering best value for money (Article II.6 of Annex II of the FP6 model contract). Where the contractor uses its usual external auditor then it is presumed that the contractor already has an agreement with its external auditor and is not obliged to find new bids. That is, it is assumed that the requirements for selection of the auditor required by Article II.6 of Annex II of the FP6 model contract are already fulfilled. Where the contractor uses an external auditor who is not their usual external auditor, then they would have to fulfil the requirements of Article II.6 of Annex II of the FP6 model contract.

Public bodies have the choice between an external auditor or a competent public officer. Where a public body elects to use a competent public officer, the auditor's independence is usually defined as independence from the audited contractor "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 Statement (Form C). Relevant national authorities establish the legal capacity of the competent public officer to carry out audits of that specific public body. This is usually done by a letter of notification to the relevant research Directorate General and subsequent letter of confirmation from that Directorate General. Reference should be made to this notification in the certificate.

## **3. PERIODICITY OF SUBMISSION OF AN AUDIT CERTIFICATE**

The periodicity of submission of the audit certificate for each contractor (along with its periodic reports and Form C) is determined by Article 7.2 of the contract. Article 9 of

the contract should also be checked to determine whether a special clause relating to the provision of audit certificates has been included.<sup>6</sup> There must be at least one audit certificate per contractor covering the whole duration of the project provided at the last reporting period.

However, an audit certificate will always be required where the Community's financial contribution requested by the contractor in its Form C exceeds EUR 750,000 for a specific reporting period. (See Article II.7.3 of Annex II of the FP6 model contract).

The audit certificates shall be submitted at the latest 45 days after the end of the corresponding reporting period. For the final reporting period, this delay may be increased by 45 days at the request of the consortium.

#### **4. SCOPE AND CONTENT OF AN AUDIT CERTIFICATE**

##### **4.1 SCOPE**

An audit certificate is issued by the external auditor (or the competent public officer) to the attention of the contractor (not to the attention of the Commission).

An audit certificate will certify (first paragraph of Article II.26 of Annex II of the FP6 model contract)<sup>7</sup> for one or several of the reporting periods identified in Art 6 of the contract

- that the total eligible costs declared by the contractor in Box 2 of one (or several) Form(s) C comply with the following cumulative conditions:
  - they are determined according to the relevant cost reporting model<sup>8</sup> for which this type of legal entity is eligible;
  - they fulfil the definition of eligible costs<sup>9</sup>, except for the requirement of necessity (which is assessed by the EC) in the allocation of resources by the contractor;

For the two cost reporting models that incorporate a flat rate contribution deemed to cover indirect eligible costs (FCF and AC), the auditor must certify that the correct rate has been used and that it has been applied correctly.

- the total amount of receipts declared by the contractor in Box 3 Form(s) C;

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<sup>6</sup> Further the relevant amendments to the contract can contain specific provisions as the periodicity of submission (i.e. amendments regarding 'Special clause 39')

<sup>7</sup> Article II.26, first paragraph, of Annex II of FP6 model contract:  
*“For each period for which an audit certificate is required, each contractor shall provide an audit certificate prepared and certified by an external auditor, certifying that the costs incurred during that period meet the conditions required by this contract. The certificate should expressly state the amounts that were subject to verification. Where third parties' costs are claimed under the contract, such costs shall be audited in accordance with the provisions of this Article.”*

<sup>8</sup> For interpretative guidance in relation to cost models for FP6 projects, see [http://ec.europa.eu/research/fp6/model-contract/pdf/fp6\\_cost-models-annex5231\\_en.pdf](http://ec.europa.eu/research/fp6/model-contract/pdf/fp6_cost-models-annex5231_en.pdf)

<sup>9</sup> See especially Part 2 of the FP6 Guide to Financial Issues.

- the total amount of interest yielded by the pre-financing declared for the relevant period by the **coordinator** in Box 4 of Form(s) C;
- the relevant basis for the conversion rate used of EURO
  - either the conversion rate on the date the actual costs were incurred
  - or, the rate applicable on the first day of the month following the end of reporting period
- the price paid by the contractor for the audit certificate in Box 6 of Form C.

## 4.2 ELIGIBILITY OF COSTS

In the remainder of this section further guidance is given on some of the terms used in order to assist an auditor when certifying costs.

- (1) Article II.19.1.a of Annex II of the FP6 model contract states that **costs must be actual**. This means that the costs must in principle be real and not estimated, budgeted or imputed. Where actual costs are not available at the time of establishment of the audit certificate they may be reported in the subsequent period. Where the costs of a third party are to be reimbursed and the actual costs are not available for the audit period, any necessary adjustments must be reported in the financial statement (Form C) for the subsequent reporting period.<sup>10</sup> Whenever actual costs for the (interim not final) audited period are not available for declaration in Form C this has to be clearly indicated in the audit certificate.

Average rates for hourly labour rates and overheads are acceptable if they are calculated on the basis of actual costs provided that this corresponds to the usual accounting practice of the contractor (i.e. the averages are not purpose made for the Commission) and that the averages reflect a fair approximation which does not systematically result in deviations in favour of the contractor. Certifying auditors are requested to verify the reasonableness of the average rate calculation on the basis of professional judgment.

When an audit certificate is required the auditor must report on the use of averages and confirm that costs claimed using averages reflect the requirements of the contract and they are in conformity with the principles described above. In case of a financial audit carried out by (or on behalf of) the EC, the Commission reserves the right to adjust the claims- made on the basis of averages not in conformity with these principles- to real costs.

- (2) Furthermore, Article II.19.1.a of Annex II of the FP6 model contract states that cost must be **economic**. In certifying the costs auditors are requested to certify that “costs **reflect the contractor’s economic environment**”. This essentially implies that costs are in line with the usual administrative and management practices of the contractor and are not excessive or extravagant (see also

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<sup>10</sup> See adjustment line in Form C.



definition of non-eligible costs). Costs which would not be in line with the economic environment of the contractor are for example, employment contracts specifically concluded for the performance of an EU co-funded project and in excess of the usual remuneration levels.

- (3) Article II.19.1.b of Annex II of the FP6 model contract states that costs must be determined **in accordance with the usual accounting principles of the contractor**. The contractor must in accordance with the provisions of the contract, in particular the definition of direct and indirect costs (see below) and the principles mentioned above, apply its usual definition of types of eligible costs. For example, a contractor would declare the depreciation cost of equipment bought for the purpose of the project as a direct eligible cost based on its own depreciation system. The notion of usual accounting principles has been introduced to avoid the creation of new and specific accounting principles specifically for EU co-funded research projects.
- (4) Article II.20 and II.21 of Annex II of the FP6 model contract distinguish between direct and indirect costs. Direct costs are essentially eligible costs that can be identified by the contractor in accordance with its accounting system and can be attributed directly to the project. Indirect costs cannot be directly attributed to the project but can be identified and justified by the accounting system as being incurred in direct relationship with the eligible direct costs. The following items may typically be considered as indirect eligible costs: general administration and management, cost of office or laboratory space, communication expenses, common office equipment including PCs, recurring consumables. For the two cost reporting models that incorporate a flat rate contribution, these costs are deemed to be covered.
- (5) Not only the costs but also **receipts and interest**<sup>11</sup> (for a definition see Art. II. 23 and II.26 of the contract) have to be certified.

### 4.3 CERTIFICATION OF THIRD PARTY COSTS

Costs of third parties also need to be certified either as part of the audit certificate of the contractor which claims the costs of the third party or in an audit certificate covering specifically these third party costs (see Art. II.19.1(e) of the contract).

The costs of the third party have to be certified by an external auditor: either by their own external independent auditor or by the auditor of the contractor concerned. The rules applying to the contractor relating to the calculation and payment of the grant (especially those concerning eligible costs and audit certificates) apply also for costs incurred by those third parties. (for further explanation see question 35-37 in annex 1)

N.B: Third parties providing resources to a contractor are required to provide an audit certificate. Subcontractors, although considered 'third parties', do not provide audit certificates (as they are reimbursed at a price established by an invoice not real costs).<sup>12</sup>

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<sup>11</sup> Verification of whether the pre-financing has yielded interests is only applicable for project coordinators.

## **5. FORM OF AN AUDIT CERTIFICATE**

To the extent possible, the external auditor or competent public officer should follow the model proposed by the Commission in Annex 7 of the FP6 Guide to Financial Issues, a copy of which is also contained in Annex 1 to these notes. This model template is not binding, however, deviations may result in additional information and clarification being requested by the Commission and the subsequent risk of rejection of the certificate.

The certificate must be signed (signature and stamp) and dated by the external auditor (or competent public officer). To state the amounts that were subject to verification, the Financial Statement (Form C) completed and signed by the contractor should be attached to the certificate. It is recommended that the Financial Statement (Form C) is signed for identification by the auditor.

With respect to the language of the audit certificate, Article 7.1 of the FP6 model contract states that “Reports shall be submitted in [language]”. Therefore, the audit certificate should be in the same language used for all other reports. Where the audit certificate is not provided in the language of the reports, the external auditor should attach a translation in that language. (N.B.: Article 7.1 covers all reports including the audit certificate, not only those mentioned in Article II.7.2 of Annex II.)

## **6. QUALIFIED OPINIONS**

The contractor and the auditor are expected to address any questions on factual data or detailed calculations prior to submission of the Financial Statement (Form C) and the audit certificate to the Commission. It is also recommended that the contractor takes into account the auditor’s preliminary comments and suggestions in order to avoid a qualified opinion or to reduce the scope of the qualifications.

The purpose of the audit certificate is to certify unqualified eligible costs. In cases where a portion of the amount of the total eligible costs is qualified, only the amount of the total eligible costs that are unqualified should be mentioned.

## **7. REIMBURSEMENT OF THE COSTS OF AN AUDIT CERTIFICATE**

The cost of an audit certificate (excluding VAT) is an eligible cost according to Article II.26.1 of Annex II of the FP6 model contract. It is usually a direct cost<sup>13</sup> and is declared in both Form C, box 2 – “Declaration of costs”, under “Management of the Consortium Activity” and in box 6 -”Audit certificates”.

- If a competent public officer internal to the contractor has provided the audit certificate (public bodies only) then the identifiable direct actual costs (gross remuneration and related charges) will be considered eligible. Overheads can also be

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<sup>12</sup> For further details in relation to third party costs or subcontracting costs, see sections 2.1.2.3 and 2.2.1.1 of the FP6 Guide to Financial Issues

<sup>13</sup> For some public bodies it is possible that these costs cannot be identified directly and/or that they are considered to be part of their normal overheads. The latter is more likely for those using the full cost reporting model.

charged to this amount, except in case of permanent staff when the contractor uses the additional cost (AC) model (see page 45 of the FP6 Guide to Financial Issues). The total amount charged shall exclude any profit margin.

- If an external auditor is used to provide the audit certificate (which is a form of subcontract), no overheads can be claimed on this amount by contractors using the AC or full cost flat rate (FCF) because the flat rate does not apply to direct costs related to subcontracting. Full cost (FC) contractors may charge indirect costs if their normal accounting practices and system permits and they do so normally.
- The price charged for an audit certificate is subject to the general eligibility criteria of the grant agreement and should consider relevant market prices for similar services (see also question 15 in annex I)
- The auditor invoices directly to the contractor giving a breakdown of the amount of fees charged and the VAT applied. The amount of VAT is not an eligible cost reimbursed by the Community financial contribution.

## **8. PRACTICAL HINTS FOR CONTRACTORS AND ESSENTIAL BACKGROUND DOCUMENTS**

In order to avoid delays in the submission of audit certificates contractors should select and contract the auditor well before the financial statement is due. As a first step it is essential that the auditor fully understands the requirements of the audit certificate and that the auditor is provided with a complete set of the documents necessary for the audit certification (see below).

The auditor will then establish an audit plan/audit strategy which normally includes familiarisation with the contractual provisions. An indicative model for an audit programme and some procedural suggestions and examples of potential findings are provided in Annexes 4 & 5 of these notes. In the execution of the audit programme, the auditor may need access to further detailed information and contractors should ensure that relevant staff is available to provide any explanations/additional information that may be needed.

At an early stage of contact with the auditor, the contractor will need to communicate a number of essential parameters that will determine the certification process. These include:

- The cost reporting model used. If an AC/FCF cost reporting model is used, indirect costs do not need to be examined as a flat rate is applied. If an FC cost reporting model is used the indirect costs will need to be certified.
- The number of staff involved in the project. The major cost of a project is normally personnel costs. Certification of these costs may imply a verification of the time spent by staff on the project<sup>14</sup>, the calculation of the hourly personnel rates, the calculation of the productive hours and for example, an examination of the employment contract. In particular for contractors using the AC cost

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<sup>14</sup> Note that the Form C requires that eligible costs are reported by type of activity (see Article II.2 and Article II.25 of the contract)

reporting model, the temporary nature of the contract or the dependence on external funding will need to be verified (see Article II.20.2 of Annex II of the FP6 model contract).

- The usual accounting rules for example, whether travel costs are usually considered to be direct or indirect costs.

The following documents serve as a basis for certification. The list refers to principal documents and does not include the audit evidence which must be obtained from the accounting system of the contractor. The list is therefore not exhaustive.

- Contract signed between the contractor 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) and Annex III (Integrated Projects, Networks of Excellence, Infrastructures, SMEs)
- Periodic Management report including the justification of the resources deployed by the contractor and Form C ‘Financial Statement’ as completed by the contractor
- ‘Guide to Financial Issues relating to Indirect Actions of the Sixth Framework Programmes’. As mentioned above these guidelines have been designed to help both contractors and auditors to understand the financial provisions of the FP6 model contract and the applicable procedures for Financial Statement certification. Particular reference is made to:
  - Part 2 “Framework of eligible costs for FP6 grants which reimburse costs”. This part contains concise explanations regarding cost eligibility principles and cost reporting models.
  - Part 3 in particular 3.1.3.3 “The notion of receipts”
  - Part 6.1 Annex I “Examples of potential eligible costs”
  - Part 6.7 Annex 7 proposed model for an audit certificate.
- Proposed model for an audit certificate (see Annex 2)
- Indicative model of an audit programme (see Annex 4)
- Suggested model-procedures to be performed (see Annex 5)

## ANNEX 1: FREQUENTLY ASKED QUESTIONS

#	TOPIC:	QUESTION:	ANSWER:
1.	Competent public officer	How does a public body establish the legal capacity of the internal audit unit to act as competent public officer?	<ul style="list-style-type: none"> <li>- Relevant national authorities establish the legal capacity of the internal audit unit (of a given public body) to act as competent public officer.</li> <li>- This is usually done by a letter of notification to (and subsequent letter of confirmation from) the relevant research DG.</li> </ul>
2.	Competent public officer	Does the competent public officer have to possess a recognised qualification in accounting or auditing?	<ul style="list-style-type: none"> <li>- Yes, the competent public officer has to be qualified and independent.</li> </ul>
3.	Competent public officer	Can the competent public officer be a staff member of the auditee organisation, as long as they are not closely involved in the contract activity?	<ul style="list-style-type: none"> <li>- Yes, the competent public officer can be a member of staff but their independence has to be established by the relevant national authorities.</li> </ul>
4.	Competent public officer	How do we demonstrate that the competent public officer is completely independent of the contract activity - scientifically, administratively and financially?	<ul style="list-style-type: none"> <li>- An organigram of the organisation can show that the competent public officer is not involved in processing the financial claim. Internal audit officers usually have this independence.</li> </ul>
5.	Competent public officer	Do we have to name the competent public officer to the Commission in advance of a cost statement?	<ul style="list-style-type: none"> <li>- No, the name of the competent public officer does not need to be given in advance.</li> </ul>
6.	Competent public officer	Does the appointment of a named competent public officer have to be confirmed to the EC by a delegate from the [UK] government?	<ul style="list-style-type: none"> <li>- No, but it is good practice to create a network of competent public officers for exchange of information, experience and training.</li> </ul>
7.	Competent public officer	Is an internal auditor of an International Organisation eligible to deliver audit certificates to that organisation?	<ul style="list-style-type: none"> <li>- International organisations are treated as public bodies for the purposes of FP6. Accordingly, such organisations can opt for an Internal Auditor.</li> <li>- N.B.: An internal auditor for a public body must meet the criteria described in the Guide to Financial Issues</li> </ul>
8.	Audit certificate template	Will the European Commission pre-approve the content of an individual audit firm's proposed model audit certificate/ cost reporting template etc.?	<ul style="list-style-type: none"> <li>- The Commission is unable to confirm in advance the proposed wording of the audit certificate or provide detailed comments.</li> </ul>
9.	Audit certificate template	Is the model audit certificate template provided in the FP6 Financial Guidelines binding?	<ul style="list-style-type: none"> <li>- The model audit certificate template provided in the FP6 Financial Guidelines is not binding, however, where possible, we would recommend that this model is followed, particularly as regards the</li> </ul>

			identified “checklist” of conditions relating to the eligibility of costs declared on the financial statements.
10.	Qualifications of auditors	Is it possible for an auditor (that is properly authorised to issue audit certificates in an EC country) to certify the costs of a contractor located in a different country?	<ul style="list-style-type: none"> <li>- Yes, it is sufficient that the “EC-auditor” fulfils the qualifications of the 8th Council directive 84/253/EEC.</li> <li>- Auditors that are qualified to provide an audit certificate in one member state are qualified to provide an audit certificate in all Member States.</li> </ul>
11.	Qualifications of auditors	Is the audit firm required to provide evidence that they are “qualified to carry out statutory audits of accounting documents” in accordance with the 8th Council Directive or similar national regulations?	<ul style="list-style-type: none"> <li>- Although such supporting documentation would be a “nice to have”, it is not strictly required as it is only mentioned in the financial guidelines and not the contract.</li> <li>- As per the guidelines, relevant information establishing this qualification should be attached if the auditor is not known internationally or for a competent public officer whose competence to provide an audit certificate has not been attested to by its national authorities.</li> </ul>
12.	Unqualified audit certificates	<p>One of the footnotes to the model audit certificate template specifies “In case where part of the amount of the total eligible costs should be qualified, modify the sentence and mention only the amount of the total eligible costs that are unqualified.”</p> <p>What is meant by the terms “qualified” and “unqualified”, and how should the entire sentence be interpreted?</p>	<ul style="list-style-type: none"> <li>- In the event that the total costs reviewed by the audit do not meet the cumulative conditions of the EC contract (i.e., actual, incurred in accordance with usual accounting principles of the contractor, during the life of the project, recorded in the books of the contractor or third party etc.), then: <ul style="list-style-type: none"> <li>i. Only that part of the costs which comply with these conditions is certified. (i.e., unqualified).</li> <li>ii. The other part of the costs which do not comply with these conditions is unable to be certified. (i.e., qualified).</li> </ul> </li> </ul>
13.	Scope of Audit Certificate	Is an audit based upon a sample of the total costs sufficient, or is a complete check of all transactions required?	<ul style="list-style-type: none"> <li>- It is clear that the audit cannot cover every detail in a big project. The auditors determine the level of control, depending on their experience with the type of project and complexity given the legal framework.</li> <li>- The auditors must be sure that the results are reliable and acceptable within their responsibility.</li> </ul>
14.	Cost	How much should an audit certificate cost?	<ul style="list-style-type: none"> <li>- The cost of an audit certificate is determined by the professional judgment of the auditor, who must find the right balance between determining the procedures to provide a reasonable level of assurance and on the other hand, the amount of work required (and the directly related price).</li> <li>- The cost of an audit certificate depends on the auditor and the amount to be</li> </ul>

			certified.
15.	Cost	Is there an upper limit to the cost of an audit certificate?	<ul style="list-style-type: none"> <li>- Generally there is no upper financial limit set for the certificate itself. As any other subcontract the costs have to reflect a reasonable market price and the general eligibility criteria of the annex II (Art II.19) to the grant agreement.</li> </ul>
16.	Cost	To which activity should the cost of the audit certificate be charged?	<ul style="list-style-type: none"> <li>- The cost of the certification may be charged to the management of the consortium activity.</li> <li>- The costs of these management activities are reimbursed at a rate of 100% to all contractors regardless of their cost model, up to a limit of 7% of the EC financial contribution to the project.</li> <li>- The limitation of 7% of the Community financial contribution does not apply to each individual contractor but to the project as a whole.</li> <li>- Once the limit of 7% of the Community financial contribution is reached, a management activity that is linked to another activity of the project may be charged under the latter activity if it is necessary for the project and meets the other requirements of the contract (such activities might include writing technical reports, project meetings etc.). In that case, the maximum reimbursement rate of eligible costs for that activity per cost model applies.</li> </ul>
17.	Cost	Can a contractor charge the cost of an audit certificate to an activity other than management of the consortium before the 7% management budget is reached?	<ul style="list-style-type: none"> <li>- Art II.2 of the contract establishes a hierarchical list of what must &amp; may be charged to the management of the consortium activity by order of priority. It states as its first item under "Management of the consortium activities": "obtaining audit certificates by each of the contractors" So here one should read that the cost of obtaining an audit certificate is always a management cost and since this cost is first on the list, it is the first cost which should be claimed under the management of the consortium activity.</li> <li>- Therefore contractors MUST charge the cost of the audit certificates to the management of the consortium activity and with preference over any other management cost.</li> <li>- NB: there is no obligation for contractors to charge eligible costs to the project - there are some cases that we are aware of in which the audit certificates will not be charged as an eligible cost to the project as the participants wish to carry those costs themselves.</li> </ul>

	Cost (Example)	The budget of a partner is about EUR 8 000 for the first 18 months. The audit certificate will cost EUR 5 000. How should this be dealt with?	<ul style="list-style-type: none"> <li>- Although the cost of obtaining the audit certificate is part of the management costs and therefore eligible for 100% reimbursement from the EC Financial contribution, it would appear that the audit certificate cost is excessive and is certainly out of line with the eligible costs that have to be certified. It is possible that the auditors have not understood the requirements of an audit certificate.</li> </ul>
18.	Reporting period	In which reporting period should the cost of the audit certificate be charged?	<ul style="list-style-type: none"> <li>- Costs related to the audit certificate may be charged to the project in the current reporting period when they are recorded in the accounts of the contractor (see Article II.19.1d) of the contract) during that period.</li> <li>- The contractor may also record and charge to the project an estimate of the costs related to the audit certificate in the current period and adjust as appropriate in the next period.</li> <li>- If the costs related to the audit certificate are not recorded in the accounts of the contractor until after the current reporting period, they cannot be charged to the project in the current reporting period.</li> <li>- However, if costs are only to be charged in the next reporting period, the table included in Point 6 of the Form C “Audit certificates” should still be completed and indicate the cost of the audit certificate provided for that period, even though the cost will not be included in Point 2 of the Form C “Declaration of eligible costs” in the current reporting period. This cost will be included in the “Declaration of eligible costs” in the next reporting period.</li> <li>- Similarly, the cost of the audit certificate should also be indicated on the actual audit certificate, regardless of the reporting period in which it is charged.</li> <li>- Costs of the certification related to the last reporting period should be included in the financial statement of the last period. If due to the accountancy system the costs related to the audit certificate are not recorded in the accounts of the contractor within the 45 days (or eventually an extended period) after the final reporting period, the amount as indicated by the auditor in the final audit certificate (excl. VAT) should be included in the statement.</li> </ul>
19.	AC cost model and competent	Is it possible for a public body using the additional cost (AC) model whose internal	<ul style="list-style-type: none"> <li>- The general rule is that contractors using the AC cost model charge the direct costs of carrying out a project under FP6</li> </ul>



	public officer	audit department will prepare the audit certificate, to charge the working time of the internal audit department to the project?	<p>that are additional to their recurrent expenses.</p> <ul style="list-style-type: none"> <li>- As an exception to this rule, contractors using the AC model can charge, but only to the management of the consortium activity, costs of permanent personnel to the extent that they can identify their actual costs with precision.</li> <li>- Consequently, the working time of the personnel (permanent or temporary) in charge of preparing the audit certificates can be charged to the management of the consortium activity (provided the actual costs of this activity can be identified).</li> <li>- There need not be any previous tradition of the audit department charging its costs to the projects it audits.</li> </ul>
20.	Audit costs and subcontracting costs	Are audit fees subcontracting costs?	<ul style="list-style-type: none"> <li>- The costs of audit fees associated with the preparation of audit certificates are considered to be a form of subcontract if they are incurred by an external auditor.</li> <li>- Where the contractor uses its usual external auditor then it is presumed that the contractor already has an agreement with its external auditor and is not obliged to go out and find new bids. That is, it is assumed that the requirements for selection of the auditor required by Article II.6 of the contract are already fulfilled.</li> <li>- Where the contractor uses an external auditor who is not their usual external auditor, then they would have to fulfil the requirements of Article II.6.</li> </ul>
21.	Overhead costs	Is it possible to claim overheads on audit costs?	<p><u>Additional costs (AC)</u></p> <ul style="list-style-type: none"> <li>- If the contractor is using the AC cost model, then overheads are calculated on the basis of the flat rate foreseen in Article II.22 of the contract, that is, “20% of all direct additional costs minus costs of subcontracts”. <ul style="list-style-type: none"> <li>o If a competent public officer internal to the contractor has provided the audit certificate (public bodies only) then their direct costs will be considered eligible (special exception as explained in FAQ 19 above), however, no overheads can be claimed on this amount, as these are not direct ADDITIONAL costs.</li> <li>o If an external auditor is used to provide the audit certificate (which is a form of subcontract) then no overheads can be claimed on this amount because the flat rate does not apply to subcontracting costs.</li> </ul> </li> </ul> <p><u>Full Cost Flat Rate (FCF)</u></p>

			<ul style="list-style-type: none"> <li>- If the contractor is in Full Cost Flat Rate (FCF) model, then overheads are calculated on the basis of the flat rate foreseen in Article II.22 of the contract, that is, “20% of all direct costs minus costs of subcontracts”.</li> <li>o If a competent public officer internal to the contractor has provided the audit certificate (public bodies only) then their direct costs will be considered eligible and overheads can also be charged to this amount.</li> <li>o If an external auditor is used to provide the audit certificate (which is a form of subcontract) then no overheads can be claimed on this amount because the flat rate does not apply to subcontracting costs.</li> </ul> <p><u>Full Cost Rate (FC)</u></p> <ul style="list-style-type: none"> <li>- If the contractor is using the full cost (FC) model with actual costs then the calculation of overheads will depend on its normal accounting practices.</li> </ul>
22.	Competent public officer and internal invoicing	Would it be possible for the internal audit service to present an invoice for the service to the department which could be charged to the project? Would this cost be eligible?	<ul style="list-style-type: none"> <li>- The principle of using a public competent officer within the same organisation to prepare the audit certificate means that the real costs of effecting that work would be eligible.</li> <li>- That is, it is not possible to charge a market price for work carried out by the same contractor within the EC contract.</li> </ul>
23.	Selection of audit firm	Should the statutory auditor provide the audit certificate?	<ul style="list-style-type: none"> <li>- The advantage of using the statutory auditor (the same auditor of the contractor’s annual financial statements) to provide the audit certificate is that they are familiar with the in-house procedures, which is one of the aspects reviewed in certifying the costs incurred under the contract.</li> </ul>
24.	Selection of audit firm	Is it necessary for a contractor to use the same auditor for the duration of a project, for all projects?	<ul style="list-style-type: none"> <li>- No. A contractor may change auditors if necessary, however, the contractor should use its normal auditor to the extent possible as otherwise the costs of obtaining the certificate tend to increase unnecessarily.</li> <li>- The conditions of Article II.26 of the model contract must be respected.</li> </ul>
25.	Selection of audit firm	Is there a contradiction in using the statutory auditor? If the external auditor already audits the Contractor’s financial statements and/or provides other services such as tax, consulting etc. does this not restrict the auditor’s independence, in as much as there is an “economic” link	<ul style="list-style-type: none"> <li>- There is no contradiction.</li> <li>- Contractors may use their statutory auditors, provided that they are independent. The fact that the contractor usually uses the same auditor need not affect the independence of the latter.</li> </ul>

		between the two parties?	
26.	Form C	Is the coordinator required to submit an audit certificate for the consolidated Form C given that the figures submitted should all be supported by each contractor's Form C and individual audit certificate?	- No. There is no need for an audit certificate related to the consolidated Form C. Individual certificates confirming the costs of each partner are sufficient. (It is the Coordinator's responsibility if they make a mistake in drawing up the consolidated Form C).
27.	Costs claimed	Is an audit certificate required for a Form C with no costs?	- No. Audit certificates are not needed if no costs have been incurred during the period.
28.	Costs claimed	Must the contractor whose involvement is only for part of the term of an IP for which annual certificates are required, produce blank certificates for the years during which they are not involved in the IP?	- A contractor involved in only part of a project term can choose to leave the consortium mid-term (after its tasks are completed) or stay without any tasks or expenses. If no costs are incurred or claimed, no audit certificates are required.
<b>EC FINANCIAL OFFICERS</b>			
29.	Language of audit certificate	In what language should the audit certificate be provided	<ul style="list-style-type: none"> <li>- Article 7.1 of the contract states "Reports shall be submitted in [language]". That is the legal basis. Once language is chosen, there should be consistency, hence the same language that the contractors chose for the reports is kept for the audit certificates (and if there is a change, then a translation must be provided).</li> <li>- NB: Article 7.1 covers all reports including the audit certificate, not only those mentioned in Art II.7.2.</li> <li>- To assist contractors with any potential translation burden, a model audit certificate template is provided in English, in Annex 7 to the FP6 Financial Guidelines.</li> </ul>
30.	Overstated costs	What happens if the costs certified by an audit certificate were overstated?	<ul style="list-style-type: none"> <li>- If a Commission audit (the certificate does not diminish the right of the Commission to audit the contract by its own staff or authorized representatives) reveals that the certified costs were overstated, the Commission will seek recovery of the money from the contractor.</li> <li>- It is up to the contractor to seek any possible redress vis-à-vis its auditor.</li> <li>- It should also be noted that a provision in the FP6 contracts permits the Commission to apply liquidated damages to amounts unduly received as a result of overcharging.</li> </ul>
31.	Necessity of	Does the external auditor need to certify that the costs	- No. Necessity is one of the eligibility conditions required by article II.19 of the

	costs	were necessary to carry out the project?	<p>model contract, but this is not determined by the audit certificate.</p> <ul style="list-style-type: none"> <li>- Necessity is a condition that is determined by the EC services.</li> </ul>
32.	Subcontractor	Is it necessary for a subcontractor to submit an audit certificate?	<ul style="list-style-type: none"> <li>- The subcontractor is not required to submit an audit certificate itself.</li> <li>- Subcontracting costs are costs incurred by the contractor and will be included with all other costs of the contractor and is covered by its audit certificate.</li> <li>- However, even though a separate audit certificate for the subcontractor's costs is not needed, the contractor has to ensure that the contract between itself and the subcontractor includes provisions indicating that the EC and CoA or their representatives may carry out financial audits or controls on any subcontractor.</li> </ul>
33.	Subcontractor	What is to be certified in the case of subcontracting?	<ul style="list-style-type: none"> <li>- The audit certificate will only certify that the amount paid by the contractor to the subcontractor (i.e., the price) is correct according to the invoice.</li> </ul>
34.	Subcontractor	Does the auditor have to be independent from the subcontractor?	<ul style="list-style-type: none"> <li>- The authority providing the audit certificate must be independent vis à vis the contractor, but not necessarily the subcontractor.</li> </ul>
35.	Third parties	Who has to submit the audit certificates in the case of a third party?	<ul style="list-style-type: none"> <li>- In most cases, the costs of the third party may be identified in the financial statement (Form C) of the contractor and therefore covered by the audit certificate of the contractor.</li> <li>- However, when special clause 23 is used each third party may have to submit a separate financial statement (Form C) and a separate audit certificate. In this case, the Auditor may be the same on a different one provided that it is independent from both the contractor and the third party.</li> </ul>
36.	Third parties	What is to be certified in the case of third party resources?	<ul style="list-style-type: none"> <li>- Unlike subcontracting costs, costs from third parties having made available some resources to a contractor are not based on a price established by invoice.</li> <li>- The eligibility and reimbursement of these costs depends on the fulfilment of the requirement of the contract (as for any other cost of the project), especially Article II.19 (and II.20 in case of AC model), as well as Article II. 23. So, an audit certificate covering the third party's contribution is necessary in order to verify all eligibility conditions of costs (except the necessity).</li> <li>- Two cases must be distinguished: <ul style="list-style-type: none"> <li>1) Where the costs of the third party's resources are reimbursed by the</li> </ul> </li> </ul>

			<p>contractor:</p> <p>In this case, the Auditor must certify that the cost is in the accounts of the contractor as well as in the accounts of the third party and that the amount is the same.</p> <p>Where the contractor has reimbursed an amount superior to the costs recorded in the accounts of the third party, two different conclusions can arise depending on the specific case: 1- the difference is not considered as an eligible cost or 2- it must be considered as a subcontract and therefore all the rules set up in the contract for these cases must be applied.</p> <p>2) Where the costs of the third party' resources are not reimbursed by the contractor:</p> <p>In this case, the Auditor must certify that the cost is in the accounts of the third party. Article II. 23 (Receipts of the project) does apply and therefore the condition on this Article must also be checked by the Auditor.</p>
37.	Third parties	<p>Who is responsible for the audit certificates (independence, qualification, quality of the work...) in the case of subcontractors or third parties?</p> <p>How are the cost of a third party changed, for entities that when are contractors participate under the AC cost model?</p>	<ul style="list-style-type: none"> <li>- Only the contractor, who has signed the contract with the Commission, is responsible towards the Commission. So, the responsibility re audit certificates lies with the contractor.</li> <li>- Subcontractors or third parties making available resources to a contractor, as third parties to the EC contract, have neither rights nor obligations towards the Commission. However, the contractor has to take provisions that costs of the third party can be audited by the EC.</li> <li>- Third parties do not have a cost reporting model only contractors.</li> <li>- Costs of third parties have to be real costs; therefore if they are able to identify the costs of the permanent personnel they could charge those costs. However, they cannot charge 20% flat rate overheads; they have to charge real costs.</li> </ul>

## ANNEX 2: PROPOSED MODEL FOR AN AUDIT CERTIFICATE

See the FP6 Guide to Financial Issues, pages 216-218 (February 2005 Version)

### **Option 1: one contractor / third party(ies) contributions certified by the contractor's auditor=> one single audit certificate**

#### Addressed to

*[full name and the address of the contractor concerned<sup>15</sup>]*

We *[legal name of the audit firm]*, established in *[full address/city/state/province/country]* represented for signature of this audit certificate by *[name and function of an authorised representative]*, hereby certify that:

- we have conducted an audit relating to the cost declared in the Financial Statement(s) per Activity of *[name of contractor]* hereinafter referred to as contractor, to which this audit certificate is attached, and which is to be presented to the Commission of the European Communities under contract *[EC contract reference: title, acronym, number]* for the following period(s) covered by the EC contract *[insert period(s) covered by the Financial Statement(s) per Activity]*.
- We confirm that our audit was carried out in accordance with generally accepted auditing standards respecting ethical rules and on the basis of the relevant provisions of the above-referenced contract and its annexes.

The above mentioned Financial Statement(s) per Activity was(were) examined and all tests of the supporting documentation and accounting records deemed necessary were carried out in order to obtain reasonable assurance<sup>16</sup> that, in our opinion, based on our audit:

- the amount of the total eligible costs (*[insert amount in number]* (*[insert amount in words<sup>17</sup>]*)) declared in Box 2 of the attached Financial Statement(s) per Activity is complying with the following cumulative conditions<sup>18</sup>:
  - ✓ they are actual<sup>19</sup> and reflect the contractor's economic environment<sup>20</sup>;
  - ✓ they are determined in accordance with the contractor's accounting principles<sup>21</sup>;
  - ✓ they have been incurred during the periods covered by the Financial Statement(s) per Activity concerned by this audit certificate<sup>22</sup>;

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<sup>15</sup> See head of the core-contract (if the contractor is the coordinator) or the second paragraph of article 1 of the core-contract.

<sup>16</sup> Reasonable assurance is an accounting expression meaning a high degree of confidence that information is valid and unaltered.

<sup>17</sup> In EURO.

<sup>18</sup> In cases where a part of the amount of the total eligible costs are qualified, modify the sentence and mention only the amount of the total eligible costs that are unqualified. The purpose of the audit certificate is to certify unqualified eligible costs. The auditor should clearly identify any amounts for which he/she cannot give reasonable assurances that the cost meet the criteria

<sup>19</sup> Eligible costs are actual. They are not budgeted costs. Where actual costs are not available at the time of establishment of the audit certificate, the closest possible estimate can be declared as actual if this is in conformity with the accounting principles of the contractor. This must be mentioned in the financial statement. Any necessary adjustments to these claims must be reported in the Financial Statement for the subsequent reporting period. For the last reporting period, only actual costs can be declared.

<sup>20</sup> Article II.19.1.a)

<sup>21</sup> Article II.19.1.b)

[they also include the eligible costs incurred in drawing up the final reports referred to in Article II.7.4 of this contract, which may be incurred up to 45 calendar days after the end of the project;]<sup>23</sup>

- ✓ they are recorded in the accounts of the contractor [and/or the third party in the case of contributions to the contractor from third parties] at the date of the establishment of this audit certificate<sup>24</sup>;
- ✓ they are exclusive of any non-eligible costs identified below which are established in the second paragraph of article II.19 of the above mentioned contract with the Commission of the European Communities:
  - ❖ any identifiable indirect taxes, including VAT or duties;
  - ❖ interest owed;
  - ❖ provisions for possible future losses or charges;
  - ❖ exchange losses;
  - ❖ costs declared, incurred or reimbursed in respect of another Community project;
  - ❖ return on capital;
  - ❖ debt and debt service charges;
  - ❖ excessive or reckless expenditure;
  - ❖ any cost which does not meet the conditions established in Article II.19.1. of your contract with the Commission of the European Communities.
- ✓ they have been claimed according to the following cost reporting model [*insert the relevant cost reporting model*] which the contractor is eligible to use according to article II.22 of the above mentioned contract with the Commission of the European Communities;

[As such, they are also exclusive of any additional direct eligible costs covered by contributions from third parties defined in indents a) and b) of Article II.23 of the contract with the Commission of the European Communities]<sup>25</sup>.
- ✓ [they have been claimed according to the following cost reporting model [*insert the relevant cost reporting model*] which the contractor is eligible to use in the specific activities aiming to provide trans-national access according to article III.13 of the above mentioned contract with the Commission of the European Communities;]<sup>26</sup>

[As such, they are also exclusive of any additional direct eligible costs covered by contributions from third parties defined in indents a) and b) of Article II.23 of the contract with the Commission of the European Communities]<sup>27</sup>.

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<sup>22</sup> Article II.19.1.c)

<sup>23</sup> If relevant, to be inserted only for the last audit certificate provided for this contract.

<sup>24</sup> Article II.19.1.d)

<sup>25</sup> To be added only for contractors using the additional cost reporting model (AC).

<sup>26</sup> To be added only for contractors involved in the specific activities aiming to provide transitional access in an Integrated Infrastructures Initiative contract or a Specific Support Action contract.

<sup>27</sup> To be added only for contractors using the additional cost reporting model (AC) involved in the specific activities aiming to provide transitional access in an Integrated Infrastructures Initiative contract or a Specific Support Action contract.

- ✓ [they are claimed according to the following basis for the conversion rate used of EURO:
  - ❖ the conversion rate of the date where the actual costs were incurred
  - ❖ the rate applicable on the first day of the month following the end of reporting period]<sup>28</sup>
- as declared in the Box 3 of the attached Financial Statement(s) per Activity, the total amount of receipts<sup>29</sup> for the periods covered by this(those) Financial Statement(s) per Activity is equal to (*insert amount in number*) (*insert amount in words*<sup>30</sup>);
- [as declared in the Box 4 of the attached Financial Statement(s) per Activity, the total amount of interest yielded by the pre-financing<sup>31</sup> received from the Commission of the European Communities for the periods covered by this(those) Financial Statement(s) per Activity is equal to (*insert amount in number*) (*insert amount in words*<sup>32</sup>)]<sup>33</sup>;
- accounting procedures used in the recording of eligible costs and receipts respect the accounting rules of the State in which the contractor is established and permit the direct reconciliation between the costs and receipts incurred for the implementation of the project covered by the EC contract and the overall statement of accounts relating to the contractor's overall business activity<sup>34</sup>;
- our company [organisation – for competent public officers] is qualified to deliver this audit certificate in full compliance with the second and third paragraphs of article II.26 of the contract;
 

[Relevant information establishing this qualification is included with this audit certificate;]<sup>35</sup>
- as declared in the Box 6 of the attached Financial Statement(s) per Activity, the contractor paid for this audit certificate a price equal to (*insert amount in number*) (*insert amount in words*<sup>36</sup>) in which VAT is equal to (*insert amount in number*) (*insert amount in words*<sup>37</sup>).

Date, Signature and Stamp of the audit firm

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<sup>28</sup> To be inserted only if some costs have not been incurred in EURO and to be based on the official exchange rates established by the European Communities and valid for the month during which the costs were incurred.

<sup>29</sup> As defined in article II.23 of the Annex II (General conditions) of the FP6 model contract (except for actions to promote human resources and mobility).

<sup>30</sup> In EURO.

<sup>31</sup> As defined in article II.27 of the Annex II (General conditions) of the FP6 model contract (except for actions to promote human resources and mobility).

<sup>32</sup> In EURO.

<sup>33</sup> To be inserted only for the coordinator.

<sup>34</sup> Article II.19.1.d)

<sup>35</sup> If the auditor is not known internationally or for a competent public officer whose competence to provide an audit certificate has not been attested to by its national authorities.

<sup>36</sup> In EURO.

<sup>37</sup> In EURO.



### **ANNEX 3: LIST OF FREQUENT ERRORS IN FINANCIAL STATEMENTS**

This list of frequent errors is based on the experience gained in previous framework programmes.

#### Non-substantiation of working time

The working time to be charged to the contract must be recorded throughout the duration of the project by any reasonable but reliable means (including time sheets). The person in charge of the work designated by the contractor should certify the records. A simple estimation of hours worked is not sufficient. There must be a system that allows the time of anyone working on the project to be followed and audited. Good practice suggests that the link between the project and the time record is clearly established and that the type of work performed is indicated.

#### Budgeted versus actual costs

A further problem observed is the use of budgeted personnel and overhead rates. At the time of submitting cost statements actual costs must be reported and in fact the contractor has amongst others to certify that 'costs are actually incurred'.

#### Use of average personnel rates

Only actual costs are in principle eligible for cost reimbursement. Many contractors however generally base cost claims on average personnel rates. Here the argument that is often put forward is that the organisation normally uses average personnel rates and these should therefore be acceptable to the Commission. This is not necessarily correct as it needs to be verified whether the average personnel rate reflects the actual costs incurred in the specific project. Contractors should be aware that the acceptance of average rates by national authorities is of limited value in this respect as cost claims need to comply with the specific financial provisions of the research contract.

#### The calculation of hourly personnel rate

A further problem concerns the calculation of the hourly personnel rate. The hourly personnel rate is to be calculated as 'the actual costs (gross remuneration and the employer's portion of social charges) divided by the number of productive hours'. Audit evidence indicates that in general a plausible number of productive hours are in the order of 1680 hours per year. If in the calculation of the hourly personnel rate a significantly lower number of productive hours is used a solid justification should be on file.

#### Personnel Costs for contractors using the AC cost reporting model

The conditions for personnel costs related to contractors using the AC model are more specific and refer to 'a temporary contract for Community RTD projects ..., a temporary contract for completing a doctorate, a contract which depends upon external funding additional to the normal recurring funding of the contractor ...'.

#### Indirect costs

The principal errors in the calculation of overhead are as such:

- cost items which do not meet the eligibility criteria as set out by Articles II.19 and II.21 of Annex II in terms of "necessary for implementation of the project"

are included in the claimed overhead costs. Prominent examples are non-productive hours of researchers or non-chargeable activities like time and costs spent by the contractor on internal research projects

- use of budgeted rates
- non-eligible cost items like notional costs
- unbalanced apportionment of overheads

Overheads must be identifiable and justified by the accounting system of the participant as being incurred in direct relationship with the eligible direct costs attributed to the project.

### VAT

It has been observed that VAT, has been included as part of, for example, the ‘travel and subsistence’ or ‘consumables’ costs claimed. The contract in general excludes ‘any identifiable indirect taxes, including VAT’ or duties as an eligible cost.

### Lack of prior agreement

The contract requires that where it is necessary to subcontract certain elements of the work or where certain tasks are executed by a third party that this is clearly identified in Annex I. It is observed that such identification is sometimes missing.

### Substantiation of costs claimed

The contractor is obliged to keep full supporting documentation to justify the costs claimed on file.

In order to substantiate costs for example, durable equipment and travel supporting invoices, tickets etc. must be filed so that there is a proper audit trail

#### **ANNEX 4: INDICATIVE MODEL OF AN AUDIT PROGRAMME**

This model audit programme is designed as a guideline to cover the main areas in need of attention during a complete audit. The prime objective of each audit will always be to verify that the costs incurred in performing research contracts, have been claimed in compliance with the contractual rules defined in each specific contract under audit.

##### 1. Ensure availability and access to the following documents:

- Contract signed between the contractor and the Commission (FP6 model contract)
- Annex I Description of Work
- Annex II General Conditions (Part B contains the applicable Financial Provisions)
- Annex III (Integrated Projects, Networks of Excellence, Infrastructures, SMEs)
- Periodic management report including Financial Statement (Form C) as completed by the contractor
- Guide to Financial Issues relating to Indirect Actions of the Sixth Framework Programmes. These guidelines have been designed to help the contractors and auditors alike to understand the financial provisions of the FP6 model contract and the applicable procedures for financial statement certification. Particular reference is made to:
  - Part 2 “Framework of eligible costs for FP6 grants which reimburse costs”. This part contains concise explanations regarding cost eligibility principles and cost reporting models.
  - Part 3, in particular 3.1.3.3 “The notion of receipts”
  - Part 6.1 - Annex 1 - Examples of potential eligible costs
  - Part 6.7 - Annex 7: Proposed model for an audit certificate (also included as Annex 1 of this document)

##### 2. Establish which cost reporting model is applicable

##### 3. Review costs claimed

- Direct costs - personnel
  - ✓ Reconcile the charged working time with supporting documents (time records)
  - ✓ Verify that the hourly labour rates have been correctly calculated, i.e. gross remuneration plus the employers portion of social charges divided by productive hours (indicator: 1.680 p.a.); verify that the number of chargeable hours used for the calculation of the hourly rate is reasonable and in line with the contractor’s normal practice. Ensure that the actual number of productive hours performed does not exceed the number of productive hours applied in this calculation.

- ✓ Verify that the amounts charged correspond with the amounts (gross remuneration plus employers portion of social charges) actually paid and are recorded in the official books of the contractor, N.B. provisions are non eligible costs.
- ✓ Substantive testing of underlying documents regarding costs charged to the cost statement such as personnel files, labour contracts, salary information, progress reports as well as minutes of meetings, publications concerning the project
- ✓ Conclude on the eligibility of the labour costs claimed, and calculate the audit adjustment, if necessary.
- Direct costs - other
  - ✓ Reconcile the claimed costs with the supporting documentation.
  - ✓ Verify compliance of the claimed costs with the terms of the contract (II.19 and II.20 of Annex II)
  - ✓ Ensure that the rules on subcontracting have been complied with (2.2.1. Guidelines on Financial Issues)
  - ✓ Ensure that no VAT is included.
  - ✓ Conclude on the eligibility of the costs claimed, and calculate the audit adjustment, if necessary
- Indirect costs
  - ✓ Review system of overhead apportionment, calculation method and allocation to contracts.
  - ✓ Agree the figures considered for the calculation of overheads with the profit and loss accounts and review the accounting records.
  - ✓ Verify compliance with the terms of the contract regarding the costs charged (II.19 and II.21 of Annex II; n.b. overheads must be identifiable and justified by the accounting system of the participant as being incurred in direct relationship with the eligible direct costs attributed to the project.
  - ✓ Verify that overheads have been claimed in line with the applicable cost reporting model
  - ✓ Verify that the number of chargeable hours used for the distribution of overheads is reasonable and in line with the contractor's normal practice. If overheads are distributed over salaries, verify that the percentage has been correctly calculated.<sup>18</sup>
  - ✓ Conclude on the eligibility of the overheads claimed, and calculate the audit adjustment.

4. Verify receipts

- ✓ Verify if the project has received receipts (financial transfers or their equivalent to the contractor from third parties, contributions in kind from third parties, income generated by the project)

5. Verify conversion rates

- ✓ Verify that the conversion into Euro has been done in compliance with the terms of the contract

6. Verify interest yielded by pre-financing

- ✓ Verify if the pre-financing of pre-financing has yielded interests (only applicable for project co-ordinators)

7. Verify accounting procedures

- ✓ Verify that the accounting procedures used in the recording of eligible costs and receipts respect the accounting rules of the State in which the contractor is established and permit the direct reconciliation between the costs and receipts incurred for the implementation of the project covered by the EC contract and the overall statement of accounts relating to the contractor's overall business activity.

8. Verify any adjustments to previous cost claims

9. Complete and sign the Audit Certificate and submit to the contractor.

## ANNEX 5: SUGGESTED MODEL-PROCEDURES TO BE PERFORMED

*For further guidance and to help the certifying organisation to assess and plan the required resources for the audit certification the following overview constitutes a recommended list of most important procedures to be performed. The list refers to the suggested standard procedures to be carried on the certification of the usual model contract. The list shall not be considered exhaustive in all cases. Additional procedures may be necessary or recommendable based on the individual case or the relevant contractual provisions:*

The Auditor shall designs and carry out his verification work programme in accordance with the objective and scope of the engagement and the procedures to be performed. When performing these procedures the Auditor may apply techniques such as inquiry and analysis, (re)computation, comparison, other clerical accuracy checks, observation, inspection of records and documents, inspection of assets and obtaining confirmations.

The Auditor shall obtain sufficient appropriate verification evidence from these procedures to be able to certify the cost claimed. For this purpose the Auditor can refer to the guidance provided by International Standard on Auditing 500 “Audit Evidence” and in particular by the paragraphs relating to ‘sufficient appropriate audit evidence’.

The Auditor shall exercise professional judgment as to what is sufficient appropriate verification evidence where he believes that the guidance provided by ISA 500, the terms and conditions of the Grant Contract and the scope of the certification engagement are not sufficient.

The 18 procedures recommended to be performed are listed as follows together with example definitions and findings to guide the auditor in the nature and presentation of the facts to be ascertained. The example findings are meant for illustrating. They should therefore only be considered as explicit addition to the standard model Audit Certificate template where a respective qualification deems necessary:

Procedures	Definitions, examples and findings
<p>1. Reconcile with the actual costs recorder in the accounts (general ledger, payroll system).</p>	<p><u>Definition:</u></p> <p>Verify that the amounts which are included in the claim made to the Commission can be traced to the relevant project account in the beneficiary's accounting system, and for personnel costs, that the remuneration claimed can be traced to the payroll records of the relevant researchers. In each case the costs should be actual costs supported by invoices or contracts. (otherwise for interim periods to be indicated in certificate)</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The amounts claimed by the beneficiary could be reconciled to the accounts, except for an amount for EUR X.</p>
<p>2. Recalculate hourly personnel and overhead rates for personnel (full coverage if less than 20 researchers, otherwise a sample of minimum 20, or 20% of researchers,</p>	<p><u>Definition:</u></p> <p>Using the beneficiary's methodology, for each sampled researcher show how the amount charged to the contract can be derived using the payroll remuneration, productive hours, time recording or other allocation method.</p>

Procedures	Definitions, examples and findings
<p>whichever is the greater), indicate productive hours used and hourly rates. Where sampling is used, selection should be random with a view to producing a representative sample.</p>	<p><u>Example:</u></p> <p>Annual employer's costs EUR 33,600, productive hours 1680 = 20 EUR per hour X 450 hours charged = 9.000 EUR charged to the project. Productive hours is the number of hours made available by the employee in a year after the deduction of holiday, sick leave and other entitlements. If other deductions of time are made for certain paid activities, these should be notified as factual findings.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The amounts claimed by the beneficiary could be verified according to the stated methodology for the sample chosen, except for an amount of EUR X. The beneficiary has deducted 150 hours per year for administrative time to reach the productive hours figure.</p>
<p>3. For the same selection examine and assess time recording of researchers (paper/ computer, daily/weekly/monthly, signed, certified).</p>	<p><b><u>Example Factual Finding:</u></b></p> <p>Researchers fill in their time on a daily/ weekly/ monthly basis using a paper/computer-based system. The sample records are/ are not certified by the project manager or other superior.</p> <p>Or: No time records are available. Researcher time is allocated using estimates. (to be indicated in certificate)</p>
<p>4. Employment status and employment conditions of personnel (direct employee/ consultant paid directly by beneficiary/ consultant paid indirectly by beneficiary)</p>	<p><b><u>Example Factual Finding:</u></b></p> <p>For the [no.] researchers selected, the auditor found that:</p> <p>x were direct employees with permanent contracts</p> <p>y were direct employees with temporary contracts</p> <p>z was a consultant reimbursed via a charge from a company other than the beneficiary</p> <p>Based on the documentation provided, all researchers worked:</p> <ul style="list-style-type: none"> <li>• on the beneficiary's premises/ mainly off-site;</li> <li>• were/ were not directly supervised by the beneficiary;</li> <li>• at similar hourly rates to other team members who were direct employees.</li> </ul>
<p>5. For 2 researchers, reconcile productive hours used with those provided by time recording</p>	<p><b><u>Example Factual Finding:</u></b></p> <p>The auditor compared the sum of the totals presented on the time sheets with the productive hours used in the calculation of hourly rates and found there was no difference/ a difference whereby the productive hours used was X and the productive hours listed on the time records was Y.</p>
<p>6. Use of average/ estimated costs versus <i>ad personam</i> calculations</p>	<p><b><u>Example Factual Finding:</u></b></p> <p>The auditor observed that the costs charged to the financial statement:</p> <ul style="list-style-type: none"> <li>- represent the result of a separate calculation of actual costs for each individual researcher, or</li> <li>- represent a total derived from an average calculation where</li> </ul>

Procedures	Definitions, examples and findings
	<p>researchers' actual employment costs are grouped and an average taken, or</p> <ul style="list-style-type: none"> <li>- represent an estimated or standard rate which has not been derived from actual costs.</li> </ul> <p>(non-use of actual costs to be indicated in certificate – see 4.2)</p>
<p>7. Temporary staff correctly charged</p>	<p><u>Definition:</u></p> <p>Where the contract specifies that only temporary staff are to be charged confirm for each researcher in the sample that:</p> <ul style="list-style-type: none"> <li>- their contracts of employment have a defined end date (give the end date in each case)</li> <li>- whether the contracts contain an explicit reference to the contract under review or the EU project (give the nature of the reference)</li> </ul> <p><b><u>Example Factual Finding:</u></b></p> <p>Temporary staff sampled were found to have contracts linked to the project of a fixed duration, except for X contracts which represent an amount of EUR Y where the staff had permanent contracts.</p>
<p>8. Equipment correctly identified and allocated to the project</p>	<p><u>Example:</u></p> <p>The auditor traced the equipment charged to the project to the accounting records and the underlying invoices. The beneficiary has/ has not documented the link with the project via a charge to the project accounting system or other documentation. The depreciation method used to charge the equipment to the project complies with the beneficiary's normal accounting policy in this respect.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>Equipment and depreciation have been calculated according to the normal accounting policy, except for EUR X.</p>
<p>9. 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.)</p>	<p><u>Definition:</u></p> <p>The beneficiary should normally have an unambiguous method for allocating travel costs to each project (via marking of invoices and purchase orders, resulting in correct allocation in the project accounts). Costs which are not allocated to project accounts and do not have an unambiguous attribution (normally by writing the project number on the original invoice) should be considered <b>undocumented</b>.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The beneficiary has/ does not have a written policy for travel costs. The auditor compared the travel charged to the contract with the policy and found the selection and authorisation of travel means and supplier was in compliance with this policy. For the sample chosen, the beneficiary used economy/ first class travel which is/ is not in line with its normal policy. Of the costs claimed EUR X were found to be undocumented under the <u>Definition</u> provided.</p>



Procedures	Definitions, examples and findings
<p>10. Subcontracting correctly identified and allocated to the project</p>	<p><u>Example:</u></p> <p>The provision of services xy were tendered via a limited call for tender requiring 3 offers. The supplier selected provided the least expensive/ most cost effective proposal as documented by the beneficiary.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>Tendering was carried out in line with the contract requirements.</p>
<p>11. Consumables correctly identified and allocated to the project</p>	<p><u>Definition:</u></p> <p>The beneficiary should normally have an unambiguous method for allocating consumable costs to each project (via marking of invoices and purchase orders, resulting in correct allocation in the project accounts). Costs which are not allocated to project accounts and do not have an unambiguous attribution (normally by writing the project number on the original invoice) should be considered <b>undocumented</b>.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor verified the costs underlying the amounts charged and of a total of EUR x found EUR y to be correctly documented and allocated to the project and EUR z to have been undocumented under the <u>Definition</u> provided.</p>
<p>12. Costs related to the management of the consortium activities correctly identified and allocated to the project</p>	<p><u>Definition:</u> Subject to a 7% limit, management costs can be charged to the project, but as with other costs, must be identifiable.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor examined the project account/ invoices from the managing organisation, and ascertained that the costs were unambiguously identified and documented as being in relation to the contract by the beneficiary.. However costs of EUR x did not have clear identification within the accounting system.</p>
<p>13. Obtain and review a detailed breakdown of overheads (reconciled to the financial accounts) and confirm that the following costs are not present:</p> <p>a) identifiable indirect taxes including value added tax [except where borne by the beneficiary],</p> <p>b) duties,</p> <p>c) interest owed,</p>	<p><u>Definition:</u></p> <p>Obtain a detailed breakdown from the accounting system of the overheads which have been charged to the contract. Reconcile the amounts to the general ledger of the beneficiary. For each element of the breakdown, inquire with the beneficiary as to whether it contains one 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>The contract foresees that the costs must reflect the contractor's economic environment and are exclusive of excessive or reckless expenditure. This has to be certified by the auditors. The following</p>

Procedures	Definitions, examples and findings										
<p>d) provisions for possible future losses or charges,</p> <p>e) exchange losses, cost related to return on capital,</p> <p>f) costs declared or incurred, or reimbursed in respect of another Community project,</p> <p>g) debt and debt service charges, excessive or reckless expenditure<sup>38</sup>.</p>	<p>are indicative definitions that may support the auditors when developing their judgment in the certification process:</p> <ul style="list-style-type: none"> <li>• Economic: 'Minimizing the costs of resources used for an activity, having regard the appropriate quality'</li> <li>• Excessive: 'Paying significantly more for products, services or personnel than the prevailing market rates, resulting in an avoidable financial loss to the project'</li> <li>• Reckless: 'Failing to exercise care in the selection of products, services or personnel resulting in an avoidable financial loss to the project'</li> </ul> <p>These elements could be assessed by way of at least three suggested (not limitative) different approaches or their combination – whichever is the most appropriate:</p> <ul style="list-style-type: none"> <li>• The cost has to be within the same range as it would have been if it had been in the contractor's normal course of business. Costs do not differ from those the contractor normally uses in non-EC related engagements if this can be verified with supporting evidences. (e.g; samples of non -EU contracts/methods, etc using similar prices)</li> <li>• If the first approach can not be used, it could be assessed if whether the cost corresponds to the contractor's "economic environment". This entails another approach and could be verified if the contractor uses the same price levels generally applied in its specific field/country, etc. (e.g. central rates/market rates etc generally applied for a certain field, etc)</li> <li>• The public entities will follow the public procurement rules, other beneficiaries if applicable, their internal procurement rules.</li> </ul> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor obtained the breakdown of overhead costs and confirmed by observation and inquiry with the beneficiary that all of the ineligible costs specified had been excluded. A breakdown of the main elements charged are (amounts only over 5% of the total are listed):</p> <table border="0" style="width: 100%;"> <tr> <td>Rent</td> <td style="text-align: right;">x</td> </tr> <tr> <td>Electricity</td> <td style="text-align: right;">x</td> </tr> <tr> <td>Admin staff</td> <td style="text-align: right;">x</td> </tr> <tr> <td>Etc</td> <td></td> </tr> <tr> <td>Total</td> <td style="text-align: right;"><b>X</b></td> </tr> </table> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor identified amounts of ineligible costs ((b) duties and (c)</p>	Rent	x	Electricity	x	Admin staff	x	Etc		Total	<b>X</b>
Rent	x										
Electricity	x										
Admin staff	x										
Etc											
Total	<b>X</b>										

Procedures	Definitions, examples and findings
	interest owed) representing EUR X of the overheads claimed.
14. Assess use of a simplified approach to calculating overheads	<p><u>Definition:</u></p> <p>The beneficiary may use a simplified overhead calculation (either due to the lack of analytical accounting or use of a form of cash-based accounting). This does neither permit the use of a generalised estimate, nor 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><b><u>Example Factual Finding:</u></b></p> <p>The beneficiary's accounting system does not permit overheads to be separately identified for the individual departments. <b>[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 which are made together with the source of the relevant accounting entries as follows:</p> <ul style="list-style-type: none"> <li>• Adjustment for depreciation of buildings was derived from a fixed asset application/ spreadsheet which is not integrated in the accounting system</li> </ul>
15. Verify exchange rates	<p><b><u>Example Factual Finding:</u></b></p> <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/ did not use:</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> </ul>
16. Correct treatment of VAT and other direct taxes	<p><u>Definition:</u></p> <p>Indirect taxes, especially VAT, are not eligible costs. Research organisations should generally be registered for VAT and be able to reclaim costs via the normal procedure according to the relevant national rules.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor inquired and confirmed via observation of the relevant official documents that the beneficiary is/ is not registered for VAT (or is exempt/ partially exempt) and as such can/ cannot/ can partially recover VAT incurred. The auditor in its sample analysis of costs verified that VAT and indirect taxes had not been included in the costs claimed.</p>
17. Management of contract	<p><u>Definition:</u></p> <p>As per article XX, the coordinator is obliged to remit funds to the participants with xx days. This can be ascertained by examination of</p>

Procedures	Definitions, examples and findings
	<p>the relevant bank statements.</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor verified that all remittances had been made within the contractual deadline.</p>
18. Identification of receipts	<p><u>Definition:</u></p> <p>The beneficiary is obliged to deduct from its claim any receipts related to the project (interest on pre-financing, income from events, rebates from suppliers, etc.)</p> <p><b><u>Example Factual Finding:</u></b></p> <p>The auditor examined the relevant project accounts and obtained representations from the beneficiary concerning possible sources of income connected with the contract. On the basis of this examination and the representations for the beneficiary the amounts included in the claim regarding receipts correctly reflect the position in the project accounting.</p>