

Practical View

The Commission's Financial Audit Process

Introduction

With the European Commission's plans to increase the number of audits¹ performed by the European Commission during and after the completion of a project² organisations participating in Framework Programmes are more likely than ever to receive a letter from the Commission informing them that one of their projects is going to be audited: financial or technical. We will discuss here our experience with a financial audit after the completion of a FP6 project, the financial risks for the institute and the consequences for financial management of FP6 and FP7 projects.

A financial risk of FP6 and FP7 projects is that any error of a systemic nature, which will be identified by the Commission's auditors, will give rise to an extrapolation of similar corrections in all cost claims related to all other projects of the organisation in question. Beyond these corrections, sanctions may be applicable as well (Cordis Europa, Audit and certification policy).

The conclusion: it is more important than ever for current and future participants in the Framework Programmes to not just start paying more attention to the cost management of the projects they are participating in – but to also get to better understand what ex-post audits are all about.

Ex-ante audit versus ex-post audit

It is important to understand that the Commission's auditors, who come to audit the project documentation after the project is completed, do not consider the previous ex-ante audit reports (made by external auditors³ on behalf of the contractor or beneficiary during the implementation of the project according to the requirements of Article II.4 of the Grant Agreement) as a relevant starting point.

Instead, they begin the audit process as if no previous audit reports exist. Consequently, any positive audit reports we received from external ex-ante auditors on behalf of the contractor/beneficiary during the implementation of the project hold little to no weight. They certainly do not mean that we shall pass the Commission's audit process entirely problem-free.

In FP7 the European Commission has minimised the administrative burden by reducing the number of certificates required for claiming payments⁴, thereby increasing the financial risks of the institute. To complicate the matter, we can say from our practical experiences that the quality of these ex-ante audits can vary to an alarming degree. Particularly, the knowledge of some of the external ex-ante auditors can be quite weak which can lead to them missing both glaring and less-glaring mistakes we have made in managing our project costs (and supporting cost documentation).

As a consequence, their positive audit reports lead us to believe we have been managing costs successfully when that is not the case and we keep making the same mistakes later on. While these mistakes may be overlooked



Damjan Struna,
Consultant for EU Grant Funding,
RR & CO. Knowledge Centre Ltd,
Slovenia



Robert Rudolf,
Senior Partner, RR & CO. Knowledge
Centre Ltd.,
Slovenia

at the time, they can also result in failing the Commission's audit process. And by then, it is too late to correct the mistakes that should have been corrected much earlier on.

¹ <http://ftp.cordis.europa.eu/pub/fp6/docs/awareness-leaflet-2007.pdf>

² See article II.29 in FP6 Model Contract Annex II, general conditions and articles II.22 and 23 in FP7 Grant Agreement Annex II, general conditions.

³ Or competent public officer in the case of public organizations etc.

⁴ See article II.4.4 in FP7 Grant Agreement Annex II, general conditions.

Who performs ex-post audits and how?

When it comes to performing ex-post audits, the European Commission usually authorises one of the big, established international audit firms (such as, for instance, Deloitte). Alternatively, the EC can send auditors from other institutes. Also the European Court of Auditors has the right to conduct a financial audit of FP projects. In any case, ex-post auditors are invariably very experienced experts who will take their time going through the original documents (which we have to provide to them down to a single little item). This kind of examination can sometimes take up to several weeks before it is finished!

On the basis of these original documents, they will construct a financial report from scratch for the project partner who is the object of the audit. They will then compare this newly constructed financial report with the financial reports which have been submitted during the project and write down all the differences between them along with detailed explanations of these differences. In the end, they will write an audit report based on their findings.

This is not, however, their final audit report because before they finalise the report, the partner under audit still retains the right to look the audit report over and submit its own objections and/or explanations. The auditor will take these into consideration if they are valid and well argued (and vice versa). After that, the finalised audit report is issued. It represents the basis for all the sanctions that may or may not follow, in accordance with the signed grant agreement and all the relevant legislation.

The crucial element in the issued audit report is the difference in the total amount of the eligible costs between the financial report constructed by the auditor and the financial reports submitted by the partner during the implementation of the project. If the overall difference between the two amounts is not significant in favour of the partner, then the audit report deems the previous financial reports acceptable and the partner won't have to pay back anything. There are also cases where the ex-post auditor labelled as acceptable financial reports in which many individual costs have been calculated incorrectly but in which total amount also didn't deviate from the calculations of the auditor by a significant margin.

Commission's
plan to increase
audit



Besides the expert opinion (findings) of the ex-post auditor, the audit report usually also consists of a detailed description of the state of documentation and the analysis of the cost management and controlling systems found when auditing the partner. This analysis should be extremely valuable not just to the audited partner but to others as well as we can take this analysis and use it to – by working on the weaknesses – improve our own systems of cost management and controlling in Framework Programmes projects.

So, instead of perceiving the Commission's audits as a great potential danger to us and our organisations, we should take them as a well-meaning consultation which can drastically improve our FP project management in the long-term.

Key mistakes discovered during ex-post audits

Based on our experiences, the majority of problems when facing the ex-post audits stems from the following mistakes made during cost management and controlling of costs:

1. Personnel costs

- Timesheets are managed in a way which does not make transparent that the hours recorded in them haven't also been recorded on various other projects.
- Timesheets are not signed by the employee and/or the responsible person for the project (project leader).
- It's not possible to establish a connection between the hours listed in the timesheets and the actual work done on the project (only the number of hours is listed in the timesheet but no description of work provided).
- In the timesheets, the hours are recorded – for instance – as a monthly summary (an example: 170 hours for January 2007) without any specifications and explanations.
- Personnel costs include various performance allowances for which there are no legal basis or obligations for payment.

Personnel costs of an individual on the project are significantly different from his/her personnel costs outside the project.

2. Travel costs

- Problem here is incomplete support documentation to prove that the travel costs did occur and that the right person went travelling for the purpose of the project (frequently missing are boarding passes, lists of those who attended the meeting, minutes of meetings, etc.).
- Support documentation often includes VAT which is not an eligible cost.

3. Durable equipment

- For the equipment which is not used exclusively on the project in question, problem is that there is no support documentation to help ascertain the amount of use of this equipment on this particular project.

4. Real overhead (when partner uses FC model – Full cost model)

- Frequently, the depreciation costs of equipment and/or premises which have no connection with the project itself are included as eligible.
- Also frequently, the depreciation costs of equipment and/or premises bought through public financing are included as eligible (which leads to double public financing).
- There are no clear measures for the allocation of indirect costs or the indirect costs are allocated in an arbitrary manner. The indirect costs are allocated to different projects through different methods regardless of the way these projects are financed.



Conclusion

These are just some examples of what the eagle eye of the Commission's auditor can and has found wrong with project documentation. The important things to remember are the following:

- Positive audit reports from your external ex-ante auditors (during the implementation of the project) do not necessarily mean everything is right with your cost documentation or the way you manage costs.
- Detailed support documentation and maintaining adequate accounting records is of crucial importance if we wish to properly justify the costs reported (it is better that support documentation especially is as detailed as possible; in this particular case, less is definitely not more).
- Pay particular attention to personnel costs, travel costs, costs of durable equipment and the indirect costs (if you have FC model).
- Make sure you get a good and dependable ex-ante auditor. Not opting for the cheapest choice can save you a lot of time, nerves and money later on.

Things every professional ex-ante auditor should check but often doesn't:

- All relevant legal documents (contracts); this can especially be a problem regarding public bodies as the auditor fails to pose a question from what sources comes the salary of the employee working on the project and if this is contractually in order.
- When auditing Full cost model: which sources financed the purchase of assets (assets bought with public financing must be taken out of the whole equation).
- Pay a lot more attention to the connection between costs and actual work done (every single invoice, travel cost, recorded hour of work has to be connected to specific task and/or work package along with the clear description of why this cost occurred and how it is connected to the content of the task/work package).

And last but not least, remember that the Commission's auditors are not our enemy. So, instead of treating them as such with trepidation and fear, we need to use the experience (if we are chosen for the audit) and/or the experiences of others who have went through the Commission's audit process to learn from our collective mistakes and stop making the same mistakes in the future. In which case there will definitely not be any need to fear the Commission's auditors and their eagle eyes.